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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/5

3:00 p.m., January 11, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	M. K. Bush
	M. Lundsager, Temporary
J. de Groote	H. G. Schneider
	X. Blandin
	G. E. L. Nguyen, Temporary
	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	
J. E. Ismael	
R. K. Joyce	L. Leonard
A. Kafka	H. A. Arias, Temporary
	A. Lindå
	A. S. Jayawardena
	V. Govindarajan, Temporary
	A. Vasudevan, Temporary
E. I. M. Mtei	
F. L. Nebbia	
	J. E. Suraisry
P. Pérez	
J. J. Polak	
	A. V. Romuáldez
G. Salehkhou	A. A. Agah, Temporary
	T. A. Clark
S. Zecchini	
Zhang Z.	Wang E.

L. Van Houtven, Secretary
A. Wright, Acting Secretary
B. J. Owen, Assistant

Also Present

Administration Department: H. J. O. Struckmeyer, Deputy Director; P. Hirschfeldt, J. D. Huddleston, N. J. Smith, L. A. Wolfe. Asian Department: Tun Thin, Director. European Department: L. A. Whittome, Counsellor and Director; D. A. Brodsky, P. Dhonte, A. Leipold, G. A. Mackenzie, K.-W. Riechel, J. S. Van't dack, M. Xafa. Exchange and Trade Relations Department: M. Guitián, Deputy Director; G. Begashaw, J. O. Bonvicini, J. T. Boorman, J. A. Clement, S. Kanesa-Thasan, F. L. Osunsade, P. J. Quirk, M. H. Rodlauer. External Relations Department: R. Heller. Fiscal Affairs Department: E. S. Kreis. Legal Department: G. P. Nicoletopoulos, Director; S. A. Silard, J. V. Surr. Research Department: R. R. Rhomberg, Deputy Director. Secretary's Department: R. S. Laurent. Treasurer's Department: G. M. Fitzpatrick. Western Hemisphere Department: S. T. Beza, Associate Director; D. N. Lachman, L. E. Molho, R. Ramaciotti, C. L. Ramirez-Rojas. Bureau of Computing Services: W. N. Minami, Director; N. S. Arya, A. Coune, M. E. Kepner, R. L. Kline, F. A. Maranto, K. X. Nelick, C. K. Rhee. Bureau of Statistics: J. B. McLenaghan, E. W. Saunders. Office of the Internal Auditor: B. C. Huang. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: G. R. Castellanos, L. K. Doe, K. A. Hansen, J.-C. Obame, E. M. Taha. Assistants to Executive Directors: I. Angeloni, W.-R. Bengs, L. E. J. M. Coene, J. de la Herrán, J. J. Dreizzen, G. Ercel, G. D. Hodgson, Z. b. Ismail, A. K. Juusela, H. Kobayashi, S. Kolb, R. Msadek, K. Murakami, W. K. Parmena, D. J. Robinson, C. A. Salinas, Shao Z., L. Tornetta, A. J. Tregilgas, A. H. van Ee, Wang C. Y., B. D. White.

1. BELGIUM - 1984 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/85/4, 1/11/85) their consideration of the staff report for the 1984 Article IV consultation with Belgium (SM/84/271, 12/14/84). They also had before them a report on recent economic developments in Belgium (SM/84/279, 12/26/84).

The staff representative from the European Department explained that over the lifetime of the current Parliament, real wages in Belgium were projected to fall by some 13 percent, representing a considerable effort undertaken in two or three stages. The staff had acknowledged that such an effort could not be accomplished without exerting some constraints on the system and considered the temporary imposition of constraints on the wage formation process to be one of the costs of adjustment. As several Executive Directors had noted, the system of regulations governing wage formation in Belgium tended to be extremely rigid, imposing heavy costs on the economy.

At some point in 1983, a request for an additional wage restraint on the part of the civil service had led to some sharp social protests, the staff representative continued. At present, it was understood that civil servants would be treated in the same way as other wage earners.

No progress had been made in changing the reference cost of living index used for wage indexation, the staff representative said. He assumed that the authorities were concentrating on using the existing system as a lever to achieve certain reductions in real wages. Presumably in 1986, when a return to a free system of wage formation was planned, they would engage in a more fundamental rethinking of the system.

In discussing the scope for expanding employment through more labor-intensive production techniques with the authorities, the staff had pointed out that, for ten years, Belgium had been experiencing a sort of productivity differential: labor productivity had been rising faster in Belgium than in partner countries by about 1 percent per annum, the staff representative went on. The staff had related the gains in productivity to pressure from rapidly rising real wages, which had been high to begin with. The idea had been that a return to a more competitive real wage position and perhaps to more slowly growing real wages would allow the economy to eliminate that productivity differential and thus to achieve higher employment for a given level of GNP.

Altogether, from 1983 to 1985, assuming that the budget for 1985 was carried out as planned, real noninterest expenditures of the General Government would decline by about 5 percent, and the ratio of government spending to GNP would decline by about 3 percentage points, the staff representative noted. Such adjustments would have a significant effect, although even greater ones would be required to avoid any increase in fiscal pressure and still achieve the planned reduction in the Treasury deficit to 7 percent of GNP. That reduction was an essential intermediate target; it was apparently the authorities' intention to bring the deficit

down further. In any event, the intermediate target represented the point at which the authorities would regain control of the dynamics of the public debt.

Many Directors had emphasized the need not merely to achieve the target for the deficit but also to take effective steps to reduce expenditure relative to GNP, the staff representative recalled. For instance, the postponement until 1986 of some interest payments that would normally have fallen due in 1985 had been criticized as a presentational device. However, by contrast, the authorities also had taken significant steps on noninterest payments. For example, the use of index jumps meant that over three years social benefits would be cut by 6 percent in real terms, an unprecedented development in Belgium. The same applied to civil service wages.

Furthermore, in an attempt to hold down spending, the authorities were proceeding with their plan for reforming social security, the staff representative said. One of the principles of social security reform in Belgium was to make sure that income support was directed to those who needed it; for that purpose, the authorities were making an attempt to take into consideration the income not merely of the individual recipient but of the total family.

The thought of rebasing social security revenue from essentially a wage-taxable base to a value-added base was still being considered by the authorities, the staff representative noted. Nonetheless, they had always intended to promote the idea throughout the European Community, and development of the idea was proceeding relatively slowly. As to the possibility of further cuts in the budget, the staff would single out transfers to enterprises and households as areas where further cuts were possible.

Although no longer integrated into the general income tax schedule, the proposed tax on interest and dividend earnings was expected nonetheless to produce an increase in revenue because there was a higher schedule for the withholding tax, the staff representative remarked. That comparison did not necessarily incorporate the component of tax based on the integration of interest and dividend earnings in the general income tax.

The remark made by the staff in the report on recent economic developments about the role of administrative regulation in promoting financial innovation had been meant to serve as a historical clarification rather than an indication of approval by the staff, the staff representative observed. The staff necessarily would not see innovation as an advantageous step in the Belgian financial markets; what would be really beneficial might be slightly more competition. However, there were few practical steps that the authorities could take for that purpose, given that the economy was already quite open, even in the banking system. The staff had explored with the authorities the possibility of introducing a wider range of financial instruments, as a gap existed between the rates of return on fairly short-term Treasury bills and those on long-term Treasury paper.

The staff's evaluation of market shares for Belgium was slightly different from that used by the OECD, the staff representative admitted, owing largely to different weighting schemes used in computing the comparator indicator. For recent data the staff had had to use estimates of volumes exported by Belgium; the OECD might well have used different estimates. Generally, the staff perception was that the Belgians had been able to keep up with expanding foreign demand. In talking with the Employers' Federation and a number of large firms, the staff had received the impression that recent gains in profitability had not yet been sustained for a sufficient period to revitalize the Belgian economy. Indeed, it might take a fair amount of time from the moment when industry achieved better competitiveness to the moment when it achieved higher capacity growth. The indications were that the buildup in investment in 1984--together with an increase in capital stock and in the capacity of industry to deliver--suggested that gradually the system was responding. For a number of years, investment in Belgium had been fairly low, a factor that doubtlessly had influenced the available capital stock. Actually, if the indicator of capacity utilization were corrected--taking into account the capacity that had been hopelessly lost, as in steel and textiles--there might turn out to be little spare capacity left in Belgium at present, and in some sectors there might be signs of capacity constraints.

The inflation differential between Belgium and its partner countries was of concern to the authorities, who considered that a vicious circle might eventually develop, the staff representative said. It should be kept in mind that the inflation differential, measured in terms of relative labor costs, was lower than if it were measured in terms of consumer price inflation. That difference was particularly marked when Belgium was compared with Germany, where gains in real wages had taken place. Broadly, Belgium's competitiveness on a unit labor cost basis remained sound.

The view that there was a risk of competitive wage restraint among European countries was somewhat a technician's view, the staff representative considered. Fundamentally, the authorities were willing to admit that in an isolated country faced with expanding demand, wage restraint might work well, but if practiced simultaneously in a large, integrated group of countries, it would depress demand; a country in such a group could achieve little by changing its relative prices. Thus, the authorities did not wish to use wage restraint beyond the point where it seemed clearly necessary.

As to the dual exchange system, the staff's primary concern during the consultation had been to encourage the authorities to devise appropriate policy reactions when pressures arose in the exchange market, the staff representative remarked. No set of institutional arrangements was going to provide solutions to all difficulties in changing circumstances; what the authorities needed was a way of responding flexibly. In the consultation discussions, the staff also had emphasized monetary policy and long-term interest rate management; the authorities should display readiness to use both instruments in promoting stability in exchange markets. Once stabilization had been achieved, the functioning of the

dual exchange market would become much less important. Indeed, in recent months, it had practically ceased to operate. It remained open to question whether the authorities would feel confident enough to abandon the dual exchange market formally until exchange market stability had been established for some time and had gained further credibility.

Transfers to enterprises, amounting to 6.5 percent of GNP, were not limited to industry, the staff representative explained, although 20 percent of such transfers did go to a number of ailing industries such as textiles, steel, and shipyards, where the difficulty was to phase out those industries or their old segments. The Belgian Government was operating in the context of a Europe-wide coordination of policies toward "sunset" industries, and the adjustment was proceeding fairly rapidly. During the past year, the authorities had arrived at a solution for the extremely intricate and difficult issues raised by the steel sector. Another 30 percent of transfers to enterprises involved price subsidies; as in most European countries, the bulk of such transfers was absorbed by the railroads. Finally, 50 percent of such transfers represented general-purpose funds intended to support innovation, research, and development and also to provide incentives for firms to locate in areas of high unemployment. Whether the transfers to enterprises were being spent effectively was difficult to determine, all the more so because authority for industrial policy was increasingly being delegated to regional authorities by the Central Government. The staff agreed that all government programs should be examined for possible expenditure reductions.

The official answer to work sharing in Belgium was that in 1983/84 it had prevented an increase in unemployment equivalent to 1 percent or so of the labor force, the staff representative went on. The staff regarded work sharing as appropriate, provided that it was cost neutral, something that the authorities had been extremely careful to ensure. Thus, it was likely that work sharing had not cost any jobs in enterprises. Besides, the issue had to be seen in the broader context of labor relations. In 1983, the issue had been whether it would be possible to continue with further wage restraint or whether there was a risk of a catchup from the wage cuts of 1982. The adoption of the work-sharing scheme had been part of a compromise that had also included remuneration for wage catchups.

If the IMF forecasts for private consumption in 1984 and 1985 were compared with those of the OECD, the estimates of the two organizations would be seen to to be the same for the two years together, the staff representative pointed out.

The authorities formulated their trade policy within the European Community, the staff representative noted. By EC standards, the Belgian authorities would probably rank among the more liberal national delegations in their attitude toward protectionism. Therefore, the staff had sought to focus the discussions on another aspect of potential restrictions on trade--aid to enterprises--that might eventually distort the country's competitiveness.

The Belgian authorities continued to be operate under severe constraints, the staff representative said. The 1984 Article IV consultation discussions in Brussels had occurred at a time when the authorities were beginning to implement a second major adjustment package, and definitive results were still not available. By 1986 the economic situation in Belgium would have become fully sustainable again: the public debt would have come under control, the current account would be registering a small surplus, and the profit position of enterprises would be acceptable. By 1986, the authorities would have regained some degree of freedom of maneuver.

The opinion was well established that a number of Belgian investors had expanded their portfolios abroad, in particular because they wished to avoid the withholding tax levied on assets in Belgium, the staff representative from the European Department observed. Those holding that opinion believed that it had been a major mistake to increase the withholding tax rate from 20 percent to 25 percent, a move that the Government had made as a quid pro quo for dropping the requirement to repay such income.

Mr. Fujino commented that 25 percent was a rather low figure, especially as it was not included in the tax declaration. In Japan, the withholding tax had been successfully raised to 35 percent.

The Chairman noted that in Table 4 of the staff report, part of the improvement under Scenario A in the net financing requirement of the Central Government was expected to come in response to discrete actions taken from 1985 to 1987. Subsequent improvements were merely a passive reflection of increases in output. Was that so, or did the projection assume further discretionary action by the authorities beyond 1987?

The staff representative from the European Department explained that, in principle, the authorities would not need to have a new package of measures to secure the continued improvement after 1988. However, Scenario A assumed that the reform of the social security system, gradually getting under way, would be carried far enough so that there would be no growth in spending on social security, despite the aging of the population.

Under Scenario A, the staff had assumed that after 1988 there would be no growth in real noninterest expenditure and also that the tax pressure would be stabilized, the staff representative remarked. After 1987, the debt would remain high, perhaps a source of instability in the economy, but it would at least have lost its explosive character. Another argument, which inhibited additional moves to reduce public sector spending, was based on the strong belief in Belgium that good prospects for profitability and demand were needed to trigger a pickup in private investment, and that any promise by the Government to continue making cuts in expenditure might reduce the chances of such a pickup.

The Chairman commented that, after 1987, interest payments of the Central Government would reach a plateau at 11 percent of GNP, a figure

hardly propitious for any pickup in investment. It might be worthwhile to suggest that the authorities should consider maintaining a more active stance toward spending cuts beyond 1987.

Mr. de Groote observed that public finances had greatly improved since the Government had launched the adjustment program at the start of 1982. The share of the economy taken up by the public sector deficit, having registered rapid increases in previous years, had stopped rising and from 1982 to 1984 had fallen by 1.5 percentage points of GDP. Although internal borrowing from households and enterprises to finance the deficit had increased from 9 percent of GDP in 1982 to 11 percent in 1984, the deficit for the current fiscal year was almost entirely covered by domestic resources. As the current account was roughly in balance, the external borrowing that still took place served mainly to compensate for capital outflows.

When the present Government had asked him to propose the broad outlines of a program based on the Fund's analysis of the Belgian economy, Mr. de Groote continued, the restoration of competitiveness in the productive sector had been considered the primary goal. To effect a massive transfer from the income of households toward enterprises, a reduction of real incomes by more than 10 percent over four years had been planned and was being implemented. The devaluation of the franc and the deindexation of wages had been essential elements of the adjustment package. It had generally been considered that the proposed measures could not succeed in correcting the financial position of enterprises if domestic demand were to be further compressed by more substantial budgetary measures. Thus, the program had begun by transferring resources from households to enterprises, then proceeding to transfer resources from households to the public sector. In retrospect, the phasing of the two adjustments--restoring the profitability of enterprises and reducing the budget imbalance--had on the whole been correct. The policies adopted had had only modest success in restoring business profitability, Belgium's external market shares having risen only slightly. As Mr. Lindå had said, competitiveness might not yet be fully restored. For that reason, there had been little room for further reductions in the government deficit during the first phase of the program.

When the program had begun, some had favored a more substantive adjustment in the exchange rate for the franc, Mr. de Groote recalled. As it had turned out, the authorities had managed to persuade their partners in the European Monetary System to accept a devaluation of merely 8.5 percent. They had thus wished, at the beginning of the program, to avoid any extra deflationary action that might reduce the likelihood that enterprises could regain their earlier profit margins.

Measures currently envisaged for the second phase of the adjustment would encourage a transfer of resources from households to the Government, Mr. de Groote remarked. At present, there was general acceptance by all segments of society of the need to bring the budget more nearly into balance. Even the trade unions recognized that the budget deficit tended

to hold down employment; the system of indexation negotiated with the trade unions provided for large transfers of resources to improve the fiscal position. Moreover, most civil servants had voluntarily accepted large reductions in real income. There might thus be grounds for the authorities to move even further than they were prepared to admit during a pre-election year. Parliament had also enacted a law establishing a procedure under which, quite early in the budget year, a review was conducted of the budget's objectives which, in case of need, led automatically to the adoption of additional measures. As the authorities carried out the reduction of the deficit in terms of GDP, no further negotiations would be required in order to implement additional measures. The system was automatic.

The difficulties of making progress should not be underestimated, Mr. de Groote pointed out. For instance, social security receipts covered only about 60 percent of social security outlays, and the deficit of the system equaled 9 percent of GDP. In all, transfer payments represented some 40 percent of GDP.

Many Belgians held their portfolios in neighboring countries, so that the rise in the withholding tax from 20 percent to 25 percent had little effect in terms of income, Mr. de Groote noted. On the contrary, it was generally felt in Belgium that a total abrogation of the withholding tax would greatly increase fiscal revenue, because many citizens would repatriate their portfolios and subscribe to Belgian government bonds. In fact, serious discussion was going on in all political parties about the possibility of no longer taxing proceeds from sales of such bonds. It would be a much better solution if, by raising interest rates a little higher, the authorities could finance a much larger share of the deficit by using the long-term bond market.

The proposal to base social security contributions on the value added in each enterprise would be quite fruitful, since it would allow for much lower contributions from smaller companies, especially from those using a large proportion of manpower relative to capital, Mr. de Groote observed. Although the authorities were discussing the idea, authorities in Belgium's trading partners would have to reach similar decisions in order to make it practical. Otherwise, any such change would probably affect Belgium's foreign trade, one of the reasons why the authorities had not pursued it further. The observation was quite correct that the liquidity of the financial market and the substantial savings of households did not furnish any reason whatever for considering that there was any less need to reduce the deficit.

During the 1983 Article IV consultation with Belgium, Mr. Polak had observed that monetary policy in that country was in a state of submission to the Treasury, Mr. de Groote recalled. Clearly, short-term interest rates had been guided by balance of payments objectives. For the first time in many years, the Banque Nationale de Belgique had agreed to raise short-term interest rates, thereby ensuring that the Belgian franc would not systematically be at the low end of the European Monetary System

"snake." The adoption of a reserve target had also limited the possibility of monetary financing of the public sector deficit; in an indirect and roundabout way, monetary policy was beginning to have an impact on overall economic policy. Of course, the monetary authorities were unable to decide when a certain long-term rate should be changed, since it was entirely up to the Government to decide whether it would finance its deficit with foreign resources or domestic ones. The authorities felt that long-term rates could not be increased at present, when they had risen above 7 percent in real terms; any increase would discourage investment and construction. However, if the downward movement of interest rates were to continue, the authorities intended to prevent long-term rates from declining as much as market forces would otherwise dictate. It would certainly weaken the Belgian franc if they chose to let long-term rates decline; they wished to take advantage of a possible downward movement in such rates to re-establish a better time structure for all interest rates.

Belgium was characterized by a great number of autonomous segments within the financial market, Mr. de Groote considered. Each segment had its own functions; all were used by the Treasury to finance its deficit. All were highly specialized and attracted different sources of financing. In the future, a decrease in the role of government would probably make it possible to unify different segments of the financial market and to establish a correct foundation for monetary policy.

In official circles in Belgium, a great deal of reflection was going on about the need to maintain the dual exchange market, which had indeed lost most of its usefulness, Mr. de Groote considered. Given recent financial developments, it was becoming more difficult to distinguish current transactions from financial transactions; some transactions that were current on one day became financial on the next. To a large extent, the system was manipulated in the sense that certain categories of transactions that were accomplished in one exchange market at one time were, at another time, placed in the other market. For instance, because of the size of Belgium's portfolio investments in neighboring countries, current receipts from overseas had risen so high that they had upset the balance between the free market and the official market. In other words, if the banks had not been allowed to repatriate such financial flows through the official exchange market, the free-market rate for the Belgian franc would probably have fallen below the rate on the official market because of the magnitude of repatriation of incomes. Paradoxically, such a development would imply a loss of reserves, if the free-market rate fell below the official rate.

The distinction between the two exchange markets was somewhat artificial, Mr. de Groote noted. In spite of all the shortcomings, the free market continued to have some usefulness because it acted as a cushion during periods of pressure on the exchange rate, Mr. de Groote said. Also, public opinion might react adversely if people had to conduct their financial transactions through the official market. One way to prevent

that reaction and forestall any further acceleration of capital outflows would be to continue the practice of not identifying those who usually exported funds through the free market if they used the official market.

The Luxembourg authorities wished to maintain a system of free movement of capital, which was essential for the development of the country as a financial center, Mr. de Groote continued. Indeed, it was hard to establish a unified system without imposing some form of capital control, particularly in small, open economies.

Belgium did indeed have a centralized system of wage determination, Mr. de Groote explained. The country imposed a unified wage level, and each enterprise was not free to negotiate its own employees' wages at the present stage. Gradual but continuous improvement was occurring because of dramatic changes in attitudes, but the country had a long way to go. Rigidities in the labor market were only one aspect, but probably the most damaging one, of an old industrial economy based on coal, textiles, and steel, currently experiencing aging workers, outdated equipment, and a long-standing tradition of social solidarity and equitable distribution of income. Belgium also had a long-standing and active tradition of compromise, under which every viewpoint was taken into account whenever an issue was discussed.

As observed by several Executive Directors, the limits imposed on the indexation system by the introduction of an international comparator had represented a restriction within a restrictive system. Perhaps it might be better to forget about such a system altogether and to free wage determination entirely. In practice, he doubted whether there would be any chance in the near future to abandon either form of indexation. The idea was now accepted, however, that the system would have to be subjected constantly to guidelines like index jumps that set limits on the percentage of wage increases possible during one year.

On work sharing, Mr. de Groote explained that the total number of hours worked had increased recently; it had not been that some were working less while others were working more. Indeed, the working population had increased, and if employment had not effectively increased in the meantime, the rate of unemployment would have pushed up as well. Thus, there had occurred a real reduction in unemployment in terms of hours worked, resulting from the adjustment measures taken at the beginning of the program. Since those who had been put to work were considered workers and received pay from enterprises, those working a smaller number of hours had to accept a reduction in income. Work sharing was helping to promote wage moderation.

It would be useful, as suggested by several Executive Directors, to have a comprehensive study presented to the Board on the impact of unemployment compensation on the high rate of unemployment, Mr. de Groote considered. In his view, some connection existed between the extreme generosity of unemployment compensation in Belgium and the high rate of unemployment, especially in relation to participation in the labor force

by women. Because total household income was being taxed, many young couples hesitated before marrying. Moreover, in Belgium, a large number of those receiving unemployment compensation were working on the parallel market in the underground economy. It was difficult to quantify the size of that market, but proposals for remedying the situation were being studied with great attention by the Government.

Following the improvement in public finances, the authorities would have to deal with industrial rigidities and excessive subsidies to ailing enterprises, Mr. de Groote remarked. Within the European Community the Belgian Government usually took a progressive stance favoring liberalization.

Consultations with the Fund were at the very center of the public debate in Belgium on economic policies, Mr. de Groote concluded. The staff had given the right balance between citing developments that could be regarded as improvements and those that required further improvements still. In addition to the positive results already achieved the possibility of obtaining further progress by the end of 1985 when the legislative session would normally end had strengthened the authorities' determination to persevere with the necessary changes.

The Chairman made the following summing up:

> Executive Directors warmly commended the Belgian authorities for achieving significant success in the adjustment process since the previous consultation. They noted the continuing improvement of the external current account and observed that the performance of consumer prices was also improving. They especially welcomed the stabilization of employment following several years of decline and noted the renewed vigor in industrial activity. Directors considered these developments to be an encouraging response to the country's adjustment efforts and particularly to the partial suspension of wage indexation, which had helped restore competitiveness, allowed a recovery of business profitability, and made possible the present recovery of investment.
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> Directors observed, however, that serious imbalances remained in the economy, including notably high and rising unemployment, severe weaknesses in the industrial structure, and unsustainable levels of public sector expenditure and deficits. They agreed that in order to improve employment prospects and in order to make further progress in reducing inflation, which continued to exceed that of Belgium's main trading partners, the recent gains in competitiveness must be preserved in full, and that wage restraint therefore remained necessary. Many Directors, while noting favorably the system of index jumps, regretted the reintroduction of wage indexation. They stressed that the system of wage determination in Belgium might be overregulated and urged the authorities to tackle this rigidity.

Directors stressed again the urgency of reducing the fiscal deficit, which in recent years had declined only modestly. They commended the authorities for initiating the implementation of a three-year program calculated to reduce the public sector borrowing requirement to 7 percent of GNP by 1987. This was seen by several Directors as an essential although intermediate target in view of the present and prospective burden of interest payments on the public debt. Directors felt that success in securing the objectives of this fiscal program was necessary to consolidate the gains from recent adjustment efforts and restore a balanced economic and financial basis for growth. A number of Directors expressed some doubt whether with present policies the 1987 target could be achieved, and some Directors believed that in the light of the high public debt burden the 1987 target should be more ambitious. At any rate, most Directors saw the three-year adjustment program as an absolute minimum that left no room for slippage. Directors accordingly urged the authorities to stand ready to take additional measures in order to avoid any slippage in the implementation of the fiscal program. While supporting the aims of the program, Directors considered that it had placed perhaps too much weight on revenue-raising measures and that the emphasis should be shifted to expenditure cuts, particularly in such areas as social security transfers and subsidies to industry.

Directors reiterated their view that the weaknesses in the public finances complicated the conduct of an appropriate monetary policy. They welcomed the tightening of monetary policy in Belgium in the first part of 1984 and the firmer management of short-term interest rates. They observed that this posture had helped support the exchange rate of the Belgian franc within the EMS. They encouraged the authorities to maintain a relatively tight stance of monetary policy and to extend it to the long term. The improvement of the current account had to some extent been offset by larger net private long-term capital outflows, which Directors saw as a source of concern given, in particular, the rapidly rising external debt. They related this development in part to insufficient adjustment in long-term interest rates, and in that context a number of Directors noted that only a modest part of the treasury deficit was being financed through the domestic bond market. They emphasized, accordingly, the need to increase the attractiveness of investment in long-term Belgian securities.

Directors noted the pervasiveness of the regulatory framework and the concurrent lack of flexibility in the Belgian economy, particularly in labor relations, and the deep involvement of the public sector in all aspects of economic life. They believed that progress in restoring more flexible conditions and in reducing the very high ratio of public expenditure to GNP

must be achieved if the economy were to be able to adapt satisfactorily to changing world conditions. In this context, Directors stressed that the modernization of industry was one of the main challenges for the Belgian authorities. While commending the authorities' commitment to liberal trade practices, Directors emphasized that the heavy weight of subsidies to enterprises and the restrictions on trade should be reduced.

Finally, a number of Directors encouraged the authorities to abolish the dual exchange market, and Belgium was commended on the level of its ODA.

The next Article IV consultation with Belgium would normally be held on the standard 12-month cycle. However, in the light of the authorities' request that the annual consultation mission be shifted to a February date, it is expected that exceptionally the next Article IV consultation will not be concluded until May 1986.

2. PARAGUAY - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Paraguay (SM/84/276, 12/19/84). They also had before them a report on recent economic developments in Paraguay (SM/84/274, 12/28/84).

Mr. Nebbia made the following statement

At the outset, I would like to state the general agreement of my Paraguayan authorities with the staff appraisal and the analysis contained in the set of papers prepared for this discussion. In their opinion the documents present an objective analysis of Paraguay's current and prospective economic situation and a balanced description of the Government's economic program and policy intentions.

Paraguay's economic performance in the second half of the 1970s was impressive. An average real growth rate of around 10 percent was observed then, with international reserves steadily increasing, low rates of inflation, a moderate level and a favorable structure of the public sector external debt, high levels of employment, and a reasonable balance on public sector operations.

Besides these developments, the construction of the Itaipu hydroelectric project and the starting of the Yacyreta project played a major role. They not only contributed to boosting economic activity in related areas of the economy, but also made it possible, in the light of stable and moderate economic policies, to introduce major transformations in the economy.

Investment in farming, forestry, construction, manufacturing, and agroindustries expanded rapidly. The private sector was also allowed and encouraged to play a major role, which in turn contributed to a more efficient and flexible resource allocation process in the economy.

After mid-1981 economic activity weakened and in 1982 and 1983 GDP registered a cumulative decline of 5 percent. At the same time, the balance of payments deteriorated and inflationary pressures accelerated from their previous relatively low levels. To a large extent, this was the result of adverse external developments, including the winding down of construction at Itaipu, delays in the development of the Yacyreta project, unfavorable climatic circumstances in 1983, and financial difficulties of Paraguay's neighbors. However, the authorities recognized that certain domestic imbalances also have had a part in the overall economic deterioration, in particular, in such areas as the public finances and the exchange rate system.

Therefore, during 1984 a number of measures have been implemented toward the prompt restoration of a more sustainable external and internal position of the economy. Most of them are also in line with the recommendations suggested by the Board on the occasion of the 1983 Article IV consultation (EBM/84/7, 1/16/84).

In the exchange rate field, measures were adopted in May in order to simplify the system and to move the exchange rate to a more realistic level. As a consequence, there are now three basic exchange rates instead of the seven different ones prevailing since mid-1982. While further actions in this area have not been ruled out, the authorities fear that at this time additional devaluations might bring higher inflationary pressures. Nonetheless, they will continue to transfer exchange transactions among segments of the exchange market in a gradual process toward the unification of the whole system.

Regarding fiscal policies, through 1984, the authorities have decisively implemented tighter control over current expenditures and cutbacks in capital expenditure, which in turn have meant a significant reduction in the central administration's deficit. At the same time, the financial position of a number of public enterprises was strengthened through substantial increases in tariffs. All in all, these measures have led to a successful reduction in the recorded overall public deficit by about 2.5 percentage points, to the equivalent of 3 percent of GDP in 1984.

In order to strengthen the fiscal position further, a new tariff law has been presented to Congress as a part of the 1985 budget. This law, as the staff clearly had explained in its papers, is aimed at rationalizing Paraguay's tariff structure

within a general range of between 5 percent and 30 percent and at simplifying the many charges and fees to which imports are currently subjected. The authorities expect that passage of this law would increase the proportion of international trade transacted through regular channels, and therefore should boost international trade tax collections. It might be noted that this simplification of the Paraguayan tariff structure reflects the full commitment of the authorities to effectively enact, to the extent that domestic economic conditions permit, the recommendations raised by this Board during the last Article IV consultation regarding liberalization of trade proceeds.

The expected improvement in the public finances will make an important contribution to the required tightening in monetary management. Within this context, the authorities have also made clear their intention to tighten the rediscount policy of the Central Bank, which has been one of the major causes of credit expansion over the past two years. They note that the reduction of the rate of credit expansion will be consistent with the objective of restoring price stability, as well as contribute to strengthening the external balance of the economy.

The authorities acknowledge the negative effect on the growth potential of the economy of maintaining the existing tax structure and the present structure of interest rates. Regarding interest rates, they note that they have been considering measures which would correct current distortions, and that they will move, as soon as the general economic conditions of the country permit, toward a more freely determined system. The authorities also note the need to modernize the country's tax structure so that the public sector can fulfill its role in areas such as the provision of social services, infrastructure to facilitate productive development, and technical assistance. Studies are being made in this area aimed at devising a tax system which should increase and stabilize revenues through lower rates applied to a broader base. This should mitigate the need for drastic curtailments of public investment like the ones applied in the past to cope with unfavorable circumstances.

Mr. Arias said that he was in broad agreement with the staff appraisal and that he could support the proposed decision. There could be no doubt about the improvement in the Paraguayan economy during 1984, following the firm action by the authorities. The public sector deficit had been reduced to 2.9 percent of GDP from 5.3 percent in 1983, partly thanks to the policy of expenditure restraint and partly to increased public sector savings resulting from adjustments in the charges of some public enterprises. Those adjustments meant that the operating costs of the enterprises were more accurately reflected, and he encouraged the authorities to continue to move in that direction where necessary.

It would be interesting to know the size of the projected public sector deficit for 1985, Mr. Arias continued. He attached great importance to a major tax reform as a means of boosting revenue in order to strengthen the fiscal position. The new tariff law that had been presented to Congress, aimed at improving the efficiency of the tariff system and at avoiding trade transactions through unofficial channels, was evidence of the authorities' willingness to remove structural rigidities that had been affecting public finances adversely.

Interest rates on savings and time deposits were still negative in real terms because inflation had continued to accelerate, Mr. Arias observed. In order to stimulate savings and to make it possible to follow a consistent course of economic policy, the authorities should promptly adopt a flexible interest rate policy to ensure the efficient allocation of resources.

Finally, Mr. Arias stated that the recent measures aimed at simplifying the exchange rate system were commendable, reflecting as they did the authorities' intention to move toward an appropriate, unified exchange rate. The gradual and cautious approach that they had chosen to follow, while at the same time attempting to prevent undue inflationary consequences, was adequate. But exchange rate action was not the only way to improve competitiveness. The delayed economic recovery had led him to wonder whether it would not be desirable for the authorities to consider further action to improve Paraguay's competitive position to avoid further reserve losses and financial imbalances.

Mr. Pérez noted that Paraguay's financial situation had deteriorated significantly in 1982 and 1983. One contributing factor had been the downturn in economic activity compounded by the financial difficulties of neighboring countries and Paraguay's main trading partners. Traditionally, the Paraguayan authorities had followed conservative financial policies, but in recent years monetary and fiscal policy had been relaxed, and an overvalued real exchange rate had been maintained. As a result of those external and domestic factors, international reserves had declined and commercial arrears had accumulated.

The immoderate expansion of domestic credit and the persistence of negative real interest rates were of concern to him, Mr. Pérez continued. Those monetary policies had contributed to the misallocation of resources and to capital outflows, with an adverse effect on the savings ratio. Therefore, he encouraged the authorities to adopt a more flexible interest rate policy and to modify the system whereby the central bank automatically rediscounted certain special credits that the commercial banks were required to make available in order to avoid continued excessive credit expansion.

Encouraging efforts were being made to strengthen the public sector finances though a tight control over and a reduction of central government expenditures as well as through the proposed simplification of the tax structure and stricter tax administration, Mr. Pérez commented.

Those measures, together with the flexible exchange rate policy, would reduce the evasion of taxes on international trade. The present tax system remained complicated and difficult to administer, and its reform would be a basic factor in the improvement of the financial position of the public sector. The authorities intended to continue to reform the tax structure and administration.

The deficit on the current account of the balance of payments had been significantly reduced over the past year in comparison with 1983, Mr. Pérez remarked. However, the reduction had been based far too little on the growth of exports and far too much on a reduction of imports. That import compression reflected the current restrictiveness of trade policies and the scarcity of foreign exchange and capital inflows; it also reflected the great limitations on economic activity in Paraguay resulting from the lack of imported imputs. The reduction of errors and omissions might indicate a decline in capital flight, following the outflow of capital in 1981-83. Yet there had been only a very minor net reduction of commercial arrears; even though the authorities had established a program in 1984 for reducing commercial arrears, new arrears had been accumulated. He underlined the necessity of establishing a schedule for the settlement of those payment arrears in 1985 to promote the restoration of international confidence in Paraguay.

A set of measures had been introduced in 1984 in line with the recommendations of the Executive Board during its discussion of the 1983 Article IV consultation with Paraguay, Mr. Pérez recalled. A modification of the exchange system in May had been one of the most important of those measures. However, the exchange rate regime remained complex and the authorities should continue their efforts to simplify the system by moving toward exchange rate unification.

The current and future status of the steel plant constructed in Paraguay raised sensitive issues, Mr. Pérez commented, especially with respect to its excess capacity in relation to the market, at home and abroad, for its output. The financial cost of the project would represent a heavy burden for Paraguay in the future. The authorities should thoroughly re-examine all matters relating to the feasibility of the project, taking courageous action if necessary. In addition, the authorities still had great strides to make in order to adjust Paraguay's financial position in the medium term, thereby laying the foundations for durable economic growth and for restoration of the confidence that would encourage private sector investment and domestic savings. The re-establishment of positive interest rates in real terms, the return to rates of credit expansion that were more in line with the desired expansion of nominal GDP, the strengthening of the tax structure, and the abolition of restricted trade policies would be indispensable to the achievement of those goals.

Ms. Lundsager recalled that since the Executive Board had last discussed Paraguay, the authorities had made some significant policy changes, most notably the substantial devaluation in May. The staff report outlined additional measures under consideration that were appropriate in

terms of the direction of change although they might not be sufficiently strong to completely correct the earlier deterioration in the economy. Although some economic indicators had improved in 1984, including the rate of growth and the balance of payments, the inflation rate had jumped to over 20 percent while international reserves had declined and external arrears remained. Without a more rapid turnaround, Paraguay would face additional reserve losses; and if external arrears were not reduced further, the country's credit rating would suffer, thereby increasing its cost of borrowing.

Both capital and current expenditures were budgeted to increase by less than the expected rate of inflation in 1985, Ms. Lundsager remarked, thanks to continued expenditure restraint. Real wages in the capital city would probably decrease again in 1985. The simplification of the trade regime could be expected to bring in more trade through official channels, thus increasing fiscal revenue, but the authorities should avoid committing any of those estimated revenues until they actually materialized. The authorities' plan to exempt exports from all taxes and charges could create incentives for increased export production.

Developments in the public enterprise sector had been mixed, Ms. Lundsager commented, with some entities operating on a sounder financial basis following increases in their tariffs. However, it was difficult to envisage how the cement company or the steel company, with capacity that was expected to exceed domestic demand by two and three times respectively, would ever be able to operate profitably, given export prospects. Unfortunately, it was too late to stop those projects and, like Mr. Pérez, she suspected that Paraguay would be faced with the need to adjust the economy further in order to free the domestic resources required to cover the cost of servicing external debt relating to those investment projects.

Monetary policy should be tightened, Ms. Lundsager continued, in light of the increase in prices over the past year due to a rate of monetary expansion exceeding the rate of economic growth. Furthermore, the higher inflation rate had made real interest rates significantly negative, with an adverse impact on both domestic savings and the balance of payments. If usury laws prohibited adequate adjustments in the interest rate structure, the authorities should make every effort to contain inflation through tighter fiscal and monetary policies.

Significant exchange rate adjustments earlier in 1984 had reversed the three-year trend of the currency to appreciate, Ms. Lundsager remarked, but as shown in Chart 1 and in the Information Notice on Exchange Rates issued on December 21, the real effective rate had appreciated by about 16 percent since June 1984. Unless further adjustments to the rates were made, the beneficial effects of that devaluation would be lost. Furthermore, the continued--although reduced--multiplicity of rates created hidden costs for the Government in the form of central bank subsidies on currency conversions, which were estimated to have equaled 1.6 percent of GDP in 1984. Moreover, the authorities would be making further progress toward the unification of the exchange markets.

The overall balance of payments could in fact be in balance beginning in 1985, Ms. Lundsager commented, if, as the staff had noted in evaluating Paraguay's medium-term prospects, "policies were geared to promoting export growth and restraining imports." While the exact nature of the necessary policies was not made clear, the information in Table 5 on Paraguay's medium-term external debt projections should enable the authorities to determine the impact of various policy measures on the balance of payments and on the debt service ratio. Even assuming the right policies, the debt servicing burden would remain high, at above 30 percent of exports of goods and services. She supported the proposed decision.

The staff representative from the Western Hemisphere Department noted that the authorities had made efforts to redress imbalances that had become apparent in the economy during the past two years. There had been significant exchange rate action following a lengthy period over which the exchange rate had been maintained at an unrealistic level. Important steps had also been taken to reduce the budget deficit to more manageable levels; recent information from the Fund's resident representative in Paraguay indicated that the final outturn for 1984 might well be a budget deficit below 3 percent of GDP, the estimate in the staff report. As Mr. Nebbia had stated, the 1985 budget was likely to be passed in much the same form as it had been submitted to the Congress. However, although the Tariff Law should have the effect of reducing the amount of trade through unrecorded channels, the authorities would not be wise to base their budget policy on such a reduction in unrecorded trade.

Although the adjustment process might have begun, the staff representative continued, much remained to be done. In the two months since the staff mission had been in Paraguay, the monthly rate of inflation had picked up to about 3 percent, bringing the 12-month inflation rate to 30 percent. While that rate might be low by regional standards, it had to be viewed against Paraguay's history of relative price stability. Moreover, in the months ahead, the balance of payments was likely to come under additional pressure due to low cotton and soybean prices in international markets. In addition, capital inflows related to the construction of Paraguay's hydroelectric projects were likely, at best, to be similar to those of 1984, and they might even be lower as a result of delays in completing the Yacyreta project due to Argentina's current financial difficulties.

Those developments highlighted the need for additional adjustment efforts, the staff representative noted, and the authorities had embarked on the right course. In addition to a tighter budget for 1985, the rediscount policy had been significantly changed in December in order to bring the monetary and credit aggregates under better control, consistent with the authorities' objective of regaining price stability. Active consideration was also being given to additional modifications to exchange rate and interest rate policies. Those were the basic structural requirements for a sustained revitalization of the economy, as well as for the strengthening of the balance of payments.

Exchange rate policy was not the only way to restore competitiveness, as the authorities themselves were aware, the staff representative continued. It would be necessary to scale down the rate of inflation and eventually to restore price stability, and the authorities intended to follow policies geared to that end. A schedule had been established for the repayment of arrears in 1983, based on the date on which the arrears had been accumulated. While new arrears had arisen in 1984, the authorities had at least made an attempt to deal with outstanding arrears in an orderly manner. It was their firm intention to reduce arrears in 1985.

The cement plant and the steel plant were both expensive public enterprise projects, which had been financed largely abroad, the staff representative said. The authorities hoped that demand for steel would recover strongly once the Yacyreta project was fully under way; they believed that Paraguay's geographical location might enable it to break into the market in Brazil and Argentina. The staff had certain doubts about both projects, and as indicated in its appraisal, felt that if sales did not pick up as expected, additional fiscal measures might have to be considered.

Mr. Nebbia observed that the Paraguayan authorities had always followed a very conservative decision-making process in dealing with their economic difficulties. Each step in terms of economic management had always been considered in a framework that went well beyond exclusively economic considerations, to define a policy approach consistent with the major objectives for the economy as a whole. However, faced with a changing environment, both economic and social, the authorities had been prepared to exercise a high degree of flexibility. Their open-minded attitude had been the major factor in the proposals aimed at modernizing the economy and to redress emerging economic imbalances.

The Fund's advice had always been taken into account by the Paraguayan authorities, Mr. Nebbia concluded. A number of the measures adopted during 1984 and those envisaged in the economic program for 1985 illustrated the authorities' commitment to the full implementation of an orderly adjustment process along the lines recommended by the Fund. The authorities were well aware that much still needed to be done, particularly with respect to the unification of the exchange rate system and to increasing fiscal revenues through a major tax reform. Nevertheless, steps in the right direction had been taken on both counts. Therefore, the Fund should continue to offer its helpful technical assistance to ensure that the Paraguayan authorities' efforts would finally lead to the successful achievement of the goals they were pursuing.

The Chairman made the following summing up:

> Executive Directors were in general agreement with the views expressed in the staff appraisal of the report for the 1984 Article IV consultation with Paraguay.

Directors welcomed the modification of the exchange system in May 1984 as an important step in the necessary strengthening of Paraguay's external accounts. However, they stressed the drawbacks of the multiple rates and urged that further measures toward the unification of the exchange rate be taken, particularly in view of the expected reduction in foreign exchange inflows related to the construction of Paraguay's hydroelectric projects. The real appreciation of the exchange rate over the past months highlighted the need for further exchange rate flexibility and a tightening of demand management policies in order to provide room for the needed shift of resources to the external sector.

Directors were encouraged by the efforts that had been made in 1984 to strengthen the Central Administration's finances, and they welcomed the authorities' intention to continue such efforts in 1985. Directors felt that special efforts were needed to focus on measures aimed at improving Paraguay's tax effort, noting in this regard that a basic reform of the tax system was required. Directors also encouraged the authorities to evaluate more carefully investment outlays by public enterprises; some doubts were expressed on the steel and cement investments.

Directors expressed concern about the recent rapid growth in the monetary and credit aggregates. They indicated that the continuation of such a trend would be inconsistent with the authorities' objectives of balance of payments equilibrium, price stability, and economic growth. Directors underlined the need for raising interest rates to promote financial savings and to secure a better allocation of resources.

Directors emphasized the need for a basic redirection of macroeconomic policies to provide the basis for dismantling the restrictive trade policies and exchange controls that have come to characterize the Paraguayan exchange and trade system. They also urged the authorities to eliminate the commercial arrears that have been accumulated over the past two years.

It is expected that the next Article IV consultation with Paraguay will be held on the normal 12-month cycle.

The Executive Board then took the following decision:

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

2. The Fund notes the complexity of Paraguay's exchange system and urges the authorities to simplify it by unification of the exchange rate and by the removal of restrictions on payments and transfers for current international transactions.

Decision No. 7886-(85/5), adopted
January 11, 1985

3. ANNUAL REPORT ON EXCHANGE ARRANGEMENTS AND EXCHANGE RESTRICTIONS, 1985 - PART ONE - OUTLINE

The Executive Directors considered a proposed Outline for Part One of the Annual Report on Exchange Arrangements and Exchange Restrictions (EBD/84/314, 12/12/84).

Mr. Nguyen said that the structure of the Report for the preceding years still appeared relevant to his authorities, who therefore saw no need for any change. The modifications proposed by the staff in the outline attached to EBD/84/314 would result in the addition of counter trade practices to the heading and section on bilateral payments arrangements and the division into two of another trade section, entitled imports and import payments, to cover state trading. The increased importance given to trade matters did not seem justified in a report that already paid enough attention to trade and that would consequently no longer bear much semblance to an Annual Report on Exchange Arrangements and Exchange Restrictions. Moreover, the argument that state trading should be a main heading because it involved import and export trade was not very convincing; it could equally well be adduced to support a further development of the material on state trading in Section 1 and Section 2 of Chapter III, as had been done in the reports for the three preceding years.

Mr. Grosche said that he had no problem with the proposed outline, including the suggested changes.

Mr. Leonard remarked that he too could accept the proposed changes, which seemed presentational rather than substantive.

Mr. Vasudevan stated that he could accept the staff's proposal to separate state trading from imports and import payments, and to treat it as a separate section in Chapter III. State trading concerned both import and export trade and did not deal only with imports and import payments.

Referring to the second change proposed by the staff to expand the heading bilateral payments arrangement to include counter trade practices, Mr. Vasudevan recalled that there had been only one paragraph on such practices in the 1984 report. Furthermore, counter trade practices were not related to bilateral payments arrangement but formed part of bilateral trade arrangements; as such, those practices should be discussed under a separate heading.

The heading of Chapter IV, main developments in regional arrangements had the advantage of providing an opportunity for a useful discussion of those arrangements, Mr. Vasudevan commented, although it might have the disadvantage of obscuring certain restrictive practices that might arise under some regional trade or payments arrangements. The exclusion of such practices from Chapter III, which dealt with main developments in restrictive practices, might make it necessary to devise ways of singling out the elements of restrictiveness in regional cooperation arrangements--if those arrangements were in fact leading to or were tantamount to restrictive practices of any kind or to any degree--for coverage under Chapter III, leaving the broader aspects of regional cooperation to be dealt with in Chapter IV.

Ms. Lundsager said that she endorsed the proposed outline.

The staff representative from the Exchange and Trade Relations Department confirmed that the relevant sections in previous reports dealing with counter trade practices and state trading had been very limited. The inclusion of those two new sections was therefore not a matter of great concern to the staff, although it would be useful to identify counter trade practices in a subheading because of the general interest shown by the Executive Board.

All features of existing regional arrangements would be dealt with in Chapter IV, the staff representative explained, including restrictive aspects. If pointed attention needed to be given to any particular restrictive features, that would be done in Chapter III.

The staff representative from the Exchange and Trade Relations Department, in response to a question by the Chairman, explained that restrictive features of regional arrangements would be covered under the relevant subsection of Chapter III. For instance, if payments arrangements between the various members of the regional arrangements gave rise to the restrictive measure, the subject would be dealt with under the section on bilateral payments arrangements. Other restrictive aspects would be dealt with under the appropriate headings.

Mr. Vasudevan said that he had no objection to such a presentation, although it was still not clear to him that counter trade practices should be included in the section on bilateral payments arrangements. Interest in counter trade practices was growing, and the topic might deserve separate treatment.

The staff representative from the Exchange and Trade Relations Department, in response to a further question by the Chairman, said that state trading could be covered under Section 1 and Section 2 of Chapter III, as in previous reports, in order to meet Mr. Nguyen's concern.

The Executive Directors approved the following decision:

The Executive Board agrees that the structure of the 1984 Annual Report on Exchange Arrangements and Exchange Restrictions shall be along the lines set forth in the attachment to EBD/84/314 (12/12/84), as amended in the light of the discussion.

Adopted January 11, 1985

4. ADMINISTRATIVE BUDGET FOR FY 1985 - REQUEST FOR SUPPLEMENTARY APPROPRIATIONS FOR MAINFRAME COMPUTING SERVICES

The Executive Directors considered a staff paper on the need for supplementary appropriations for mainframe computing services under the administrative budget for FY 1985 (EBAP/84/276, 12/13/84). They also had before them as background information a staff paper on the three-year outlook for Fund computing services, including those requiring mainframe computers (EBAP/84/281, 12/28/84).

Mr. Blandin stated that the request for supplementary budget appropriations to purchase a mainframe computer and to initiate the process of establishing a new computer facility would require the Executive Board to take a decision that would be the first step toward determining the entire direction in which the Fund would move with respect to data processing. Before taking a position, he therefore wished to be sure that all other options had been explored.

The new IBM-compatible computer would have to respond to the needs of the Data Fund System, the accounting and reporting systems of the Treasurer's Department, and the budget and procurement system of the Administration Department, Mr. Blandin noted. Financial operations with member countries and internal budgeting transactions were of course confidential, and the related data should certainly be collected under the Fund's control. But questions of internal management aside, he had strong reservations about the Fund developing its own data processing system at a time when the strengthening of Fund/Bank collaboration was being discussed. The gains from a pooling of data would outweigh the losses. The argument that some data must be kept secret was irrelevant, because technicians knew how to protect access to the data. In addition, member countries would save manpower and energy if they were not obliged to meet demands for the same data from several sources.

He had not been fully convinced from the staff papers that the Executive Board had been given a clear picture of the extent to which it was feasible to collaborate closely with the World Bank on a data processing system, Mr. Blandin added, or that it had been given any reasons for the relaxation of such collaboration in the past few years. The future location of the computer system had been singled out for discussion. Although he fully understood that the present location was no longer adequate, he failed to see why a joint location with the World Bank was

not envisaged. The Bank had razed old buildings in the neighborhood, but had not yet constructed new ones; thought should be given to modifying the building plans to incorporate a joint computing facility. In sum, until he knew whether the possibilities of working together with the World Bank had been fully explored, he would refrain from supporting any hastily taken decision.

Mr. Grosche noted that the staff had made another effort in the papers under discussion to demonstrate the need for a comprehensive overhaul of the Fund's computing services. While he recognized that major steps would have to be taken to modernize the Fund's computing facilities, the proposed expenditures were substantial. Not being an expert, he was unable to judge whether the staff was aiming at the optimum cost/benefit ratio, but he nevertheless felt somewhat uneasy about the request to the Executive Board to approve appropriations for the purchase of a mainframe computer, in the absence of information about other possible options. Moreover, by approving the purchase and by appropriating expenditures for the selection of a site for a computing center, the Executive Board was indirectly being asked to endorse the full multiyear program. Admittedly, that endorsement had been implicit in the Executive Board's approval in the Administrative Budget for FY 1984 and FY 1985 of appropriations for replacement systems that were compatible with IBM-compatible technology.

On balance, he could go along with the proposed decisions, because the Fund should be appropriately equipped to accomplish its important tasks and because he trusted the staff to limit expenditure to the maximum extent possible, Mr. Grosche stated. As he had mentioned in the seminar on Electronic Data Processing (Executive Board Seminar 84/3, April 23, 1984), not everything that was technically feasible should be considered absolutely necessary. Finally, he asked the staff to keep Executive Directors fully informed about any future steps it considered taking, and in particular about possible options and their implications for costs.

Mr. Lindå remarked that he had been puzzled by the breakdown in collaboration between the Fund and the World Bank on computer services. He had understood that economies of scale were possible. In his view, the time had come to make a full review of the Fund's computer policy. The separate paper by the staff, analyzing the Fund's longer-term needs rather than the usual one-year budget framework, was therefore helpful.

The costs of modernizing the computing equipment were high, Mr. Lindå observed, although he understood that the switch to IBM-compatible equipment was considered essential if a high quality, flexible system was to be maintained in the long run. Not being a computer expert, he would not tackle that issue, although he felt that the decisions made in the past had left rather limited room for maneuver when it came to finding answers to the specific question that the Executive Board had been asked to consider at the present meeting. The existing computer capacity was not sufficient to meet the Fund's needs, but new technology was not readily

usable; the Board had thus been asked to approve the upgrading of the present Burroughs capacity together with an active shift toward a different technological environment.

At the same time, arrangements had to be made to provide temporary space for Fund-owned computer equipment, pending completion of a new facility, Mr. Lindø said. Such temporary arrangements should be replaced at the earliest convenient time with longer-term measures, both for reasons of cost and the Fund's special requirements, including the need for security. In that context, he emphasized the desirability of close collaboration with the World Bank, which was facing similar space problems. The result might be a reduction in costs, beginning with the request for $200,000 for a preliminary site survey and a subsequent construction cost estimate. Finally, like Mr. Blandin, he asked whether space in the new building being planned by the World Bank would be available for the purposes envisaged.

Mr. Zecchini stated that in accordance with the position taken by his chair in the seminar on Electronic Data Processing, he supported the proposed purchase of a large IBM-compatible computer. The current and prospective markets for hardware and software offered the Fund an opportunity to shift gradually toward an integrated IBM-compatible technology, except for special uses for which other hardware equipment--for instance, microcomputers--might be advisable. The important question was how to minimize the net cost of the transition over the foreseeable future.

The location of the computer facility in a remote building might be sensible, based on considerations of direct costs, but it might create communication difficulties, Mr. Zecchini remarked. He had in mind the communication of data by cable, the handling of tapes and other supporting material, and the communication between the staff members located in the Fund building as opposed to those working in the distant building. It was of course difficult to quantify the advantages of close working contacts. Those communications difficulties should be studied carefully, at an early stage, so that appropriate measures could be devised to avoid them. In that connection, it would be interesting to know what proportion of the personnel of the Bureau of Computing Services would be located in each of the two buildings.

Referring to the issues covered in the background paper on the three-year outlook, Mr. Zecchini said that as he understood it, the main scope of the proposed Economic Information System (EIS) would be to avoid the duplication of data between the Fund's main database and the databases on individual countries that were maintained and used by area departments. However, the Fund's main database was constructed on the principle of the maximum possible uniformity and cross-country comparability of data, whereas the work done by desk economists often relied on data that were more similar to those used by member countries and that better reflected their institutional arrangements, techniques of policy implementation, or simply data collection procedures. There was a qualitative difference between those two classes of data, and the use of one or the other on

different occasions depended on whether cross-country comparability or a relatively close match with the specific data of individual member countries was desirable. How could the EIS satisfy, at one and the same time, the need to accommodate the databases of individual countries and also satisfy the requirement of comparability underlying International Financial Statistics and other Fund publications?

The electronic data processing needs of Executive Directors varied widely in nature and scope, Mr. Zecchini noted. However, the great majority of Executive Directors had expressed interest in having direct access to the Fund's database, possibly with additional analytical capabilities, through a terminal; in addition, many Executive Directors had expressed the desire for additional electronic office equipment, as shown in Table 9 of EBAP/84/281. There was thus no reason for not meeting the specific needs of Executive Directors upon request, and without waiting for a more detailed survey to be carried out early in 1986. Accordingly, as suggested by the staff in EBAP/84/281, some amendments to the present guidelines for EDP support (EBAP/83/207, 12/12/83) were in order; the meeting of the Executive Board Committee on Administrative Matters, scheduled for January 24, 1985, might be a suitable occasion for a discussion of those amendments. As far as his own office was concerned, he took the opportunity to reiterate his request for a second word processor or terminal for the printer already in place.

Furthermore, an extended effort should be made to develop office automation Fund-wide, Mr. Zecchini concluded. The potential gains from developing such a system were substantial; in particular, the large flow of documents to and among the offices of Directors could be handled more efficiently under an automated system.

Mr. Romuáldez said that he supported the direction of electronic data processing developments in the Fund as they were set out in the two staff papers. The background paper on the three-year outlook usefully illustrated the well-known fact that capital outlays on EDP hardware almost always amounted to only a small proportion of overall EDP expenditures. His chair had borne that fact in mind in considering the requests for additional budget appropriations for a new mainframe computer and for a new building to house the Fund's computer facility. The expenditures that would ensue from the present approval of capital outlays would by and large arise in any event on account of ongoing operational needs; indeed, expenditures on the latter account could be greater than those projected for the new system if extensive breakdowns occurred and "patch up" work was required.

In considering specific requests for additional hardware, the concern of his chair was rather the need to keep in mind that the key to effective electronic data processing lay in the management of total EDP resources, Mr. Romuáldez continued. While it was important to have the right equipment, it was unlikely to be of much assistance if neither the equipment nor the people using it were effectively managed. In recent years, the Fund had strengthened the management of its EDP resources, notably by way

of the formation of a Bureau of Computing Services and by setting up the Executive Committee for Computing Services. The benefits were clearly reflected in the staff paper. However, it would be helpful to know whether current procedures provided for the regular preparation of reports on computer utilization, response times, and trends in computer use by different departments and for various activities. If not, he asked whether such information would have assisted in identifying problems that had emerged before they became so pressing. He also wondered how much satisfaction the Fund could take in the growth and productive use of its computer resources in all areas, and whether it could rest assured that the potential savings and benefits of moving to automated systems would be realized. The qualifications relating to the financial benefits of the Economic Information System, mentioned on page 9 of EBAP/84/281, were relevant in that respect. The question was whether planning was an ongoing activity and to what extent statistical information on computer usage was available for planning support purposes. The growth in the use of minicomputers and microcomputers was a specific example. Had an analysis been made of the implications of developments in computer utilization for future mainframe needs, and, more generally, had a thorough review of historical trends in EDP use within the Fund been undertaken, with a view to providing a helpful base for projecting future needs? Another general issue concerned the commitment of sufficient resources to ensure that all interested Fund staff were made fully familiar with the new EDP facilities. Staff comment on current training programs and those envisaged for the future would be helpful; problems with new technology almost always stemmed, at least in part, from inadequate training.

Referring more specifically to the proposals in EBAP/84/276, Mr. Romuáldez asked what use would be made of the space freed up on the concourse level of the Fund building if a new building was constructed to house the mainframe computer. He had the impression, perhaps mistakenly, that modern mainframes required less space and placed fewer demands on site conditions than their predecessors, yet the requirements for the new IBM-compatible mainframe computer seemed to suggest otherwise.

Little attention seemed to have been given to the possibility of renting a mainframe computer, Mr. Romuáldez added. The cost difference between renting and purchasing would appear to be sufficiently small to warrant close analysis, especially given the risks of obsolescence of purchasing equipment. Would it be possible to upgrade the new mainframe computer in future without having to replace it completely? Was a minimum expected life of five years realistic and to what extent was the expected life related to the choice of computer? The staff seemed to have attached little importance to the potential for obsolescence in purchasing a computer and locating it in a commercial establishment for two years, especially in the footnote on page 11 of EBAP/84/276. Deferring a final commitment on a specific computer for two years might be a major advantage. Moreover, the 20 percent depreciation allowance for obsolescence over two years, which had been cited for illustrative purposes, but not apparently taken into account in the analysis underlying Table 2 of EBAP/84/276, seemed to imply an expected life of ten years.

It would be helpful to know to what extent the optimum configuration of a new computer center would depend on decisions yet to be made in relation to the replacement of Burroughs equipment, Mr. Romuáldez said. The proposed upgrading of the Burroughs facility was more than marginal: although leased, a mainframe was to be replaced.

The staff should maintain its present approach to EDP development, formulating proposed capital outlays and bringing them before the Board within an appropriately broad framework, Mr. Romuáldez considered. To avoid undermining the effectiveness of the overall EDP effort, the Fund should not compromise its standards with respect to EDP hardware any more than it did in other areas.

Mr. Joyce said that he agreed with Mr. Grosche that the Fund should be properly equipped to carry out its electronic data processing activities; he too hesitated to delay action on the recommendations under discussion. Nevertheless, he considered that it would be wise to give urgent and deeper thought to the possibility not only of sharing a common building but of sharing mainframe computer facilities with the World Bank. As an interim solution, he could support the purchase of an IBM-compatible computer to be located temporarily at a commercial establishment, subject however to analysis of the alternative rental option mentioned by Mr. Romuáldez. That option was not unimportant, given the continuing pace of technical advance in the computing field.

Mr. Suraisry noted that upgrading the Fund's computer facilities was essential to enhance operational efficiency and to maintain the high quality of the Fund's work. An IBM-compatible mainframe computer seemed best suited to the Fund's requirements, both at present and for the foreseeable future; from the evidence in the staff paper, that option also appeared to be the most cost effective one over the medium term. He could therefore support the additional authorizations in the Administrative Budget for FY 1985 for that purpose. He also favored the proposal to locate the new computer in a specially constructed building, and he could agree to the proposed increase in authorized data processing expenditures to carry out preliminary research on the site survey. The research should be conducted as quickly as possible; he asked the staff how long the study was likely to take.

It would be helpful if the Fund and the World Bank could make joint use of the computer facilities to be housed in the new location, Mr. Suraisry noted. Therefore, he wondered whether it would be appropriate to ask the World Bank to contribute toward the costs of the site survey. He had the impression, from the background section in EBAP/84/276, that the Fund continued to cooperate closely with the Bank to ensure mutual backup facilities, provision of time-sharing services as necessary, and compatibility of equipment to facilitate the exchange of data. In the meantime, he could go along with the temporary arrangement described in paragraph 3 of the proposed decision, pending completion of the new facilities. However, he emphasized that the arrangement should be temporary. He also had no problem endorsing the request for additional staff positions.

Mr. Kafka commented that the staff's presentation had convinced him of the need for action, although his own limited knowledge made it difficult for him to agree or disagree with its recommendations. Before a decision was taken, he would await the staff's answer to Mr. Blandin's pertinent question about the feasibility of closer collaboration with the World Bank on electronic data processing activities.

It would also be helpful to know why a new Burroughs 7900 computer was being purchased, and whether other equipment existed that might be either more economical or more compatible with the future design of the computer facility, Mr. Kafka commented. In addition, he asked what provisions were being taken to guard the security of the data stored in the Fund's memory banks, some of which was extremely confidential.

Mr. Sugita said that he generally supported the staff's proposed decision. It was evident that the Fund's computing services were in need of major improvements, and the general direction of the staff proposals was appropriate, based on the cost/benefit analysis in the background paper.

The rising cost of computing services, which would have an expansionary effect on the Fund's administrative budget in coming years, was of some concern to him, Mr. Sugita noted. It might be said that that was an inevitable consequence of the conservative policy followed for many years and that the projected costs were justifiable. In his view, however, as costs increased, more emphasis would have to be given to minimizing expenditures and to realizing commensurate benefits. It was particularly important, from the budgetary point of view, for the gains from improved computer services to be identified promptly as they accrued, and for timely additional action to be taken to achieve the maximum degree of cost reduction through, for instance, the reallocation of staff and budgetary appropriations from the departments that had benefited from improvements in computing services toward departments facing persistent pressures for expansion.

His second point concerned the tape receipt and electronic data transfer project, which was connected with the new EIS, Mr. Sugita continued. He wondered whether that project would cover the scheme under which member countries would be able to retrieve data on line from the Fund's computer. Such a scheme, if properly safeguarded, could be beneficial not only to member countries but to the Fund itself; once the benefit of improved computer services became more visible to members, their support for the Fund's scheme would be broadened. A third related issue was the possibility of the Fund recovering part of its costs by providing data bank services to the general public, to the extent that such data was disclosed in Fund publications. The staff view on that point would be helpful.

Finally, Mr. Sugita said, although the use of two Burroughs computers might be inevitable in the initial stage of the transition, it seemed advisable to terminate the double use of those computers as soon as possible in order to minimize costs.

Mr. Polak remarked that it would take an expert to reach a considered judgment on the staff proposals, which nevertheless had struck him as being based on a thorough study of the options that also gave full attention to the costs and benefits of the Fund's various major computer activities. In that respect, the reorganization of computing services in the Fund had already paid off. Of course, as the staff itself recognized, cost estimates were much firmer than benefit estimates; moreover, the savings in terms of staff years, which might in many cases seem to be composed of the addition of many minutes saved, might not in fact be fully realizable.

Many of the questions raised by other Directors had come to his mind, and he felt sure that the staff had also considered them, Mr. Polak added. He would be particularly interested in the staff's response to the specific question relating to Fund/Bank collaboration on computer systems. He had been satisfied with the de facto separation of the computer activities of the two institutions and with its essential continuation, except for the possible joint housing of the two respective mainframe computers. Joint computer activity made sense as long as a single large computer could serve the needs of both the Fund and the World Bank, but experience had shown the need to weigh the possible financial savings against the inherent difficulties of negotiating and administering a joint system of priorities. The institutions' needs were great enough to keep a number of large computers busy, and he saw no benefit in trying to maintain a joint computer service on grounds of principle alone. The substantive, practical importance of Fund/Bank collaboration was the ability of the computers of the two institutions to communicate with each other and not that the Fund and the Bank should use the same computer. He supported the proposed decision.

Ms. Bush commented that she too had found it difficult to make judgments on the technical subject of the Fund's changing needs for computer services, which did however clearly need improvement, as the staff paper showed. The staff had also made a fairly convincing case that the IBM-compatible system had some definite advantages over the existing Burroughs equipment. However, some aspects of the staff's proposal raised certain questions. As other Directors had already mentioned, it would be helpful to know more about the reason for the staff's decision to buy rather than to lease or rent computer equipment. She was concerned above all with the trends in cost; although it had been stated in the staff paper that a rental option was more expensive, the possibility of technological obsolescence, if the Fund purchased equipment, might be a relatively greater risk.

Before taking a position on the need for an additional two or three staff positions, Ms. Bush asked whether it would be possible to retrain existing staff members to work with the new IBM-compatible equipment, and whether compensating adjustments in the staff ceilings could be made elsewhere in the organization.

She had not been fully convinced that the ultimate location of the computer facility should involve the construction of a new building, Ms. Bush commented. The analysis reflected in Table 1 of EBAP/84/276 included an equity evaluation based on a 7 percent discount rate. A sensitivity analysis might reveal that the construction of a new building might be less attractive than the purchase of an existing building or sharing space already available to the World Bank.

The acquisition of a new IBM-compatible computer would involve staffing, utilities, supplies, and data communication recurring costs of about $2 million a year, Ms. Bush observed. She asked whether those costs were associated only with the IBM computer or whether they covered all the Fund's automation projects. In addition, she inquired whether the amount of $2 million was already included in the projected administrative budget for FY 1986.

Finally, Ms. Bush noted that some attention was being paid to the EDP needs of Executive Directors' offices for more analytical capability and word processing equipment, a concern that her chair had stated on previous occasions.

Mr. Alfidja commented that the two staff papers provided helpful background information on the Fund's existing computer services and its long-term need for such services. To the best of his knowledge, the staff proposals would meet that need, and he could therefore support the decision. The staff's suggestion that the needs of Executive Directors' offices should be considered, and the new cable project for the Bureau of Language Services, were both welcome. The countries in his constituency attached great importance to whatever could be done to improve the availability of translations, not only of cables, but of staff papers and Fund publications.

Mr. Govindarajan remarked that the staff papers had clarified a number of questions raised in the seminar in April 1984. The need to modernize the Fund's EDP systems and to improve the quality and timeliness of the data available for various analytical purposes, was beyond dispute. However, before taking a decision on the proposed budgetary authorizations, which would in effect commit the Fund to the three-year plan outlined in EBAP/84/218, it was necessary to resolve certain issues such as Fund-Bank collaboration.

The production costs of the Fund's electronic data processing system would average about $20 million a year for the next 3 years--representing a substantial increase in expenditure of $10 million to $12 million on average--or about 10 percent of the Fund's total budgetary expenditures, Mr. Govindarajan observed. He asked whether comparable figures were available for other organizations. Perhaps the increase was necessitated by the parallel operation of two systems, but the question was whether that large increase in expenditure would lead to an appreciable gain in productivity.

While considerable work had obviously been done on the costs and benefits of various proposals described in the staff papers, the impact on the Fund-wide ceiling on staff positions was not clear, Mr. Govindarajan said. The ceiling was increasing annually by from 30-40 persons, and the projected outlay of an additional $100 million, over a three-year period, was significant enough to warrant quantitative as well as qualitative results.

Referring to the various proposals submitted for the decision of the Executive Board, Mr. Govindarajan reiterated that he could go along with the authorization to purchase an IBM-compatible computer, for the various reasons given by the staff, subject of course to his preceding observations. The request for approval to spend $200,000 on a site survey and construction cost estimate seemed premature, until all other options had been discussed and excluded; such a survey might not be absolutely essential until there was agreement on the question of construction of a building. The third proposal, to locate the Fund's own computer equipment in a commercial establishment, would require that possible problems relating to the confidentiality of data be fully taken into account. As for the fourth request to increase the total staff ceiling by three positions, while he could understand the need for in-house expertise in hardware, software, and data communications in connection with the new IBM-based facility, he wondered whether existing staff members, who had been working with the World Bank for some time on an IBM computer, had not already acquired such expertise. Moreover, he asked whether staff members who had been working with the Burroughs equipment would be retrained and redeployed, if that equipment was to be phased out.

Mr. Clark stated that in general he strongly supported the objective of bringing the Fund's computer equipment up to date, although the present budgetary environment was perhaps not the most auspicious for such major expenditures. Before offering his view on the proposed decision, he would be interested in the staff's answers to the various questions that had been raised, especially Mr. Blandin's initial question of whether the change comtemplated in the Fund's computing facilities did not call for further consideration of a joint Fund/Bank computer facility.

Mr. Zhang remarked that he could support the proposed decision in principle. However, he asked whether the Executive Board of the World Bank had any views about collaboration with the Fund on computer systems. In addition, it would be helpful to have an idea from the staff of prospective staffing requirements for a few years ahead.

Mr. Agah stated that, as in the past, his chair could support any essential modernization of the Fund's computer facilities. Apart from certain questions in his mind that were similar to those expressed by others, he recalled that, during the seminar on the Fund's electronic data processing system, he had asked what measures had been planned to deal with the possibility of a breakdown of the equipment.

The Director of the Bureau of Computing Services observed that considerable interest had been shown in the relationship between the computer systems of the Fund and the World Bank. First of all, it should be noted that since the time when the Fund and the World Bank had first shared a computer facility, the costs of computers had fallen significantly, making it possible for the World Bank to buy three large computers for its own use, and the Fund itself had purchased two computers. The two systems had been fully segregated, and the computers had been dedicated to separate operations. The only two systems that were at present fully shared were those for the Annual Meetings and for the Joint Library. Nevertheless, the two institutions still cooperated with each other; the World Bank ran the Fund's data center--the computers and data systems--which was located in the Fund building. In fact, the advantages of sharing had come over time to center on specialized physical requirements, such as power sources, reinforced flooring, and security. However, the use of common space also had disadvantages; fire or water damage to the joint facility would leave both institutions without any backup facilities. The World Bank was running out of space in its new computer center and was looking for rented space while it worked on plans for another center. It might therefore be timely for the Fund to think in terms of cooperation with the World Bank on plans for a joint computer center. However, owing to the condition of its existing data center, the Fund could not defer action while the World Bank drew up its plans for the longer term.

The most important feature of the Fund's ongoing cooperation with the World Bank was that data could be exchanged between the IBM and the Burroughs computer, the Director stated. A similar capability for exchanging data with member countries was also important, and over time, as the proper procedures for ensuring security were developed, it would become possible to exchange data with member countries as well.

The Deputy Director of the Administration Department added that a continuing effort was being made to learn more about the medium-term and long-term plans of the World Bank. It should be noted that the World Bank had preceded the Fund by acquiring its own IBM equipment in 1981. The Fund was now paying the World Bank for the time sharing of the Bank's IBM computer as well as for the management by Bank staff of the Fund's Burroughs computer center. There thus would be no saving of staff positions if the Fund acquired its own IBM computer, or were to assume management of the Burroughs computer center. As noted in the staff paper, the benefits of sharing facilities with the World Bank would be limited to physical space. The World Bank had held out no hope that it would be able to accommodate the Fund's computer hardware in its new buildings in the downtown vicinity. However, the World Bank had plans to build elsewhere, and subject to the approval of the Executive Board, the Fund would be willing to be associated with such a venture, if it made economic sense. Apparently, the World Bank had in mind plans for building not simply a computer center, but training facilities as well. Their space requirements were not only much larger, but were more directed over the medium term, the Bank having recently moved into a new computer center, while the Fund had very pressing immediate needs for space. Although the

staff intended to explore further the possibilities of some form of a joint operation, authorization had been sought to proceed with a study of an appropriate site because the less pressing space needs of the World Bank made it unlikely that its plans would be firmed up within the same timeframe required by the Fund. The capability to exchange data with the Bank and to provide backup facilities was of course very important. It was not yet possible to predict when the site survey would be completed, and it was also difficult to seek a contribution from the World Bank for the cost until more was known about the World Bank's own plans. Meanwhile, the Fund had to move ahead in an attempt to meet its own immediate needs.

The Director of the Bureau of Computing Services said that the new Burroughs 7900, which would be leased, and the IBM mainframe computer, which would be purchased, were both needed to upgrade the Fund's computing capabilities. The delay in upgrading had severely affected current operations; for instance, a number of major users of the computer had had their access suspended to enable the staff to compile data for the most recent World Economic Outlook, with detrimental effects on staff morale and efficiency. Therefore, the new Burroughs was filling a transitional need while the IBM-computer system was introduced. A program had been set up to review the provisions for ensuring the security of data for both systems--the software and hardware procedures--and to establish proper standards.

As he had already mentioned, the Fund's data center was at present staffed by the World Bank, under a management contract on a fixed price basis, the Director continued. The request for three additional staff positions was based primarily on the need to ensure efficiency and security in the operation of the Fund's new computer. The Fund staff members who were familiar with the Burroughs computer were being cross-trained to familarize them with the IBM computer, but the learning process would take time.

It had become customary to move computer centers from central locations to more remote sites, the Director explained, particularly in high cost urban areas. For the Fund, rental costs might fall from $30 to as little as $12 a square foot. In addition, it became easier to recruit support staff because transportation was less of a problem. As for the impact on the communication of data, technology had improved significantly, and many computers were operated at sites that were at great distances from the users of the data.

Although computers had become smaller over time, and power and other requirements had been reduced, the Director explained that the amount of data accumulated in day to day operations had grown at a much greater rate, in response to demand.

There were several reasons for the increase in operational costs during the three years covered in EBAP/84/276, the Director noted. First, the load on the overall system was being increased because new systems were being built. Second, the cost of maintaining the existing systems

had been increasing; the normal technological life of a system might be as much as 5 to 7 years, but the Fund had systems that were 15 years old, and the expense of maintaining equipment beyond its normal lifespan would inevitably be reflected in operating costs. Finally, the use of microcomputers, word processing, and other equipment in direct support of the Fund's day to day operations had increased costs.

Leasing computer equipment no longer offered very much protection against technological change, the Director said. A decline in the cost of computers had reduced the payback period of leasing to about 2 1/2 to 2 years. Moreover, even if computers were purchased, they could be upgraded subsequently under the contract reached with the vendors.

The Deputy Director of the Administration Department commented that the move to an IBM-compatible technology, as mentioned in the staff papers, was based on the flexibility offered by the greater availability of software, and thus on cost effectiveness. While the new technology was being introduced, it would be necessary to improve the response time on the present Burroughs machines. A number of smaller, self-contained programs were being run on minicomputers and microcomputers in order to distribute the work load. But the new mainframe computer would be essential to operate the present Data Fund System, and its replacement, the Economic Information System.

Appropriate procedures were in place for reporting on computer use, the Deputy Director explained. As noted in EBAP/84/276, planning and budgeting procedures for electronic data processing outlays had been significantly strengthened as part of the process of reorganizing the Fund's EDP activities. The cost/benefit calculations in the staff papers were based on statistics that were detailed project by project.

The staff was keenly aware of the need for sufficient manpower to back up new development projects, the Deputy Director continued. For that reason, certain projects, such as the office automation pilots, had not been carried forward as quickly as would have been possible, had sufficient support staff been available. The present Burroughs computer system was manned by the World Bank under a management contract and the introduction of the IBM-compatible mainframe computer would thus call for an increase in the staff ceiling. Even if staff members in the Bureau of Computing Services could be retrained to operate the new computer, the positions they left would have to be filled by new staff. Every effort would be made to slow the rate of increase in the Fund-wide staff ceiling, to reflect office automation and the increase in EDP activities in general.

Based on the cost/benefit analysis described in the staff paper, the break even point for the office automation project could come within three years, the Deputy Director remarked. The cost/benefit analysis had been made, based on industry-wide quality standards, by a reputable consultant. Cost data were of course more reliable than benefits data, which did indeed call for judgments to be made based on sampling techniques,

but the increases in productivity and savings in time nevertheless did add up. The assumed time savings had been estimated on a very conservative basis; they were below industry-wide standards.

The space that would be freed up on the concourse level, if the mainframe computers were moved to an outside location, would be very much in demand for various essential services at headquarters--for instance, graphics, and storage--the Deputy Director stated. Moreover, the concourse space had not been designed to house computer facilities.

It was becoming more and more economical to purchase rather than to lease equipment, the Deputy Director of the Administration Department observed. Vendors gave purchase credits of up to 75 percent of the rental costs so that it became advantageous to purchase equipment, sometimes within two years, and ahead of improvements in technology even for equipment that was being updated at a fast rate. The Budget and Planning Division would be assisted greatly in its continuing effort to decide whether to lease or to purchase by one of the three main IBM-based systems presently under development, for instance, the budget and procurement system.

The decision to construct a new computer center did not have to be reached at the present stage, the Deputy Director commented. The staff recommendation had been that $200,000 should be appropriated to enable the matter to be investigated further and to permit the various options to be outlined and a proposal to be submitted to the Executive Board.

The recurring costs of $2 million to which Ms. Bush had referred were included in the Administrative Budget for FY 1986, the Deputy Director noted. The Fund's total data processing expenses, as a percentage of total administrative expenses, were less than half those of the Federal Reserve Board: about 10 percent in the current budget as compared with an average, over ten years, of 20 percent for the Federal Reserve Board.

The World Bank and the Fund were anxious to cooperate with each other, the Deputy Director said. The two institutions were exchanging information and, within the limits of decisions already adopted, were exploring the possibilities for keeping their computing facilities in the same location. Like the Fund, the Bank stressed the importance of mutually compatible equipment, which had the additional advantage of providing backup facilities.

The Director of the Bureau of Computing Services added that provision had been made in the proposed computer center for 5,000 feet of office space, where it was his intention to locate as many as possible of those staff members who would actually be working with the computer. Communication with staff at the headquarters building should not be a problem because those working at the center would be primarily the programmers, including contractual employees, whereas those who designed and analyzed the systems would be senior staff members of the Bureau of Computing Services.

It would take one to three days to move a computer from one location to another, the Director noted. The cost, which was included in the estimates in the staff paper, would be about $100,000. The production costs of the existing Burroughs Center were not included in the recurring costs amounting to $2 million, which covered only the cost of operating the IBM-compatible mainframe computer. The new Burroughs computer to be leased represented an upgrading in that certain functions had been improved or redesigned. If the IBM-compatible computer had been installed four or five years previously, such updating would have been unnecessary, but the Burroughs computers had now outlived their product life cycle of five years. Financial commitments in computers represented a capital investment, and it was thus important to have a fairly good idea of computer usage over time. The background paper did in fact represent a concerted effort made by the staff over the past 18 months to develop data, based on planning information provided by the user departments throughout the Fund. The estimated costs of carrying out those plans were of course a subject for annual budgetary review.

The staff representative from the Bureau of Statistics noted that it was true that the need for international comparability had historically been a major principle underlying the construction of the Fund's main data base in view of its orientation toward publications. An effort had been under way for some time, however, to align the work of the Bureau of Statistics with the work of the area and functional departments in collecting and maintaining data. As had been mentioned during the Executive Board seminar on electronic data processing in April 1984, concern about the utility, within the Fund itself, of data on individual countries had resulted in a decision to proceed with the Economic Information System as a way of bringing together the requirements of international comparability--and those of publication needs--with the requirements of the area and functional departments. It was envisaged that the Bureau of Statistics would continue to collect data that would find their way into Fund publications, but it would also maintain specific country data in cooperation with area departments for use in Fund staff papers and documents. Desk economists might still have to maintain the most current data for their own use.

The possibility of the Fund recovering part of its costs by providing data bank services to the general public, including data in the form of tapes, was a matter of the Fund's policy on publications, the staff representative added. In recent years, sales of data tapes had generated revenues of $200,000 annually.

The Deputy Secretary noted that the pilot projects for office automation that had been under way in two departments had reached a stage at which reasonably firm views could be arrived at on the most suitable types of equipment. It might therefore be possible to decide fairly soon--subject possibly to the views of the Executive Board Committee on Administrative Matters--on additional "stand-alone equipment" for Executive Directors' offices, including word processors and personal computers. It would take longer to reach the next phase which might involve the

networking of systems in Executive Directors' offices, because it would be necessary to analyze specific needs with care. Considerable manpower and financial resources would also be required to implement that second phase.

He would take up with the Chairman of the Committee on Administrative Matters the suggestion by Mr. Zecchini that the Committee consider interim changes in the guidelines on electronic data processing for Executive Directors' offices, the Deputy Secretary said.

The Deputy Managing Director stated that the Fund was taking a pragmatic approach to the expansion of its computing facilities. The objective, with respect both to mainframe and other computer services, was to meet the ongoing needs of the staff, rather than to experiment with new technology for its own sake. At the same time, the Bureau of Computing Services was making every effort to ensure that actions taken at present would not preclude the Fund staff from exercising other options to meet the requirements of the users. A certain balance had to be maintained between short-term and longer-term needs.

The Bank and the Fund were working closely together in order to determine when it made sense to integrate their respective computer facilities and when it would be more efficient to separate them, the Deputy Managing Director considered. While the decisions on their integration should be based essentially on cost/benefit analysis, it was also necessary to focus on the changing and differing needs of the users in the departments of both institutions. The ongoing work of the Fund and the Bank should also encompass both mainframe and minicomputer facilities, because both institutions used and developed systems for purposes of simulations and debt analysis and because it would eventually be just as necessary for departments within the Fund to be able to communicate with each other.

Mr. Blandin remarked that he did not question the need for the Fund to have an up-to-date computer system and that he could go along with the proposed decision. However, the decline in the cost of computers was not a sufficient reason for the Fund to move away from collaborating with the World Bank. In that connection, he regretted that the computing operations of the two institutions had already been separated, with the exception of the Joint Library and the Annual Meetings systems. The outlays involved in introducing an IBM-compatible mainframe computer were not negligible--at $100 million over the three-year period covered by the projections--and a saving of even $10-20 million would be worthwhile at a time when the Fund's budget was under pressure. The possibilities for sharing computer resources should have been explored more fully. Despite the different needs of the two institutions in certain areas, there were surely other opportunities for sharing, even if only on the storage data. He would also have been more reassured if a higher priority had been given to the desirability of a common location for the computers of the two institutions.

The Chairman remarked that the Fund's move toward an IBM-compatible system was in a way an act of collaboration with the World Bank. The two institutions had been operating separate Burroughs systems. In addition, the World Bank had updated its computing technology by introducing an IBM-compatible computer; the Fund was now in the process of updating its outmoded equipment that no longer met users' needs.

The Deputy Director of the Administration Department recalled that originally it had been possible for the two institutions to share, first one and then additional computers, but at a certain point, the demands on those computers had made it essential to establish priorities for their use. The World Bank, with its greater needs, had decided to adopt IBM technology and the Fund, which was in fact still cooperating with the World Bank to the extent that the Burroughs computers were managed by the Bank, now had an opportunity to regain some of the benefits of using a common technology. He reiterated that the two institutions did not have to use the same machines, or even to locate their separate machines in the same location, in order to reap the benefits of compatible computers. The exchange of software and the ability of the systems to communicate with each other were of paramount importance.

The Chairman remarked that one way in which the Fund and the Bank could harmonize their investment plans might be for the Fund to update its system while at the same time retaining the services of the World Bank for the operation of the Fund's Burroughs system. However, it was not clear to him that such a joint operation would produce economies of scale or that it would fully satisfy the Fund's requirements.

Mr. Blandin confirmed that the concept of cooperation outlined by the Chairman was what he had had in mind.

The Deputy Managing Director added that the staff of the Fund and the World Bank would have to make a careful assessment of their respective space requirements before deciding whether it would be advantageous for the two institutions to move simultaneously in the years ahead to find a new computer center location. The various possible economies of scale from sharing a common facility would be explored fully in the next review submitted to the Executive Board.

The Deputy Director of the Administration Department said that the management services provided at present by the World Bank could also be obtained from a commercial company that specialized in computer management. Alternatively, the Fund's movement toward an IBM-compatible technology might make it feasible to tie the operations of the two institutions together again, under one management.

The Director of the Bureau of Computing Services noted that there were three aspects to computer collaboration: that of the equipment itself, the data, and the physical facility. To buy a large enough mainframe computer to satisfy the needs of both the Fund and the World Bank would in fact lead to diseconomies of scale, because of the cost of the

computer itself. The staffs of the two institutions were in constant and close touch to make sure that software and data could be shared. As for the physical location of the computer center, there were advantages to sharing a facility, if certain timing problems could be overcome, and the matter would be examined thoroughly as part of the site survey. The possibility of having the World Bank run the Fund's computer, in a joint center, had not been excluded.

Mr. Clark suggested that the issue was rather whether a full joint center would offer economies as opposed to a joint center that was run as two separate units by the two institutions.

The Director of the Bureau of Computing Services responded that most of the savings would come from the construction of a single building. Sharing software offered fewer benefits over time, and indeed began to lead to inefficiencies when the priorities of the two institutions differed. The major disadvantage of a common building was the lack of any backup facilities in case of physical damage.

Ms. Bush said that as she understood the proposed recommendations, it was a foregone conclusion that a building would actually need to be constructed, but that all other options would be explored. As for the manning of the new computer center, it was still not clear to her to what extent the cost of the additional staff positions would be offset by the savings from terminating the management contract with the World Bank, especially if there was a possibility of the World Bank being able to continue to manage the Fund's new IBM mainframe computer.

The Director of the Bureau of Computing Services responded that the management contract with the World Bank had recently been renegotiated, and was now on a fixed price basis rather than on a cost sharing basis. As a result, labor costs had been reduced by about $140,000. The Fund would have to provide offsetting management support for various functions, including billing and general management strategy.

The Chairman suggested that the staff should prepare a further short paper--possibly in consultation with the staff of the World Bank--in which the various questions raised by Executive Directors would be thoroughly examined before the matter was brought back to the Executive Board for a decision. 1/

The Executive Directors accepted the Chairman's proposal, and concluded for the time being their discussion of supplementary budget appropriations for mainframe computing services.

1/ See EBAP/84/276, Supplement 1 (2/19/85)

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/4 (1/11/85) and EBM/85/5 (1/11/85).

5. PORTUGAL - TECHNICAL ASSISTANCE

In response to a request from the Portuguese authorities for technical assistance in the form of a survey of the country's tax system, with emphasis on its administration, the Executive Board approves the proposal set forth in EBD/85/7 (1/7/85).

Adopted January 11, 1985

APPROVED: October 23, 1985

LEO VAN HOUTVEN
Secretary