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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 94/43

10:00 a.m., May 16, 1994

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Executive Board Attendance

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors

M. Al-Jasser

J. Bergo

H. Fukui
K. P. Geethakrishnan

J. E. Ismael

A. Kafka

G. Lanciotti
K. Lissakers
R. Marino

L. J. Mwananshiku
G. A. Posthumus

D. E. Smee
E. L. Waterman

Zhang M.
A. G. Zoccali

Alternate Executive Directors

A. A. Al-Tuwaijri
M. Sirat
D. Desruelle, Temporary

J. Dorrington

L. E. N. Fernando
N. Prasad, Temporary
K.-T. Hetrakul
R. F. Cippa, Temporary
A. Chang Fong, Temporary
A. V. Mozhin
J. Hamilius, Temporary
F. Moss, Temporary
N. Coumbis
B. S. Newman
J. R. Suárez, Temporary
M. Daïri

O. Havrylyshyn
J.-C. Obame, Temporary
K. Kpetigo, Temporary
E. Wagenhoefer
Y. Y. Mohammed
G. F. Murphy
A. M. Tetangco, Jr.
H. Petana, Temporary
Yang X., Temporary
A. F. Jiménez de Lucio

L. Van Houtven, Secretary and Counsellor
A. Leipold, Acting Secretary
M. J. Miller, Assistant

Also Present

IBRD: E. S. Ghani, Eastern Africa Regional Office. Administration Department: G. F. Rea, Director; C. Ahl, D. A. Anderson, G. Archer-Davies, S. L. Chung. African Department: P. A. Acquah, C. Brachet. Central Asia Department: H. Neiss, Director. Fiscal Affairs Department: V. Tanzi, Director. IMF Institute: P. B. de Fontenay, Director. Legal Department: W. E. Holder, Deputy General Counsel; H. Elizalde, J. S. Powers. Middle Eastern Department: P. Chabrier, Director; P. A. Cashin, A. J.-P. Feler, H. Ghesquiere, H. Hirschhofer, G. M. Iradian, O. T. Kanaan, M. D. Knight, A. H. Mansur. Policy Development and Review Department: T. Leddy, Deputy Director; P. F. Allum, N. L. Happe, A. K. McGuirk, J. P. Pujol. Research Department: M. Mussa, Economic Counsellor and Director; M. Goldstein, Deputy Director. Secretary's Department: B. R. Hughes. Southeast Asia and Pacific Department: L. M. Koenig. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; J. E. Blalock, M. J. Buchanan, W. J. Byrne, J. C. Corr, Z. Farhadian-Lorie, D. Gupta, R. Thorne, M. A. Wattleworth. Western Hemisphere Department: C. M. Loser, Deputy Director; M. E. Bonangelino, L. E. Escobar, E. R. J. Kalter, J. M. Landell-Mills, C. G. Muñiz, L. Schmitz, S. C. de Sosa, J. E. Zeas. Office of the Managing Director: G. Saunders, Personal Assistant; J. Prust. Advisors to Executive Directors: J. Jamnik, Y.-H. Lee, M. F. Melhem, R. Meron, M. J. Mojarad, A. Törnqvist. Assistants to Executive Directors: R. N. A. Ally, T. Berrihun, A. Cathcart, G. El-Masry, S. S. Farid, R. Ferrillo, L. Fontaine, A. Galicia, C. Gaseltine, M. Giulimondi, H. Golriz, N. P. Hahnemann, M. A. Hammoudi, O. Himani, G. H. Huisman, C. Imashev, S. Ishida, T. Kanada, A. M. Koulizade, T.-M. Kudiwu, N. Laframboise, K. J. Langdon, G. J. Matthews, S. del C. Olgiati, J. Pesola, S. Rouai, M. Ryan, P. Salles, A. Sighvatsson, T. Sitorus, V. Verjbitski, R. von Kleist, Wang X., A. Wechsberg.

1. REPORT BY MANAGING DIRECTOR

The Managing Director stated that he had visited Spain in the preceding week for discussions with the Spanish authorities ahead of the Annual Meetings in Madrid. He had had the honor of an audience with His Majesty Juan Carlos I, the King of Spain. He had paid a call on the Prime Minister, with whom he had discussed the Spanish economy and world economic problems. He had also met with the Minister of Economy, the Governor of the central bank, and with groups of academics, parliamentarians, businessmen, and the press.

His discussions with the Spanish authorities had been guided by the summing up of the Board's latest Article IV consultation discussion with Spain (EBM/94/6, 1/26/94), the Managing Director continued. There had been many positive developments in the economy, including the good inflation performance, an improvement in the trade balance, clear signs that the economy had begun to recover from the recession--with the export sector as the locomotive at present--and some indications that investment demand was recovering. There was a general consensus that the two major issues that the authorities would have to address were the fiscal deficit and the very high level of unemployment--about 24 percent of the labor force in 1993.

During the 1993 Article IV consultation discussion, Executive Directors had commended the authorities for addressing those issues in the midst of the recession with a courageous budget, the Managing Director recalled. He had remarked to the Spanish authorities that, as a minimum, the budget should be implemented, complemented by far-reaching measures to make the labor market more flexible. While the first steps had been taken, much remained to be done, as the authorities and Spanish society clearly understood. From his meetings with various economic committees of the Parliament and the different political parties, he had formed the impression that other measures would be approved in the near future as well.

The questions that had been addressed to him most often during his travels were the priorities for the Fund in the future, and the problems of corruption around the world, the Managing Director observed. With regard to issues for the Annual Meetings and beyond, he had stressed the paramount importance of strengthening the international monetary system through effective economic policy coordination and surveillance, in respect of which the Fund was striving to make its own work more effective.

The authorities and Spanish business had shown great interest in the forthcoming Annual Meetings, the Managing Director reported, and they recognized that they presented an opportunity for Spain to show to the world how far it had come in the previous 20 years, how closely the country was integrated with the rest of Europe, and how promising the future could be, provided that the two big problems of the fiscal deficit and high unemployment were solved.

The preparations for the Annual Meetings were going well, the Managing Director remarked. He had visited with the Secretary the places where the meetings would be held. The accommodations were truly magnificent; the design of the new buildings appeared to match perfectly the needs of the Annual Meetings, although they had not been constructed solely for that purpose. The design was beautiful and imaginative, and he was sure that the country delegations would find the facilities appropriate.

He wished to thank Mr. Merino for the preparations that had been made for his pleasant and efficient visit to Spain, the Managing Director concluded.

The Deputy Managing Director then took the chair.

2. THE BAHAMAS - 1994 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1994 Article IV consultation with The Bahamas (SM/94/107, 4/28/94). They also had before them a background paper on recent economic developments in The Bahamas (SM/94/111, 5/3/94).

Mr. Smee made the following statement:

My Bahamian authorities are in agreement with the thrust of the staff report for the 1994 Article IV consultation. The report provides a balanced assessment of recent economic and financial developments, highlighting the specific areas of weakness that will require continued vigilance, while pointing out the measures taken by my authorities to address some of the problems facing the Bahamian economy. My authorities are appreciative of the staff's efforts and wish to acknowledge the important contribution that consultations with the Fund make to policy formulation. My authorities have thus requested that The Bahamas be placed on the standard 12-month cycle.

Tourism continues to play a pivotal role in the Bahamian economy. My authorities are encouraged by the recent revival in stopover arrivals. However, they recognize that there is no room for complacency, as The Bahamas faces strong competition from other tourist destinations in the Caribbean and elsewhere. Given the need to reduce costs and improve the quality of the tourist product, the Government will continue to promote wage restraint and pursue responsible taxation and expenditure policies as they relate to the tourism sector.

My authorities' strategy for development of the tourism sector is to rely on private sector initiative. With divestment of state-owned hotel properties remaining a top priority, the Government's role is to be limited to providing support for

necessary infrastructure and ensuring an overall economic environment conducive to private investment. This strategy is showing some signs of success. New investments to upgrade major resorts in New Providence and Grand Bahamas are in train, and prospects for developing niche markets in the Family Islands are promising.

Upon assuming office in August 1992, my authorities were deeply concerned about the deterioration in the public finances in previous years. They introduced an interim budget for the first six months of 1993 that aimed at a small surplus, and in the fiscal year 1993/94 budget they sought overall balance, increasing revenue by over 1 percent of GDP and reducing expenditure by almost 2 percent of GDP, compared with 1992. In the event, these objectives proved unattainable and, while an important part of the projected deficit can be attributed to the elimination of arrears left by the previous administration, my authorities are determined to redouble their efforts to move toward fiscal balance.

The 1994/95 budget, which will be tabled on May 25, will demonstrate considerable consolidation. Anticipated revenue measures equivalent to about 1 percent of GDP, along with expenditure restraint, will result in a balanced central government current account. The overall central government budget deficit is expected to be trimmed from an estimated 4.7 percent of GDP in fiscal year 1993/94 to less than 2 percent of GDP. The hallmark of the budget will be containment of the wage bill. Recognizing that high wage settlements undermine competitiveness and risk aggravating the unemployment problem, my authorities intend to exercise public sector wage restraint, and they will urge public enterprises and labor unions to follow the same course.

My authorities are committed to further improving the tax regime to provide a sustainable base for the future. They are concerned that, over time, The Bahamas has developed a proliferation of tariff rates and import tax exemptions, and they believe that there is an urgent need to reform the trade and incentives regime. As a next step in what they consider a two-stage process, my authorities will explore ways to broaden the tax base. My authorities also intend to reinforce the role of the Ministry of Finance by undertaking a major two-year program to strengthen expenditure controls and improve accountability.

The main task of monetary policy in The Bahamas is to preserve the parity with the U.S. dollar and, to this end, to keep an appropriate level of international reserves to deal with unforeseen developments and maintain domestic and external confidence in the exchange rate peg. The Central Bank has maintained, and will continue to maintain, a strict monetary

stance. The Central Bank is prepared to allow interest rates to rise as warranted by market conditions, and it has already removed the ceiling on deposit rates.

Following the completion of major investment projects, the financial performance of the public enterprises improved, with their combined overall balance shifting from a deficit of \$150 million (about 5 percent of GDP) in 1991 to a surplus of \$40 million (over 1 percent of GDP) in 1993. However, some public enterprises continue to generate current as well as overall losses. My authorities are committed to placing the public enterprises on a sounder financial basis. To this end, they aim to improve overall control and accountability in these operations and keep transfers to the enterprises to a minimum. They also intend to scrutinize investment projects and foreign borrowing by public enterprises, so as to both ensure their financial viability and protect the country's creditworthiness.

As noted above, my authorities are moving forward with their plans to sell the Government's holdings in the hotel sector. They also intend to reduce their holdings in the Bank of The Bahamas this year and to privatize the generation facilities of the Bahamas Electricity Corporation, as well as some activities of the Water and Sewerage Corporation.

Miss Chang Fong made the following statement:

The Bahamian economy appears to be emerging from the doldrums of the last few years. Having achieved a level of stability by the end of 1992, the economy grew at a modest rate of 2 percent in 1993. The overall fiscal situation also showed some improvement in that period--excluding the operations of the National Insurance Board, the deficit declined from 8.9 percent in 1991 to 2.7 percent of GDP in 1993, owing principally to the reduction in capital spending following the completion of major projects in electricity and aircraft acquisition. The recent round of wage increases, however, could threaten the fiscal position anew. Mr. Smee mentions a deficit of 4.7 percent for fiscal year 1993/94, which ends June 30, 1994. Is this the result of the wage increases?

There is, therefore, still some way to go, especially as the public debt rose from 29 percent of GDP in 1989 to 44.6 percent at the end of 1993. While debt service has not yet reached critical levels, either in terms of the budget or the balance of payments, the increase should raise some cautionary flags.

The budget for the 1994/95 fiscal year appears to be seized of the task at hand, and we are encouraged by the statements of Mr. Smee about the forthcoming budget for 1994/95, which will seek to improve the fiscal performance of the Central Government. The

initiatives being taken in respect of improving the financial performance and accountability of the public enterprises are also welcome--in this regard, the subject of utility tariffs needs to be addressed early.

If the extent of tax and customs evasion and arrears, reported as between 25 percent and 30 percent of total revenue, is close to being correct, there would seem to be much to be gained from an early and concerted effort at improving tax administration. However, a more comprehensive overhaul of the tax structure and system would seem to be called for, having regard to the disparities, apparent anomalies, and exemptions described in the staff report. In view of the fact that tax revenue--as, indeed, total revenue--as a percentage of GDP is relatively low compared with other more developed countries in the Caribbean, there would seem to be scope to rationalize the tax system and broaden the tax base without intruding on the tax-free status of incomes.

As an economy heavily dependent on tourism for both its contribution to GDP and to employment, the health of the tourism sector is critical to the future of The Bahamas. The increase in stopover arrivals is a good sign. However, even before the effects of the United States recession took hold, it was recognized that The Bahamas was losing ground to other destinations in the Caribbean and elsewhere. The current staff report underscores the gains being made by other countries in the new growth in the industry. Part of this probably has to do with the emergence of new destinations, but a great part is also due to the changing tastes and demands of travellers.

With limited natural resources at the country's disposal, the scope for diversification from tourism, or within tourism, appears to be constrained. The Bahamas' vulnerability to changes in the industry will continue, and it must, therefore, increase its flexibility to deal with new challenges. A large part of its current efforts must necessarily focus on improving the quality and cost of the product. Care also needs to be taken that, in the efforts to nurture the agricultural sector, additional burdens are not added to the cost structure of the tourism sector by enforcing linkages between the two.

Some brief final words on environmental issues and on statistical data. The environmental impact of development is no small matter for the continued survival of the tourism industry and fishing resources. The problem of waste disposal on the Family Islands should be addressed, and physical and legal systems put in place to ensure a sustainable footing for the next growth phase of the industry. I hope that some provision will be made in the forthcoming budget for this.

There is no indication as to whether the authorities deem the balance of payments and production data as either useful or necessary. We would, however, encourage the authorities to take advantage of the technical assistance of the Fund in this regard, if necessary.

Mr. Lanciotti made the following statement:

Following a period of weak economic performance, The Bahamas' economic situation seems to be improving, with a recovery of tourism activity linked in particular to the buoyant growth in the United States, which accounts for a large majority of tourist arrivals and expenditures. However, the Government faces important challenges in maintaining a sound macroeconomic framework conducive to investment and growth, and in preserving the country's competitiveness in the tourism industry vis-à-vis newly emerging Caribbean destinations. The staff report identifies two main areas in which efforts should be focused: the fiscal accounts, and structural policies aimed at ensuring further development in the tourism sector.

The most important and difficult task is to address the weaknesses of the public finances. The fiscal position needs to be strengthened; public sector savings should increase in order to free resources for private sector investment, enhancing the country's growth prospects while reducing its dependence on external savings. As anticipated by Mr. Smee, the authorities intend to correct previous slippages in fiscal policy by presenting a new budget for 1994/95 that entails considerable fiscal consolidation, reducing the general government budget deficit from 4.7 percent of GDP in the current year to less than 2 percent of GDP. However, the proposed effort, while representing a step in the right direction, appears to be not ambitious enough, in particular on the revenue side. In fact, public sector savings will be achieved mostly through expenditure restraint, while the anticipated increase in revenues amounts to just 1 percent of GDP. There seems to be further scope for measures aimed at broadening the tax base, given that tax revenues are currently low in relation to GDP in comparison with other comparable Caribbean countries. Moreover, a more effective action aimed at increasing the relative importance of tax receipts from industries in the general economy other than the tourism sector would achieve a more efficient distribution of the tax burden across the productive sectors. In order to improve the incentive regime, the reassessment of the public tariff policy, the reform of trade tariffs, and the reduction of tax exemptions would also play an important role. Given the high levels of tax evasion, efforts aimed at improving tax administration procedures would be desirable.

The hallmark of the 1994/95 budget proposal, as Mr. Smee states, will be the restraint on current expenditures, obtained especially through the containment of the wage bill. Action aimed at limiting expenditures on public wages is urgently needed in view of the recent wage increases awarded in the public sector, and also of the large increase in salaries for hotel workers, which risks undermining The Bahamas' competitiveness and leading to higher rates of unemployment. The background paper highlights some empirical evidence showing that labor costs in the tourism sector in The Bahamas are about 50 percent above the Caribbean average, which underscores the need to reduce costs in this critical sector. The authorities have also stated their intention to strengthen expenditure controls throughout the public sector and to improve accountability. Finally, the fiscal consolidation process would be accompanied by actions aimed at speeding up privatizations, in particular in the electricity sector and in the hotel facility industry, which would contribute to an increase in public sector savings and bring about greater economic efficiency.

Given its overwhelming importance in The Bahamas' economy, developments in the tourism sector represent an area of special focus for implementing structural measures aimed at improving its overall economic performance. Recent trends in this sector are a matter of concern because, as highlighted in the staff papers, The Bahamas appears to be losing market share to its Caribbean competitors. I found particularly interesting the comparative analysis of tourism trends in The Bahamas and other Caribbean competitors. An important observation advanced in the staff paper is that The Bahamas' loss of market share may be due to the inability of its tourism facilities to evolve in concert with the changes in tourist tastes. The low quality of the tourism services offered and insufficient investment in infrastructure in the sector help explain the reduced attractiveness of The Bahamas to higher spending visitors, in particular from European countries. In consequence, The Bahamas is increasingly dependent on U.S. tourists, and its vulnerability to the economic cycle in the U.S. has therefore also increased. To combat the decline in the tourism sector, the authorities have adopted a strategy that relies on private sector initiative to upgrade tourist facilities and diversify the tourism product. However, I concur with the staff's view that the Government should not underestimate the contribution that it can make to this process by maintaining a favorable macroeconomic framework, implementing new investments to improve the country's infrastructure, and promoting an effective incomes policy that would help limit labor cost dynamics.

Mr. Dorrington made the following statement:

The economy is clearly highly dependent on tourism. Thus, it is a matter of concern that the share of Caribbean tourism has

been declining. The recession in the United States, and more generally, has no doubt been responsible for some of the weakness over recent years, and things should now tend to improve, but cyclical factors cannot be responsible for the trend decline in share. I get the impression that The Bahamas is drifting toward becoming a relatively high-cost, and relatively low-quality, destination--that is clearly an unsustainable picture.

This urgently requires active, but not interventionist, policy responses. Facilities are improving elsewhere and tastes are changing, and resting on one's laurels is rather like standing still on the down escalator. The authorities are right in seeing the strategy as being one of creating an environment in which the private sector develops the tourist industry. Some welcome measures have been taken in that direction, but others are needed. In short, the authorities' plans need to be accelerated.

What is not needed is a change in exchange rate policy. The Bahamas is particularly dependent on the U.S. market, and in this context, and more generally, the link of the exchange rate to the U.S. dollar has served The Bahamas well. I agree with the authorities and the staff that they would be wise to maintain it.

However, the fixed exchange rate makes it even more essential to contain costs in order to remain competitive. Wage costs in hotels, and in the tourism sector more generally, are clearly highly important. Good infrastructure is also important, but a prerequisite for private investment of sufficient volume is a coherent, transparent tax regime. The background paper on recent economic developments makes it clear that this is far from being the case.

I found the issues-based organization of the background paper very useful, making it easy to focus on the key issues. The key issues themselves were also well presented.

The tax system is riddled with an incredible variety of rates, with no apparent rationale. Some rates are clearly excessive, and there are widespread exemptions and special provisions. No doubt some of the exemptions were motivated by a desire to offset some of the effects of some of the excessive rates. It is not clear what the objectives of the current system are, and whatever they are, it is highly doubtful that they are being achieved. The current structure creates distortions, encourages rent-seeking and evasion, and must be almost impossible to administer. Moreover, the high rates do not even generate much revenue.

What is clearly needed is a rational, transparent, broad-based tax system with a low number of rates and few, if any,

exemptions; and one that generates enough revenue to finance priority expenditure. This should be addressed as a matter of priority. Such a tax system would obviously also encourage private sector development in sectors other than tourism, with the obvious possible exception of those sectors that benefit the most from the exemptions now in place. However, to the extent that there is uncertainty and lack of transparency, and taking account of multiplier effects, even these sectors might benefit.

I appreciate the fact that care will be needed to pay attention to the effects on the offshore financial center in designing tax reforms, but I find it difficult to understand objections to a broad-based tax on expenditure. More generally, while the staff report and the background paper on recent economic developments are admirably comprehensive on tourism and taxation, they are relatively sparse on prospects for the offshore financial sector and for diversification. I would appreciate some comments on prospects in these areas, particularly in the context of the staff proposals for the fiscal regime.

I am happy to support the request to move to an annual cycle for Article IV consultations. However, this raises again in my mind the question of whether we need to have a full Board discussion of every staff report for every Article IV consultation on every occasion. The same applies to some program reviews. This is something that could be addressed in the context of a general review of the functioning of the Board.

Mr. Suárez made the following statement:

The staff papers on The Bahamas provide us with a clear picture of the current economic situation of these islands. I am in broad agreement with the staff assessment. My overall sense from reading the staff papers is of an economy that, according to some economic indicators, has experienced a favorable trend. The inflation rate fell from 5.8 percent in 1992 to 2.7 percent in 1993, real GDP grew by 2 percent in 1993 after declining in 1991 and remaining stagnant in 1992. The public sector deficit has been declining, from 6.7 percent of GDP in 1991 to 1.4 percent of GDP in 1993.

However, despite those positive results, the public finances remained weak, as evidenced by the continued decline in public sector savings, the heavy dependence of some public enterprises on government transfers, and the cutback in public investment.

As long as the economy is very open and so dependent on tourism, it will remain vulnerable to external shocks. Indeed, developments in the U.S. economy are likely to have the most significant impact on The Bahamas' economic development in the

medium term. It is for this reason that the Bahamian authorities should ensure that policies over which they have control create conditions that maximize economic potential.

Given the vulnerability of the external sector of the economy and the excessive dependence on tourism, the Bahamian authorities should look into an alternative development strategy. Perhaps there is scope for further growth in other activities, such as agriculture or banking. The staff report seems to focus only on a strategy for the tourism industry. I would welcome any comment from the staff on this matter.

With respect to macroeconomic policies, it is certainly the fiscal front that deserves special attention. I fully agree with the staff about the role of the Government in adopting policies aimed at reducing expenditures and improving tax administration. One point should be underscored: the need to moderate public sector wage increases if competitiveness in the tourism industry is to be secured.

We welcome the authorities' commitment to fiscal balance in the Central Government in fiscal year 1994/95, and their intention to sell the Government's holdings in the hotel sector and to privatize the generation facilities of the electric company. I wonder if a specific program or a timetable for this already exists.

Like Miss Chang Fong, I would like to stress the need to improve data collection, taking advantage of the technical assistance of the Fund.

We commend the authorities for the results achieved in the last two years.

Mr. Newman made the following statement:

Economic recovery in the United States is starting to give a cyclical lift to the Bahamian economy, but longer-term prosperity will be determined by how well the economy adapts to an increasingly competitive Caribbean tourism market. On this latter point, the jury is still out. The staff report makes a strong case that firmer fiscal management and continuing wage discipline are going to be needed if The Bahamas is to sustain and develop its principal industry--tourism.

The basic economic strategy The Bahamas is following calls for the private sector to develop the tourism industry while the Government provides the necessary infrastructure. This framework is sound. What is needed to make the strategy work is an adequate

flow of savings, both private and public, to support the needed investment, both private and public.

The success of this effort will depend importantly on how the following issues are addressed.

The public sector borrowing requirement is still too large. Getting the public sector borrowing requirement down from 6.7 percent of GDP in 1991 to 1.4 percent in 1993 was a substantial achievement. However, it is disconcerting that the deficit is expected to expand this year to 3.4 percent of GDP, notwithstanding the cyclical improvement in the economy. Furthermore, the budget consolidation that has been achieved has, to a considerable extent, reflected a working off of the backlog of foreign financed public investments. Moreover, the amount of the deficit that needs to be financed through the domestic banking system has not come down nearly as rapidly as the overall deficit, and it is continuing to put pressure on internal finances.

Public sector wage discipline needs to be reinforced. Some catch-up wage increases were negotiated in 1993, but the staff report suggests that these went beyond what the market required. The wage pattern set in the public sector makes budgetary control difficult and undermines wage containment in the private sector. This is an important consideration, as studies indicate that wage costs in The Bahamas are substantially above those of neighboring countries competing for the same tourism markets.

Tax reform is needed to distribute the tax burden more evenly and to reduce the direct burden on tourism. As a tax haven, The Bahamas tries to avoid most forms of direct taxation. This means that the burden falls on indirect taxes. As imports and tourists are the easiest to tax, the tax burden falls most heavily on them. The result is a tax system that biases upward the costs of the islands' most important industry. This tax strategy seems to have reached its limits. Recent rate increases have not netted much revenue, as increased distortions prompt increased exemptions. The background paper on recent economic developments provides a good analysis of the tax and trade system, and makes a number of recommendations for reforms that would broaden the tax base and reduce the extent of tax distortions. We strongly endorse these recommendations.

Public sector enterprises are a drain on the economy's resources and remain another issue that must be addressed more effectively. The staff report documents that the state enterprises in recent years have been contributing less and less to their own investment requirements, and have been requiring greater and greater budgetary transfers. Other studies report significant overstaffing and noneconomic pricing. Privatization

should be pursued more aggressively. We hope that the planned sales of government hotels will, in fact, be completed in 1994, because it is hard to see any justification for these remaining in the public sector, especially as the government hotels are apparently among the least profitable on the islands. Privatization of public utilities would also be desirable, but it appears that this would also need to be accompanied by regulatory reforms that would permit more rational pricing.

In the monetary area, the staff appropriately highlights concerns that heavy reliance on bank financing of recent budget deficits has left the banks highly liquid. There is the risk that, as the economy improves, excess reserves will lead to overly rapid monetary expansion or necessitate an inopportune and abrupt tightening of monetary policy. I would be interested in more staff commentary on this possibility. From the 1993 data, it looks like the banking system had already begun to work down its excess reserve position in the last half of 1993.

Very high lending margins are another issue in the banking system that needs some clarification. The staff report indicates that spreads on lending to the private sector reached 10 percentage points. What supports these wide spreads? Lack of competition? Official actions to make credit available to the public sector, while squeezing out private borrowing? Weak bank portfolios? Or a combination of all these factors? Whatever the origins of this distortion, excessive borrowing costs to the private sector must be a major impediment to the Government's stated strategy of relying on the private sector to take the lead in developing the islands' main industries.

The staff representative from the Western Hemisphere Department stated that the importance of the offshore banking sector to the overall economy had declined in recent years. Although the number of banks and branches had increased slightly, from about 390 three to four years ago to about 405 at present, the volume of transactions had not increased. In fact, it appeared that both the volume of transactions and the number of employees in the sector had declined somewhat. At the same time, the authorities considered the sector to be important, because it provided jobs and increased the skills of the local labor force, made local expenditure contributions to the tax system, and had some important externalities on the rest of the economy.

The authorities attached a great deal of importance to diversification, in particular to agriculture and light manufacturing, the staff representative explained. The potential for agriculture seemed to be strong, as the share of cultivated land in total arable land was fairly small. At the same time, too-rapid growth of agriculture could have an adverse impact on the environment. It also needed to be borne in mind that high wage levels in the hotel sector could act as a constraint on development of the agriculture and light manufacturing sectors, to the

extent that labor costs would be high, or labor unavailable, for those sectors.

The limited availability of medium- and long-term credit was another factor that might act as a constraint on the growth of the agriculture sector, the staff representative pointed out. However, it was to be hoped that the situation might be ameliorated somewhat by a loan that the authorities were currently discussing with the Inter-American Development Bank. The cumbersome nature of the tax system might also be limiting agriculture development. The authorities were in the process of looking hard at the tax system with a view to making it more transparent and less distortionary.

With regard to privatization, the authorities were trying to sell their shares in the hotel sector as soon as possible, the staff representative went on. Two small government-owned hotels had been sold already in 1994. The authorities also hoped to make progress in privatizing the utility sector, although movement in that direction had been fairly slow until the present, given the time needed to overhaul the related regulatory framework and to make the necessary changes in the legal status of the enterprises concerned. That being said, he doubted that much would be done before the end of the year.

The wide spreads on financial intermediation in The Bahamas were related both to a lack of competition and the character of credit demand, the staff representative explained. With regard to the latter, until end-1993, credit demand was essentially for personal loans rather than for construction or manufacturing. The banks attempted to restrain growth of personal loans by maintaining high interest rates. At the same time, it could not be denied that lack of competition had played an important role. The staff had suggested to the authorities that they allow Bahamian residents to borrow abroad, and in that sense, to liberalize the capital account a bit, but they were concerned that that could be destabilizing given the economy's small size.

The reserve position of the Central Bank had increased in the first four months of 1994, the staff representative from the Western Hemisphere Department concluded, reflecting in part seasonal factors, including tourism, and the fact that the central government deficit in the first quarter of the year had been somewhat smaller than anticipated. The staff was not certain whether that improvement reflected a favorable performance of tourism, with a related impact on revenues, or delays in payments pending authorizations to the Government to issue treasury bills.

Mr. Dorrington said that he wondered whether there was any evidence that uncertainty about future changes in the fiscal regime was constraining investment at present.

The staff representative from the Western Hemisphere Department responded that the staff could not discern such an effect. The main issue,

in the staff's view, was that the whole tax and trade system could be sending a wrong signal to the private sector, in particular to domestic investors.

Mr. Desruelle made the following statement:

I associate myself with the positive comments of previous speakers on The Bahamas' economic situation. Let me therefore concentrate on some of the remaining weaknesses.

I share the concerns expressed by lead speakers on the weakening of the fiscal accounts, and I concur with their assessment of a need for fiscal consolidation, noting in particular Miss Chang Fong's argument on the rapid rise in public debt.

With regard to fiscal policy, I have a question about the implementation of the authorities' objective for fiscal year 1994/95, and another question about the composition of expenditures. Concerning the first, the staff states in its appraisal that "[it] will require strong efforts to improve tax administration, reduce tax exemptions, contain current expenditure, and strengthen expenditure controls throughout the public sector." I wonder whether the staff could go beyond this statement and tell us whether, in its view, sufficient measures are being taken or contemplated to reach the authorities' fiscal objective.

With regard to the second question on the composition of expenditures, I would like to reflect on the combination of three elements: first, the strategy of the Government in the tourism sector--with which I very much agree--calling for general reliance on private activity, but with public provision of the necessary infrastructure; second, the indication that the present infrastructure and services are overloaded; and third, the information that spending on education has declined in real terms over the past years. Given these elements, I wonder whether the staff views the present level of public expenditures on human and physical capital as adequate, or whether there is a case for increasing such expenditures. If the latter is true, given that the overall ratio of expenditures to GDP--or of revenue to GDP--is low compared to neighboring countries, fiscal efforts should be concentrated forcefully on revenue generation. Here, I concur with Mr. Lanciotti's remarks.

With respect to monetary policy and the banking sector, like Mr. Newman, I was struck by the information given in the staff report on the size and evolution of the spread between deposit and lending rates. There can be little doubt that such spreads adversely affect investment and growth.

I see considerable merit in the staff's suggestion to introduce additional competition into the banking sector by lifting restrictions on domestic residents' access to external financing. Indeed, given the relatively small size of the onshore financial market in The Bahamas and the returns to scale in the banking industry, increasing competition through foreign exposure seems the most promising route.

The point raised by the Central Bank as to the future risks of this course is well taken: imprudent borrowing for unprofitable ventures could indeed carry such risks. Nevertheless, this issue could be addressed, first, by making sure that no explicit or implicit public guarantee is attached to foreign borrowing, and second, by strengthening central bank supervision.

Unemployment has declined recently, in line with the recent recovery in activity, but it remains high. This situation has had, and appears still to have, a significant impact on many policies: the previous authorities took control of hotels to protect employment in that sector; and a reduction of overstaffing in public enterprises is hampered by the overall employment situation. Furthermore, the attempt to limit dependence on the tourism sector and to increase domestic agricultural production could be seen as well as a measure to increase employment.

The efficacy of some of these policies--and in particular, of the import substitution strategy--is highly debatable, taking into account the experience of many other countries. Therefore, I would appreciate additional information as to discussions between the staff and the authorities on alternative policies to deal with unemployment. It is of course noted that the evolution of wages in the hotel sector could have a significant impact on the employment situation.

Ms. Petana made the following statement:

It is encouraging to note that there has been some improvement since the last Article IV consultation, with growth recovering, inflation declining, and some progress being achieved in containing the public sector deficit, with an improvement in particular in the financial position of some of the public enterprises. However, economic management of the country is still beset with underlying weaknesses in the finances of the public sector and rising competition in the tourism sector. I am in general agreement with the staff's recommendations.

The Government's strategy for private sector-led involvement in the tourism sector, with the Government providing infra-structural and regulatory support, is an appropriate one to pursue given the decline in the share of The Bahamas in tourism.

However, there is an important question concerning the Bahamian authorities' options for diversifying the country's economic base if its tourism share continues to decline, taking into account the influence of cyclical conditions in industrial countries that are a major source of tourists in the region--and to The Bahamas in particular; the fierce competition from neighboring countries and other regions; and the development of internal markets for tourism in the United States itself. In The Bahamas, as in other small island countries, the options may be limited to small agriculture-based diversification, because any industrial development may lead to heavy subsidization, including protectionist measures through tariffs, which would be self-defeating in the light of current fiscal imbalances and the fragile structure of the economy. Then again, the cumbersome tax system and high wages are not conducive to supporting diversification. Unless these have been addressed adequately, changing the economic focus will be a problem. Perhaps it is something to think about in the medium to long term, given the significant role of tourism in the economy.

It is apparent that fiscal policy will be crucial in maintaining financial restraint if the authorities are to contain inflation and achieve overall balance in the medium term.

The main challenge to the authorities will be the containment of the government wage bill and persuading public enterprises and labor unions to follow suit. I note that there was little reference to employment within the Central Government; given the size of the wage bill, perhaps some thought should be given to downsizing the public service. There could also be budgetary pressures from transfers to public enterprises, particularly where there are likely to be slippages in operational costs as a result of weak management decisions to rationalize costs relative to the size of operations, or where there are delays in setting appropriate tariffs. For this reason, it is encouraging to note that the authorities are committed to improving their financial performance and accountability, including monitoring closely foreign borrowing by the corporations. However, investment decisions and the operation of some of these corporations may be enhanced further through privatization or commercialization.

On the revenue side, the proliferation of tariff rates and import tax exemptions, as well as weak administration, has combined to undermine the revenue base. Early action toward a simpler and more transparent system should enhance revenues in the medium term. However, new revenue measures will be required to meet additional costs of operations and future investment. In this regard, it is encouraging to note that the authorities are also looking at broadening further the tax base.

The authorities have demonstrated their resolve in the past to manage their economy prudently, and the steps that they propose to undertake in the medium term are a further indication of this resolve.

Mr. Prasad stated that the turnaround in tourism in 1993 had resulted in positive developments in almost every sector, with GDP growing, inflation declining, and employment increasing--although the present estimated level of unemployment was still of concern. The fact that the revival of tourism alone had had beneficial effects on so many fronts demonstrated the high degree of dependence of the economy on the tourism sector. Having to depend on one star performer had been the undoing of many a fine athletic team. Given the constraints, he wondered what the options were for some economic diversification, but it was disturbing that even in tourism, The Bahamas was losing out to many other Caribbean tourist destinations, as its share of regional tourism had declined from 20 percent to 13 percent. What was even worse, the big spenders from Europe were reportedly all heading for Barbados and Jamaica, leaving The Bahamas largely dependent on the more conservative U.S. East Coast tourism trade, the growth of which, moreover, did not seem to be commensurate with the overall increase in volume. With the thin operating profits in The Bahamas, those losses in market share would not be easy to recoup. In that regard, it needed to be borne in mind that Jamaica's GNP per capita was 12 percent of that of The Bahamas, while operating margins in Jamaica were as much as seven times that of The Bahamas. Obviously, The Bahamas' competitors would not lose their advantages easily. Notwithstanding those difficulties, he regarded the authorities' strategy for reviving tourism as appropriate. At the same time, he wondered whether it would be adequate, or whether it should be intensified. He shared the staff's concern in that connection.

Another area of concern was tax administration, Mr. Prasad noted. The authorities' encouraging plans to explore ways to broaden the tax base addressed the fact that The Bahamas' tax ratios were relatively low in comparison with other countries in the Caribbean, while having at the same time a larger international trade component. The authorities must therefore look inward for improvements in the tax system. One critical area was tax evasion. The background paper on recent economic developments suggested that revenue loss from tax evasion could be as high as 25-30 percent. Many of the corrections required in that connection could be put into effect without any material difference to the authorities' plans for a tax haven, and would have a direct positive impact on the deficit. That being said, he could support a stronger recommendation to the authorities to strengthen tax administration than what had been provided in the staff appraisal.

The fact that the authorities were requesting that The Bahamas be placed on the 12-month consultation cycle was perhaps a measure of their recognition of, and concern about, those developments, Mr. Prasad concluded. He had no hesitation supporting that request.

The staff representative from the Western Hemisphere Department stated that the fiscal measures in the budget for fiscal year 1994/95 that the authorities expected to be approved by the Cabinet and the National Assembly were in line with what the staff had recommended, in particular with regard to the savings position of the Central Government. Measures to strengthen tax administration--and to desist from granting new tax exemptions--would also be required. The problem in the past had been that budgets had been introduced that had seemed compatible with the fiscal objectives, but new tax exemptions or modifications had been introduced in the course of the fiscal year that had diminished the impact of the budget policies.

Given the structure of the economy, the only viable option to deal with unemployment in the short term seemed to be the recovery of tourism and construction--which were closely related--which the authorities were trying to promote, the staff representative commented. The staff had discussed with the authorities the need for more flexibility in the labor market and in wage negotiations, in particular in the tourism sector, to make such a recovery possible. Because of the fiscal constraints and the need to reduce the deficit, there were no possibilities for increasing employment in the public sector. In fact, the unemployment problem was a key impediment to a faster deficit reduction, because the Government did not wish to reduce public sector employment abruptly in light of the overall level of unemployment.

The level of taxation in The Bahamas, although not high in comparison with other countries, was such as to not provide much room for further significant increases, the staff representative from the Western Hemisphere Department pointed out. The staff recommended that the authorities follow tax policies that would not hinder external competitiveness, given the fixed exchange rate. At the same time, there was room to create a more efficient tax system at the same--or perhaps slightly higher--rates by broadening the tax base and reducing tax exemptions. A more efficient tax system could thus allow for some increase in social expenditures, which, in fact, had increased in the preceding few years, although the composition of those expenditures had changed. The staff encouraged the authorities to raise the effectiveness of social expenditure in order to ameliorate the conditions of the people.

Mr. Smee thanked his colleagues for their helpful comments on The Bahamas. During the 1980s and into the early 1990s, The Bahamas had tended to take its tourism sector for granted. The authorities had been able to borrow relatively easily, both domestically and externally, to keep the tourism situation manageable, without having to face up to the real problems. The combination of the cyclical downturn in the United States and its impact on the tourism sector, the slowly improving competitiveness of The Bahamas' competitors in the Caribbean, and the change in government in August 1992, had finally brought the Government around to recognizing the fiscal and structural problems of the economy, especially in respect of the tourism sector and economic diversification.

The authorities had started to make some headway on the fiscal deficit, Mr. Smee pointed out. The authorities' fiscal goals should be more ambitious, however, especially in the areas of domestic and foreign savings, and the personal and public sector contributions to domestic savings. It was to be hoped that the comments of Directors on those points would assist the Minister later in the day in the cabinet discussions on the budget for the succeeding fiscal year.

The authorities realized as well that fiscal consolidation was a necessary, but not sufficient, condition for a turnaround, Mr. Smee continued. Obviously, they would have to work first on the most important tourism sector. Privatization and holding wages down would be important to secure competitiveness and maintain the exchange rate at its current rate. The authorities also needed to help the tourism sector go more up-market and become more profitable. In order to do that, the tax base would have to be broadened, thus getting the tax system off the backs of tourism and imports. Economic diversification would also be important, because even if the tourism sector improved, it would not provide all the jobs and output growth that The Bahamas required.

His Bahamian authorities looked forward to being placed on the 12-month cycle for consultations, which would allow them to have the Fund's advice on a more timely basis, Mr. Smee concluded.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They observed that tourism and economic activity were strengthening with the improvement of the U.S. economy, and that the public deficit had declined. Nevertheless, they noted that some of the underlying problems that had affected adversely economic performance in recent years persisted. Costs in the tourist sector remained relatively high, and The Bahamas continued to face strong competition from other high-quality tourism destinations. Also, public sector savings remained low, and the fiscal position was beginning to weaken again.

Directors emphasized that to sustain the incipient recovery of tourism, The Bahamas would need to reduce costs in that sector and improve the quality of its product. In that regard, they noted that the proposed wage agreement with hotel workers was likely to hurt competitiveness and employment. They commended the authorities' strategy of relying on private investment to upgrade and diversify tourist facilities, but noted that the Government should play a stronger role in improving performance by promoting wage restraint and adopting expenditure and tax policies that would contribute to improving tourist infrastructure, strengthening external competitiveness, and shifting some of the tax burden from the tourist sector to the economy in general.

Directors noted with concern that the fiscal stance posed risks. The buildup of the public debt, if not curbed, could weaken confidence, with adverse effects on international reserves and the economy in general. A substantial improvement in public sector savings was needed to put economic growth on a firmer basis, and Directors stressed the importance of the authorities' commitment to move toward fiscal balance in the Central Government in the 1994/95 fiscal year and to strengthen savings in the rest of the public sector. Achievement of these objectives called for strong efforts to contain current expenditure throughout the public sector, improve tax administration, and reduce tax exemptions.

Directors observed that the fiscal effort for 1994/95 should be ambitious, particularly on the revenue side, and that the existing complex tax system was in need of an overhaul. Directors noted the authorities' intentions to explore ways of broadening the tax base to help boost the fiscal position in a sustainable way. They advocated greater urgency with respect to the pace of privatization of government-owned hotels and of some operations of public utilities, which would improve economic efficiency and help bring about greater flexibility in the labor market.

Directors agreed that the long-standing parity of the Bahamian dollar vis-à-vis the U.S. dollar had provided an effective framework for financial discipline and price stability. Concern was expressed about wide lending margins in the financial system and the adverse impact of high borrowing costs on private investment. Greater competition in domestic banking in The Bahamas was called for.

Directors noted that resource allocation, the efficiency of investment, and fiscal revenues would benefit from a simplification of the trade regime and the elimination of nontariff barriers.

It is expected that the next Article IV consultation with The Bahamas will be held on the standard 12-month cycle.

3. SUDAN - OVERDUE FINANCIAL OBLIGATIONS TO THE FUND -
REPORT AND COMPLAINT UNDER ARTICLE XXVI, SECTION 2(C)
WITH RESPECT TO COMPULSORY WITHDRAWAL FROM THE FUND

The Executive Directors considered a staff paper on a report and complaint with respect to the compulsory withdrawal of Sudan from the Fund (EBS/94/78, 4/8/94), together with the Managing Director's complaint under Article XXVI, Section 2(c) (EBS/94/77, 4/8/94).

The staff representative from the Middle Eastern Department made the following statement:

At the request of the Sudanese authorities, a staff team consisting of Mr. Chabrier, Mr. Ghesquiere, and Mr. Corr visited Khartoum during April 28-May 2, 1994, to discuss the Government's recent proposal to the Managing Director for renewed cooperation with the Fund, in particular a resumption of a staff-monitored program that could pave the way for an eventual rights accumulation program.

The authorities expressed grave concern at the prospect of compulsory withdrawal from the Fund. They indicated that the Head of State had instructed that no effort be spared to arrest the process of compulsory withdrawal. The authorities reaffirmed their desire to maintain cooperative relations with the Fund and their commitment to economic policy reform and to make maximum efforts in payments to the Fund.

The staff stressed that, given recent unsatisfactory performance on cooperation, only very substantial actions, both in terms of policies and on payments to the Fund, would be evidence of renewed satisfactory cooperation with the Fund. The mission noted that Sudan's undertaking to enter anew into a staff-monitored program, that would also include specific undertakings by Sudan to make monthly payments to the Fund that would stabilize arrears at the end-1994 level, would not result in the cancellation of the Executive Board meeting on Sudan on May 16 or the meeting proposed in July for the Executive Board's substantive consideration of the complaint of the Managing Director. However, prompt resumption of payments and understandings on a substantive economic reform program for 1994/95 would be important new developments that would be taken into account by the Board in its deliberations.

Following discussions, the authorities made a commitment to pay the Fund SDR 13 million before end-1994. An amount of SDR 2.5 million would be paid before May 16, followed by a further SDR 2.5 million prior to the substantive consideration of the complaint by the Executive Board proposed for July 6. Further monthly payments averaging about SDR 1.6 million would be made in the remainder of 1994. This pattern is consistent with clearance of Sudan's arrears to the SDR Department by end-1994. However, the authorities were not in a position at this time to commit themselves to payments for the period after December 1994. The staff indicated that a schedule of payments--totaling SDR 16 million--for the first six months of 1995 that would effectively stabilize arrears to the Fund at the end-1994 level would need to be part of a staff-monitored program.

In terms of policy reform, the staff highlighted the need for a bold, comprehensive, and credible program with substantial policy action up front. Such policies were all the more needed since little or no foreign assistance was anticipated. The authorities responded that they were ready to embark on a one-year program starting July 1, 1994 to be monitored by the staff. The staff team explained that key elements of a program would need to include: (i) reform of the exchange and trade systems aimed at enhancing the role of market forces and increased predictability and transparency--in particular, the exchange rates would be unified at the parallel market rate at the start of the program and the rate would afterwards follow closely the parallel market rate; (ii) a substantial tightening of fiscal and monetary policies, including higher real interest rates in order to bring about a sharp reduction in inflation; and (iii) further price deregulation, including in agriculture. The specific targets and policies of the program would be negotiated by a mission that would return to Khartoum after the May 16 Board meeting, but only if Sudan had made the promised payment of SDR 2.5 million by that date. If this mission goes forward, the staff will report on its results prior to the Board's substantive consideration of the complaint.

The latest information available indicates a rate of inflation of 112 percent by February 1994 over the preceding 12 months. At the time of the mission's visit, the commercial bank exchange rate was LSd 400 per U.S. dollar, the parallel market rate reportedly LSd 500 per U.S. dollar, and the official exchange rate LSd 215 per U.S. dollar. Press reports since the mission's return have indicated that there has been an appreciation of the commercial rate to LSd 350 per U.S. dollar, in line with an appreciation of the parallel market rate following a further tightening of restrictions affecting the parallel market.

Fiscal developments have been adversely affected by a shortfall in collection of direct taxes. Direct tax revenue had been projected to triple to LSd 60 billion in 1993/94, a target the authorities now consider unattainable. Indirect tax revenue has been performing as expected, in part as a result of an increase in the customs exchange rate from LSd 140 at the beginning of the fiscal year to LSd 200 in February 1994. Despite the revenue shortfall, the authorities were confident that government borrowing from the banking system could be limited to LSd 36 billion, consistent with the budget limit. It was expected that containment of expenditures would contribute to meeting the limit, but incurrence of domestic arrears by the Government was envisaged as well.

The staff representative from the Treasurer's Department confirmed that the payment that the Sudanese authorities had undertaken to make before the present Board meeting had been received. Therefore, it was intended that a further staff mission leave for Sudan at the end of the week to begin discussions on an adjustment program for 1994/95.

Mr. Mwananshiku stated that the case of Sudan's financial obligations to the Fund was well known in the Board. Until recently, there had been no indication that a satisfactory solution would be found to that protracted problem. The current meeting was intended simply to note the Managing Director's complaint against Sudan and set a date for its consideration in a process intended to lead to Sudan's compulsory withdrawal from the Fund. Fortunately, however, his authorities' attitude to the problem of arrears to the Fund had been evolving, and now provided an important window of opportunity for finding a satisfactory solution to the problem.

Following the Managing Director's letter to the Minister of Finance, dated February 14, 1994, the authorities had responded by indicating their desire to resume active cooperation with the Fund by substantially increasing their payments and implementing a comprehensive adjustment program beginning July 1, 1994, Mr. Mwananshiku observed. Those commitments had been renewed during the recent staff visit to Sudan. The authorities had agreed to both increase their payments to the Fund during the six-month period ending December 1994, and to receive a staff mission to work out the details of a program.

Sudan had already paid the initial SDR 2.5 million to the Fund, as confirmed by the staff--a sum that represented both a substantial increase over the payments of the past, and a sign of the country's willingness to resume cooperation with the Fund, Mr. Mwananshiku continued. He was encouraged that management had responded positively to that payment, and would be sending a staff mission to Khartoum in the course of the week.

In the authorities' discussion with the staff, they had agreed to a staff-monitored program of one year's duration before embarking on a formal rights accumulation program, as reflected in the staff report, Mr. Mwananshiku concluded. However, the authorities hoped that the Board would agree to shorten the period of the staff-monitored program to, say, six months, if performance--including on payments--during the period to end-December 1994 was satisfactory. In making that request, they were aware of the difficulties and frustrations of the past. However, in view of the changes that had taken place at both the Ministry and the central bank--changes that had contributed to the evolution of the policy on the arrears problem--they hoped that the Board would consider the request favorably.

Ms. Lissakers made the following statement:

We have been quite disappointed by Sudan's continued lack of action to normalize its relations with the Fund in the time that has passed since our discussion in February.

Cooperation in terms of both payments and policies continues to be deplorable. On the policy front, we see no indication that any measures have been taken to reverse the economic deterioration. On the payments side, the payment that has just been made is welcome, although it is quite small. We note that it is the only payment made since August 1993, despite a series of promises or commitments in the meantime that a more ambitious payments effort was going to be made.

In the period leading up to the July 6 meeting, we will be looking for concrete evidence to back up the positive rhetoric reported by the staff. Sudan must take very strong action immediately to show that it is serious about resuming cooperation with the Fund.

We strongly support the proposed decision.

Mr. Fukui made the following statement:

I note that the authorities expressed their desire to normalize relations with the Fund at the discussions with the staff during last month's mission, and that they committed themselves to resuming payments and embarking on a one-year program to be monitored by the staff. I also note that a payment of SDR 2.5 million was in fact made on May 12, as promised.

However, it is very disappointing that, despite the fact that the authorities indicated their commitment last July to make monthly payments of at least \$0.3 million, and that just before the last Board meeting, they expressed their intention to make some payment to the Fund prior to the Board meeting, they failed to meet all their commitments. Their repeated failure to meet their commitments has seriously damaged their credibility.

In order to be convinced that they are making their best effort to normalize their relations with the Fund, we must see further convincing evidence in the form of both payments and the implementation of required policies.

The evidence presented to us at this time, in terms of both payments and policy implementation, is obviously so weak that, in the present situation, there is no other choice but to support the proposed decisions, in line with the timetable of actions under the strengthened arrears strategy. I hope that the staff will continue its consultations with the authorities and try to do as much as possible to change the present situation.

With this hope, I support the proposed decision.

Mr. Sirat made the following statement:

I would like to express my full support for the rapid response from management and the staff to the window of opportunity created by the Sudanese Minister of Finance's letter of last March. I can certainly go along with the proposed scheme, according to which, first, some payments--albeit minimal--would be made before the July Board Meeting; second, the principles of a staff-monitored program would be soon discussed, including significant up-front actions; and third, payments would be resumed, and discussions on an economic program would not suspend the course of our procedure--that is, the Board meeting foreseen for July would take place in any case.

By then, we will be in a position to appreciate the progress made toward active cooperation with the Fund, both in terms of payments and of formulation of appropriate policies.

I understand that the staff hopes that a one-year monitored program would be succeeded by a three-year rights accumulation program. The duration of the monitored program is linked both to the past track record and to the time needed before Sudan could be in a position to stabilize the level of its arrears to the Fund. Should Sudan be able to accelerate the repayments contemplated under the monitored program, it should certainly not refrain from doing so, so as to accelerate its way back into the international financial community.

In any case, given the need for donors' and creditors' support during a rights accumulation program, it would certainly be appropriate for the staff to report on the implementation of the staff-monitored program on a regular basis.

It is certainly too early to celebrate a happy outcome of the long and dreadful relationship with Sudan. However, I hope that the Sudanese authorities will continue to show their very recent readiness to make reforms and normal payments over the next few years. I support the proposed decision.

Mr. Zhang made the following statement:

I thank the staff for its statement on the recent economic and policy developments in Sudan, and Mr. Mwananshiku's opening remarks.

Like Mr. Mwananshiku, I regret that the Sudanese Government has not meaningfully strengthened its efforts to discharge its financial obligations to the Fund since the suspension of its voting rights. However, I welcome the authorities' declaration that they are willing to increase substantially payments to the

Fund. If payment of SDR 13 million is made before end-1994, it would be most welcome evidence of their commitment. We therefore urge the Sudanese authorities to do all they can to bring this about. We would also call on the Government to lose no time in negotiating an adjustment program with the Fund that might lead to a rights accumulation program.

More time would be needed to allow the authorities to go ahead with their recent commitment, especially to formulate and implement an adjustment program promptly, than that implied by the schedule proposed by the staff under the procedures on the compulsory withdrawal of Sudan from the Fund. I agree that Sudan should enter into a rights accumulation program as soon as possible if we are satisfied with Sudan's performance over the next six months, both in terms of repayments and embarking promptly on a program to be monitored by the Fund. Therefore, I would prefer to postpone the proposed decision, and wait to see what the result of developments will be during the next six months.

Mr. Cippa made the following statement:

We support the proposed decision to place the Managing Director's complaint on the agenda of the Executive Board for consideration on July 6, 1994.

Within the framework of the strengthened arrears strategy, the Executive Board agreed to use two criteria to judge whether a member is actively cooperating with the Fund or not, following the declaration of ineligibility: assessment of the country's payments performance to the Fund, and evaluation of the set of policy measures introduced in addressing the country's balance of payments problems.

Sudan's payments record speaks for itself: since the declaration of ineligibility in 1986, and abstracting today's SDR 2.5 million payment, Sudan has settled a mere 5.2 percent of obligations falling due. Since 1991, Sudan has paid more in debt-service payments to other multinational institutions and other official creditors than to the Fund, thereby clearly violating the Fund's preferred creditor status. Since the suspension of its voting rights, Sudan has made no payments at all to the Fund, despite having committed itself to making monthly payments. These facts show that Sudan has persistently violated the obligations under the Articles of Agreement.

Sudan has repeatedly failed to implement the appropriate policy measures needed to address the country's structural and financial problems.

We appreciate the recent declaration of the Sudanese Finance Minister that his Government intends to normalize relations with the Fund. We welcome Sudan's willingness to increase substantially the payments to the Fund and start negotiations with the Fund on an adjustment program beginning July 1, 1994. However, this declaration has to be followed by clear and unambiguous actions. At present, the facts do not allow us to see such improved cooperation as about to take place. Although we welcome today's payment, we think that this is not sufficient to postpone the discussion in July.

Sudan's overdue obligations impose a financial burden on the members of the Fund, debtors as well as creditors, and weaken the Fund's income position. Sudan's overdue obligations will continue to grow and the Fund and its members will have to share the financial burden of the arrears.

This situation is not acceptable. We therefore urge the Executive Board not to back out of the strengthened arrears strategy unless Sudan starts to resume active cooperation with the Fund. Failure to apply compulsory withdrawal would establish a negative precedent for other countries with arrears. The Fund's financial integrity and credibility would be at stake if it does not deal with Sudan resolutely.

Mr. Obame made the following statement:

We welcome the statement by the staff regarding its latest discussion with the Sudanese authorities. The statement contains important elements that could lead to a satisfactory solution to the issue of Sudan's overdue obligations to the Fund. Among these, we note the initial payment of SDR 2.5 million made by Sudan and the authorities' strong commitment to make regular monthly payments for the remainder of 1994. We note in particular that the process of the compulsory withdrawal of Sudan is a matter of serious concern to the authorities, and that the Head of State himself has instructed that no effort be spared to arrest that process.

Furthermore, we are encouraged by the policy measures already implemented, together with the authorities' readiness to embark on a one-year staff-monitored program.

All these are positive developments and steps in the direction that we have been hoping for from the Sudanese authorities. They are clear indications that the authorities are serious about their stated intention to maintain cooperative relations with the Fund.

We therefore welcome the fact that a staff mission is due in Khartoum very shortly to assist the authorities to put in place a program of economic reforms. While we agree with the staff on the main area of emphasis and the substantial prior policy measures needed for such a program to be credible, we would nevertheless point out that the accumulated imbalances cannot be corrected overnight, and that, given the likely unavailability of external assistance, the staff will need to be realistic and pragmatic in its expectations, as well as with regard to the sequencing of policies.

We would like to support the authorities' request for shortening the informal monitoring period to six months. In this regard, we concur with Mr. Mwananshiku that if, by end-1994, all the prior actions in the monitored program have been implemented and the proposed payments to the Fund have been made, Sudan should be allowed to start a rights accumulation program without any delay.

It is our strong hope that the Sudanese authorities will take this unique opportunity to take the right steps so that normal relations with the Fund resume, and that a rights accumulation program could be started soon.

Mr. Mohammed made the following statement:

The reaffirmation of Sudan's desire and willingness to normalize its relations with the Fund, which was contained in the authorities' letter of March 29, 1994, together with the authorities' proposal on how the process may be moved forward, may prove to have been quite significant. Far more important will obviously be a successful outcome of the next round of discussions with the authorities on a staff-monitored program. We welcome Sudan's resumption of payments to the Fund, and we endorse fielding a staff mission to Khartoum at the earliest possible date to work with the authorities on a staff-monitored program that could pave the way for an eventual rights accumulation program. In this regard, we note the authorities' preference for a monitored program of a duration of less than one year, as conveyed by Mr. Mwananshiku.

The purpose of today's meeting is to note complaints relating to the compulsory withdrawal of Sudan and to place them on the agenda for substantive consideration. In this connection, I note that the authorities were informed that their undertaking to enter anew into a staff-monitored program would not arrest the process of withdrawal initiated last February. I note that they were also informed that prompt resumption of payments, and understandings on a substantive economic program for 1994/95, would be taken into account by the Board in its deliberations. While, clearly,

developments on the payment and policy fronts do, at various stages of the remedial component of the arrears strategy, form the basis on which Board judgments are made, I believe that it was useful and appropriate for the staff to convey this assurance to the authorities. I also believe that it would be constructive to give that assurance content today by formally recognizing recent steps taken by Sudan and the positive effect that a follow-through by the authorities with their stated intentions will have on Sudan's relations with the Fund.

Mr. Lanciotti stated that, while his chair stood ready to seize any sign of cooperation from the Sudanese authorities, such as the recent payment of a notional amount, it nevertheless agreed with the staff that only very substantial actions, both in terms of policies and of payments to the Fund, could bear witness to the renewed willingness of the authorities to collaborate with the Fund. Taking into account the current advanced stage of the procedures for compulsory withdrawal in the case of Sudan, and the discouraging record of payments--which had been modest before ceasing completely in August 1993, following the suspension of voting rights--it could not be said that those substantial actions had yet been seen. In particular, the cessation of payments shed light on the fact that, so far, the Sudanese authorities had misunderstood the function and meaning of the Fund's strengthened arrears strategy, which relied on a serious, albeit perhaps adaptable, timetable of progressively more severe measures, on the one hand, and continued, and even intensified, collaboration between the Fund and the member in arrears, on the other. That implied that the main way for the member in arrears to show its readiness to resume cooperating with the Fund and safeguard its membership was the making of reasonable payments to the Fund, regardless of the status of the procedure adopted toward it. To avoid undermining the Fund's credibility and to defend its operations and the positions of members that were striving to keep current with the Fund in spite of their precarious situations, the Fund's arrears strategy could not be watered down. Significant payments from members in arrears remained the only way to slow down the compulsory withdrawal process. In the same vein, serious policy undertakings and the stabilization of arrears were the prerequisites for setting in place a Fund-monitored program.

His chair supported the proposed decision, Mr. Lanciotti concluded. At the same time, strong, appropriate and timely signals from the authorities, like those envisaged during the staff mission to Khartoum between April and May, would certainly be taken into account by the Board in its substantive consideration of the compulsory withdrawal of Sudan.

Mr. Bergo made the following statement:

The track record of Sudan with regard to cooperating with the Fund in solving the arrears problem has been very disappointing and is deeply regretted by this chair.

While welcoming the indications in the staff paper and in the statement of Mr. Mwananshiku that the Sudanese authorities now apparently have recognized the seriousness of the situation and are concerned at the prospect of compulsory withdrawal from the Fund, this chair agrees with the staff that, at this stage of developments, only very substantial actions to redress the arrears problem would be evidence of renewed satisfactory cooperation with the Fund.

Based on that, this chair supports the proposed decision--to note the complaint and decide that substantive consideration of the complaint be scheduled for July 6. It is our hope, however, that in time for that discussion, the Sudanese authorities will have committed themselves to a long-term plan for paying the Fund, and will have shown their determination by having followed up meticulously on the payments promised at present, as well as by having made important advances in reaching an understanding with the Fund on a substantive economic reform program.

Mr. Hamilius stated that, like other speakers, he supported the proposed decision. He regretted that the present situation had arisen in the case of a country the situation of which was so fragile. However, he saw signs of hope in the Sudanese Government's new willingness to cooperate with the Fund. He urged the Sudanese Government to make maximum efforts to pay the Fund, and he asked the Government to again deliver some solid evidence of its cooperation before July 6.

Mrs. Wagenhoefer stated that she supported the draft decision. She still hoped, however, that the Sudanese authorities would prove willing and able to resume active cooperation with the Fund. She strongly advised the authorities to make use of the late opportunity to remain a member of the international financial community. She noted with interest that the authorities had reaffirmed their desire to maintain cooperative relations with the Fund, as well as their commitment to implement economic policy reform and to make maximum efforts in payments to the Fund. However, she agreed with the staff that, given the recent unsatisfactory performance on cooperation, only very substantial actions, both in terms of policies and on payments to the Fund, would be evidence of renewed satisfactory cooperation with the Fund.

Mr. Tetangco made the following statement:

We can agree with the proposed decision to consider in a substantive manner the complaint against Sudan on July 6.

Recent discussions would seem to indicate that the authorities recognize the serious consequences stemming from their protracted overdue payments to the Fund. It is our hope that this will lead them to improve their relations with this institution.

We certainly welcome the proposed payments for 1994 outlined by the staff in its statement, part of which has already been received. However, as noted by other speakers, these are small compared with outstanding obligations.

We encourage the authorities to work with utmost urgency toward providing further visible signs of commitment to clear the remaining arrears. However, until this is achieved, we feel that it will be difficult to follow a course that deviates from the path set out under the compulsory withdrawal procedures.

Mr. Geethakrishnan made the following statement:

I am heartened by the statements contained in the staff paper, as well as Mr. Mwananshiku's opening statement, of Sudan's commitment to normalizing its relationship with the Fund. This is a very welcome development. No doubt, as Mrs. Lissakers pointed out, the Sudanese authorities have yet to spell out the details of the earlier proposal for setting their economy in order, but then we have at least Sudan's commitment in this regard. Again, while Sudan's arrears are quite large, the fact remains that they have made a beginning, albeit a small beginning, by making a small payment. This again is a welcome step.

Given this background, there is every case for giving Sudan the necessary opportunity for translating into action what they have now conveyed in words. A final decision at this juncture helps neither Sudan nor the Fund.

In these circumstances, like Mr. Zhang, I would prefer postponing the decision in this regard by another six months. If, however, the final view of this body is to consider this item on July 6 as earlier scheduled, then I would hope that, in the coming intervening six weeks, the Sudanese authorities will take the necessary action and give sufficient indication of setting their economy in order and of normalizing the relationship with the Fund to enable this chair, as well as others in this Board, to take a decision favorable to Sudan, and consequently to Fund as well, when the Board meets on July 6.

Mr. Daïri made the following statement:

During the recent discussion with the staff, the Sudanese authorities reiterated their firm willingness to pursue a cooperative solution to their problem with the Fund. The authorities' continued dialogue with the staff, even after the suspension of Sudan's voting rights, reflects their resolve to maintain their relations and to reinforce mutual understanding. The latest data provided by the staff suggest that the economy continues to deteriorate in an environment marked by high

inflation. We are of the view that sporadic reactions to the deep-seated problems, such as partial liberalization of prices and the exchange rate system, usually bear only limited and temporary results. We therefore call on the Sudanese authorities to adopt and implement, as a matter of urgency, a comprehensive program of economic and financial reform that will bring about the necessary economic adjustment. We are encouraged to note from the staff statement that the authorities are ready to embark on a Fund-monitored program that could eventually lead to a rights accumulation program for Sudan. The Fund, for its part, should stand ready to cooperate with the authorities in support of efforts to formulate and implement such a program. We therefore support the subsequent discussions scheduled for later this month to devise the specific targets and policies of the program. We would also support the authorities' request to shorten the period of monitoring the program before entering into a rights accumulation program.

Regarding the settlement of overdue obligations to the Fund, and given the extremely limited resources, the suggested payment schedule for the remainder of the current year, although only sufficient to clear Sudan's arrears to the SDR Department by the end of 1994, should be taken as the authorities' willingness to maintain their relations with the Fund. This willingness has been further confirmed by the recent settlement, as promised, of SDR 2.5 million.

We support the proposed decision and hope that the forthcoming discussion will improve the scope for renewed cooperation with the Fund and the settlement of arrears.

Mr. Dorrington stated that there was no staff appraisal, and thus it was not clear what the meaning of silence would be. Therefore, he wished to make it clear that, first, he endorsed the strategy that the staff was following and the comments in the staff statement, and, second, that he agreed with the proposed decision.

Mr. Posthumus stated that he had taken note of Sudan's intentions, but he was disappointed that even before a one-year program containing prior actions had been negotiated with the staff, the Sudanese authorities were already asking to shorten the program to a half year. In any case, the Board would be able to judge what had been implemented in its discussion in July 1994. He did not consider at present that Sudan's intentions, even if implemented, would be sufficient to postpone a decision to place the Managing Director's complaint on the Board's agenda. He supported the proposed decision.

The Fund should have a clear policy about what happened after compulsory withdrawal, and in particular, about what the situation of Sudan in relation to the Fund would be if it were forced to withdraw from the

Fund, Mr. Posthumus stressed. For example, under what conditions could Sudan return to the Fund? What would be the status of its debts to the Fund after withdrawal? Would the Fund continue the burden sharing of deferred charges that could be allocated to Sudan? He recalled that the Board had had an informal meeting some time ago, at which it had been suggested that the staff show the financial implications to the membership of different modalities of the write-off of Sudan's debt, if that were to take place. The Fund needed to begin thinking about what the policy would be in respect of a former member following the member's withdrawal from the Fund--before the Fund took a decision on compulsory withdrawal.

The last paragraph of the staff's statement said that the pattern of payments--of SDR 1.6 million per month--was consistent with clearance of Sudan's arrears to the SDR Department by end-1994, Mr. Posthumus concluded. He wondered whether that meant that clearance of arrears in the SDR Department would be achieved if those payments were made. Perhaps the staff intended another meaning, in which case he would appreciate some clarification.

The staff representative from the Treasurer's Department replied that Sudan's overdue net SDR charges at present were SDR 11 million. With the amounts that were to fall due between the present and the end of the year, the total would be SDR 13 million. Therefore, if the pattern of payments that had been discussed with the authorities were in fact followed, Sudan would be current in the SDR Department by the end of the year.

Mr. Zoccali made the following statement:

The Sudanese authorities' recent reaffirmation of their desire to maintain cooperative relations with the Fund, including a specific undertaking to make monthly payments that would stabilize arrears at their end-1994 level, in our view, represents a constructive step. Nevertheless, a concrete understanding on a comprehensive reform program for 1994/95 must be in place prior to the Board's substantive consideration of the complaint next July.

While it is essential that the Board retain discretion to apply with a certain flexibility the agreed timetable for the strengthened arrears strategy at all stages, the credibility of that approach, which has in the past proven effective in no less serious circumstances affecting other members in arrears, must also be preserved. In this regard, it is our hope that, as a result of the forthcoming negotiations on a staff-monitored program, the steadfast implementation of appropriate policies, and the fulfillment of the proposed schedule of payments, the way will be paved toward ameliorating the regrettable domestic and external costs of Sudan's past policies. We can go along with the proposed decision.

Miss Chang Fong stated that she was encouraged by the recent efforts made by the Sudanese authorities, as demonstrated both by the payment on May 13, 1994, and by the initiatives to resume discussions that could lead to a possible rights accumulation program. She hoped that those were a good omen. She would encourage the authorities not to let slip the new opportunity to restore some normality to their relationship with the Fund. Her chair had no objection to the scheduling of the meeting on July 6, at which time she hoped that sufficient progress would have been made to enable the Board to reverse the withdrawal procedures.

Mr. Smee stated that he was pleased to see Sudan's recent positive intentions with respect to making payments to the Fund, as well as the authorities' willingness to enter into negotiations with the Fund with respect to a program. He supported the decision recommended in the paper, as the Fund must keep the Sudanese authorities' feet to the fire to ensure that their good intentions were turned into consistent actions.

Mr. Al-Tuwaijri said he supported the proposed decision.

Mr. Marino made the following statement:

We are pleased with the first steps taken by the Sudanese authorities to resume cooperative relations with the Fund. We welcome their commitment to economic policy reform, and their promised efforts with regard to payments to the Fund. In this connection, the SDR 2.5 million token payment made before this meeting is a good indication.

We expect this new attitude of cooperation to lead very rapidly to a staff-monitored program, paving the way to a rights accumulation program. We expect to have the opportunity to discuss that program in the scheduled July meeting for the Board's consideration of the complaint of the Managing Director.

I would like to support Mr. Posthumus's request for more information on the financial consequences of compulsory withdrawal, although we are confident that the new attitude of the Sudanese authorities will make this an academic exercise.

Mr. Mozhin made the following statement:

We continue to believe that a rights accumulation program remains the best avenue for normalizing Sudan's relations with the Fund and the international financial community in general. At the time of our most recent review of progress under the strengthened cooperative strategy on April 11, 1994, we supported an extension of the rights accumulation approach for another year, having particularly in mind the situation of Sudan and the authorities' intention to avail themselves of the rights approach after a short period of informal monitoring by the Fund staff.

In this respect, I note that a staff team returned from Khartoum earlier this month with rather encouraging news. The envisaged pattern of payments by Sudan appears adequate for stabilizing its arrears to the Fund at their end-1994 level. In our view, a prompt resumption of payments to the Fund, coupled with a substantive economic adjustment program for 1994/95 that would be monitored by the Fund, could form a good basis for the commencement of Sudan's rights accumulation program and the early restoration of its voting rights in the Fund.

It is certainly our hope that, at the next Executive Board meeting on Sudan, Directors will have an opportunity to discuss in greater detail a follow-up staff paper on the authorities' policy actions to be implemented during the one-year--or six-month--program period starting on July 1, 1994. In this context, I can endorse the staff's recommendations to the authorities on the key elements of such a program, as they are outlined in the statement by the staff representative, and I urge the authorities and the staff to intensify their policy dialogue along these lines in the very near term.

With these observations, I support the proposed decision.

Mrs. Hetrakul said that her chair wished to abstain from voting on the proposed decision.

The staff representative from the Middle Eastern Department stated that, with respect to the duration of the staff-monitored program, the mission had proposed a staff-monitored program of 12 months as a minimum. At the current juncture, the staff did not foresee a rights accumulation program beginning before July 1995, because hopes in the past about restoring cooperation between Sudan and the Fund had been disappointed, and a solid testing period was therefore advisable. Beyond that, if Sudan wished to bring to the Board a request for a rights accumulation program, documentation similar to that in a policy framework paper would be required, which would demand substantial technical assistance in the period between the present and the beginning of a rights accumulation program. Sudan received hardly any technical assistance in areas such as taxation, public expenditure, agriculture, and the investment code, for example, and much work remained to be done. Of course, there was a ban on Fund technical assistance at present. Executive Directors might wish to consider lifting the ban on Fund technical assistance in preparation for a rights accumulation program. Taking all those factors into account, the staff did not believe that a Fund-monitored program of six months' duration would be enough time to set in place the necessary preparatory mechanisms.

Moreover, the staff representative added, it would be important to have financing assurances in place for the first year of the rights accumulation program. At present, the prospects for mobilizing external support on behalf of Sudan were not good. As it had done before, the mission would

urge the authorities to move boldly toward establishing the conditions that might enable external assistance to be resumed. While that could all begin soon, it was doubtful that substantial amounts could be disbursed on relatively short notice, such as a period of six months.

The staff had been encouraged by the authorities' indications that they were willing to consider a good, solid program, the staff representative concluded. The staff would try to dissuade the authorities from focusing the forthcoming negotiations on whether the Fund-monitored program should last 6 months rather than 12. Under any circumstances, if the authorities wished to achieve their ultimate goal of normalizing relations with the international creditor community, a very long, sustained period of policy efforts would be required. The authorities should focus on that instead.

Mr. Mwananshiku stated that he wished to thank his colleagues for contributing to the discussion. Their message was very clear, and he would convey it quickly to the authorities. At the same time, he wished to underline the authorities' commitment. There had been important changes in Sudan--a new Minister of Finance and a new central bank Governor. Directors might recall some adverse comments that had been made the previous governor, which were, in fact, well justified. The current Governor was well acquainted with the workings of the Fund, and in fact, had previously been employed in the Fund. He had been instrumental in assisting the tilting of policy in the right direction. Obviously, the threat of Sudan's expulsion from the Fund had been a factor as well, but the personnel changes in Sudan had been of considerable importance.

The authorities had requested to embark on a rights accumulation program as soon as possible, perhaps following a Fund-monitored program of six months' duration, Mr. Mwananshiku concluded. In that regard, he had taken note of the staff's comments, which he would communicate to the authorities. The point that needed to be emphasized was the fact that they would need to embark on a rights accumulation program as quickly as possible, as soon as they had been able to demonstrate to the satisfaction of the Board their commitment to cooperate with the Fund. In the meantime, they were looking forward anxiously to the return of the Fund mission to Sudan. He hoped that the staff's discussions with the authorities would be conclusive and would lead to a realistic program, bearing in mind the absence of support to Sudan, including in terms of technical assistance.

The Executive Board then took the following decision:

The Executive Board notes the complaint of the Managing Director dated April 8, 1994 in EBS/94/77 (4/8/94) regarding Sudan's persistent failure to fulfill its obligations under the Articles after the expiration of a reasonable period following a decision of suspension of Sudan's voting rights pursuant to Article XXVI, Section 2(b). The Executive Board decides that the complaint shall be placed on the agenda of the Executive Board for consideration on July 6, 1994. Sudan shall be informed by rapid

means of communication of this matter and of its right to present its views, both orally and in writing.

Decision No. 10682-(94/43), adopted
May 16, 1994

4. ELIGIBILITY FOR EXPATRIATE BENEFITS

The Executive Directors considered a memorandum from the Acting Chairman of the Committee on Administrative Policies relating to the review of eligibility for expatriate benefits (EBAP/94/39, 5/6/94). They also had before them a staff paper providing supplementary information on expatriate benefits (EBAP/94/39, Sup. 1, 5/13/94).

Mr. Kafka made the following statement:

We are prepared to join the consensus that may emerge on this question. Perhaps, however, before making a decision, it may be helpful to recall very briefly the background to today's discussion.

Until the mid-1980s, the Fund maintained an interest rate subsidy for a staff member's first home purchase; it also maintained the nationality criterion for home leave travel. By contrast, the World Bank had no interest subsidy and applied the visa criterion. The Joint Committee on Staff Compensation Issues, which presented its report in January 1979, recommended that the Fund should give up its interest subsidy while the Bank should adopt the nationality criterion.

In the event, the Bank made no change in its policy, but the Fund moved from the nationality to the visa criterion, with a grandfathering clause. Hence, one could say that while Bank staff members have not had any change in their status on the two questions--interest subsidy and home leave travel--Fund staff have lost an advantage which they previously had.

Mr. Newman made the following statement:

The current eligibility criterion for expatriate benefits was arrived at following extensive deliberation by the Bank and Fund in the mid-1980s. Proposals for changes to the agreed-upon visa test criterion bear the burden of demonstrating a clear problem with the current system, as well as of promising a sustainable improvement that serves recruitment and retention objectives, is administratively workable, and is consistent with budget consolidation. The proposals before us fail this test. We are not persuaded that the current criterion poses problems of fairness or hampers the Fund's ability to attract a talented

multinational staff. Moreover, we find little merit in the two alternatives discussed in the paper. Reverting back to the nationality criterion would entail significant new costs at a time of fiscal consolidation, and would cause the same problems that led to its rejection in 1985. The modified International Telecommunications Satellite Corporation (INTELSAT) option is administratively complicated and supported by neither the staff nor the management.

Distilled greatly, therefore, our choices include the status quo, which has served the Fund reasonably well, and two alternative options which are either universally unpopular or have been tried and rejected. Either alternative would inevitably create calls for new changes and, thus, more instability--hardly a desirable outcome, particularly given the less than compelling case for any change at all.

The perceived problems with the current eligibility criterion center on complaints of "new" resident alien visa holders--representing less than 5 percent of staff--who recognized and accepted the existing terms when they accepted employment. Inequity arguments ring somewhat hollow, therefore, particularly as resident alien visa holders retain important employment opportunities not available to G-4 visa holders. More important, equity arguments distract from the primary rationale for expatriate benefits: the need to attract and retain talented international staff. The visa test, like the nationality criterion, is imperfect--as will be any generally applied standard--but it does provide a logical basis for determining the need for expatriate benefits in recruiting and retaining staff. More important, the experience has shown it to be an effective criterion, as the Fund has had no difficulty recruiting and retaining resident aliens--"green card" holders.

During the recent discussion in the Executive Board Committee on Administrative Policies, arguments for the nationality criterion focused primarily on the issue of equity. In solving one equity issue, however, the nationality criterion creates new ones, which is why it was eliminated in 1985. Moreover, it would entail a significant rise in expatriate benefit costs without demonstrably improving the Fund's ability to attract foreign nationals. A variation on the nationality criterion that would provide resident alien visa holders with 50 percent of expatriate benefits would reduce the size of the cost increase, but would undoubtedly invite continued inequity claims, and is even less likely to offer any improvement in the Fund's recruitment efforts.

We would caution against proposals that would allow staff to shop for benefits by changing visa status. This creates a poor impression. The U.S. Government has generally taken a flexible

posture in responding to various exceptional circumstances involving Fund staff G-4 visa holders that have complicated their ability to stay in this country. This cooperative relationship could be undermined by proposals which treated one's visa status as a chit to be traded for benefits.

One rather tangential issue raised during the discussion in the Committee on Administrative Policies involved the question of whether resident alien visa holders without expatriate benefits should be included in tallies of foreign nationals represented on the staff. The argument seems to be that foreign nationals who do not receive expatriate benefits are somehow less French, or Mexican, or whatever their country of origin happens to be. This is a rather odd criterion by which to judge staff members' country ties, as if the sudden ability to send one's child to a private American preparatory school or Canadian university at Fund expense somehow enhances one's citizenship and home country bone fides. The argument for linking expatriate benefits and country representation strikes us as a strained attempt to fit a round peg into a square hole.

Looking beyond eligibility, we would reiterate the desirability of incorporating reviews of expatriate benefits into the broader context of staff salaries and benefits in order to permit an assessment of the entire compensation package. Regarding the benefits themselves, reasonable questions continue to be raised about how educational allowances intended in part to maintain home country links further this objective by paying for schooling at U.S. preparatory schools or third country universities.

The Chairperson of the Staff Association Committee made the following statement:

On behalf of the Staff Association Committee, I wish to thank Executive Directors for the opportunity to convey to you our views on the question of eligibility for expatriate benefits.

Our view is that the staff, and also the Fund as an institution, would be better served by a policy under which nationality and not visa status determines the eligibility for expatriate benefits. This has consistently been the view of the Staff Associations in the past, so we reiterate that all expatriate staff should be eligible for expatriate benefits, including holders of the resident alien visas, the so-called green cards.

In 1953, shortly after green cards were introduced, the Board ruled that staff holding these visas would be eligible for

expatriate benefits. This policy was reaffirmed by the Board in 1968 and by the Joint Committee on Staff Compensation in 1979. The Staff Association Committee argued in a 1984 position paper that the visa criterion was unacceptable, and that the nationality criterion should be maintained.

We continue to favor the nationality criterion for the following reasons.

First, it is in line with the rationale for expatriate benefits. The expatriate benefits package is designed to help the Fund recruit and retain an international staff, and to help them maintain contact with their home countries. The Fund defines "international" on the basis of nationality, not visa status, so the recruitment incentive--expatriate benefits--should be offered on the basis of nationality as well. Under the present visa-based system, the incentive is not well targeted.

Second, it is fairer. Resident aliens, in our judgment, are, on balance, more like G-4 visa holders than like U.S. residents. Like G-4 visa holders, they have family and personal ties abroad. Like G-4 visa holders, they typically remain in the Washington area for many years, and have varying intentions regarding their place of retirement. Like G-4 holders, they do not vote in the United States, are paid on an after-tax basis, and neither contribute to social security nor receive social security benefits. Finally, like G-4 holders, they are ineligible for many U.S. government jobs.

Third, it is administratively simple. The nationality principle is based on a simple, objective criterion. Therefore, it is easier to administer. In an environment of streamlining and simplifying administrative procedures, this should be an important consideration.

Fourth, it would be durable. The nationality option, because it is fair, transparent, and well targeted, will stand the test of time better than the visa option. The durability of the nationality criterion in the past, and the persistent representations during recent years by affected staff at the Bank and the Fund for its reinstatement, are evidence of this.

Fifth, and very important, it allows the Fund to be more consistent in its internal procedures. The use of different criteria for assessing the geographical distribution of staff on the one hand, and for determining eligibility for expatriate benefits on the other, may not be objectionable from a legal standpoint as is argued in the Administration Department's supplement to the paper EBAP/94/39, Supplement 1 (5/13/94). However, it is objectionable from the standpoint of consistency.

and fairness. It is difficult to defend using one definition--nationality--to determine if the objective of geographical distribution is met, and then using a different definition--visa status--to decide who is to be eligible for expatriate benefits, as the Fund does.

We recognize that there is the question of cost. However, the additional cost associated with returning to the nationality option is modest. In this regard, we would strongly oppose any arrangement that would erode the benefits package that is currently in place.

Mr. Posthumus commented that the Chairperson of the Staff Association Committee had said that green card holders, like G-4 visa holders, were ineligible for many U.S. government jobs that might be attractive to Fund staff. He was surprised to learn that there were G-4 visa holders who were eligible for U.S. government jobs. He wondered whether there was a difference between the eligibility for U.S. government jobs between green card holders and G-4 visa holders.

The Chairperson of the Staff Association Committee said that the chief argument was that U.S. nationals were eligible for U.S. government jobs, whereas G-4 visa holders were not.

The Chairperson of the Staff Association Committee then left the room.

Mr. Sirat made the following statement:

From the standpoint of the employee, there is a perceived inequity deriving from the fact that people in the same objective situation receive different benefits according to their visa status at the time they entered the Fund. It is obviously difficult to categorize real life according to visa status. From this point of view, I would have some sympathy for the idea of at least leaving people the choice of their visa status.

From the standpoint of the institution, there is some inconsistency between the nationality test and benefits eligibility. This logical inconsistency is not significant quantitatively in the Fund, according to the latest staff paper, but I understand that it is in the World Bank, where the last few years have seen a large increase in the number of permanent resident visa holders in proportion to the staff total. This is linked clearly and directly to the fact that permanent residents are cheaper to employ than holders of G-4 visas.

All these elements lead this chair to believe that we should change the status quo, but we are relatively open about the options. We have only two concerns: that the same policy should

be applied in the World Bank as in the Fund; and that whatever option is chosen, it should be relatively cost neutral.

All in all, we could live with the modified INTELSAT option, which has been agreed upon by the Board of the World Bank. However, and given the fact that the staff argues very strongly that this system is too complicated to administer, we could also go along with the "50 percent option," whereby we would shift to the nationality criterion, but we would allow only 50 percent of the benefits to be given to staff who were in permanent resident visa status in the 12 months prior to appointment, and with no changing of visa status permitted. This would avoid the problem of equity that arises with changing visa status.

Mr. Mwananshiku made the following statement:

The choice of eligibility criteria for expatriate benefits should be guided primarily by the principal staffing objective of the Fund, namely, to have the best staff drawn from a wide geographical area of its membership. In selecting such criteria, the Fund should not be distracted from this fundamental objective.

Given this basic consideration, we have to choose an option that meets most of the criteria specified, and which at the same time supports our basic objective.

A quick review of the three main options put forward indicates that the modified INTELSAT option is the weakest. Its implementation would be complicated and would lack transparency. With regard to the option based on the nationality criterion, there are strong arguments in its favor, particularly in terms of transparency and administrative simplicity. However, it would create a group of resident alien visa holders that is likely to enjoy the best of two worlds. I am, therefore, unwilling to support this option.

I would support an eligibility criterion based on visa status in the proposed modified form, whereby resident alien visa holders would be free to switch to G-4 visas, and thus qualify for full expatriate benefits. This would be fair, objective, and simple to administer, although there may be a small increase in cost to the Fund. The argument that staff members making the switch are likely to be mainly those who could readily reacquire the resident alien visas is, in my opinion, very weak. The important point is that while in the service of the Fund, members of staff wishing to avail themselves of expatriate benefits should surrender the rights and privileges of a resident alien. What happens after they have left the Fund should not be our concern.

Mr. Zoccali made the following statement:

EBAP/94/39, Supplement 1 highlights two aspects that we consider relevant when addressing the issue of expatriate benefits. The first relates to our mandate of securing a wide geographical distribution of staff, and the second to the nonsalary costs of recruitment by categories of staff.

On the first score, while the recruitment and retention experience does not seem to provide an argument in favor of a change in the eligibility criterion for expatriate benefits, it is also clear that the present mix of staff shows a large concentration in favor of U.S. nationals and resident alien visa holders. On the one hand, I regret that the supplement does not contain information on the rate of growth of these two categories of staff in recent years, and I would appreciate some clarification of that. On the other hand, the cost data provided reveal a large disparity in the relative nonsalary costs of the present staff mix, with average costs of expatriate benefits running at some \$10,700 annually for G-4 visa holders and grandfathered resident alien visa holders, average tax allowance payments for U.S. staff of \$27,500 annually--regardless of when they were hired as a result of the adaptation of 1992--and no costs for expatriate benefits or tax allowances payable to resident alien visa holders employed after January 1985.

Consequently, while maintaining the status quo in this area presents clear advantages in terms of costs and stability of administrative guidelines, it also constitutes a source of tension and perceived inequity, which possibly contributes to a further erosion of home country links, and therefore of the international perspective that is essential for an institution such as the Fund.

However, it can also be argued that resident alien visa holders hired after 1985 freely accepted the compensation package offered at time of employment. Moreover, any change in nationality or a modified visa option would clearly create additional pressures on the administrative budget, when medium-term budgetary consolidation is in order.

All things considered, we view this issue as part of the overall compensation package, and we regret that it is being treated piecemeal and independently of its financing. If there is a majority in favor, we could go along with the modified visa option contained in the paper of the Administration Department, namely, to extend expatriate benefits to resident alien visa holders who are willing to switch to G-4 visa status. Otherwise, our preference would be to maintain the status quo.

Mr. Bergo made the following statement:

Let me thank the staff for the illustrative and helpful papers it has prepared. Each of the alternative approaches for determining eligibility outlined in the staff paper has some merits and some problems. Our task today is to evaluate the balance of the advantages and disadvantages of each approach, and to determine if the benefits of replacing the present system justify the disruption a change would inevitably cause.

Frequent changes in the system of benefits are in themselves undesirable. Hence, any changes in the system should be avoided, unless the expected benefits from the change are sizable, and unless there is strong support for the changes, so that backtracking and further changes become less likely. Here we should keep fresh in mind the experience of the changes from the previous nationality-based criterion to the present visa-based criterion. The equity problems that these changes were meant to solve were only moved. In retrospect, it is questionable whether the decision taken at that time to change to visa status as the eligibility criterion was wise. That, however, does not justify changing back to the old system, or any other alternative.

Wherever we choose to draw the line, we will have borderline cases. This is unavoidable in any system. Those close to the border, but not quite within it, will feel unfairly treated. It is easy to understand those feelings. It is unfortunate that these problems cannot be solved, at least not without abandoning the fundamental purpose of granting expatriate benefits. Some of the alternatives to a visa or a nationality-based test may have appealing aspects, but if they are to remain cost neutral, the granting of increased benefits to one group has to be offset by taking benefits away from another group. Such a change would become the subject of even more controversy than the existing rules, and be just as unjust--not to mention the administrative problems associated with grandfathering. The very liberal policy of grandfathering is, of course, another argument against frequent changes between criteria.

The present system can be claimed to be unjust, but I fail to see that any other criteria are less unjust, although they might be unjust to different people. It is also clear that the present system is quite easy to administer. Consequently, I have to conclude that any potential benefits, if they exist at all, are too small to justify a change in the test of eligibility.

Mr. Geethakrishnan stated that any organization--including the Fund--had to change the rules of the game at any time, for good reasons. When the rules were changed, however, and if the changes impinged on staff benefits, it was usual to stipulate that the changes would be prospective rather than

retrospective, and that the current incumbents would not be affected by them--the grandfathering principle.

As had been pointed out by Mr. Newman, the new incumbents had joined the Fund with their eyes open, knowing full well that the package of benefits would be different, Mr. Geethakrishnan observed. They could not complain of discrimination in that sense, and the question of equity did not arise.

At the same time, Mr. Geethakrishnan went on, the Fund's handling of the definition of nationality had serious implications of which the Board needed to be fully aware. The fact that a person had a resident alien visa rather than a G-4 visa did not make them any less an Indian or a Sri Lankan, nor did it suggest that connections with the home country were being severed. Moreover, for purposes of the nationality distribution list, persons with resident alien visas were recorded as foreign nationals, not U.S. citizens. To consider resident aliens as foreign nationals for purposes of the nationality distribution list, but not for purposes of receiving expatriate benefits, was inconsistent and unfair. Of course, the root of the problem was with the U.S. Government, which would not extend the privilege of a resident alien visa to those persons who were employed in the United States under the terms of a G-4 visa.

The rules for the reimbursement of income tax payments for U.S. nationals were amended to the detriment of U.S. staff in 1980, and the rules for qualifying for expatriate benefits for non-U.S. nationals were amended, to the detriment of non-U.S. nationals, in 1985, Mr. Geethakrishnan recalled. The U.S. nationals who joined the Fund after May 1, 1980 had done so with their eyes open, knowing full well that the tax compensation paid would be, in some cases, less than the actual tax paid. That notwithstanding, the Board had reversed its 1980 decision in 1992, making full compensation of income taxes paid on a Fund salary available again to all staff members concerned. He wondered what had been the reasons behind the reversal of the Board decision in respect of the reimbursement of taxes paid on a Fund salary--which applied chiefly to U.S. nationals--and why a similar judgment could not be said to apply at present to the Board's reversing its decision on the criterion for receiving expatriate benefits--which, of course, concerned only non-U.S. nationals. If there was no good reason for that differentiation in judgment, then in his view the Fund might well be accused of bias against its non-U.S. staff members.

He did not like to regard the two options for addressing the inequity in the criterion for eligibility for expatriate benefits solely from the point of view of the relative cost of each, Mr. Geethakrishnan commented, or with an ill-placed overconcern about the need for budgetary consolidation. If the Board was concerned about budgetary consolidation, then it should simply impose a percentage cut in salaries and allowances for all staff. Achieving budget cuts by depriving a small number of people of their benefits was not a fair way to proceed.

Mr. Fukui made the following statement:

This issue was discussed from various points of view in 1985, and I understand that there is a rather long history behind it. Without any clear change of circumstances, I see no strong justification for changing the present policy. According to the staff paper, the present system does not impede the recruitment or retention of high-quality staff by the Fund. In this sense, the present system works without any major difficulty. Furthermore, if a staff member holds a resident alien visa, it means that he or she has opted to work in the United States. In these circumstances, expatriate benefits are not justified, as these benefits are meant to compensate for inconveniences suffered in working for the Fund, such as being cut off from one's culture. Resident alien visa holders and G-4 visa holders are different from this point of view, in that the former opted to work in the United States, and they have wider possibilities for work in the United States outside of the Fund than do G-4 visa holders.

Like Mr. Posthumus, I wonder whether the point raised by the staff representative about the inability to work as a government official in the United States is accurate. The same prohibitions apply to G-4 visa holders, I believe, so that an inability to work in the U.S. Government cannot be used as a justification to extend expatriate benefits to resident aliens. In fact, resident alien visa holders have a greater possibility of working in the United States than G-4 visa holders.

From the standpoint of equity, G-4 visa holders are under a particular constraint: unlike resident alien visa holders, spouses and family members of G-4 visa holders are not allowed to work in the United States, and are thus deprived of any possibility of adding to the family's income. From this point of view, I do not think that there is a convincing reason to change the present system. The issue should be considered not from the standpoint of cost, but from the standpoint of the differing character of the visa status.

Having said this, however, I agree to the extension of full expatriate benefits to those who shift from resident alien visa status to G-4 visa status. Also, in view of the fact that the World Bank tentatively approved a compromise plan, if the majority wishes to make some sort of compromise in view of the need to reconcile those staff who are resident alien visa holders and to keep up their morale, I can go along with it. In that context, I would like to express our embarrassment that a benefits package for a particular group of staff members was taken up separately and in a piecemeal fashion. I can also go along with a decision to give 50 percent of expatriate benefits to those who have resident alien visas.

Mrs. Wagenhoefer stated that she could support those previous speakers who had endorsed the status quo regarding eligibility for expatriate benefits. It had to be recognized that any distinction between staff, on any grounds, was likely to raise questions of arbitrariness and the perception of inequities, and the current situation was probably no worse than any of the alternatives that had been presented. Moreover, the objective of expatriate benefits needed to be borne in mind. That objective was to recruit and retain staff on as wide a geographical basis as possible. In that regard, the expatriate benefits were well targeted.

She believed that the staff paper prepared for the meeting of the Committee on Administrative Policies had tended to play down the real costs associated with changes in the current system, because it presented only those figures that related to the change at the current juncture, Mrs. Wagenhoefer pointed out. The potential savings under the current system arising from the fact that the number of grandfathered permanent resident staff was diminishing had not been taken into account in quantitative terms. A better assessment of the future costs of each alternative--including a continuation of the present system--should be made.

Mr. Murphy stated that he supported retaining the status quo, for the reasons that Mr. Newman and others had given. The existing system was fair, within its terms of reference. The primary goal of the Board should be to see that the system served its purposes, and to make sure that it was not used to serve other ends. At the same time, he agreed with some points made by others, such as by Mr. Geethakrishnan, for example. It was not primarily a question of budget consolidation; that should not be the main criterion for making a decision. As Mr. Zoccali had said, he would have difficulty considering any change in the arrangements that was separated from consideration of the entire benefits package, the aim of which was the recruitment and retention of staff. Mr. Newman had called attention to the education allowance policy that allowed family members of expatriates to attend universities in third countries, for example, and he would be open to looking at that type of issue.

Mr. Daïri stated that he agreed with several speakers that there was an equity problem in depriving staff with permanent resident visa status from expatriate benefits. That issue needed to be addressed in order to improve staff morale. Permanent residents were not treated as U.S. nationals, and they should be helped to maintain close ties with their home countries. Furthermore, maintaining a distinction between G-4 visa holders and staff with permanent resident visas was inconsistent with the present classification of both categories of staff as international staff. Correcting the existing inequity would justify maintaining staff with permanent resident visas under the classification of international staff. Otherwise, they should be reclassified as domestic staff. If that were done, the present profile of staff recruitment would be much less consistent with the objective set in the Fund's By-Laws of achieving as large a geographic distribution of staff as possible. He therefore supported the

change to the nationality criterion. He seconded Mr. Zoccali's request that the staff provide information on the growth in the number of staff in the various staff categories.

Mr. Lanciotti made the following statement:

The problem of expatriate benefits is not going to be resolved easily, as the staff paper and the history of previous Board discussions on the matter have demonstrated. On one side, the number of people who could be considered to be adversely affected by the current system is relatively small; on the other side, the principles that need to be preserved are of great importance. In the end, neither criterion--nationality or visa status--could be said to be entirely satisfactory. The key difficulty is that of trying to place existing staff into either of only two categories. Therefore, perhaps a third alternative could be devised. The modified INTELSTAT option attempts to draw a more discriminating line, but an arbitrary one. That brings me to the point of preferring the nationality criterion, with the modification that those with resident alien visas would receive only half the expatriate benefits package.

Mr. Al-Tuwaijri stated that he wished to thank the staff for the information provided in the staff supplement, which had answered many of the important questions raised during the deliberation in the Committee on Administrative Policies. It was important to review the criteria for eligibility for expatriate benefits because of the perceived inequities and inconsistencies in the present system. While cost considerations were always important in the Fund, they should not be the most important element in the Board's deliberations. Dealing with inequity and inconsistency was more important for the staff than the small increase in cost that might result from changing the status quo.

He was willing to support any consensus that emerged, Mr. Al-Tuwaijri considered. He would emphasize the importance of having a simple, transparent, and easy to administer system. The modified INTELSTAT option would certainly not meet those objectives.

Mr. Cippa made the following statement:

All the options put on the table can be, and have been, justified on the grounds of convincing elements by previous speakers, and during the Committee meetings.

If both equity and cost considerations have to be taken into account, a compromise is necessary. In this respect, our preference would be for the solution that retains the nationality criterion, with a 50 percent scale-back of benefits for resident aliens. However, in order to reach a consensus, we are also

prepared to endorse the option based on the nationality criterion, without any reduction for resident aliens.

Mr. Dorrington stated that his chair had spoken extensively in the Committee on Administrative Policies on the subject at hand. The present eligibility criterion was at least as fair as any of the other ones. The Board should make no change unless there was a strong case for doing so, and unless the change was likely to be durable. Every attempt to address one inequity seemed to result in another one. He saw no strong case for change. The arguments remained the same as they had been before. Were there to be a change, however, it should be cost neutral. Like Mr. Murphy, he would certainly be prepared to consider all sorts of changes in the context of the overall benefits package, but addressing just one piece of it would not bring the Board any nearer to achieving its objectives in a cost-neutral way--if there were winners, there would also have to be losers.

Mr. Mohammed stated that he associated himself with the comments made by Mr. Al-Tuwaijri, especially with regard to the equity aspect and consistency of the existing system. He was willing to consider a shift to another criterion if there was consensus for such a shift.

Mr. Posthumus said that he was not convinced of the arguments to change the present system. He therefore supported the status quo.

Mr. Moss made the following statement:

As an international institution, the Fund is required to recruit staff on the broadest possible geographical basis. This requirement has been assessed most conveniently on the basis of a single and rather satisfactory criterion--nationality. Expatriate benefits must be seen as a means for all non-U.S. staff and their families to maintain connections with their home countries and cultures. Whether or not such international staff is recruited locally is a question of a different nature which should not be directly linked to the issue of expatriate benefits eligibility. The statistics in Table 4 of the supplement paper, moreover, indicate that the share of locally recruited international staff is highly variable, and thus clearly related to considerations of competence, qualifications, and the needs of the Fund. In this contrarian sense, I can fully subscribe to the staff's view that there is no legal requirement to link the issue of geographical distribution of staff with the issue of eligibility for expatriate benefits, and that the question of consistency between the use of nationality for assessing the geographical diversity of staff and the use of visa status as the basis for eligibility for expatriate benefits is irrelevant.

Linking eligibility for expatriate benefits to the criterion of residence is not as straightforward as it seems at first sight, especially not in a world of increasing international migration.

Residence may be as simple a criterion as nationality, but it certainly introduces an element of inequity among non-U.S. staff, as already pointed out by Mr. Zoccali. As to the perception of inequity between U.S. staff and permanent resident non-U.S. staff, I believe that there is more involved than just the expatriate benefits. In this connection, I was struck, like Mr. Geethakrishnan and others, by the fact that tax allowance payments granted to U.S. staff are much higher than the average cost of expatriate benefits.

I agree that this is a very difficult issue, on which reasonable people can readily disagree, as the staff paper eloquently puts it. The proof is in the finding that both the Fund Board and the World Bank Board are clearly split over this issue. However, this should not inevitably lead us to the conclusion that we had better stick to the status quo if there is a broad-based willingness to change, either to reduce inequities, to keep in line with the World Bank, or to better target the overall package of benefits. This chair would support moving back to the nationality criterion as the determinant for eligibility for expatriate benefits, but, in order not to increase perceptions of inequity, we would advocate the approach of granting half of the expatriate benefits to resident alien visa holders, as Mr. Cippa and Mr. Lanciotti have indicated. A more sophisticated system to deal with inequity perceptions would involve too high a cost in terms of loss of transparency. Nevertheless, if in order to achieve a greater degree of consensus, the introduction of additional modalities for eligibility of expatriate benefits were to prove warranted, this chair would take a constructive attitude.

Mr. Waterman stated that he favored maintaining the status quo, for reasons that had already been gone into by others. If there were to be any change, however, he would like to see it as part of a more general review of expatriate benefits and their role and effectiveness in the initial recruitment and subsequent retention of expatriate staff.

Mr. Ismael said that he could go along with the status quo.

Mr. Mozhin made the following statement:

At the May 3, 1994 meeting of the Committee on Administrative Policies, we stated our strong preference in favor of a nationality-based, rather than a visa-based, criterion to determine eligibility for expatriate benefits. Since then, our position has not changed.

We find it particularly difficult to justify the Fund's continuing to deny expatriate benefits to staff with resident alien visas, and treating them like U.S. nationals for this purpose, while the host country authorities and the Fund regard

them as foreigners for tax purposes, which means that they neither pay local income taxes nor receive tax equivalency allowances from the Fund.

Therefore, I sympathize with the resident alien staff members' views that the present system is inequitable, nontransparent, and poorly targeted. It is obvious that adopting again the Fund's traditional nationality criterion would involve additional costs. Nevertheless, any other solution would be short of a complete and durable resolution of this issue. The two intermediate options described in the staff paper, as well as the INTELSTAT option, preserve, to various extents, the perceived divisive weaknesses of the present approach, and maintain the differentiation between non-U.S. staff with G-4 visas and those with resident alien visas. Accordingly, these options, if any are adopted, will make it almost certain that the whole issue will not be laid to rest, and the Board will have to deal with it once again in the not-so-distant future, unless the Fund ceases hiring new resident alien staff altogether. For that reason, we would prefer restoring the Fund's pre-1985 nationality criterion of eligibility for expatriate benefits.

Mr. Marino stated that he saw merits in the arguments on both sides of the issue. The staff made a clear presentation of the benefits and drawbacks of each option. He was inclined to maintain the status quo, especially as the group that was complaining had joined the institution with full knowledge of the situation, as Mr. Newman had noted. Nevertheless, it was not the best administrative practice to have subgroups of staff, as tensions were created, and perceived inequities surfaced. At the same time, it was not clear that, by changing the system, the Board would move very much closer to unifying the staff and eliminating the subgroups. If there were a majority in support of the nationality criterion, he could go along with it.

Mr. Kpetigo said that he would prefer to maintain the status quo.

Mr. Yang said that he supported a change to the nationality criterion, but he could go along with the status quo.

The staff representative from the Administration Department stated that there had been a shift in the ratio of permanent resident visa holders to G-4 visa holders on the Fund staff since 1985. Permanent resident visa holders represented about 10 percent of the staff, while the percentage of G-4 visa holders had actually increased, from about 57 percent to about 60 percent. The percentage of U.S. staff from 1986 to the present had remained a constant 27 percent. Therefore, the recruitment of people with G-4 visas was rising, while recruitment of those with permanent resident visas was falling.

The reinstallation of the safeguard provision for the reimbursement of income taxes paid on a Fund salary for all staff subject to such taxes several years previously had not been an exact copy of the grandfathering arrangements that had been set in place in 1980 for the staff already on board, the staff representative pointed out. It had also been stressed that the staff would not have a permanent entitlement to the safeguard arrangement. The safeguard provision had been reinstituted because some U.S. staff were experiencing as much as a 30 percent difference between the actual taxes they were paying and the national averages that were being applied to calculate their tax allowances. Therefore, the net pay of such staff members was being reduced significantly by the large out-of-pocket expenses of the additional taxes. The safeguard had been reinstated to try to solve that problem. The Board had agreed to monitor the operation of the safeguard closely to ensure that it reimbursed people who were spending significant amounts of money for taxes out-of-pocket, but that it did not become a broad-based entitlement for all U.S. staff.

As each permanent resident visa holder resigned from the Fund, the Fund saved \$11,000, but there was no way of telling whether the replacement would be a U.S. citizen--and thus more costly--another permanent resident, or a person with a G-4 visa, the staff representative noted.

Mr. Geethakrishnan said that it appeared that the Fund had changed the rules of the game in 1992 for U.S. nationals because they had suffered large losses under the game, but it was not willing to change the rules of the game for non-U.S. nationals at present, even though some of them were suffering losses.

The Director of Administration stated that there was an important difference between the legal basis for the tax allowance system for U.S. staff and the basis on which expatriate benefits were made available or withheld. Under the Fund's By-Laws, the Fund had an obligation to compensate U.S. staff members for the tax they paid on their salaries. Over the years, the Fund had attempted to respond to changes in the tax system and adjust the methods of payment, accordingly, and to find a system that would be reasonably equitable to all the U.S. staff, and which would, on the whole, achieve the legal mandate set out in the By-Laws. That mandate had forced management to act in the case of the U.S. staff; it did not apply in the case of expatriate benefits.

Mr. Geethakrishnan replied that, given that clear mandate, he wondered why the rules for reimbursement of taxes paid had been changed in the first place--in 1980.

The staff representative from the Administration Department explained that the change from a system of full reimbursement to a tax allowance system based on average national U.S. deductions provided an allowance that was either more or less than the tax that was actually due, penny for penny, on Fund net salaries. When the change was made, all staff then being covered under the full reimbursement system had been grandfathered. The

Fund had made a commitment to them that it would always reimburse them for the full tax liability coming from their Fund income. The survey that was undertaken of U.S. staff members in 1990 showed that a fairly large percentage--20-30 percent--of those U.S. staff who had joined the Fund after the establishment of the average deduction system were being under-reimbursed, in some cases by as much as 30-35 percent. That implied a significant reduction in their net pay, to the point at which equity problems arose, because the Fund was supposed to give equal pay for equal work. The recommendation in 1992 had been to extend a form of the safeguard provision to all staff members whose Fund income was subject to taxation, but not to make a permanent commitment to grandfather those staff to cover their taxes--rather, to test and monitor the system over the succeeding several years to ensure that only bona fide under-reimbursement was being remedied. The arrangement need not be permanent, as the Executive Board had made clear at that time.

The Director of Administration added that the 1992 decision was not simply a reversal of the Board decision of 1981. The 1992 decision was a further adjustment in the system prevailing in 1992, because the system had not been achieving its objectives. The change happened to take the form of introducing a safety net similar to the safety net that had been in place for grandfathered staff members before--it was similar, but it was not exactly the same. It had also been made clear that the safety net was not to be a permanent arrangement, and that it would be liable to adjustment as the Fund responded to changes in the U.S. tax system.

Mr. Geethakrishnan said that if, legally, the Fund was required to pay the full tax liability of all the U.S. nationals, then it should do so. It appeared that the Fund was legally required only to pay an allowance that was reasonably related to the tax liability on the staff member's Fund salary. The system that had been set up to do that had been done away with because some staff members were being hard hit by it. By the same token, only 133 staff members were being adversely affected by the Fund's policy of basing the criterion for eligibility for expatriate benefits on visa status rather than nationality. The amount that would be required to solve that inequity was much less than the amount that had been required to solve the inequity problem for U.S. staff members whose Fund salaries were taxed. Perhaps the criterion could be changed, with the provision that it might not be on a permanent basis, and with the understanding that it would be reviewed.

Mr. Newman asked whether the Fund paid tax allowances to staff other than U.S. nationals.

The staff representative from the Administration Department replied that the Fund paid tax allowances to staff in cases in which the country of the staff member did not participate in the agreement to exclude Fund staff from taxation. For example, the Fund paid a tax allowance to French nationals working in France.

Mr. Newman said he wondered what criteria other international organizations used to determine eligibility for expatriate benefits. It was his understanding, for example, that the United Nations used visa status, like the Fund.

The staff representative from the Administration Department remarked that the international organizations with which she was familiar used essentially the same criteria as the Bank and the Fund.

The Acting Chairman commented that the payment of tax allowances was specified in the By-Laws, and the appropriateness of the allowances paid needed to be judged on the basis of whether or not the objective of the allowance was being achieved.

The Director of Administration considered that the tax allowance system confronted a number of difficult issues. For example, the question arose of how to determine the amount of tax that was payable in respect of the Fund-paid portion of a staff member's income if there were other sources of income. Other questions included the extent to which the Fund should take into account the various possibilities for reducing the income tax due, and whether it should reimburse on the basis of the actual tax paid, regardless of whether or not the staff member had maximized or minimized his tax by taking advantage of allowable deductions, or whether it should reimburse on the basis of average deductions, which had been the basis of the system until 1992. With an average deductions-based system, the immediate problem became what to do when the tax system was changing, as it had changed in recent years, and when no information on average deductions under the new tax system was yet available.

Mr. Geethakrishnan said that he perceived a difference in the treatment of U.S. and non-U.S. staff.

Mr. Newman observed that he had believed that the purpose of the current meeting had been to answer a question that had been put to the Board by the World Bank, namely, whether or not the Fund would be interested in moving to the INTELSAT option as the basis for determining eligibility for expatriate benefits. He had heard no Director expressing a preference for that option. If there were other issues connected with that of expatriate benefits or other elements of the compensation system, he would be willing to discuss the whole panoply of issues together, as other speakers had also suggested. The narrow question the Board had been asked to comment on at present was whether or not to move to the INTELSAT option.

The Acting Chairman said that he agreed that no one had expressed a preference for the INTELSAT option, and that would be conveyed to the World Bank President. The consensus appeared to be in favor of the current system. The Bank Board, of course, would take its own decision on the matter.

The Executive Directors agreed not to change the eligibility criteria for expatriate benefits for the time being.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/94/42 (5/11/94) and EBM/94/43 (5/16/94).

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAM/94/76 (5/10/94) and EBAM/94/77 (5/12/94) is approved.

APPROVAL: March 16, 1995

LEO VAN HOUTVEN
Secretary

