5. Liberia - 1989 Article IV Consultation - Postponement; and Overdue Financial Obligations - Review Following Declaration of Ineligibility - Postponement. . . .Page 41
6. Nicaragua - 1989 Article IV Consultation - Postponement. . . .Page 42
7. Approval of Minutes. . . . . .Page 42
8. Executive Board Travel . . . . .Page 42
9. Travel by Managing Director. . . . . .Page 42

Also Present

IBRD: P. Miovic, Latin America and the Caribbean Regional Office. Staff Association Committee: H. Flinch. Administration Department: G. F. Rea, Director; H. J. O. Struckmeyer, Deputy Director; D. A. Anderson, D. S. Cutler. African Department: S. J. Stephens. Exchange and Trade Relations Department: E. Brau, J. Clarke, G. R. Kincaid, J. V. Valderrama. Fiscal Affairs Department: R. Hemming. Legal Department: F. P. Gianviti, General Counsel; R. C. Effros, J. W. Head, J. S. Powers, J. V. Surr. Secretary's Department: C. Brachet, Deputy Secretary; J. W. Lang, Jr., Deputy Secretary; B. R. Hughes. Treasurer's Department: D. R. Hutton. Western Hemisphere Department: M. Caiola, Deputy Director; L. A. Cardemil, J. Fajgenbaum, M. E. Hardy, P. C. Leme, L. L. Perez, C. M. Reinhart. Internal Auditor: R. Noë. Advisors to Executive Directors: F. E. R. Alfiler, M. B. Chatah, A. Gronn, Z. Iqbal, P. O. Montórfano, A. Napky, B. S. Newman, D. Powell, F. A. Quirós, A. Raza. Assistants to Executive Directors: S. Appetiti, H. S. Binay, B. A. Christiansen, H. E. Codrington, E. C. Demaestri, J. Gold, A. Hashim, K. Ichikawa, L. I. Jácome, C. J. Jarvis, C. Y. Legg, N. Morshed, A. Rieffel, H.-J. Scheid, J.-P. Schoder, G. Serre, M. J. Shaffrey, J. C. Westerweel.

1. PERU - REPORT BY DEPUTY MANAGING DIRECTOR

The Acting Chairman reported that following discussions the previous week between the staff and Mr. Salinas, Peru's external debt negotiator, the Peruvian authorities had agreed to receive a mission to conduct an Article IV consultation in January 1990, which would also begin discussing a policy framework paper and an economic program to enable Peru to meet its financial obligations to the Fund. Peru was expected to make a payment to the Fund by the end of the day of SDR 32.8 million, covering obligations that had fallen due since the initiation of the conversations with the authorities in September 1989. Henceforth, Peru had undertaken to remain current with obligations as they fell due.

The understandings that had been reached with Peru represented a first step in a process based on the collaborative approach, the Acting Chairman went on. The process was aimed at resolving Peru's economic difficulties, clearing its arrears to all multilateral institutions, and normalizing its relations with its external creditors. The understandings had been incorporated in a working document that spelled out the desired characteristics of Peru's future program, and the outline of a process for resolving the problem of Peru's arrears to multilateral organizations. The working document would be circulated to Executive Directors for their information. The External Relations Department would issue a brief press release once the payment from Peru was received, noting that Peru's outstanding arrears would be frozen at the level of the end of August 1989 and that Peru had undertaken to remain current with future obligations to the Fund.

In the discussions that were taking place, the Acting Chairman concluded, the Fund staff had also emphasized the importance of Peru resuming payments to the World Bank and the Inter-American Development Bank. There had been preliminary discussions between Peru's external debt negotiator and the World Bank, and he hoped that the World Bank would be able to participate in the forthcoming mission. The Managing Director was satisfied with the first step the Peruvian authorities were taking toward resolving Peru's economic problems in a cooperative manner. He hoped that the forthcoming discussions in Lima would help to establish a policy framework which could serve as the basis for the resolution of Peru's economic difficulties, and which could underpin a process of normalization of Peru's relations with its creditors.

Mr. Feldman said that he confirmed what the Acting Chairman had reported. He had just spoken with Mr. Salinas, who had confirmed that arrangements had been made in Lima to make the first payment in the following few hours.

Mr. Al-Jasser said that he wished to welcome the initiative, which was a break with the past. It was heartening that Peru was normalizing its relations with the Fund for the sake of its own economy. He wished to encourage the Peruvian authorities to persevere in the adjustment process, so that Peru could take up once again an active membership in the institution.

2. U.S. FEDERAL ESTATE TAX - SAFETY NET

The Executive Directors considered a staff paper on implications for the staff of recent changes in U.S. Federal estate tax law (EBAP/89/281, 11/22/89; and Sup. 1, 12/8/89).

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

> On behalf of the Staff Association, I would like to thank you for the opportunity to address the Board on the issue of the implications of changes in U.S. Federal estate tax law. I would like to commend Management and the Administration Department for this initiative, which provides temporary, but only partial, protection from the discriminatory legislation that was introduced by the host country in October 1988--the Technical and Miscellaneous Revenue Act of 1988 (TAMRA).
>
> The Staff Association appreciates the intentions of the Administration's proposal, which will provide fairly comprehensive protection in the case of the death of most staff members. However, I would like to emphasize that many staff members are still left at substantial risk of discriminatory treatment compared with U.S. citizens, particularly in case of the death of a spouse. I believe that the cost of providing equal protection for staff members and their spouses would not be very high in the short run, and that equal treatment should override other considerations with respect to the safety net. The safety net should be designed to offset completely the discrimination that results from TAMRA. I would urge Executive Directors to adopt the estate tax safety net today, but, without the ceilings that result in unequal treatment, which could be particularly harmful to lower-paid staff members. We would also like to see retirees included under the safety net to give them time to adjust to the new discriminatory environment. In case the U.S. legislation is not repealed, the Fund should adopt longer-term measures to assure fair treatment of all staff.
>
> I would like to mention that some staff members are concerned about the possibility of being tied up in court procedures if the Internal Revenue Service should choose their case for obtaining guidance for the implementation of TAMRA. I hope that the Fund, in due course, will assure staff members of its willingness to support them if this were to happen.

> I would like to ask Executive Directors to support the efforts to repeal the October 1988 legislation, both in their direct contacts with U.S. authorities, and through their contacts with their national authorities. The only reasonable and satisfactory solution in the longer run would be a repeal of the law, which would require a joint effort at all levels.

Mr. Warner commented that he had the strongest conviction that the Internal Revenue Service had no intention of using the cases of Fund staff members as test cases for the application of the provisions of TAMRA. That being said, he would wish the Chairman of the Staff Association Committee to withdraw his comments on that matter.

The Chairman of the Staff Association Committee said that that point had been made to the staff, but it was difficult to convince the staff that such a possibility would not arise. It was understandable, that in for example, the case of a terminally ill spouse the TAMRA provisions would increase the level of anxiety of a staff member. Even assuming that the Internal Revenue Service would not pursue cases with Fund staff members, an indication from the Fund that it would support staff members were such cases to arise would be a completely costless gesture that would reassure the staff.

Mr. Warner said that although some legal questions as to the implementation of TAMRA remained, he did not wish the position of the U.S. Government to be misconstrued. It was clear that the U.S. Government would not sanction the formulation of test cases against Fund staff members.

Mr. de Groote commented that the Chairman of the Staff Association Committee had raised some pertinent issues about the implications of the new legislation for staff members and retirees. However, he had not mentioned the staff of Executive Directors' offices, many of whom would be affected in the same way as Fund staff.

The Chairman of the Staff Association Committee replied that he had intended to include staff of Executive Directors' offices in any safety net that the Board might approve.

Mr. Yoshikuni asked whether other international organizations, such as the World Bank and the United Nations, had considered the ramifications of TAMRA. Also, in the event that certain provisions of TAMRA were not repealed because of a delay in tax administration, he wondered what would be the accounting implications of such a delay.

The Director of the Administration Department stated that toward the end of November 1989 the U.S. law on estate taxes had been changed to some extent. The impact of those changes was as yet unclear, but a potentially important one would appear to empower the Secretary of the Treasury to make special provisions regarding pensions that might be valuable, although they would not resolve the problem entirely.

If the Board were to adopt the safety net proposals, the Director went on, the Fund's potential liability in the event of a travel accident involving a staff member or members would be of concern, because the amount of insurance that would be paid would be considerable, and consequently, the amount of estate tax due on that amount would be considerable as well. That being said, it might be prudent for the Fund to purchase some additional insurance to cover such a contingency. The staff had found that the premium for such additional insurance was reasonable.

As an illustration of the potential adverse effects of the 1988 TAMRA, the Director continued, he would like to describe an actual recent case of the estate of a deceased staff member. He had the permission of the estate to do so. A senior non-U.S. staff member had died early in 1989, leaving a widow, also a non-U.S. citizen, and two daughters over the age of dependency, but still relying upon their father's estate financially. The assets left to the widow, which were in the taxable estate, consisted of equity in the house of $245,000, personal property of about $50,000, and life insurance proceeds of $200,000--a total of $495,000. Because that sum was below the exemption of $600,000, estate tax would not have been payable if that had been the sole basis for the calculation of the estate's value. However, in addition to those assets, the widow would receive a pension from the Fund and from the Central Bank which had formerly employed the staff member. The total calculated present value of those pensions was about $600,000, giving a taxable estate of about $1 million. The estate tax payable by the estate would be $216,000, reducing the widow's share of the estate by that amount. That result obtained because the pensions were given a present value and treated as a capital amount for U.S. tax purposes. In effect, the tax was chargeable against the future flow of income arising from the pensions. To pay the estate tax, the widow would be forced to commit the full amount of the life insurance proceeds and borrow money against the value of the house. In his view, that case illustrated well the adverse implications of TAMRA for the non-U.S. spouses of Fund staff.

The Staff Association had proposed that the financial limits on the safety net be removed and that the Fund accept an unlimited liability to pay the full amount of estate tax arising from the death of a staff member or spouse, the Director recalled. The Staff Association had also suggested that the interim safety net be extended to cover retirees. The Administration Department had considered both of those possibilities, and would not be averse to either of them. However, it had been felt that it would be prudent for the Fund to limit its liability, while admitting that those limits were somewhat arbitrary. Also, while the Administration Department sympathized with the position of retirees, no convincing case had been made for extending the safety net to them, since their decision to retire in the United States had been entirely their own, and presumably they would have accepted the risks of changes in U.S. law. That was not the case for active staff members, whose sole reason for being in the United States was their employment with the Fund, the headquarters of which was located there. However, if there were strong support in the Board to extend temporary protection to retirees, the Administration Department would not object.

He did not believe that the possibility of a test case involving the estate of a Fund staff member being brought before the Commissioner of Internal Revenue should necessarily be excluded, the Director stated. If the case was of general interest to all staff because it raised some points which might apply to others, there would be a case for the Fund to share the legal costs with the staff member's estate. That was not to suggest that the Internal Revenue Service would single out and pursue staff members or their estates; rather that, if an issue of interest to a number of staff members arose which could only be clarified by a ruling of the Commissioner of Internal Revenue, the Fund would consider sympathetically helping to cover the legal costs.

To his knowledge, the Director continued, the Fund was taking the lead among the international organizations in dealing with the issues arising from TAMRA, although there was evidence of increasing concern on the part of other international organizations located in the United States. The Fund had been working particularly closely with the World Bank, which was ready to join with the Fund in attempting to clarify the legal situation, and to set up seminars for the staff on the details of the legislation. The World Bank was awaiting with interest the outcome of the Fund Board's discussion on the safety net proposal, which would influence the World Bank's own recommendations in that regard.

The Administration Department was proposing that all assistance under the safety net take the form of an interest-free demand loan made to the surviving spouse, or, in certain circumstances, dependent children, the Director stated. At present, the Administration Department did not propose to address the issue of repayment. It was to be hoped that, as a result of changes in the law, even if some estates were forced at present to pay estate tax, a refund subsequently might be obtained. In that case, the Fund would recover the loan without having to regard it as more than a temporary outlay. If the law was not changed, or if no refunds were allowed, the Fund would need to take extreme care in how it expressed its intentions about the loan at present, as otherwise the Fund might inadvertently add to the estate tax or income tax liability of the recipients of its assistance. The Administration Department therefore preferred to keep the decision as to repayment undetermined. However, once the safety net was in place for some time, and once its cost was known, the Administration Department would make a firm recommendation to the Board on the disposition of the loans. The Fund might, for example, forgive the loans, making them outright grants; that would lead, however, to a gift tax liability for the recipients, and then the question of whether, in addition to paying the estate tax, the institution should also cover the cost of the consequential gift tax, would need to be addressed. Happily, those complexities were irrelevant at present and could be dealt with later, in the light of experience with the safety net.

The Secretary said that the Joint Committee of Governors on the Remuneration of Executive Directors and their Alternates was the channel for the review of benefits of Executive Directors and Alternates. Any changes in benefits that were agreed or contemplated for the staff were brought to the Committee's attention. The Committee would shortly have its first meeting for the current year, and would be informed of the status of discussions of the safety net proposal, in the context of the review of benefits of Directors of the Fund and the Bank.

Certain legal matters might pertain to Executive Directors which might not pertain to the staff in general, because of the visa status of a number of Directors, the Secretary pointed out.

Advisors to Executive Directors served under the same terms and conditions as Executive Directors, the Secretary concluded. The extension of the safety net to Advisors would be for consideration by the Executive Board's Committee on Executive Board Administrative Matters, subject to prior approval of the safety net for Executive Directors. While assistants to Executive Directors were not considered staff members, in the past the Executive Board had provided for the extension of staff benefits to them.

Mr. Fernando observed that although the reconciliation legislation for TAMRA that was passed in November 1989 could have potential importance for staff classified as residents, the treatment of nonresidents appeared to be unchanged. TAMRA had increased the tax liability of nonresident estates via a sharp increase in the tax rate, and the reconciliation legislation had not changed that. He wondered why the reconciliation legislation assisted staff members classified as residents, but not nonresidents--fixed-term nonresident staff members, for example.

The Director of the Administration Department said that the reconciliation legislation did not introduce any substantive changes in the legal status of nonresidents. TAMRA had substantially increased the tax liability for nonresidents above that which had existed previously. The only exemption currently available to a nonresident on a U.S. taxable estate was $60,000, which was insignificant in light of current costs and values. That was offset to a certain extent by certain items which could be excluded from the taxable estate of a nonresident, such as insurance proceeds and pensions. The staff had taken those factors into account. The most serious concern of a nonresident staff member would probably be the equity in a house purchased in Washington to serve as the family residence, which would almost certainly exceed the exemption of $60,000. The recent reconciliation legislation appeared to offer no relief for such a situation.

A staff representative from the Legal Department stated that the most important of the revisions in TAMRA that had been effected via the budget reconciliation act was the power given to the Secretary of the Treasury to issue regulations that would permit the treatment of distributions from the Fund's Staff Retirement Plan as a qualified domestic trust. The staff would have to await those regulations to determine precisely what tax treatment might be authorized, which might take some time.

The reconciliation legislation also permitted the transfer of both probate and nonprobate property to a qualified domestic trust after the death of the first spouse, the staff representative continued. TAMRA had authorized only the transfer of nonprobate property following the death of the first spouse. Probate transfers were those effected via the will, whereas nonprobate transfers occurred outside of the will--the payment of insurance and distributions from the Fund's Staff Retirement Plan, for example. Nonprobate property often constituted a substantial proportion of the total estate.

Another change would permit distribution without estate tax liability from a qualified domestic trust in the case of hardship, but there was no legislative history defining "hardship," or whether it would be interpreted broadly or narrowly, the staff representative observed. The staff's assessment would depend upon the regulations that were finally elaborated.

The reconciliation legislation liberalized the tracing rules with respect to the period of time that needed to be applied to joint property, and there were some additional technical changes concerning the recognition of treaties and their provisions, for example--which had been in doubt because of TAMRA, the staff representative concluded. Although those changes might be helpful, they could not be properly evaluated until some experience had been gained in practice. Despite the reconciliation legislation, however, the treatment of an estate in which the surviving spouse was a U.S. citizen would still not be the same as one in which the surviving spouse was a non-U.S. citizen; the safety net would attempt to equalize the treatment of the two cases.

The Director of Administration commented that for incoming staff the change in the tracing rules would only be helpful if the property had been acquired and held jointly before arrival in the United States; it would be of no value for property acquired after arrival. Two of the other changes were technical--concerning how to include property in a qualified domestic trust, and what could be done with it once it was there. A qualified domestic trust was a cumbersome instrument which he would advise most people to avoid. He did not regard the minor improvements in the technical arrangements relating to the qualified domestic trust--which effectively only deferred estate tax liability--as being helpful at all.

One change effected by the reconciliation legislation might be quite valuable, however--the authority given to the Secretary of the Treasury to write regulations which effectively appeared to exempt pensions from estate tax, the Director went on. One of the key problems with TAMRA--the treatment of future pension payments as a capital asset for estate tax purposes--would then be solved. In the case he had referred to, for example, no estate tax would have been payable if such an exemption had existed. However, even with such an exemption, the problems of the tax situation for residents in respect of certain payments from the Fund and the limited exemption available to nonresidents would remain.

Mr. Grosche commented that the proposed safety net provisions appeared to protect nonworking spouses of staff members who died while in the service of the Fund, but they did not accord the same degree of protection to a surviving staff member on the death of the spouse.

The Director of Administration explained that if a married staff member with a non-U.S. spouse died, the Fund would be prepared to assist with the payment of estate tax up to the amount of tax that would be payable on an estate of $600,000--the amount that could be excluded from the calculation of the tax--plus the amount of the Fund pension and the Fund insurance payments, on which a considerable amount of tax would be due. That imposed a ceiling on the amount of the Fund's possible liability. At least for the interim period, the safety net would also extend to a situation in which the spouse, not the staff member, died, because the spouse had been brought with the staff member to the United States, and logically therefore the Fund should be prepared to extend some protection. With respect to the death of a spouse, however, the Fund could have no knowledge of the extent and characteristics of the financial assets accruing on death. The surviving spouse of a staff member would receive a pension under the Fund's Staff Retirement Plan; but the spouse might also have his or her own pension arrangements, with benefits to the surviving Fund staff member. Similarly, the insurance arrangements that would apply on the death of the spouse would also not be known to the Fund. Although the spouse would not have participated under the Fund's Group Life Insurance policy, he or she might have had private insurance, or insurance arranged by his or her employer, which might be payable to the surviving staff member. Partly because the Fund would be ignorant of the likely magnitude of those amounts, the Administration Department had been worried about the possible implications for the Fund of a commitment to cover whatever tax liability might arise in the spouse's estate under his or her pension and/or insurance arrangements. For example, the spouse might have had an insurance policy of $1 million--much higher than permitted under the Fund's Group Life Insurance policy. The Administration Department also felt that the Fund had less of a moral responsibility in the case of the death of a staff member's spouse, because the staff member himself would continue to be employed by the Fund, could not be considered to be destitute, and was not relying entirely upon the spouse's property.

For all those reasons, the Director concluded, the Administration Department had believed that a lower--although arbitrary--ceiling on the Fund's potential liability should be imposed under the safety net in the case of the death of a spouse. In effect, the Administration Department was suggesting that the Fund should cover tax on an estate of up to $800,000, of which $600,000 would be exempt, therefore, the limit of taxable liability would be the tax on $200,000. He recalled that the Chairman of the Staff Association had suggested that such an arbitrary ceiling not be imposed, but that the Fund simply match as closely as possible the situation in which a staff member died and one in which the spouse died.

Mr. Kabbaj inquired as to whether any solution to the difficulties in the case the Director of the Administration Department had described earlier might be secured via a tax treaty between the United States and the country of the deceased staff member. More generally, he wondered how bilateral tax treaties had been affected by the TAMRA legislation.

The Director of Administration said that a tax treaty did exist between the country of the deceased staff member and the United States, so it was possible that the problem would be solved. However, he was not sure that that treaty was applicable, or whether it was permitted to be applicable under the terms of TAMRA, or whether the reconciliation legislation might have had some implications for the case. The reconciliation legislation had preserved some treaty provisions which would have been overridden otherwise.

The widow could reduce the tax liability in various ways, the Director pointed out. If a double taxation treaty existed, that might be helpful for this purpose. There was also the possibility of establishing a qualified domestic trust and transferring some assets to it, but under this approach some assets would be taken out of the widow's hands.

A staff representative from the Legal Department said that the provisions of TAMRA had left in doubt the validity of provisions in tax treaties that had been agreed between the United States and some 15 or 16 other countries. The question arose as to whether TAMRA worked to supersede or override those treaty provisions. The reconciliation legislation made clear that those provisions were not overruled in all cases by TAMRA.

The Director of the Administration Department said that because the Administration Department recognized that there were ways to reduce the amount of estate tax payable, paragraph 4 of the proposed policy statement on the safety net provided that the Fund would expect the estate and the beneficiaries of potential Fund assistance to take reasonable steps to minimize their estate tax liability--to take advantage of any special tax treaty, for example. In certain circumstances, setting up a qualified domestic trust and transferring some assets to it might be desirable. However, because he had strong reservations about the feasibility in practice of a trust and because there were so many unresolved questions about it--particularly with regard to the transfer of pensions to it--he would not intend to require such a step as a matter of course.

The staff representative from the Legal Department, responding to a question from the Acting Chairman, said that the calculation of the present value of pensions and insurance would be in gross terms, not net of taxes.

Mr. Kabbaj said that the case at hand surprised him, as it implied that the provisions of a national law adopted unilaterally could override international treaties. He had understood that a country would have to renegotiate treaties with the other parties before implementing such legislation.

The staff representative from the Legal Department said that the rules differed from country to country. In the United States, it was possible for a subsequently enacted law to take precedence over a previously agreed treaty. However, the law might indicate that Congress specifically recognized provisions in earlier treaties, and wished them to continue in effect, despite the language of the law. The new budget reconciliation act appeared to attempt to clarify that, which had been in doubt as a result of TAMRA. TAMRA would have overridden some of the treaty provisions completely.

Mr. Evans commented that the types of changes introduced by TAMRA did not appear to him to have been entirely novel. He wondered whether the staff was aware of other laws in other countries under which residents and nonresidents were treated differently in respect of taxes, and the net present value of pensions was included in the tax base. Were those provisions general features of estate duties in other major countries? That question was relevant in making a judgment on the temporary nature of the safety net, and also with respect to the question of including retirees under it or not.

The Director of the Administration Department said that the staff had looked into the practice in other major industrial countries, and a marital deduction of some kind--usually quite generous, and sometimes complete--was a common feature of estate tax or death duty laws. In recent years, there had been far less reliance on death duties in many countries, and a shift to other forms of raising revenue. As a result, the ceilings on amounts exempt from death duty had been raised considerably in most major industrial countries over the previous 15 years or so. The United States law was novel in that a distinction was drawn solely on the basis of nationality, so that, in the case of two residents of a country, an exemption available to one was not available to another in exactly the same situation except for nationality.

The staff representative from the Administration Department said that the World Bank had looked into the matter of the inclusion in the tax base of an estate of the net present value of an annuity to a surviving spouse, and had found no tax legislation in any other country with that provision. It might be observed that it was not really there in U.S. tax legislation either, because although the present value of the pension was included in the determination of the estate, as long as the pension went to a surviving U.S. spouse it was treated as part of the marital deduction. The U.S. authorities thus seemed to recognize that, by treating a pension to a spouse as part of the marital deduction, a surviving spouse's pension should not be taxed. In fact, the element of discrimination against noncitizen spouses which TAMRA introduced appeared to run counter to the principle that the U.S. tax authorities had themselves embraced.

Mr. Grosche stated that after careful consideration, his authorities had concluded that TAMRA was inconsistent with the bilateral treaty between the Federal Republic of Germany and the United States on the avoidance of double taxation on estates. His authorities were about to make an intervention with the U.S. authorities with the aim of repealing TAMRA in Congress. In that connection, although he did not know whether the recent reconciliation legislation took care of his authorities' concerns, that legislation would be looked at very carefully.

Mr. Kyriazidis said that in the case of a unilateral legislative act on the part of one country which abolished a treaty or part of it, the renegotiation of the treaty or the affected parts would be necessary. Treaties on the avoidance of double taxation would have to be renegotiated if they were modified unilaterally by the United States. In that respect, he understood the position of the authorities of the Federal Republic of Germany in wishing to have TAMRA repealed, and failing that, to renegotiate the double taxation treaty. He had been puzzled by the fact that, in the case referred to earlier, the pension to be paid to the spouse by the Central Bank would be included in the capitalization of the estate for tax purposes. It appeared to him that that was a clear case of double taxation, which he would have thought the double taxation treaties would have prevented.

The Director of the Administration Department pointed out that the inclusion of the foreign pension paid by the Central Bank arose logically from the proposition that U.S. federal estate tax was charged on the worldwide estate of a deceased resident. Therefore, to the extent that the estate was considered to include the present value of any survivor's pension, payable on the death of the deceased, then the worldwide estate would logically also extend pensions payable outside the United States.

Mr. Kyriazidis commented that the general principle on which the avoidance of double taxation was based was that the government under the jurisdiction of which the income arose had priority in taxing it. In that respect, the present case seemed to run completely against the idea of the avoidance of double taxation.

The Director of the Administration Department observed that if the government did not tax pensions in its own country, the question of double taxation would not arise. It also needed to be borne in mind that income tax on both of those pensions would be payable by the surviving spouse, in spite of the fact that estate tax would have already been paid on the supposed capital value of those pensions.

Mr. Fogelholm stated that he wished to hear the staff's rationale for limiting the safety net's duration only until the end of 1990, rather than leaving it in place until the underlying problems were resolved.

The Director of the Administration Department said that the Administration Department had proposed that the policy remain in effect until the Board decided to terminate it, provided that it should not be terminated before December 31, 1990. The Board would not be required to terminate it on that date. The purpose of setting a termination date, before which it could not be terminated, was to assure the staff that they would have enough time to restructure their financial affairs and conduct some estate planning, to make arrangements to minimize the estate tax liability or obtain legal counsel. The Administration Department was preparing a program to help staff with estate planning, but it would take time to implement this. He hoped that TAMRA might be changed in the meantime; indeed, there appeared to have been a move in that direction already, but it was not clear whether it would be helpful or not. The Administration Department believed that it should try to find a longer-term solution to the problem than that represented by the safety net, which had been cobbled together in a rather arbitrary fashion.

Mr. Fogelholm said that he suspected that a more permanent solution would imply a change in the law. The other measures, such as information to the staff and legal advice, would not solve the underlying problem, and he was glad to hear that the intention was to maintain the safety net until a more permanent solution was found.

Mr. Warner said that he believed that the long-term solution the Director of the Administration Department and the General Counsel said they would be pursuing was the most appropriate course at present. A wide-ranging discussion of the broad issues that a number of Directors had touched on--bilateral treaty relations, the interpretation of legislative intent in the United States, inter alia--could be unending. He did not subscribe to all that the staff representative from the Legal Department had said about the TAMRA reconciliation legislation, which had been intended to rectify what appeared to be the most inequitable areas of TAMRA. Although the possibility of solving the problems through legislation could not be ruled out, it was unlikely that the U.S. Congress would be focusing on those issues in the near term.

With respect to the safety net principles, Mr. Warner went on, the Board might be rushing to take action at a time when further study might instead be helpful. He understood the moral and financial problems faced by the staff, and he would not oppose the safety net, accordingly. However, he did not believe that the effectiveness of the reconciliation legislation's amendments should be underestimated, particularly with respect to the powers which it had conferred on the Secretary of the Treasury. In that connection, it would be appropriate to study carefully what may have been TAMRA's legislative intent, and that had been behind his comment about using the estates of Fund staff members as test cases. The Internal Revenue Service was careful about interpreting legislative intent. In conferring upon the Secretary of the Treasury certain powers, the reconciliation legislation's legislative intent was clear--an attempt to alleviate the very problems Executive Directors had identified. The question of how "hardship" would be interpreted was an area of interest as well.

A detailed discussion of all the issues would not help in focusing on the appropriate course of action at present, Mr. Warner commented. It might be better if the staff could indicate to the Board those issues it intended to pursue with the U.S. authorities. Following the meeting, he would speak with the Counsel of the United States Treasury to set up a conference between the Fund, the Bank, and the Treasury authorities as soon as possible. He would recommend that the issues be pursued jointly, to save time and effort. He wished to stress that Directors should not anticipate problems which might not in fact exist; the best hope was to pursue the matter with the Secretary of the Treasury, in the light of the authority which the reconciliation legislation had conferred upon him.

The Board should discuss the safety net proposals in the context of the assumption that the U.S. authorities would begin a meaningful dialogue with the Fund to find an equitable solution to the problem as soon as possible, Mr. Warner concluded.

Mr. Fernando said that he agreed that it might not be helpful to concentrate on the details. The Board should focus on trying to eliminate the possibility of discrimination in the treatment of U.S. and non-U.S. staff members.

Mr. Enoch remarked that, given the uncertainties which the Director of Administration had alluded to, he wondered how long it would take before the Secretary of the Treasury could respond to the staff's concerns. With respect to Mr. Grosche's point about the protection that would be accorded to a staff member when the staff member's spouse died, although he understood the reasons that had been given by the Director of Administration for lesser support than when the staff member died, he wondered whether the $200,000 limit that had been calculated would be sufficient. For example, in the case of a nonresident staff member who had lived in the United States for a number of years, any property acquired in the United States might be liable for an estate tax in excess of $200,000. While he had no problem with the Fund acquiring additional insurance to protect itself from making large payments under the safety net, the premium amount of $70,000 appeared to be on the high side.

The Director of Administration replied that the reconciliation legislation for TAMRA had only been enacted on November 24, 1989, and there had not been much time to pursue the issue with the U.S. Treasury.

One could not know whether assuming a value of $800,000 for the estate of a spouse--the amount up to which the Fund's safety net would apply--was appropriate, the Director stated. In his view, in most cases--especially if it was the wife who died--the larger income was likely to come from the staff member. Unless the wife brought to the marriage a substantial amount of personal property, he doubted that her estate would be in excess of $800,000. However, in a case in which the spouse who died was the main income earner, the situation could clearly be different. That would be of particular concern to members of the support staff, a number of whom were married and were providing only the second income for the family, not the first. The Fund would have no idea of the value of the estates which might accrue to support staff. Nevertheless, he would have thought that an estate of $800,000 acquired by a serving staff member--even one who was not highly paid--would have been reasonably sufficient for the needs of the surviving staff member and family, especially in light of the fact that he or she would continue to be paid by the Fund and would have assets coming from the Fund.

Mr. Enoch said that he was thinking more particularly of nonresidents, where the total limit would be $260,000. One might envisage that if property were held by a nonresident in the United States, the estate tax that would be attached to that property would exceed that amount.

The Director of Administration said that that could be the case. However, the staff member could probably demonstrate that he or she had contributed to the purchase of the family home, which was likely to be the main asset pushing up the calculated value of the estate. Assuming that the equity in the house was $300,000 or $400,000, a fairly large margin remained that would be covered by the safety net. Nevertheless, he agreed that it might be appropriate to reserve the possibility of returning to the Board with an interim report, assessing whether or not the limits were insufficient based on experience. He believed that it would be necessary to deal flexibly with the issues on a case-by-case basis, within the general guidelines that had been proposed.

The staff representative from the Administration Department said that the staff had investigated quotations from the insurance company that carried the Fund's travel accident policy, and the cost of increasing the insurance to five times salary would increase the Fund's annual premium by about $70,000. From the quotations, it appeared that the increases in the costs of added insurance were broadly in proportion to the added coverage.

The Director of Administration pointed out that the figure of $70,000 referred to complete coverage for the Fund, for all of its staff members. Even if all of the Fund staff members died in an accident in one year, the Fund would still have to pay out only $70,000 in premiums. In his view, given the potential costs to the Fund from an accident, the amount of insurance premium seemed rather low.

Mr. Grosche stated that he wished to thank the management and the staff for taking the lead in addressing the potentially serious problems for the Fund's staff members of the TAMRA legislation. The paper described very clearly the implications of changes in U.S. federal estate tax law. Obviously, the best solution would be to change the law again, with the objective of treating expatriate staff like U.S. nationals, as had been the case before TAMRA. He was glad to note from the supplement to the staff paper and from Mr. Warner that some changes had been made to that law, and he hoped that the Secretary of the Treasury would exert his powers to the fullest extent to alleviate the situation. At the same time, until everything was settled and the situation returned to normal, he wholeheartedly supported the approach that had been suggested by the staff, including the safety net for Fund families for an interim period, at least until the current situation was clarified and the staff had had an opportunity to reorganize its affairs.

He considered the policy statement on the estate tax safety net to have been carefully worked out, and he could endorse it, Mr. Grosche concluded. He would also encourage management to arrange for a special accident insurance policy that would cover the Fund against the risk of an unusually high cost of the proposed safety net in the case of accidental death of staff members. He would urge management and staff to look again at the issue of whether a staff member surviving his or her spouse should be accorded protection equal to that given to a staff member's surviving spouse. He supported the proposed course of action.

Mr. Hogeweg said that he regretted that it had been necessary for the Fund to design a safety net to protect the staff from the adverse discriminatory impact of TAMRA on expatriates. The necessity to do so reflected the fact that the consequences of the legislation for non-U.S. citizens working with international organizations located in the United States--who lived in the country only because the organization for which they work was located there--had not been thought through. The U.S. authorities should undo the damage as soon as possible, and it seemed that such action as would be required would go much further than the changes that have been announced recently.

He certainly agreed with the policy on the safety net as it had been drafted, Mr. Hogeweg added. He noted that, within some limits as to the personal wealth not connected to Fund pensions or life insurance payments, the safety net tried to simulate for the Fund's expatriate staff the situation that existed before the enactment of TAMRA. The staff paper mentioned that anomalies and problems had existed previously, and he would certainly encourage the United States, when reconsidering TAMRA, to look at those issues, too.

The safety net was designed as an interim measure to be in place at least until the end of 1990, Mr. Hogeweg observed. The paper mentioned, as considerations which would weigh in the determination of how long the safety net should remain in place, the availability of advice to staff and the elimination of uncertainties, especially with respect to the resident or nonresident status of G-IV visa holders. He would stress that neither advice nor the elimination of uncertainties were a solution to the inequities which had been created. Therefore, he interpreted the "interim" character of the safety net to mean, effectively, until the legislation was undone. If certain ways of managing an estate, which did not incur costs to the staff member or impose undue constraints on how the estate could be disposed of, were to be found which would limit the tax liability, so much the better, but even in that situation, some sort of safety net would be needed, in his view.

The problem had been created by the Fund's largest shareholder, and host country, Mr. Hogeweg commented. It would seem equitable then that the United States should make a special contribution toward the costs of the safety net, taking into account the fact that it has a responsibility toward the people who came to the United States to work in the Fund. The U.S. government surely realized that, at the margin, the charges paid to the Fund by the users of its resources paid for the Fund's administrative budget.

Mr. Evans said that he supported the measures that the staff had proposed in the paper, including the safety net. Mr. Warner's comments appeared to indicate that the safety net would need to be in place for some time. However, it might need to be used less often than some Directors feared at present, especially once the latest provisions modifying TAMRA were put into practice, and in light of the authority that would be conferred upon the Secretary of the Treasury with respect to interpretations. He would like to propose that the safety net be amended to apply to retirees.

Ms. Montiel said that she supported the adoption of the policy statement on the estate tax safety net. The new policy would counteract the adverse consequences of TAMRA in the short run, giving interim protection to families of staff members while the situation was clarified. She also agreed with the comprehensive work program that had already been authorized by management, which she hoped would solve, in the long run, the problems resulting from TAMRA, thus minimizing the negative effects of that legislation on the recruitment and retention of international staff.

Although the safety net policy would diminish discriminatory treatment between citizens or resident and nonresident staff members which might have resulted from the provisions of TAMRA, it would not seem to be so effective in cases in which the decedent was the spouse of a staff member, Ms. Montiel observed. In those cases, it was proposed that tax payments on the estates of resident spouses resulting from TAMRA be covered up to a maximum of $800,000, while tax on the estates of nonresident spouses would be covered up to a taxable amount of $260,000. She would appreciate comments from the staff on the rationale for that difference.

She wondered how the changes in U.S. federal estate tax law would affect the beneficiaries of a single nonresident staff member, Ms. Montiel concluded. If they were affected, why were the dependents of single staff members not eligible to receive assistance from the Fund under the safety net policy?

Mr. Sarr said that he found the papers reviewing the impact of the recent changes in federal estate tax law on non-U.S. citizen surviving spouses to be extremely useful and informative. Management had the full support of his chair for the response to the issues that had been proposed.

It was clear, however, that at the current juncture, any policy response could only be tentative, pending further clarification of a number of uncertainties--how the Internal Revenue Service would treat the issue of residency for estate tax purposes, and the direction of future changes in U.S. tax laws, for example, Mr. Sarr continued. Consequently, he would be prepared to consider in the near future some adaptations and modifications as further information became available.

He supported the establishment as quickly as possible of counseling services which should be free of charge to staff members, Mr. Sarr stated. That was justified, because the amount of the Fund's financial assistance could be greatly reduced if staff members and their families were better informed about the steps needed to minimize their tax liabilities. He was also in favor of providing Fund support to those adversely affected by TAMRA without distinction between staff members and retirees. Of course, the Fund should expect that staff members and retirees would take the necessary steps expeditiously to protect their families from the worst effects of the law. The issue of the discriminatory nature of the new tax law should figure prominently in the discussions between the staff and the officials of the U.S. Treasury.

Since the Fund could not be certain that further adverse and discriminatory tax legislation would not be enacted in the future, he wondered whether some general principles of protection of staff members against such legislation could be devised, on a more permanent basis, Mr. Sarr concluded. That could be reflected in the staff benefits package, which would help to neutralize any possible negative impact of such discriminatory laws on the Fund's recruitment efforts.

Mr. Kafka said that he agreed with Mr. Grosche's comments about the staff's proposals. He found no justification for extending the proposed safety net to retirees. He wondered whether it would not make sense for the Fund and other organizations with offices in the United States to try to persuade the United States to treat all G-IV visa holders as nonresidents. If the United States could be so persuaded, some, although not all, of the problems the staff faced would disappear.

Mr. Enoch said that he wished to associate himself with the comments made earlier by other speakers, in particular by Mr. Grosche. He agreed that the Fund should be seriously concerned about the actions by the host country that discriminated against non-U.S. nationals who came to the Fund, which would make it more difficult to recruit and retain an international staff. However, he also welcomed Mr. Warner's assurances, and he hoped that the Secretary of the Treasury would use his authority in the near future to solve the problems.

He could go along with the three procedural issues the staff had suggested in the paper, Mr. Enoch went on. He could also go along with the temporary safety net proposal. He wished to stress the temporary nature of that safety net, on the grounds that he believed that any implication that the safety net was permanent would imply the Fund's acceptance of the provisions in the U.S. tax legislation as they stood at present. In the same way, any attempt to make permanent the procedures for protecting the staff would suggest that the Fund was prepared to accept that approach to tax legislation. He could also agree with the staff's suggestion to obtain additional insurance for the possible added costs arising from the safety net.

He would urge the staff to remain in close contact with other international institutions, especially the World Bank, not only because representations to the U.S. authorities might be more effective if they were made with other organizations, but because there was a large number of staff in the Fund who had spouses working in the Bank, and vice versa. A coordinated approach seemed appropriate.

He could understand the reasons that had been given by the Director of Administration for treating retirees differently, Mr. Enoch concluded. The staff would need to look closely into the costs that might arise, and other complications, before the Board could approve including retirees under the safety net. Nevertheless, if the Board felt at that time that such a step would be in order, he would not object to it.

Mr. Fogelholm stated that he could support the staff's proposals, including the establishment of a safety net. He believed that the decision should be seen as a policy commitment to the problem, rather than a detailed set of regulations, and he agreed in that respect with the Director of Administration that the Fund would need to learn by doing. The basic aim of the policy commitment should be to abolish any discriminatory tax treatment between resident and nonresident staff members.

Mr. Cirelli said that he endorsed most of the observations made by other Directors. Like other chairs, he deeply regretted the modifications introduced in the U.S. estate tax law, which penalized non-U.S. staff. It was crucial that the Fund maintain an international staff in Washington, given the institution's responsibilities. The modifications introduced by TAMRA were clearly an obstacle in that regard. He therefore shared the concern expressed by the staff and by management. He regretted that the cost of the safety net--which was made necessary by the new U.S. law--would have to be borne by the entire membership.

The safety net was clearly only a temporary palliative, and clearly a second-best approach, Mr. Cirelli concluded. He hoped that a solution to the problem would be found through a representation to the U.S. authorities, keeping in mind the special problems of expatriate staff. He also hoped that further steps would follow the first initiative that had been taken in the Omnibus Budget Reconciliation Act, and, in particular, that the Secretary of the Treasury would rapidly exercise his new authority in that respect. He supported the proposed decision.

Mrs. Sirivedhin said that the staff had presented clearly the consequences for various categories of Fund staff of TAMRA, which the U.S. Congress had enacted in 1988. Despite some recent amendments, and others which were pending, the uncertainty and inequity of the law could have serious negative repercussions on the morale of present Fund staff, as well as potential effects on the Fund's recruitment efforts. She therefore supported the Fund's efforts to do all it could to help staff cope with the difficult issues many of them faced. The staff's proposals appeared to be reasonable, and, in principle, she could go along with the temporary estate tax safety net. She welcomed the initiative to discuss the issue, as related by Mr. Warner. At the same time, she would urge the U.S. authorities to expedite the resolution of the matter.

Mrs. Hepp said that she noted with concern the implications of the changes introduced in the U.S. federal estate tax law, and in particular, the adverse consequences on Fund staff and their families. The discrimination against non-U.S. nationals that those changes introduced was certainly worrisome. She could therefore support the Fund's initiative reasonably to protect staff members, their spouses, and dependent children from the adverse consequences of TAMRA, by creating a safety net. She fully agreed with the work program authorized by management. Because the issue had so many implications, perhaps a joint effort, and coordination with other international organizations, would produce positive results. The dialogue with the U.S. authorities suggested by Mr. Warner should be helpful, and would be an important opportunity to clarify further some of the questions. She fully supported the establishment of the safety net in the terms proposed in the draft policy statement.

Mr. Fernando stated that the principal focus of the staff should be to persuade the U.S. authorities to recognize the special status of international organizations such as the Fund and the Bank. On that basis, a simple, transparent arrangement should be devised to neutralize the disadvantages for those staff who were not U.S. citizens. That problem acquired urgency because of the potential adverse effects of TAMRA on the staff, but the implications of TAMRA on the Fund's mandate to recruit staff internationally should not be ignored. He welcomed the possible relief stemming from the reconciliation legislation, and had been pleased to hear Mr. Warner's comments on that subject. He hoped that the U.S. Treasury would cooperate fully in attempting to ease the pain on some staff members, and perhaps also the financial burden for the Fund that might arise. On the latter point, Mr. Hogeweg had already spoken of the extra costs involved for developing countries. He fully supported the staff's proposals, including the safety net, and he agreed that special accident insurance coverage should be pursued.

Mr. Yoshikuni said that he had no difficulty supporting the staff's proposal. He associated himself with the comments of previous speakers, particularly Mr. Grosche. While he appreciated the modifications to TAMRA that had already been made by the Treasury Department, he would ask Mr. Warner to convey to his authorities the strong wish of the Board for a complete solution to the problem. He looked forward to cooperation between the Fund and the Bank in dealing with the issues.

Mr. de Groote said that he could support the staff's suggestions, as well as the immediate establishment of a safety net. He wished that Mr. Warner would study Mr. Kafka's suggestion of finding an immediate solution for G-IV visa holders, since he had always understood that G-IV visa holders were considered as nonresidents, and that solution might then be extended to others. He supported strongly Mr. Fogelholm's idea that the Board should take a decision of principle, with additional measures when the circumstances required them.

He understood that a widow of a staff member had already suffered great hardship from the new legislation, Mr. de Groote concluded. It was obvious that once the safety net was in place, its benefits could be extended to the widow retroactively, but it could also be that, because of its very retroactivity, even additional hardships might be experienced. If that were the case, that should be taken into consideration as well.

Mr. Clark said that he wished to associate himself with the comments of previous speakers in supporting the proposed measures, including the establishment of a temporary safety net. He certainly agreed that action should begin immediately to find the ultimate solution to the problems created by TAMRA. He could support the concept and implementation of a safety net. He had some concerns about the situation of a staff member whose spouse had died. Mr. Enoch had raised the point that the $260,000 limit might be reached very quickly, and even perhaps the $800,000 limit. In light of the fact that it was the support staff who were chiefly concerned, there might well be a sense almost of discrimination in the way the safety net was to be implemented. Although he realized that the limits the Fund would set were somewhat arbitrary, in light of the effect on the support staff they might be reconsidered.

Mr. Al-Jasser said that he wished to reiterate the concern of his chair about the changes in U.S. federal estate tax law, and to join other Directors in supporting the staff's suggestions to mitigate the effects of those changes. He joined Mr. Enoch in emphasizing the temporary nature of the measures. He hoped that the Secretary of the Treasury would exercise the powers granted to him in the latest reconciliation legislation to correct the situation and alleviate the anxiety of the Fund's staff. Since he welcomed Mr. Warner's comments, he urged the staff and the chair for the United States to expedite contacts between the staff and the U.S. Treasury to resolve the matter. He also urged the staff to coordinate very closely their response with colleagues in the World Bank.

Mr. Kyriazidis said that he wished to echo the remarks made by Mr. de Groote, whose position he supported completely, including his remark about the specific case which had arisen. He would also support Mr. Evans's suggestion that retirees be included in the safety net, as the reasons given by the Director of Administration for excluding them were not entirely convincing. He would also support Mr. Enoch's suggestion with respect to estate taxation of the estates of spouses of staff members.

Mr. Kabbaj said that he wished to associate himself with the comments of previous speakers, particularly Mr. Grosche and Mr. Kafka. He had found the reaction of the management and the staff to the problems that might arise from TAMRA very appropriate. He had no problem going along with the staff's proposals.

Mr. Munthali said that he supported the staff's proposals, as well as the establishment of a safety net.

Mr. Othman said that he endorsed the staff's proposal, with respect both to the short-term and long-term approaches that would be followed to resolve the issues.

Mr. Zhang said that he supported the staff's recommendation and the safety net arrangements, and shared the concern expressed by previous speakers. Great attention needed to be paid to the issue, as it might affect many areas related to the Fund and its staff, especially in terms of the difficulties it might create for the recruitment and retention of high caliber staff members.

Mr. Warner observed that the most helpful approach to effecting a solution of the problems would be an investigation of the kinds of powers that had been granted to the Secretary of the Treasury by the TAMRA reconciliation legislation. A long-term solution might be advisable, but was unlikely to be forthcoming in the time period that Executive Directors were suggesting.

Mr. Kafka, subsequently supported by Mr. de Groote, had suggested that the issue of the status of G-IV visa holders be addressed in its entirety, Mr. Warner recalled. Once again, a final resolution of that matter could only be expected in the long term. Therefore, he would strongly suggest that the staff of the Fund and Bank pursue that question with the office of the Secretary of the Treasury, in relation to the special powers that had recently been conferred upon that office by the reconciliation legislation.

A number of speakers had correctly emphasized the temporary nature of the policy which the Board should adopt, Mr. Warner commented. That being said, it might be helpful and constructive if the staff were to prepare a report on the status of the TAMRA legislation and its effects on the staff, perhaps after a period of six months. In the interim, it was not unlikely that some amelioration of the problems might be found with the help of the Secretary of the Treasury. The full effect of some of the other amendments that had been made by the reconciliation legislation might also be better known by that time. He wondered whether the draft policy statement would include some of the revisions that Directors had suggested.

Mr. Grosche said that like Mr. Kafka and Mr. de Groote, he had been very troubled by the fuzziness surrounding the issue of residency and nonresidency, and he wondered what could be done to clarify it. He had understood that, for all practical purposes, staff members were considered as residents for estate tax purposes, but nonresidents for other taxes. With respect to Executive Directors, it needed to be borne in mind that not all Executive Directors held G-IV visa status. In any case, it would be helpful if the U.S. authorities could issue an authoritative statement on the status of staff members and of Executive Directors.

With respect to a staff member who had opted to obtain additional life insurance outside of the Fund's Group Life Insurance policy, Mr. Grosche noted, he believed that the proceeds from that other insurance policy should be protected as well, at least up to the amount that the Fund's scheme would provide for.

Mr. Enoch said that he fully agreed with Mr. Grosche that it would be helpful to have an authoritative statement as to whether G-IV visa holders were classified as residents or nonresidents. However, in relation to what Mr. Kafka had said earlier, he was not sure that it would be entirely preferable for all G-IV visa holders to be classified as nonresidents, because exemptions from certain kinds of income taxes went along with resident status. A number of G-IV visa holders with spouses earning salaries in a foreign country actually benefitted from resident, rather than nonresident, status.

Mr. Kafka commented that Mr. Enoch was quite right, but that had not been the point of his comment. If all G-IV visa holders were classified as nonresidents, then the Fund would not have to worry about it.

The Director of Administration recalled that Mr. Hogeweg had referred to the various anomalies and problems that predated TAMRA. The two most obvious were, first, the uncertainty as to whether an individual would be treated as a resident or nonresident for estate tax purposes, and second, the rather low exemption of $60,000 which was available to nonresidents, which had become a more significant problem over the years.

With respect to the first problem, the Director continued, the staff did believe that it would be important to try to obtain some rules from the Commissioner of Internal Revenue that might clarify the issue. The possibility of course arose of simply classifying all G-IV visa holders as nonresidents. The status of the law at present was that the classification of residency or nonresidency depended essentially upon the intention of the individual--whether he or she intended to stay in the country indefinitely. For example, a staff member or Board member from another country on a fixed-term assignment who had retained all his employment ties with his home country would be assumed to be considered as a nonresident. However, another staff member, even though a G-IV visa holder, without a permanent resident visa, who had stayed in the United States for a number of years and had no intention of leaving would be assumed to be treated as a resident, unless there were certain other facts relevant to the circumstances which strongly suggested otherwise--for example, the retention of a large amount of property overseas, or clear statements of the intent to return to the home country. The specific issue which had been brought up by a number of Directors was whether or not it would be desirable to have all G-IV visa holders ruled as nonresidents. All G-IV visa holders had been ruled as nonresidents for income tax purposes regardless of their own particular wishes in the matter, and the Fund had not been consulted. Staff members had simply been informed that they would be classified as nonresidents, which actually had been disadvantageous for many. Nevertheless, it was his belief that for most staff members, it was probably preferable to be treated as residents for purposes of the U.S. federal estate tax, rather than nonresidents, because of the very different treatment with respect to exemptions. Namely, there was a $600,000 exemption for residents, and only $60,000 for nonresidents. For the individual, of course, much would depend on how much property was owned overseas, and what proportion of the total amount of property was held overseas rather than in the United States. That being said, it should not be assumed that it would be advantageous to many, or even most, staff members to be classified arbitrarily as nonresidents. The issue of how the Fund would address that problem was not clear. It might prove useful to approach the Commissioner of Internal Revenue and seek certain presumptions which could be rebutted by appropriate evidence, but which would help to clarify the likely treatment of an individual. Perhaps the most important factor for individuals was to know what treatment they were likely to receive, what group they were likely to be classified in, because without that information suitable arrangements with respect to estate planning could not be made with confidence.

With respect to the second problem, the low level of the exemption that was available for nonresidents, that exemption had been set at a time when $60,000 could have been considered to be a fair amount of the equity in a house, the Director noted. That was no longer true. Also, it had probably been assumed that nonresidents would not own houses except as investment properties. However, in the case of the Fund and the Bank, those staff members classified as "nonresidents" were in fact living and working for the Fund and the Bank in the United States, and under those circumstances, it was perfectly reasonable and often necessary for them to buy real estate in the United States not simply as an investment, but as a personal residence.

The question had been raised as to why the safety net would be extended only to married staff members, the Director recalled. The safety net had been formulated deliberately in narrow terms, with the purpose of protecting staff members against additional liabilities that arose from TAMRA. In the case of resident staff members, TAMRA did not change the position of unmarried people. What it had done was remove the marital exemption. Therefore, the policy had been framed deliberately to achieve only that rather limited purpose of restoring the pre-TAMRA situation. It was not the objective of the safety net to resolve all of the problems that staff would experience, or all the problems that had existed before TAMRA, and which staff members might still have, with U.S. federal estate tax.

The somewhat arbitrary nature of the limits that the staff was proposing had been noted by a number of Directors, the Director remarked. Those limits were intended to protect the Fund from unexpected liabilities which could not be quantified at present. If, in practice, cases arose in which the Administration Department believed a legitimate need for additional assistance would be appropriate which fell outside the scope of the policy as it had been formulated, he would be prepared to return to the Board with an interim report proposing that those cases be dealt with in an appropriate way.

It had been suggested by Mr. Warner that the Board consider a report on the operation of the safety net by the end of June 1990, with which he could agree, the Director went on. If there was the possibility that the safety net would be removed on December 31, 1990, which was in fact the earliest date that the staff had suggested, it would only be appropriate to give the staff a suitable period of notice that it would eliminated. The possibility existed that significant changes would be effected in the TAMRA legislation which would justify proposing to the Board that the safety net be wound up or substantially modified after December 31, 1990.

The staff was not proposing any changes in the policy statement as it had been drafted, the Director pointed out. What would be done about the repayment terms of the loans would have to be decided later. At present, all assistance would be provided in the form of demand loans. The Administration Department might well wish to come back to the Board later and propose the forgiveness of any loans made up to that time, but the present juncture was not the time to take a decision on that.

With respect to the questions that had been raised about the particular individual who was already suffering from the impact of TAMRA, the Director concluded, he wished to assure Directors that the new safety net would be retroactive, and thus would apply to that particular individual. Also, because that case was the first which had involved a number of difficult legal questions, the Fund was assisting in the payment of the legal costs, which had been higher than usual because of a number of issues relating to TAMRA. To that extent, the Fund had been able to spare the individual some direct financial problems arising from the situation. Precisely because the Administration Department did not wish to place other staff members in the kind of anxious situation that that individual had faced, it had come to the Board now and requested Directors to address the problem, rather than to wait for another year as one speaker had suggested.

The Acting Chairman, responding to a question from Mr. Enoch, said that the decision on the safety net would not by its terms extend to members of the Executive Board, but the presumption was that similar decisions would be taken up by the Committee on Executive Board Administrative Matters. There appeared to be support from Executive Directors for the proposals that had been put forward by the staff. Directors had also requested the staff to give further consideration to two issues: first, the question of whether spouse's estates should be given equal protection to that given to the estates of staff members, and the limit that had been established for such estates. The second issue was the extension of the safety net to retirees.

The Executive Directors took the following decision:

The Executive Board approves the recommendation to establish a U.S. federal estate tax safety net, as set forth in EBAP/89/281 (11/22/89).

Adopted December 11, 1989

3. COLOMBIA - 1989 ARTICLE IV CONSULTATION; AND RELEASE OF INFORMATION

The Executive Directors considered the staff report for the 1989 Article IV consultation with Colombia (SM/89/233, 11/13/89). They also had before them a background paper on recent economic developments in Colombia (SM/89/246, 11/22/89).

Mr. Kafka made the following statement:

The Colombian authorities are grateful to the staff for the Article IV consultation report, and are in agreement with its thrust. The report is an accurate description of the successful policies followed by Colombia during 1985-86 and since the implementation of the monitoring arrangement--in effect, a stand-by arrangement, without money. Colombia has also adopted structural reforms in the tax and financial system, and a banking crisis has been overcome. Moreover, the economy has become more open to trade, distortions have been reduced, and exports have been diversified. Altogether, these policies have enabled Colombia to achieve growth and external balance and to avoid any rescheduling of the external debt.

As is accurately reported in the staff report, in order to address the adverse effects of the sharp drop in coffee export prices and the macroeconomic consequences of the antidrug efforts, the authorities' economic program for 1990 maintains the basic policy thrust of previous years. In order to reduce inflation further and attain balance of payments equilibrium in 1990, the authorities are taking substantial fiscal measures to avoid a significant deterioration of the fiscal deficit. These measures include a pass-through to producers of the drop in coffee export prices, reducing subsidies, a strict wage policy in the public sector, and containing public sector investment.

These achievements alone merit the special attention of the Board, because Colombia is one of the few highly indebted countries exhibiting such economic success. But there are three additional aspects which I would like to stress.

First, Colombia succeeded in its adjustment effort with the constant support of the Fund, and in close cooperation with it. Even after the successful implementation of the monitoring arrangement, close cooperation has continued, and the Colombian authorities wish to maintain this degree of cooperation in the future.

Second, and less encouraging, although Colombia is one of the very few highly indebted countries which remains current on its external debt service payments, and only refinances amortization payments, the refinancing negotiations with foreign commercial banks have been exceedingly long and difficult. The delays experienced during these operations have disrupted at times the implementation of domestic fiscal policy, and, on the external front, the uncertainties emerging from the refinancing process have led to temporary reductions in short-term trade lines of credit. Surely there is a lesson here for the debt strategy and for the Fund's policies on financing assurances.

Third, the external debt situation of Colombia is fairly unique. After all, this is a country that has adjusted successfully in order to regain normal access to international capital markets, and that has multilateral institutions (as opposed to commercial banks) as its largest single creditors. In this regard, recent external debt initiatives have been of little help to Colombia. Colombia's external debt strategy is based on the principle that the exposure of banks and multilateral institutions to Colombia would rise marginally in nominal terms, but decrease with respect to GDP, in the medium term. In that respect, the Colombian authorities consider that continuous support from multilateral institutions providing flexible and timely resources is fundamental for a successful implementation of their sound debt strategy.

The authorities attach high priority to reducing inflation and to achieving balance of payments equilibrium. Inflation has been moderately reduced from a 12-month rate of over 30 percent in June 1988 to about 27 percent in November 1989, and the authorities are committed to a further reduction in the rate of price increases.

The authorities also see a need to raise the per capita growth rate. A growth rate of about 3 percent per capita is impressive when compared with other countries in Latin America in recent years, but it must, so far as possible, be increased, inter alia, in order to reduce pockets of absolute poverty, which still exist in the country.

Consistent with the objective of increasing the growth rate and in light of a declining trend in available public sector external savings, the required levels of investment must be financed by an increase in national savings. The authorities are adopting measures to raise national savings, which include a strengthening and deregulation of the domestic financial system to raise private savings, as well as revenue and expenditure measures to bolster domestic public sector savings. In addition to these policies, the authorities are making efforts to attract direct foreign investment--including in the domestic financial system--and are carefully maintaining interest rate flexibility and an adequate level of external competitiveness by pursuing a flexible exchange rate management.

In recent years, the pursuit of prudent financial policies has allowed the authorities to achieve large surpluses in the balance of payments and to accumulate a relatively high level of net international reserves. Indeed, at the end of 1989, gross reserves are expected to reach the equivalent of 9.5 months of merchandise imports and over four months of combined payments for merchandise imports, gross interest service debits, and amortization. The authorities believe that such a strong level of reserves would allow them to aim at marginal surpluses in the balance of payments over the medium term, and permit a modest drop in the reserve ratio to a relatively high level of about eight months of merchandise imports by 1994.

For the medium term, the Colombian authorities have framed policies geared toward a continued diversification of exports. As a result, exports of petroleum and coal are expected to almost double over the next five years, and nontraditional exports are expected to rise by more than 50 percent. Altogether, this would overcompensate for a projected sluggishness of coffee exports, and bring the current account deficit down to less than 1 percent of GDP over this period. The Colombian authorities are also continuing their policy to reduce exchange and trade restrictions.

Financing the modest deficit foreseen would require the joint exposure of the World Bank and the Inter-American Development Bank to rise on average by about 2.3 percent a year, and the exposure of commercial banks to rise by about 1.5 percent a year during 1990-94. As explained earlier, the authorities have already started the negotiations, for a new lending program with multilateral institutions, and will approach commercial banks soon to seek a refinancing of maturities falling due in 1991-92.

Mr. Feldman made the following statement:

Despite some recent political difficulties, the economic performance of Colombia remains as one of the most successful in Latin America during the 1980s. Although real GDP growth, which was above 5.5 percent per annum on average during the 1970s, fell to less than 3.5 percent during the 1980s, with the help of a declining rate of population growth that rate will still yield a positive annual rate of increase in per capita GDP for the 1980s. As Mr. Kafka has stated, that is an impressive performance when compared with other countries in Latin America, even though growing demands from the population, and the existence of pockets of absolute poverty, will call for higher rates in the coming years.

Colombia's inflation record is even more stunning. An annual average inflation rate in the range of 20-25 percent for many years--very high by international standards, but relatively low by Latin American standards--challenges the notion that such a rate of increase in prices cannot be sustained over time without leading to a very high and unstable inflation rate, and, eventually, to hyperinflation.

The implementation of successful adjustment policies during 1985 and 1986, and the maintenance of sound policies thereafter, have prevented the emergence of significant macroeconomic imbalances, and hence the risk of a strong acceleration of inflation. The effective implementation of structural reforms in several areas, export diversification, trade liberalization, and the impressive positive response of private investment have also played major roles in the recent good performance of the economy.

However, the Colombian economy is now facing several risks and uncertainties which would require the maintenance of consistent and very sound policies, as well as clear support from the international financial community.

I broadly agree with the main policy recommendations and the staff appraisal. I will focus on two issues which I believe are critical for Colombia's economic prospects, namely, inflation, and Colombia's access to foreign financing, particularly in the very near future. The issues of inflation and the source of financing for Colombia's remaining macroeconomic imbalances are obviously interlinked, and consequently deserve very careful consideration by the Fund and the Colombian authorities in their forthcoming consultations and exchanges of view.

Before turning to these two key questions, however, I would like to comment briefly on fiscal policies. The Colombian authorities have given top priority to the maintenance of strong fiscal discipline since the implementation of a successful policy mix during 1985-86. More recently, as explained by Mr. Kafka, Colombia has reacted swiftly to the adverse effects of the sharp drop in coffee export prices, and to the macroeconomic--mainly external--consequences of the antidrug trade efforts, by taking substantial additional fiscal measures which would keep a strong fiscal stance. The only word of caution I would like to raise in the fiscal area is related to the process of regional decentralization of resources and expenditures. The central administration is transferring one half of its own expenditures to the rest of the public sector, the transfer being financed basically by value-added tax proceeds, which will be earmarked increasingly for municipal and regional governments. The staff report includes a reference to the fact that the increased resource transfer is not being matched by a shift of expenditures from the central administration to the local governments, and that there is therefore a clear potential danger of fiscal deterioration in this area. Other experiences, notably that of Argentina in recent years, show that the process of expenditure decentralization is sometimes complex, takes more time than expected, and, above all, that a homogeneous distribution of expenditures across regions or local governments is difficult to achieve. Also, the earmarking of an increasing share of tax revenues, without an almost simultaneous transfer of expenditures, leads in general to the creation of new sources of spending that become very difficult to eliminate later. Perhaps the staff would like to comment further on this issue, or on any new developments in the process of decentralization in Colombia.

The background paper on recent economic developments stresses the sharp fluctuations in food prices and the upward trend since 1985 in nonfood prices as two important factors in explaining the rate of inflation in recent years. In that connection, I believe that the systematic faster increase in food vis-à-vis nonfood prices has also been a clear feature during the 1980s. Data in Table 5 of the background paper show that significant changes in relative prices have been taking place in recent years which might be the reflection of a variety of factors, such as supply rigidities and administrative controls. So far, however, a detailed analysis of these factors has not been pursued; perhaps the reason for that is that the significance of these variables in explaining inflation in Colombia has been completely blurred by the statistical findings presented in Appendix I on "Inflation and Macroeconomic Policies in Colombia." In this appendix, the staff provides a very helpful analysis of the relationship between prices, output, and some key macroeconomic policy variables in Colombia. The econometric results tend to confirm previous findings, namely, that the behavior of monetary aggregates overwhelmingly explains inflation in Colombia, and consequently highlights the central role of monetary policy for controlling inflation. These findings, which are certainly convincing, bring up some questions, and call to mind some suggestions.

First, the choice of the most accurate and appropriate monetary aggregate remains an open question, and it is not absolutely clear that M1 is preferable to M2, which showed a higher correlation with inflation than M1 or the monetary base.

Second, there is the question of the relationship between fiscal policies and inflation--which is also related to the question of the choice of the monetary aggregate. In the staff appraisal, the role of fiscal adjustment in securing price stability is very important, and we concur with that conclusion. However, the omission of a fiscal variable in the estimates of Appendix I contrasts, and even appears to be somewhat inconsistent, with the main thrust of the appraisal. I wonder whether one way of reconciling and enhancing the consistency of both parts of the staff analysis would not be by choosing as the relevant aggregate the monetary base and one of its components, that is, the monetary expansion originating in the domestic financing of the fiscal sector. A significant statistical result emerging from these variables would provide a satisfactory linkage between both monetary and fiscal policies and the inflation rate.

Third, looking at actual and predicted inflation in Chart 2 of Appendix I, one has the feeling that the predictive power of the model weakens substantially after 1973; this is precisely the beginning of the subperiod of systematic cost of living adjustments to the minimum wage. I wonder, in consequence, whether it would not be advisable to run a model that allows for the estimation of different coefficients for the wage variable in two subperiods, one ending in 1972, the second starting in 1973.

With respect to the role of foreign financing, as Mr. Kafka has pointed out, Colombia has adjusted successfully, and has pursued prudent external debt policies. The Colombian case is rather unique among middle-income indebted countries, because of the large share of multilateral institutions in total debt. However, despite Colombia's success in its adjustment efforts and its outstanding record of external debt service payments, the refinancing negotiations with commercial banks have been exceedingly long and difficult; moreover, once agreements were reached, commercial banks' flows were discontinuous, and delays have brought disruption and uncertainty to the implementation of domestic fiscal and financial policies.

On top of that, the present political situation may bring with it yet more uncertainties to Colombia on the external front. One consequence of the country's antidrug trade effort will very likely be a decline in foreign exchange earnings associated to some extent with that trade. Furthermore, other revenues related to foreign investment and other capital inflows may be seriously affected in the forthcoming months, and perhaps in the next few years, as a result of the political turbulence in Colombia at present, which may continue in the near future.

In that connection, I wonder whether the staff's medium-term balance of payments projections are not too optimistic, especially regarding such items as current account transfers, private direct investment, and private capital flows in general. A related question is whether direct investment includes any assumption about possible takeovers of Colombian banks by foreign financial institutions.

At the present critical juncture, and taking into account the recent behavior of the commercial banks, Colombia deserves the full support of the international community, particularly from multilateral institutions and official creditors. Looking at the operations of the nonfinancial public sector projected for 1989 and 1990, I think that it is unfortunate that a reversal of the trend in the composition of overall financing--i.e., less foreign and more domestic financing--has been projected for 1990. It is unfortunate because the increase in the share of domestic financing at the expense of foreign financing may run counter to the objective of a lower rate of inflation for 1990. Also, if the external financing projections are overoptimistic, a shift toward a higher component of domestic financing of the fiscal imbalance may result that is larger than projected, thus increasing the risk of a serious acceleration of inflation.

Every effort should be made to accelerate the disbursement of all possible external financial resources to Colombia, which has shown great determination and courage in facing political and economic adversities.

Mr. de Groote stated that Colombia continued to draw the benefits of the successful implementation of the 1985-86 program, and of the correct policies that had been applied since then. The country's spontaneous access to financial capital markets certainly showed how success in implementation of a program was assisted by the financial markets. That was a great satisfaction not only for the Colombian authorities, but for the Fund as well, which found in the Colombian case a good illustration of the validity of its own recommendations.

On that same note, Mr. de Groote continued, it was interesting to observe that the staff, which was generally suspected of being excessively in favor of important exchange rate adjustments, felt that the current exchange rate in Colombia protected the competitive position, despite the major terms of trade losses stemming from the fall in coffee prices, because Colombia was firmly committed to marginal exchange rate adjustments under a system of pegged rates. That was indeed an interesting feature of the current recommendations.

He had only three areas of preoccupation, Mr. de Groote stated. First, the difficulty of implementing the measures that would be needed to achieve the public finance objectives; second, the need to obtain additional financing in order to achieve the balance of payments and growth objectives in 1990; and third, the excessive complication of the exchange and trade system.

In order to attain the public finance objectives for 1990, Mr. de Groote went on, the full terms of trade effects would have to be borne by the coffee producers, through a reduction in the prices paid to coffee producers, along with a further adjustment of the prices of public utilities. In his view, it was very doubtful that those unpopular measures would be implemented, leading to the need for even greater increases in the prices of public sector utilities above the inflation rate if further transfers took place in favor of the government sector, and, more specifically, in favor of salaries in the public administration. There was a tradition in Colombia of granting public sector wage increases far in excess of the rate of inflation; the exception to that had occurred only recently. A new and unwavering policy needed to be pursued in that regard. The staff had presented some interesting information about those topics in the background paper on recent economic developments.

With respect to the determinants of inflation, the staff's model showed that monetary factors were mainly responsible for inflation, Mr. de Groote observed. The models also demonstrated that wage increases in the public sector always reinforced systematically the effect of monetary factors over time. He hoped that that point would be understood by the Colombian authorities.

The study of poverty showed that while the Colombian authorities had made great progress in the elimination of poverty, reducing by about half the number of families that were living in conditions of poverty, the situation was still not one that would allow for major transfers away from producers--and mainly low-income producers--to government income, Mr. de Groote commented.

The balance of payments continued to reflect the favorable effects of the 1985-86 program, with minor movements due mainly to terms of trade developments, Mr. de Groote noted. The current account position remained sustainable. The danger lay, however, in the wide gyrations of the capital account due to the discontinuous character of the facilities granted by the commercial banks. The staff had mentioned the possibility of widening the menu. He wondered what they had in mind, in particular, whether they were thinking of debt buyback operations or debt-equity swaps. An important conclusion of the consultations should be to explain clearly to the banking community that the coherence of the medium-term scenario would depend entirely on a rollover by the banks of the payments coming due until 1992.

It was obvious from browsing through the background paper on recent economic developments that the exchange and trade system was overly complex and needed simplification, Mr. de Groote concluded. The heavy reliance on administrative control, and in particular, the necessity of registering all import and export transactions, seemed very much out of date for a country that had made such important progress in recent times.

Mr. Grosche said that the Colombian authorities deserved to be commended for their remarkable achievements over the past few years. Performance in 1989 had been broadly maintained despite some adverse effects stemming from a sharp drop in coffee prices and the Government's courageous efforts to stem drug trafficking. Due to prompt and adequate corrective measures, particularly expenditure cuts, the revenue shortfalls were expected to be offset in 1989, and the reduction in the overall fiscal deficit should be achieved as anticipated. Some progress had also been made in containing inflation. Even though the increase in prices was still relatively high, the authorities had responded well to the threat of inflation, which he noted had been a main concern of the Article IV consultation with Colombia last year.

The current account deficit was projected to increase only slightly in 1989, Mr. Grosche observed. External reserves had been built up substantially, and Colombia continued to have access to international commercial lending, despite the fact that negotiations with the commercial banks had proven to be very difficult. He shared Mr. Kafka's concerns about the difficulties and delay experienced by Colombia in those negotiations. The authorities needed to stay the course, and steadily regain normal access to capital markets. With that in mind, he had a question about Mr. Kafka's suggestion that the authorities should aim instead at a relatively higher level of borrowing from multilateral institutions.

Despite the progress that had been made, Colombia's medium-term outlook would be favorable only if sound financial policies were maintained, Mr. Grosche stressed. In that respect, he had been heartened by Mr. Kafka's statement that the authorities were committed to maintaining the basic policy thrust that had proven to be successful in previous years. In particular, he welcomed the continued readiness of the authorities to cooperate closely with the Fund. That was indeed important, as substantial challenges lay ahead for the authorities. The impact of the fall in coffee prices on the export earnings for 1989 had been concealed by relatively high coffee prices during the first half of the year, and by the increase in export volume in the second half. In 1990, the shortfalls in export earnings caused by the decline in coffee prices and the anti-drug trade measures would nearly double the current account deficit, from 1.2 percent of GDP to 2.3 percent of GDP.

That underlined the necessity of persistent adjustment efforts to reduce the vulnerability of Colombia's economy to adverse external developments, Mr. Grosche continued. Colombia had already made substantial progress in broadening its export base. Coffee exports as a percentage of total exports were declining, not only because of the price decline, but also because of the growth in petroleum and nontraditional exports. Nevertheless, it was clear that the current account deterioration that was projected for the forthcoming few years could only be reversed later if the authorities implemented the envisaged measures without delay. He fully endorsed the staff's recommendations with respect to the need to strengthen domestic savings. That included the lowering of domestic producer prices for coffee, a restrictive wage policy--including wages for public officials--and maintaining competitiveness and further actions toward reforming the public enterprises.

He therefore welcomed the authorities' awareness of those problems, and of their commitment to react promptly if additional measures became necessary, particularly in the area of fiscal policy, Mr. Grosche concluded. He fully agreed with the staff that notwithstanding the encouraging policy measures that had already been taken, a somewhat more ambitious inflation target would be desirable. There was no doubt that the process of disinflation had adjustment costs, but in the longer run, the social and economic costs of persistently high inflation rates were definitely greater. With those observations, he supported the proposed decisions.

Mr. Dawson made the following statement:

> I commend the Colombian authorities for their continuing success in maintaining the momentum of growth of the Colombian economy. Results in 1988 were mixed, but serious problems were avoided. In 1989, I was pleased to note that the authorities have responded quickly to the breakdown of the International Coffee Agreement; however, as the staff notes, it is likely that the fiscal impact will be felt mainly in 1990.
>
> I generally agree with the staff appraisal. I will focus on four main issues: inflation, structural reforms, exchange rate policy, and relations with commercial banks.
>
> At the Board discussion a year ago on the 1988 Article IV consultation with Colombia (EBM/88/157 and EBM/88/158, 10/24/88) we stressed our view that a persistent rate of inflation above 20 percent represented an underlying threat to the economy. We continue to view inflation as a critical obstacle to

strengthening growth prospects in Colombia. From that perspective, we regret that the inflation target and the fiscal deficit target for 1990 are not more ambitious.

In particular, the planned wage increase for the public sector of 20 percent establishes a floor for inflation. Furthermore, the staff report highlights the potential problems arising from the fiscal decentralization that was initiated in 1986.

On a positive note, we welcome the intention to adjust the producer price for coffee, and to phase out related subsidies.

Regarding structural reforms, we are pleased with the progress that has been made in strengthening the financial sector, including the lifting of interest rate controls. We will be especially interested in the coming year in the progress that is made in privatizing some institutions, and invigorating them with foreign participation.

The staff paper also calls attention to the problems of the electricity companies with external debt servicing. We urge the authorities to avoid any delays in meeting the conditions of IBRD power sector loans, in order to ensure that those problems will be substantially resolved during the coming year. We are also concerned about extensive controls on internal prices, international trade, and external payments. We believe that Colombia is in a position to attain the objective cited by Mr. Kafka of raising per capita growth rates if it moves rapidly to eliminate those impediments to growth.

The staff has drawn attention to the link between exchange rate policy and prospects both for coffee exports and trade liberalization. In the context of the staff's medium-term balance of payments projections, we agree that the authorities should stand ready to adjust the exchange rate policy--not so much to protect reserves as to protect growth. We would also welcome the staff's views on the extent to which exchange rate expectations contribute to inflation.

Colombia occupies an important position outside the group of countries that can improve their creditworthiness by negotiating financing packages incorporating debt and debt service reduction features. We welcome the constructive relationship that the Colombian authorities have managed to maintain with their commercial bank creditors, and believe that it will contribute to an early resumption of normal credit relations. At the same time, we believe that full normalization will occur sooner if macroeconomic policies are strengthened, structural reforms accelerated, and growth prospects improved.

Over the course of the next year, we urge the authorities to attempt to break the strong, entrenched inflationary expectations which are interfering with the achievement of the growth and balance of payments objectives. We support the proposed decisions.

Mr. Menda made the following statement:

The Colombian authorities demonstrated their ability to manage the economy in 1985, when they implemented sound macroeconomic policies and initiated broad structural reforms. The results were indeed impressive: high growth rates have been sustained, inflation has stabilized--although at a rather high level--and rescheduling has been avoided. Furthermore, Colombia succeeded in diversifying its exports substantially.

Given the authorities' capacity to react appropriately to economic imbalances and the external environment, I have no hesitation expressing my concern about recent developments and the prospects for the short and medium terms. It is clear that since 1987 the stance of fiscal and monetary policy has been looser than it was before. As a result, the inflation rate increased, the current account deficit widened, and real GDP growth decelerated.

Colombia is now facing a difficult situation, and there are many uncertainties weighing on its economic prospects: the decline in coffee prices and reduction in drug-related export flows, the outcome of future negotiations with commercial banks, and the consequences of a difficult internal security situation.

Therefore, Colombia should react without delay to the recent imbalances, by implementing a stricter demand management policy aimed at reducing inflation and restoring external balance.

First, the authorities should implement without delay the measures needed to avoid a further worsening of the fiscal position and to raise the level of domestic savings. That is all the more important given the increasing fragility of the external current account. The rapid deterioration of the public finances since 1987 clearly warrants decisive measures, and I have some doubts about the real outcome for 1989. I would appreciate further comments from the staff on this issue.

Given the sensitivity of nontax revenues to terms of trade fluctuations and recent adverse developments, the search for alternative sources of revenue, including an increase in rates for the value-added tax and a broadening of the revenue base, are warranted. Like Mr. Feldman and Mr. Dawson, we believe that there is a need to monitor carefully the process of decentralization and the transfer to local governments of expenditures formerly incurred by the central government.

On the expenditure side, the phasing out of coffee price subsidies and the reduction of producer prices in line with external prices are of the utmost importance. A close monitoring of capital expenditure seems warranted, given the excess capacity that has resulted from past investments in some sectors.

In Appendix I of the background paper on recent economic developments, the staff offers an elegant demonstration of the paradigm of monetarist theory on the close link between money and prices when the exchange rate is fully flexible. But the staff's appraisal is less clear on the current stance of monetary policy, and I would appreciate further comments focusing on the measures to be taken to reduce inflation more decisively. Given the uncertainties concerning inflationary expectations, real interest rates may not be high enough to exert a sufficient downward pressure on the nominal evolution of prices, in our view.

The balance of payments projections are surrounded by many uncertainties. This is certainly a case where different scenarios would have been of great help in assessing the external constraints which weigh on Colombia's future. On exchange rate policy, this chair does not particularly favor a crawling peg system, and there seems to be some evidence of a link between exchange rate policy and the persistence of inflation in Colombia. I fully agree with the staff that further significant steps are needed with respect to exchange and trade policy, particularly in order to induce a further diversification of output and exports. Lastly, the staff assumes an additional refinancing operation of $1.2 billion from commercial banks in 1991-92, which seems far from what the authorities initially requested. Could the staff or Mr. Kafka comment on this issue?

Mr. Al-Jasser made the following statement:

I join other Directors in commending the authorities on their continued determination to adjust and open up the Colombian economy. The prudent macroeconomic policy package that has been followed so far is appropriate. However, the near-term outlook may be less buoyant than that presented in the staff paper, owing to a number of noneconomic considerations. In that context, I note that the authorities are generally cognizant of the need for additional actions if circumstances so require. I call upon the foreign commercial banks to be more forthcoming, so that refinancing uncertainties which could disrupt the hitherto smooth adjustment process are minimized.

While I agree with the general theme of the staff appraisal, there are a number of issues that deserve further elaboration. In particular, the staff has suggested that the authorities need to take into account the sharp decline in coffee prices in formulating their exchange rate policy. Surely, if the present price decline is of a secular nature, it would imply a change in Colombia's competitiveness, and would call for a reappraisal of the entire policy package, including the exchange rate policy. However, if it is a temporary price development and the authorities are encouraged to respond by a more durable shift in exchange rate policy, would the staff also recommend an appreciation, if and when coffee prices recover? Does the decline in coffee prices reflect a fundamental disequilibrium? The basic question in this context is whether the Fund should recommend an exchange rate change to correct an inherently self-correcting deterioration. Perhaps there are other and better ways of handling such a transitional problem. Would the Fund recommend a similar solution to exporters of other primary products? Would it also apply to members of the West African Monetary Union?

The staff has also recommended that, should the budgetary situation not improve, a more ambitious pricing policy for state enterprises be pursued. Does that mean that these prices do not reflect market conditions? If so, then they should be adjusted irrespective of the prospective budgetary situation. If not, then adjustment in such prices would be uneconomical, and should not be entertained.

I am considerably intrigued by the proposed decision for release of staff reports for 1989 and 1990 consultations to commercial banks. The decision, as it stands, calls for supplying the 1990 consultation report to banks even before Directors will have commented on it. Would it not be advisable to modify the decision by replacing, in paragraph B, the statement that "...the 1990 staff report shall not be transmitted by Colombia earlier than two weeks after its circulation..." by a statement that the report shall be transmitted after the conclusion of the consultation?

The Executive Directors agreed to continue their consideration of the 1989 Article IV consultation with Colombia in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/89/159 (12/6/89) and EBM/89/160 (12/11/89).

4. SDR DEPARTMENT - DESIGNATION PLAN FOR DECEMBER 1989-FEBRUARY 1990

The Executive Board approves the designation plan for the quarterly period beginning December 6, 1989 as set out in EBS/89/226 (11/29/89).

Decision No. 9314-(89/160) S, adopted
December 6, 1989

5. LIBERIA - 1989 ARTICLE IV CONSULTATION - POSTPONEMENT; AND OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

1989 Article IV Consultation - Postponement

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend further the period for completing the 1989 Article IV consultation with Liberia to not later than December 22, 1989. (EBS/89/223, Sup. 1, 12/15/89)

Decision No. 9316-(89/160), adopted
December 8, 1989

Overdue Financial Obligations - Review Following Declaration of Ineligibility - Postponement

Paragraph 5 of Decision No. 9237-(89/108), adopted August 23, 1989, shall be further amended by substituting "by December 22, 1989" for "by December 18, 1989." (EBS/89/223, Sup. 1, 12/15/89)

Decision No. 9317-(89/160), adopted
December 8, 1989

6. NICARAGUA - 1989 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the 1989 Article IV consultation with Nicaragua to not later than January 12, 1990. (EBD/89/380, 12/6/89)

Decision No. 9315-(89/160) adopted
December 8, 1989

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 89/53 and 89/54 are approved. (EBD/89/373, 11/30/89)

Adopted December 6, 1989

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/89/239, Supplement 1 (12/6/89) and EBAP/89/290 (12/6/89) is approved.

9. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/89/291 (12/6/89) is approved.

APPROVED: August 3, 1990

LEO VAN HOUTVEN
Secretary