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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/159

10:00 a.m., October 26, 1988

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
	W. K. Parmena, Temporary
F. Cassell	C. Enoch
Dai Q.	
C. H. Dallara	C. S. Warner
	A. Rieffel, Temporary
	J. Prader
	H. S. Binay, Temporary
A. Donoso	E. V. Feldman
	M. Hepp, Temporary
M. Finaish	A. M. Othman
G. Grosche	B. Goos
J. E. Ismael	J. Reddy
A. Kafka	J. E. Zeas, Temporary
M. Massé	W. N. Engert, Temporary
Mawakani Samba	
	I. A. Al-Assaf
G. Ortiz	L. Filardo
	V. J. Fernández, Temporary
J. Ovi	M. Fogelholm
H. Ploix	D. Marcel
	G. Pineau, Temporary
	G. P. J. Hogeweg
C. R. Rye	C.-Y. Lim
	F. E. R. Alfiler, Temporary
G. Salehkhou	
A. K. Sengupta	L. E. N. Fernando
	A. Vasudevan, Temporary
K. Yamazaki	S. Yoshikuni
	T. Morita, Temporary
S. Zecchini	N. Kyriazidis

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

Also Present

IBRD: G. T. Park, Latin America and the Caribbean Regional Office. Administration Department: T. N. Usmani. African Department: E. A. Calamitsis, Deputy Director; S. J. Anjaria, D. M. P. Frecaut, A. B. Taylor. Asian Department: P. R. Narvekar, Director; R. Hemming, S. M. Schadler. European Department: M. Russo, Director; G. C. Pastor. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; E. Brau, J. Martelino, A. M. Wolfe. External Relations Department: A. F. Mohammed, Director; B. Nowzad, Chief Editor; J. M. Landell-Mills, A. Mountford, E. Ray. Fiscal Affairs Department: V. Tanzi, Director. IMF Institute: G. M. Teyssier, Director; O. B. Makalou. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; J. V. Surr. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; L. Alexander, R. G. Alter, N. R. Chrimes, R. Pownall. Secretary's Department: C. Brachet, Deputy Secretary; J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat, G. Djeddaoui. Treasurer's Department: O. Roncesvalles. Western Hemisphere Department: S. T. Beza, Director; M. Caiola, Deputy Director; J. Ferrán, Deputy Director; J. Berengaut, L. E. DeMilner, C. S. Lee, A. S. Linde, C. M. Loser. Bureau of Language Services: A. Medrano. Bureau of Statistics: J. B. McLenaghan, Deputy Director. Advisors to Executive Directors: N. Adachi, A. A. Agah, M. Al-Jasser, E. Ayales, M. B. Chatah, A. G. A. Faria, P. D. Péroz.. Assistants to Executive Directors: S. Appetiti, B. R. Fuleihan, R. Comotto, Di W., J. Gold, S. Guribye, C. L. Haynes, A. Iljas, C. J. Jarvis, P. Kapetanović, K. Kpetigo, M. A. Kyhlberg, C. Y. Legg, V. K. Malhotra, C. Noriega, L. M. Piantini, S. Rouai, D. Saha, C. C. A. van den Berg, R. Wenzel.

1. ANNUAL REPORT - RESTRUCTURING

The Executive Directors considered a staff paper containing proposals to restructure the Annual Report (EBD/88/267, 9/20/88).

Mr. Enoch remarked that, as the events surrounding the 1988 Annual Meetings had vividly shown, there was an urgent need to convey to the public in all member countries a clear and accurate picture of the Fund and its work. The Annual Report was in many ways the formal keystone of the Fund's external relations effort and was therefore a logical starting point for seeking to improve the Fund's external relations.

The Annual Report had evolved over the years, Mr. Enoch noted. In particular, technical material that had been included in the Annual Report now appeared in the World Economic Outlook and other Occasional Papers. However, apparently the restructuring of 1986 had not gone far enough. The two-chapter structure had not achieved the objective of the restructuring, namely, to "focus more closely on the work of the Executive Board and deal rather less comprehensively than in the past with general world economic developments."

He therefore fully supported the staff's proposal to eliminate the present two-chapter structure and replace it with a short overview followed by a single main chapter, clearly divided into several subsections, which would focus primarily on the activities of the Fund, Mr. Enoch continued. Relevant elements of the present Chapter 1, on world economic developments, would then be blended into the new single chapter as background to the particular activity to which they related. He also supported the idea of using a series of thematic subheadings both to link the overview to the relevant parts of the main chapter and to connect the different sections of the main chapter.

The current procedure of considering the Annual Report exclusively in a Committee of the Whole could perhaps be looked at again, Mr. Enoch said. Such oversight should not be returned to the Executive Board, but it might be helpful for the Board to provide more guidance than it did at present to the Committee of the Whole at the outset of the review of the Report. The proposals by the staff for a more detailed outline to be offered to the Board could be a helpful way in which to set the parameters for the Committee. The Board perhaps could also discuss the overview.

There would be some benefit in establishing some basic ground rules to guide the conduct of the Committee of the Whole, including the use of such devices as a show of hands--not voting--to speed the discussion, Mr. Enoch remarked. The staff's idea of separately listing Executive Directors' comments, rather than incorporating the comments within a second draft, might also be helpful, as most of the discussion in the Committee had in practice tended to focus on modifications suggested by individual Committee members, usually with the result that many of the modifications were removed or further amended. Finally, he doubted whether the introduction of additional colors in the Annual Report would be cost effective.

Mr. Grosche said that he supported the idea of increasing the focus in the Annual Report on Fund policies and activities. Nevertheless, he had some doubts about replacing Chapter 1 altogether, as it offered the only opportunity for the Executive Board to express itself publicly on current problems in the world economy and on possible solutions. While he therefore favored a further shortening of Chapter 1, it should not become a negligible quantity. He favored replacing the present press summary with an overview, possibly followed by a shorter Chapter 1. It would also be useful to consider including the shorter Chapter 1 in the new main chapter under a specific heading.

He agreed with the staff that most of the information currently contained in Appendices I and II should not be woven into the new Chapter 2 of the Annual Report itself, as that would make the Report too difficult to digest, Mr. Grosche commented. In general, the Executive Board should refrain from making drastic changes in the Annual Report, as readers were accustomed to the present structure and might become confused by the sudden introduction of a very different structure. However, the proposal to subdivide Chapter 2 was appropriate.

In addition, the idea of introducing thematic subheadings was useful, Mr. Grosche went on. While producing charts in additional colors would certainly enhance the Report's readability, the additional costs were high and a cautious approach was therefore called for.

He broadly supported all the procedural suggestions in the staff paper, Mr. Grosche commented. He did not favor circulating a list of comments received on the initial draft. The practice of starting the discussion on the Report on the basis of a revised version of the first draft should be continued. During the discussion, the aim should be to seek a consensus, rather than to resort to voting. More active participation than hitherto by Executive Directors and their Alternates in the drafting sessions was desirable, as it was their Report, but there was admittedly considerable time pressure on the Executive Directors.

Mr. Yoshikuni said that, in general, he fully shared the concern of other Executive Directors about the accessibility of the Annual Report. In the light of the publication of various studies by the Fund, particularly the World Economic Outlook, the present opportunity to review the role of the Annual Report was welcome. In conducting the review, the Executive Directors should bear in mind the basic character of the Annual Report--it was the only authorized publication of the Executive Board on the policies and activities of the Fund.

As to the contents of the Annual Report, he supported the proposals in Sections 1(a) and 1(b) of the staff paper, in view of the need to enhance the Report's readability, Mr. Yoshikuni stated. He, like the staff, was not enthusiastic about the idea of incorporating information found in the appendices into the main body of the Report, as mentioned in Section c(i). That proposal made the Report less attractive, even redundant.

As to the proposal in Section c(ii), the review of the Annual Report should be aimed at limiting the total volume of the Report, Mr. Yoshikuni continued. His authorities were concerned about the recent increase in that volume. Although the volume had been gradually reduced over several years to 177 pages in 1986, it had increased in 1987 and particularly in 1988, when the Report was 229 pages. Accordingly, he supported the proposal in Section c(ii) only if it would help to reduce the volume of the Report by eliminating unnecessary duplications of the material involved.

He could go along with the proposal in Section d(i) on the condition that it would not lead to a lengthening of the Report, Mr. Yoshikuni said. At the same time, he agreed with the staff that the introduction of four-color charts would be costly and should be considered cautiously.

Since the Annual Report presented the views of the Executive Board, due consideration had been given, in examining the contents and wording of the Report, to maintaining the confidentiality and frankness of the Board's discussions, Mr. Yoshikuni noted. He strongly urged the staff to continue that cautious approach regardless of the outcome of the present review.

He fully agreed with the staff that the review of the procedures for considering the Annual Report should not result in an increase in the amount of time spent discussing the Report, Mr. Yoshikuni commented. That point was particularly important, since the discussion of the Annual Report was conducted at a time when the Executive Board's schedule was very tight because of the preparations for the Annual Meetings. Accordingly, the proposals presented on page 7 of the staff paper were counterproductive, with the exception of the suggestion to produce a more detailed outline than hitherto. In particular, a detailed listing of the initial comments would greatly increase the work load of the staff and Executive Directors. If the basic purpose of the listing was to avoid undesirable amendments, that objective could be achieved under the current procedure, since all the accepted amendments were explicitly shown in the revised draft.

Mr. Al-Assaf remarked that, of all the Fund's publications, the Annual Report received special attention from the press and the general public. Every effort was warranted to ensure that the Report reflected unambiguously the Fund's views and objectives regarding the world economy. Given the experience in Berlin, the Fund obviously was largely misinterpreted, and, therefore, the Executive Board should use its Report to, inter alia, project the correct image of the Fund.

The suggested attempts to make the Report as accessible as possible were therefore appropriate, Mr. Al-Assaf continued. In that connection, eliminating the two-chapter structure would be helpful. Chapter 1 should be replaced by an overview that projected a clear theme and described the Fund's objectives during the previous year. It would be crucial to have the overview fully incorporate the Executive Board's views on the challenges facing the world economy and the means to effectively address them. Chapter 1 should not be replaced by a watered down overview that sidestepped the main issues; an inadequate overview would minimize the Report's impact and undermine the Report's role as an active element in the Fund's external relations. Chapter 2 would then deal with the Fund's activities and its attempts to realize its objectives. Such a structure would help to avoid unnecessary duplication with the World Economic Outlook and, more important, would give direction to the Report.

He had an open mind on the divisions within Chapter 2, Mr. Al-Assaf said. He could go along with carving out several chapters or sections, provided that approach would not unnecessarily lengthen the text or give rise to duplication. That approach would obviously require meticulous editing by the staff. The tabular and statistical material on the Fund's financial transactions and operations would then need to remain in the appendices.

To improve the format, he endorsed the use of thematic subheadings that were clearly linked to the overview, Mr. Al-Assaf remarked. In addition, while he wished to increase the attractiveness of the Report, he was concerned about the costs of moving to four-color reproduction. If those costs could be limited, he would be willing to go along with that move. Four-color reproduction might be more appropriate for the pamphlets produced by the External Relations Department, as they were targeted to the wider public. The External Relations Department's work in that connection was commendable, and the staff should cover additional facets of Fund activity in future pamphlets.

He strongly favored the distribution, as early as possible, of a detailed outline that would flag the main issues and craft an overall theme for the Report, Mr. Al-Assaf commented. Such an outline and the suggested overview could be discussed by the full Executive Board, so that Executive Directors could set the overall theme and direction of the Report. That approach would facilitate the work of the Committee of the Whole in drafting the Report's main body.

It would be helpful not to incorporate suggested amendments into a revised draft, Mr. Al-Assaf said. Instead, the amendments should be listed by section and distributed separately prior to the first reading of the Report. That process would ensure that a consensus would be achieved before an amendment was included, instead of the procedure followed for the 1988 Annual Report, under which a consensus was in effect required to remove a suggested amendment.

Mr. Kafka commented that many, although not all, the suggestions in the staff paper were useful. The experience during the 1988 Annual Meetings, including the attention that the Fund drew from certain parts of the public, suggested that the Fund's external relations were not affected largely by public relations skills, but rather by more substantive factors.

The staff had proposed eliminating the two-chapter structure, Mr. Kafka noted. He agreed with Mr. Grosche that, since the Annual Report was the only document in which the Fund--rather than the staff--expressed its views, he preferred not to give up the two-chapter structure, although Chapter 1 could certainly be shortened considerably. It would not be wise to incorporate Appendices I and II into the new Chapter 2. However, it would be appropriate to subdivide Chapter 2 by using thematic subheadings. Using additional colors for the Report would not be very helpful.

It would be useful to have a more detailed outline of the Report, Mr. Kafka continued. In addition, there could be some experimentation with the review of the initial draft in the way that the staff had suggested. Approving amendments of the draft by vote, rather than by consensus, was clearly inappropriate; voting was clearly not advisable for important policy and operational matters and should not be used for the Annual Report. Finally, the Executive Directors did not have time to consider the Annual Report at full meetings of the Board.

Mr. Rye said that he agreed with previous speakers that fairly substantial revisions were needed in the structure of the Report in order to mount a more effective public relations effort and because the World Economic Outlook had become a published document. The World Economic Outlook was essentially a staff document, although it did include some input from the Executive Board. It was difficult to imagine that the Annual Report could say anything significantly different from what was said in the World Economic Outlook without causing great confusion and anxiety with respect to where the Fund actually stood on the issues concerned. Hence, he strongly agreed with the staff that the Annual Report should be a more active element in a more forward policy of external relations by the Fund, although the Report was unlikely to be a best seller. The discussion of the world economy in the Annual Report could be reduced. The present structure was clearly unbalanced: the 1988 Annual Report contained 34 pages on the world economy and only 24 pages on the Fund's activities.

In principle, he favored expanding Chapter 2, Mr. Rye continued. However, the statistical information in the appendices should not be weaved into the main body of the Report. Such information was appropriately located in the appendices. In addition, Chapter 2 should be subdivided, as the staff had suggested.

As to improvements in the format, the proposal to include a series of thematic subheadings would be helpful, Mr. Rye said. However, using additional colors in the charts would be costly and was unnecessary at the present stage.

He would welcome a more extensive outline of the Annual Report, Mr. Rye said. It should be discussed in the Executive Board, thereby giving Executive Directors an opportunity to contribute. However, participants in the discussions of the Report in the Committee of the Whole would of course suggest changes in the text on the basis of the full authority of their Executive Directors. It would not be helpful to circulate comments on the initial draft of the Report instead of having a revised draft based on recommended changes. Circulating a list of changes separately would be confusing and would increase the discussion time required. During meetings of the Committee of the Whole, it would be helpful to have informal canvassing of views, rather than a formal vote. At the same time, a Committee of 22 persons was obviously an unwieldy drafting instrument, and the contributions by the staff, acting in effect as an editor, would be instrumental. The Committee members should agree in advance to avoid debating merely small word changes and should concentrate their efforts on points of genuine substance. Finally, the Annual Report could usefully conclude with a brief overview of the challenges facing the Fund in the period immediately ahead.

The Acting Chairman remarked that discussions in the Committee of the Whole on the Annual Report were typically dominated by four or five participants, and it was often difficult for the Chairman to draw up a sense of the meeting with respect to issues that were raised and debated by relatively few speakers. It would be helpful to have a larger number of Committee members give their views on issues as they arose during the discussion; that approach would speed up the process of reviewing the text.

Mr. Rieffel said that he generally agreed with the five elements highlighted at the conclusion of the staff paper. In his view, a restructuring of the Annual Report that was based on those five elements would not be a major restructuring. It would instead be a further refinement of the 1986 restructuring.

He supported the elimination of the two-chapter structure and the suggestion to divide up the information on the activities of the Fund into a number--perhaps five or six--of separate sections that would begin with thematic headings, Mr. Rieffel continued. The main themes represented by those headings would then be combined in an overview at the beginning of the Report, which would also serve as a press summary. The section on the world economic outlook could then be shortened to four or five pages.

His chair had suggested incorporating material in Appendices I and II in the sections of the Report on the activities of the Fund, but the suggestion had been overinterpreted, Mr. Rieffel said. His authorities had in mind incorporating some of the textual material that had been presented in the appendices to avoid duplication; they certainly had not had in mind including the statistical tables.

Because of the costs involved, a four-color format should not be introduced, Mr. Rieffel considered. However, it might be possible to design a more attractive cover that would not be more expensive than the present one.

He supported circulating a more detailed outline and would have no objection to having comments circulated prior to the first reading, although he was not convinced that that practice would be more effective than the present practice, Mr. Rieffel remarked. Otherwise, the current procedures were satisfactory.

Mr. Parmena said that he agreed that many aspects of the Fund's activities were complex and were therefore not amenable to presentation in a very accessible format. Nevertheless, the staff should be encouraged to continue to enhance the readability of the Annual Report among the general public without compromising the standards and purposes associated with the Report under the Articles and the Rules. In that connection, the estimated additional $20,000 to move to four-color reproduction should be seen as a cost of maintaining the Fund's external relations, although he seriously doubted whether the addition of the colors would enhance the Report's accessibility. It might be more cost effective to use the additional expenditure in a more direct manner on the Fund's public relations.

It was desirable to give greater prominence to the Fund's activities by focusing more attention on Chapter 2, Mr. Parmena considered. That approach would be one clear way in which to avoid duplication with the World Economic Outlook. Accordingly, Chapter 1 should be replaced with a brief overview of developments in the world economy followed by a single, fairly short chapter. The shorter chapter's main role should be to provide the background for the discussion of the main problems, such as fiscal and payments imbalances, inflation, debt, and other problems that were to be addressed through the Fund policies dealt with in the present Chapter 2. Therefore, to minimize repetitions in Chapter 2, cross references could be made to the World Economic Outlook, the World Bank's World Development Report, and other similar publications that were readily accessible to the public. The chapter on the policies and activities of the Fund should be divided into two parts in order to improve the balance in the Annual Report.

The outline of the Report should be sufficiently detailed to indicate the main issues that would be presented and an overall theme for the Report in any particular year, although only if a clear theme was discernible, Mr. Parmena considered. Otherwise, only the main issues should be outlined. There was no need to depart from the present practice of inviting comments on the initial draft. In addition, the present practice of agreeing on amendments by consensus, rather than by voting, was satisfactory.

Little would be gained by moving the process of reviewing the Annual Report from the Committee of the Whole to the Executive Board, Mr. Parmena said. Advisors and Assistants fully consulted with their Executive Directors in advance of discussions in the Committee of the Whole and were in any event familiar with the sensitivities of their particular constituency. However, during the review, a genuine effort should be made to reflect the opinion of the Executive Board in a balanced manner.

Mrs. Hepp stated that she fully agreed with the objectives of restructuring the Annual Report, particularly to shorten the Report, avoid duplication, and focus more closely on topics related to the Fund. In reviewing the Report's content, it was important to keep in mind the mandate under the Articles and the description of the content of the Report given in the relevant By-Laws; they clearly noted the importance of the discussion of policies and activities of the Fund as well as a review of the international monetary system, including the adequacy of global reserves and the financial activities of the Fund.

Accordingly, she could go along with the proposal to replace the present Chapter 1 with a brief overview followed by a main chapter focusing on Fund policies and activities, Mrs. Hepp continued. The overview should be seen as a introduction to, and a summary of, the content of the Report. It would have the advantage of avoiding the present duplication and could serve as the press summary.

The material in the appendices on international reserves and the Fund's financial operations should be kept in Appendices I and II, Mrs. Hepp considered. Those issues were also mentioned at the end of the present Chapter 2 in the discussion of the adequacy of international reserves and financial policies and activities. In addition, she could go along with the idea of separating the present Chapter 2 into several sections, as suggested in the staff paper. That change would have the advantage of providing a more orderly presentation of the main chapter and would also help in the implementation of the proposal to have a series of thematic subheadings. She strongly supported the idea of using subheadings and of clearly linking them to the overview.

The cost of including additional colors in the chart was too great to justify, Mrs. Hepp said. In any event, the addition of colors was unnecessary.

She did not have strong feelings on the idea of circulating a more detailed outline of the Report, Mrs. Hepp said. She supported the practice of inviting comments from the Committee members on the initial draft prior to the first reading; that practice made an important contribution to saving time.

The tradition of reaching decisions by consensus was important to maintain, Mrs. Hepp stated. At the same time, asking for a show of hands in cases in which the Chairman of the Committee of the Whole felt that it would be appropriate to do so, could help to identify or clarify the views of the Committee members.

Mr. Prader said that he agreed with previous speakers that an effort should be made to improve the presentation of the Fund's policies to the public. At the same time, he doubted whether the Annual Report was the appropriate instrument for correcting misperceptions of the Fund. Other means would perhaps be needed to change the Fund's public image. As to the specific proposals in the staff paper, he wished to associate himself with the views of Mr. Enoch.

Mr. Hogeweg remarked that he was struck by the fact that the thrust of the 1986 restructuring was identical to what was being proposed for the present review. Perhaps the 1986 restructuring had not gone far enough. Changing the present format was fully acceptable; the changes in the direction mentioned in the staff paper were improvements. However, some continuity should be kept after the present review.

He accepted the proposal to focus on the present Chapter 2 and to add a brief overview section that would also serve as the press summary, Mr. Hogeweg continued. The use of thematic subheadings and arranging the material as indicated in the staff paper also were appropriate.

He favored leaving as much statistical material as possible in the appendices, Mr. Hogeweg remarked. However, technical assistance was a very important Fund activity and a description of it in the main text might well be warranted. He did not favor moving to four-color reproduction at the present stage.

In the light of the external relations aspect of the Annual Report, it might be useful to consider presenting on the inside of the front cover the provisions of Article I on the purposes of the Fund, Mr. Hogeweg commented. So doing would immediately give the reader an idea of what the Fund was about.

He was generally satisfied with the present procedures for reviewing the Annual Report, Mr. Hogeweg said. Abolishing the Committee of the Whole on the Annual Report would not be helpful. The lack of discretionary authority of Assistants to Executive Directors was not a problem in reviewing the Annual Report. Linguistic and editorial improvements in the text should be kept separate to the extent possible--and should be circulated in advance--from more substantive issues, which should be discussed in the Committee.

He welcomed the suggestion to prepare a more detailed outline for the 1989 Annual Report, Mr. Hogeweg commented. It should be available early enough for the Executive Board to discuss it and for the staff to write the Report accordingly after that Board discussion.

Mr. Fogelholm said that the staff paper suggested that the Committee of the Whole could consider itself fortunate that in 1988 it had spent "only" 20 hours discussing the 1988 Annual Report. He agreed with previous speakers that further improvements in reviewing the Report were warranted.

He basically agreed with the staff's proposals, Mr. Fogelholm commented. In particular, the main objective should be to focus the Report on the activities of the Fund. Therefore, he supported the proposal to eliminate the two-chapter structure, thereby minimizing overlapping with other Fund publications. He agreed with Mr. Rye that it was inconceivable that the Fund would produce two Reports--the World Economic Outlook and the Annual Report--that conveyed different messages to the public. A shorter Annual Report with a new structure would increase the Report's value for public relations purposes; in that context, he strongly favored including an overview section.

Also from the public relations point of view, the Annual Report would benefit from more attention on the descriptions and discussions of Fund policies, Mr. Fogelholm continued. The Report would be easier to read if it contained more diagrams, preferably to replace at least partly sections that hitherto had been crammed with detailed figures. In turn, an increase in the number of diagrams might require that the related data be provided in an annex. In order to keep the main body of the Annual Report succinct and easily readable, most of the specific and statistical information should be confined to the annexes. Therefore, he did not favor the suggestion to incorporate information that was at present included in the appendices into the new Chapter 2.

There was certainly scope for increased efficiency in the procedures for reviewing the Annual Report, Mr. Fogelholm considered. The efficiency could be considerably enhanced if, at the beginning of its session, the Committee agreed to adhere strictly to certain procedural rules. That and other streamlining should be tried before Executive Directors became directly involved in the drafting process. However, he agreed with Mr. Enoch that it could be useful to have the Executive Directors discuss the overview section.

Mr. Engert stated that he wished to associate himself with the comments made by Mr. Enoch.

Mr. Zecchini said that he agreed with most of the staff proposals. There should be a greater focus than hitherto in the Annual Report on Fund policies and activities, particularly lending. Chapter 1 should be shortened but not eliminated. A shorter Chapter 1 would basically be equivalent to a long overview, and either solution was acceptable, provided that the overview was long, and not short. In addition, it would be appropriate to subdivide Chapter 2 in order to make it more readable. He saw no reason to keep the material contained in Appendices I and II in that location. Only statistical tables should be left in the appendices. The contents of the first two appendices should be moved to the relevant subdivisions of the new Chapter 2.

The discussion on the Annual Report should be shortened, Mr. Zecchini considered. It was helpful to have a first reading of a revised draft, but a second reading was not always necessary; a written procedure could be used to avoid that reading. A second reading should be held only if there were insurmountable differences of views on specific amendments. In that event, the discussion should focus entirely on those differences of views.

It would not be wise to employ voting to reach agreement on amendments to the text, Mr. Zecchini said. The principle of reaching a consensus should be the basic guideline for the procedures for reviewing the Annual Report.

He had serious misgivings about the proposal to increase the involvement of Executive Directors in the procedures for reviewing the Annual Report, Mr. Zecchini remarked. Efforts in that direction could be seen as reflecting a lack of confidence in the work of Alternates and Assistants. Since Alternates and Assistants typically discussed proposed amendments with their Executive Directors, it was not absolutely necessary to involve the Executive Directors in the review of the Annual Report. Hence, the present procedures should be maintained.

Mr. Salehkhou commented that, while he supported improvements in the quality of any aspect of the Annual Report, frequent changes of the content of the Report would not necessarily improve its quality. The previous major restructuring of the Annual Report had taken place only 18 months previously. There had been no major changes since then in either the world economic environment or the Fund's activities. Accordingly, frequent changes in the Annual Report and any reversal of Executive Board decisions in that area might, by implication, be interpreted as disqualifying previous Annual Reports in the eyes of the public, thereby undermining a current Report's acceptability. The Executive Board should therefore accept only proposals that would not discredit Annual Reports.

Directors need not be greatly concerned about possible duplication between the Annual Report and the World Economic Outlook, Mr. Salehkhou continued. The objectives, official character, substance, and procedures of those documents were different. There were official, institutional, substantive, and procedural differences between the Annual Report of the Executive Board and the World Economic Outlook of the staff. The Annual Report was an official and formal document of the Fund; the Executive Board was mandated by the Articles to report to the Board of Governors and the public at large. However, despite its increasing popularity, the World Economic Outlook was a staff document, and the Executive Board, the Board of Governors, and the Interim Committee might or might not fully agree with its contents. The official and institutional differences between the two documents clearly showed that prominence between them should be given to the Annual Report, which was an item on the agenda of the Fund's annual meeting. On page 2 of EBD/88/267 the staff had stated that the Annual Report "has always been regarded as a publication that presents the views of the Executive Board, rather than the staff," and that "from the outset, the Annual Report was given special attention in the press and by the public as the sole authoritative published pronouncement of the Fund's views on the world economy and on the working of the international monetary system." Therefore, the official status of the Annual Report should remain intact, particularly in view of the Report's wide circulation in the media and among the public.

As to the substantive difference between the Annual Report and the World Economic Outlook, the latter was more comprehensive and forward-looking in terms of general world economic developments than the former, but the content of the Annual Report, including the discussion on world economic developments, certainly should not be considered as being less important than the World Economic Outlook, Mr. Salehkhou considered. Under Section 10 of the By-Laws, the Annual Report was to cover the activities of the Fund, which, in one way or another, included a host of world economic, financial, and monetary issues and policies. In other words, the activities of the Fund should not be considered as separate and isolated from member countries' domestic economic activities or international economic activities. Otherwise, the Fund's surveillance function, particularly with respect to the functioning of the international monetary system, would be meaningless. Moreover, if the Annual Report appeared to be somewhat out of date by the time it was released to the public, that was because the Report reflected the activities of the Fund during the financial year just past.

The procedures for preparing the Annual Report differed from the procedures for preparing the World Economic Outlook, Mr. Salehkhou noted. The Annual Report was an official and binding document of the Fund drafted by the Committee of the Whole. The World Economic Outlook was a staff report that might or might not include the comments of all Executive Directors. The procedural differences were reflected in the staff's approach to and position in discussing the Annual Report in the Committee of the Whole and its approach to and position on the world economic outlook discussion in the Executive Board. While in drafting and introducing any changes in the Annual Report the staff rightly considered itself to be under the guidance of the Committee of the Whole, that was not the case for the World Economic Outlook. In sum, the official character of each document understandably required different appropriate preparatory procedures.

In the circumstances, while some of the proposed revisions might be helpful at some time in the future to improve the quality of the Annual Report, he accepted only three of the proposals at the present stage, Mr. Salehkhou went on. First, he had no difficulty in accepting the inclusion of an overview in the Annual Report that would serve as the press summary. However, it should not replace Chapter 1, which provided necessary background on the world economic environment, in which the

Fund's activities were taking place. Second, as to the expansion of Chapter 2, he could go along only with the proposal to divide Chapter 2 into two or three chapters or sections, as described by the staff on page 6. With respect to improvements in format, he agreed only with the proposal to enhance the effectiveness of the proposed overview by using in the body of the Annual Report a series of thematic subheadings and by having clear links between the overview and the subheadings.

Mr. Vasudevan said that his position was similar to that of Mr. Enoch. The discussion in the Annual Report on the world economic outlook, however, need not be as short as four or five pages; it could take up eight or nine pages. The staff could experiment with the size of the discussion. He did not favor circulating comments on the initial draft of the Annual Report. Most of the comments were merely corrections, rather than substantive suggestions. In that connection, the experience with the 1988 Annual Report had been most unfavorable; there had been hundreds of corrections, of which only seven had been suggested by Executive Directors from developing countries.

Mr. Ismael stated that he supported the staff proposals in EBD/88/267. He agreed with Mr. Hogeweg that the objectives of the Fund stated in Article I should be displayed at the beginning of the Annual Report.

Mr. Pineau considered that the proposal to substitute an overview for the present Chapter 1 was the key to the suggested restructuring. Chapter 2 could then be divided into several chapters or sections introduced by subheadings. It should be possible to incorporate part of the most relevant statistical material in the appendices into the main body of the Annual Report. It would be particularly helpful to include in the main body statistics on exchange rates and international liquidity developments as well as the more significant figures on the Fund's financial activities.

Early circulation of a more detailed outline of the Annual Report would be helpful, Mr. Pineau said. He agreed with the staff that the comments by Committee members on the initial draft of the Report should continue to be discussed on the basis of a revised draft. The provision of a separate detailed list of comments would not help the discussion.

There would be little merit in increasing the Executive Directors' participation in the drafting of the Annual Report, Mr. Pineau commented. Increased involvement by the Executive Directors would not necessarily enhance the substance of the Report. However, greater Executive Board input in the discussion of the detailed outline of the Report would be acceptable.

Mr. Fernández said that he agreed with Mr. Grosche and Mr. Kafka that the space devoted in the Annual Report to Chapter 1 should not be drastically reduced.

The staff representative from the External Relations Department commented that the discussion had provided useful guidelines to the staff for the restructuring of the Annual Report. As a number of speakers had noted, it would be helpful in general to avoid excessively frequent restructuring of the Annual Report, as the Report had a certain standing with its readers, and some degree of continuity and tradition was probably desirable.

As the staff had noted in its paper, there were certain differences between the World Economic Outlook and the Annual Report, the staff representative continued. The World Economic Outlook was basically a forward-looking, analytical, and very detailed document. In addition, the pronouncements of the Interim Committee, which were also forward-looking to some degree, had been available for a number of years. The Annual Report, which had evolved over the years, had two particularly important features: it provided an authoritative statement by the Executive Board; and it was retrospective in nature, providing (as required by the Articles) a review of policies and activities of the Fund against the background of the world economic developments.

The staff had also found the Annual Report to be a useful public relations tool, the staff representative remarked; it was helpful for the staff and the press to have the Report be made available two weeks before the Annual Meeting. The discussion of the world economic situation in the Report was frequently used and often quoted by the press. Accordingly, a succinct and coherent expression of the world economic situation in the Report was probably useful.

Several views had been expressed by Executive Directors on the possible structure of the Annual Report in the future, the staff representative remarked. One view was to have a very short first chapter on the world economic situation, followed by a chapter on the Fund's policies and activities. The second view was that there should be an overview encompassing the present Chapter 1 followed by a chapter on the activities of the Fund. The third view was that there should be a short chapter on the world economic situation, a longer chapter on the activities of the Fund, and a brief overview encompassing both. Given the use that was made of the Annual Report, the staff preferred the third option.

The staff clearly benefited from the comments that were received from Executive Directors prior to the first discussion of the draft of the Annual Report, the staff representative said. The staff was glad to have such comments--particularly on substantive points--in a timely fashion, since the staff operated under a very tight schedule. The staff was pleased that Executive Directors wished to continue the current practice with respect to the provision of comments on the initial draft.

By being imaginative, the staff could improve the design and presentation of the Annual Report, thereby making it more attractive, without using four colors, the staff representative from the External Relations Department remarked. The restructuring of the Report was a good opportunity to attempt to redesign it at the same time.

Mr. Zecchini remarked that it might be useful to include the objectives of the Fund as set out in Article I on the inside cover of the World Economic Outlook as well as in the same place in the Annual Report.

The Acting Chairman made the following concluding remarks:

> Let me make some concluding comments on the basis of this discussion. First, I think that everyone agreed that the Annual Report is, and should continue to be, a statement by the Executive Board on Fund activities. Second, I did not sense that there was a desire for revolutionary changes in either the content and structure of the Report, or the procedures for reviewing the text. Third, Directors noted the external relations aspect of the Report and stressed that it is desirable to use clear and precise language in explaining what the Fund has been doing. I suspect that even Mr. Mawakani, who had perhaps the strongest reservations about the public relations aspect, and some others, would support that conclusion.
>
> With respect to the structure, there was clear support for beginning the Report with an overview, which would also be a useful presentation to the press. That text should be a clear and concise statement of the basic thrust of the Annual Report.
>
> On the question of having a structure based on one chapter rather than two, the differences of view were not basic. All speakers today seemed to agree that the report should be integrated, so that all the chapters and subheadings would be seen as a part of a single entity; accordingly, we would not present a lengthy separate world economic outlook chapter, and, instead, it would be clear that the text on the world economic outlook was meant to provide the right context for the subsequent discussion on the activities of the Fund over the previous year. In presenting the outline of the Report, the staff could suggest whether one chapter or two would be appropriate. In developing the outline, the staff may find that, one chapter, with a subheading, would set the economic context within which the Fund activities, under other subheadings, would be discussed. There was a consensus on trying to keep the Report relatively short and succinct.
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> With respect to the appendices, the overriding principle that we should follow is that aspects of the appendices could be included in the main body of the text only if in so doing the readability and integration of the Report would be enhanced. Otherwise, we should continue to leave to the appendices more detailed technical explanations and statistics.

Most Directors were concerned about the cost of producing charts in more colors in the Report, but possible ways of making greater use of graphics should be explored. In addition, it was agreed that the provisions of Article I should appear inside the front cover of the Annual Report.

There was a clear desire to have for the Executive Board discussion a more detailed outline highlighting the Report's themes, which is often a major issue for the Committee of the Whole. Indeed, if anything stretches out the discussion, it may be differences of view on the underlying themes, and, in that context, the extent to which we should emphasize the problems that the Fund is trying to deal with while presenting a picture of the world economy that is not overly negative. It would therefore be useful to have the guidance of the Board on the basic themes.

On other procedural matters, there was general support for continuing the practice of having for the first reading of the Report a revised draft based on comments by Directors. Whether or not there need be a second reading could be decided at the time of the Committee of the Whole's discussion. That decision would depend on the extent to which the first reading produced major changes, which normally would require a further look by the Committee of the Whole. In that context, the Committee of the Whole's work has been facilitated by making it clear that once the first reading is done, the parts of the text that were agreed should not be reopened for discussion at the second reading.

The practice of making decisions by consensus was strongly confirmed. The process of reviewing the draft Report could certainly be sped up if the participants in the discussion would indicate their views on the various issues raised by individual participants. There seemed to be no great interest in having the Board be more deeply involved than it has been in the past in the discussion of the Annual Report.

2. GUATEMALA - 1988 ARTICLE IV CONSULTATION; REQUEST FOR STAND-BY ARRANGEMENT; EXCHANGE SYSTEM; AND USE OF FUND RESOURCES - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1988 Article IV consultation with Guatemala, together with Guatemala's request for a 16-month stand-by arrangement (EBS/88/202, 9/22/88; Cor. 1, 10/14/88; and Cor. 2, 10/21/88), and Guatemala's request for a purchase under the compensatory financing facility (EBS/88/203, 9/22/88; Cor. 1, 10/14/88; and Sup. 1, 10/24/88). They also had before them a background paper on recent economic developments in Guatemala (SM/88/222, 10/12/88).

The staff representative from the Western Hemisphere Department said that, since the circulation of the staff report, the staff had received preliminary data indicating that the performance with respect to the indicative targets for the end of September 1988 was broadly on track. Net international reserves had fallen short of the target, but the deviation had amounted to only $6 million, or less than 1/2 percent of projected exports of goods and services in 1988. Moreover, there had been a strong improving trend in the reserve position during September 1988, as measures to control credit and curb imports taken at the beginning of the month had begun to take hold. As to Guatemala's relations with its relatively few bank creditors, recent contacts pointed to progress in the negotiations on rescheduling past due principal. Guatemala had remained current on interest payments to commercial banks. Finally, irrevocable payment instructions had been issued on October 25, 1988 by the Central Bank of Guatemala which had the effect of clearing Guatemala's arrears to the World Bank.

Mr. Ortiz made the following statement:

> On behalf of my Guatemalan authorities, I would like to express their appreciation to Fund management and the staff for their support of the country's adjustment efforts. They are also of the view that the staff report for the 1988 Article IV consultation presents an objective overview of recent developments and they broadly agree with the staff's analysis of Guatemala's economic situation. At the same time, I would like to convey my authorities' appreciation for the technical assistance provided by the Central Banking Department in the area of monetary policy and financial programming, and by the Bureau of Statistics in the collection and compilation of financial data.
>
> Guatemala experienced a severe economic and financial crisis during the first part of the present decade, characterized by a sharp reduction in per capita income, a significant increase in unemployment, relatively high levels of inflation, and a marked deterioration in the country's external position. In addition to the external shocks which affected most developing countries in those years, Guatemala's difficulties were compounded by the escalation of social and political unrest in the area, and a concomitant slowdown in regional trade.
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> Faced with this situation, the present Government, which took office in early 1986, introduced a comprehensive adjustment program--which, as described in the Report, included wide-ranging fiscal, monetary, and exchange rate measures--whose main objectives were to strengthen the external position, stabilize prices, and resume sustainable growth. These efforts yielded very positive results in the same year that the program was adopted: the deterioration of the economic activity was arrested, inflation was sharply reduced, and the external position strengthened. Moreover, with the rationalization of the

exchange system, the central bank's losses were reduced considerably, and the combined public sector deficit was more than halved, to less than 3 percent of GDP.

Despite the adverse external conditions in 1987, stemming from a sharp deterioration in the terms of trade as coffee prices fell by almost one third, economic growth resumed (real GDP rose by 3 percent), and inflation decelerated to 12 percent, from 37 percent in 1986. However, the economic recovery and the restocking of inventories, combined with the deterioration in terms of trade, exerted pressures on the current account. Nevertheless, balance of payments support from bilateral sources, debt relief provided by commercial and bilateral creditors, and significant inflows of private capital contributed to mitigate the effects on international reserves.

Following the overall satisfactory performance during the first two years of the current administration, the authorities adopted a comprehensive program in 1988 aimed at preserving and consolidating the gains attained in domestic stabilization, strengthening the external position and growth prospects, and attending some of the most pressing social demands with the limited amount of resources available. The main objectives of the country's economic program in support of which the authorities are requesting the stand-by arrangement are: (a) a real GDP rate of growth of 4 percent in 1988 and 4 1/2 percent in 1989; (b) a decline in the rate of inflation to 12 percent in 1988 and to less than 10 percent in 1989; (c) a reduction of the combined deficit of the public sector (including losses of the Bank of Guatemala) to 3.2 percent of GDP in 1988 and 2.6 percent of GDP in 1989; (d) a reduction of the external current account deficit from 8 1/2 percent in 1987 to 6 1/2 percent of GDP in 1989 and 5 1/4 percent of GDP in 1989; and (e) an improvement in the overall balance of payments from a deficit of about $50 million in 1987 to a deficit of $40 million in 1988 and to a surplus of around $60 million in 1989.

The Government has implemented--and continues to pursue--a number of policy actions. In late 1987, a major tax reform was introduced that is expected to yield additional revenues equivalent to 1.4 percent GDP in 1988. The reform, which includes a thorough revision of the income tax system and changes in the value-added, property, stamp, and vehicle taxes, is expected to improve significantly the tax structure, both in terms of progressiveness and coverage. In early 1988, electricity tariffs were adjusted to make it possible for the power company to meet the higher local currency costs of servicing its external obligations following the unification of the exchange rate in June 1988. Furthermore, prices of gasoline and diesel fuels were increased by 8 percent and 38 percent, respectively. It should also be noted that, as a result of the consolidation of the exchange markets, the exchange losses of the central bank have ceased and will decline to less than 1 percent of GDP in 1989.

The unification of the exchange rate system referred to above, involved the merging of transactions from three distinct markets into a single market with an exchange rate set initially at Q 2.70 per U.S. dollar, which implied a depreciation of about 10 percent. With a view to achieving medium-term viability in the context of an export-led growth strategy, the authorities will adjust the rate of exchange in the future according to balance of payments developments. This flexible exchange rate policy is being accompanied with important structural--legal, administrative, and tax--measures, which are described in detail in the staff report, emphasizing export promotion particularly of nontraditional products to new markets.

In the monetary sphere, the ceilings on domestic commercial banks' deposits and lending rates, which already provided for positive real interest rates, were raised by an additional two percentage points. A restrictive credit policy will be supported by more active central bank participation in open market operations, which will be facilitated by the establishment of a stock exchange in the very near future. It is expected that the existence of an organized secondary market for securities will significantly contribute to the modernization of the financial sector, a necessary condition to increase the pool of domestic resources--both public and private--as well as to improve their allocative efficiency. Furthermore, it is the authorities' intention to maintain a flexible interest rate policy and to keep under review central bank discount rates and legal reserve requirements.

The Guatemalan authorities believe that the economic program for 1988-89 will not only consolidate recent gains toward eliminating domestic and external imbalances, but also provide the basis for higher economic growth in the years ahead and improve the standards of living of the population. In support of these efforts, they request a stand-by arrangement for 15 months in an amount of SDR 54 million, and a purchase equivalent to SDR 21.6 million under the compensatory financing facility.

As is clearly stated in EBS/88/203, Guatemala experienced a drastic export shortfall during the period April 1987-April 1988, estimated at SDR 151.7 million, equivalent to 140 percent of the country's quota, which can be attributed entirely to factors beyond the control of the authorities. The causes of the shortfall and export earning prospects are thoroughly analyzed in the staff paper. The Government's decision to limit the request to 20 percent of quota at this time--with the possibility of making a further request before the expiration of the stand-by arrangement--is based on the country's reserve management objectives.

Mr. Zeas made the following statement:

In view of the important adjustment policies already implemented by the authorities, we strongly support the proposed use of Fund resources. According to the authorities, the main goal of the 1989 program is to establish the foundation for sustained growth and a viable balance of payments, which will help to meet the economic and social needs of the people of Guatemala in the period ahead. Thus, in 1989, the economy is projected to grow at a rate of at least 4.5 percent, the rate of inflation is to be reduced below 8 percent, and the overall balance of payments is to shift from a deficit of $41 million to a surplus of $60 million. With these goals in mind, the authorities are proceeding with the implementation of important fiscal, monetary, exchange rate, and structural reforms that we welcome and support.

Although we agree with the main parameters and policies proposed for the achievement of the program goals, I wish to make a few comments on the policies designed to correct the imbalances and to achieve growth. Given the dramatic immediate social needs--for example, the large number of people without access to safe water and without adequate housing--and the high illiteracy rate, we would have expected that the program would have included a larger amount of public sector capital expenditure than the equivalent of 2.7 percent of GDP, which is smaller than the proportion achieved in 1984. At the same time, we would have expected that the bulk of these additional expenditures would have been financed by multilateral development agencies.

In this context, the very limited involvement of the World Bank during the recent past is a cause for serious concern that we hope both the authorities and the staff will address urgently. Guatemala, with some 8.3 million inhabitants, a rapid rate of population increase, and a per capita income of less than $950, should not continue to receive annual net disbursements from the World Bank of less than $9 million, as it did on average during the previous five years. The World Bank's loan disbursements to Guatemala are weak in the context of the country's annual imports of approximately $1.5 billion per year, and the social and developmental needs of the country.

The success of the program in the external sector depends on several factors--for example, a rather optimistic export growth performance of more than 12 percent in 1989, compared with an annual average rate of increase of near zero percent in the previous four years. Given the instability of prices for commodities, such as coffee, which accounts for approximately 50 percent of Guatemala's exports, we have some doubts about the projected export growth performance even under normal weather conditions. Consequently, we welcome the authorities' decision to use only 14 percent of Guatemala's entitlement under the compensatory financing facility, thereby leaving room for any contingency that might arise in the coming period.

The program also calls for the total elimination of arrears by June 1989. To this end, the authorities must close a refinancing agreement with the commercial banks in six months. This seems feasible, but if Costa Rica's experience is any guide in Central America, the Guatemalan authorities may well run into difficulties on this front. This concern is reinforced by the authorities' statement in paragraph 4 of their Letter of Intent that "discussions with commercial banks on the rescheduling of past due principal (which comprises the bulk of debt arrears) have been held intermittently since 1986." Therefore, we would have preferred a program that provides more time and flexibility in this area; the elimination of arrears does not depend solely on the authorities' efforts.

The expected improvement in the balance of payments is also based to a large extent on the containment of import demand and a large sectoral loan by the World Bank in support of, inter alia, the reduction of import tariffs. While other, more developed countries maintain outright import prohibitions and quotas, forcing these import tariff reductions on a financially weak country like Guatemala is asymmetrical. Moreover, in a country where the tax effort is equivalent to only 10 percent of GDP, for a series of well-known historical reasons, it is premature and dangerous to reduce an accepted and important source of revenue for the Government. Furthermore, if tariffs are reduced, it will be much more difficult to contain the increase in the demand for imports. Under the program, imports are projected to increase by only 6 percent in 1989. With the proposed tariff reduction, the external sector's goal in the program will be particularly difficult to achieve. Therefore, we would have preferred to see the World Bank's loans concentrated on the developmental, reconstruction, and social needs of Guatemala, while postponing the import tariff reductions until the country's financial position is stronger.

Mrs. Hepp made the following statement:

We fully support the proposed decisions. All the requirements for compensatory financing have been met.

Guatemala's economic performance in the first half of 1988 has been broadly satisfactory, with the continuation of the favorable trend of higher growth and a lower rate of inflation that began in 1986. However, the external position has deteriorated, and net official international reserves have declined sharply. In this connection, the series of measures adopted in June 1988 to reinforce the adjustment effort are a timely response by the authorities and are especially welcome.

We broadly agree with the staff appraisal, and I will comment on economic policies recently introduced in Guatemala.

The combination of revenue measures and expenditure restraint, together with the elimination of central bank losses, should achieve a combined public sector deficit of 3.2 percent of GDP in 1988 and 2.6 percent in 1989. The recently adopted tax measures are welcome; in addition to increasing tax revenues and improving the tax administration, they have rationalized the structure of the tax system, reducing its regressiveness and broadening its base. The reorientation of expenditure toward social services and rural development, within the limits of expenditure restraint, is also noteworthy. However, the existence of constitutionally mandated expenditures could impose some rigidity in the budget and could imply some difficulties if additional adjustment should be required. The unification of the exchange rate has eliminated the exchange losses of the Bank of Guatemala; other losses are expected to decline in the future. The authorities should persist in their efforts to achieve the fiscal targets in order to make room for the expansion of credit and private sector activities, which are the basis for continued growth together with low rates of inflation.

We agree with the design of the authorities' monetary policy, which is consistent with the objective of maintaining low rates of inflation, economic growth of about 4 percent, and strengthening international reserves. The establishment of a stock exchange, which will facilitate the central bank's open market operations, as well as the operations in government bonds and other financial instruments, are important steps in the right direction. Particularly crucial is the authorities' intention to maintain a flexible interest rate policy and positive real interest rates in order to permit efficient resource allocation and to provide incentives for the development of the domestic capital market.

As to the external sector, it is clear that the key measure is the reunification of the exchange rate system. The authorities' intention to maintain a flexible exchange rate, consistent with balance of payments developments, is welcome. In addition, all the initiatives that have already been taken to promote exports are very positive steps, and the authorities should continue in that direction. In the area of trade reform, the assistance and support of the World Bank through an export promotion loan are welcome.

The medium-term outlook shows that if Guatemala returns to pre-1980 overall fiscal deficits of approximately 1 percent of GDP, and if appropriate economic policies are maintained, growth rates in the range of 5-8 percent--similar to those achieved prior to 1980--could be regained by the beginning of the 1990s. The projections also show a gradual reduction in the current account deficit, which would be consistent with a further decline in the ratio of external debt to GDP to approximately 28 percent in 1994. It is noteworthy that changes in the basic assumptions would result in only minor changes in the outcome under the base scenario.

Mr. Alfiler said that he supported the proposed decisions. He agreed with the authorities and the staff that the economic and financial program for which Fund support was being requested would provide a sound basis for sustained growth and durable balance of payments adjustment and would contribute toward meeting the economic and social needs of the Guatemalan people.

It was encouraging to note that the new administration, which was the first democratic one after 30 years of military rule, and having weathered several coup attempts over the previous two years, had found the confidence to implement valiant measures to reduce the fiscal deficit, unify the exchange rate, and work for the settlement of the country's arrears, Mr. Alfiler remarked. More important, those efforts had paved the way to a Fund-supported program that, in turn, was expected to catalyze more funding from aid agencies and other multilateral institutions, as well as commercial bank rescheduling arrangements.

The objectives under the authorities' program were appropriate, Mr. Alfiler considered. The fiscal and monetary measures that had been implemented thus far, as well as the decontrol of most commodity prices, were in the right direction.

The measures to rationalize the income tax and indirect taxes were substantial and should allow greater responsiveness to improvements in real economic activity, Mr. Alfiler commented. The simplification of the tax structure also could result in substantial improvement in tax administration. On the expenditure side, he welcomed the authorities' willingness to implement cuts that would offset any unexpected increase in expenditures associated with the civil service reform.

The improvement in the fiscal position should relieve some of the apprehension about the possible need to implement a more aggressive financial policy reform, Mr. Alfiler said. The authorities might wish to consider eliminating altogether interest rate ceilings on loans and deposits, since the expected annual rate of inflation over the coming two years was below the ceiling on deposit rates, and a more market-dictated yield on financial savings could help to close the wide gap between savings and investment. A market-determined interest rate could thenceforth be used as a reference for the central bank's rediscount rate.

The authorities might also wish to consider issuing government securities for open market operations, Mr. Alfiler continued. That practice could enhance monetary management and create an instrument for tapping nonbank resources for budget deficit financing--two important objectives of the country's economic program.

In the area of exchange rate policy, it was important to preserve the gains that had been made with the unification by adopting a flexible stance, Mr. Alfiler considered. Therefore, the authorities' intention to adjust the exchange rate from time to time in accordance with international developments was welcome. Moreover, exchange rate flexibility was essential for an export-led growth strategy.

Needless to say, it was important for the Fund-supported program and for the donor community to ensure that the schedule for the elimination of arrears was followed, Mr. Alfiler commented. Finally, he was encouraged by the authorities' confidence and resolve to steer the economy toward a sustainable external payments position and stable growth, and he was confident that, with the help of the international financial community, the Fund-supported program would be successful.

Mr. Grosche made the following statement:

> The authorities are to be commended for the adjustment efforts undertaken since 1986 and for their decision to give new impetus to adjustment with the Fund's support. The measures adopted in June 1988--especially the unification of the exchange rate, the adjustment of interest rates, and the additional fiscal measures--demonstrate the authorities' determination to redress the external and internal imbalances. The proposed program, if fully implemented, should go some way toward restoring economic and financial stability. The resumption of private capital inflows and the much improved overall business climate show that the authorities' determination is already paying off and should encourage them to fully implement the program.
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> Most important, the authorities should be aware that the full potential benefit of the adopted or contemplated measures will be realized only if they are supplemented by an appropriate degree of financial restraint. As the staff has clearly stated, and bearing in mind Guatemala's past experience, the eventual success of the program hinges especially on appropriate fiscal policies. A further reduction of the fiscal deficit would certainly reduce the pressure on domestic resources and would

facilitate the attainment of the authorities' inflation objective. Perhaps even more important, a smaller fiscal deficit would also make a necessary contribution to lowering interest rates and to promoting investment activity and growth. The recent rise in interest rate ceilings is welcome, but flexible--or, even better, market-determined--interest rates would be preferable for generating greater domestic and external savings.

In light of the need for further financial restraint, I wonder whether the program is fully adequate, as it includes almost no fiscal adjustment in 1988 and only a moderate reduction in the fiscal deficit in 1989. However, I recognize that achieving even those moderate fiscal targets requires the authorities' full determination. Fiscal performance continued to be exposed to adverse developments and, as has become clear in recent months, some of the adjustment measures might encounter resistance, thereby threatening or at least delaying their implementation. Therefore, I fully support the staff recommendation that "it is important that the authorities stand ready to take any further measures that may be needed to safeguard the achievement of the program's fiscal objectives." At the same time, the authorities' prompt and adequate reaction to possible expenditure overruns owing to higher public sector wages is heartening.

In the area of structural adjustment policies, the authorities have already implemented important measures, such as further steps toward price liberalization and the adjustment of public tariffs. At present, it is important for macroeconomic measures to be taken parallel with structural adjustment measures to ensure that, for example, price liberalization and exchange rate adjustment do not lead to an increase in inflation.

In sum, the authorities have introduced comprehensive and important measures at the outset of their program, which bodes well for the eventual successful implementation of the program. The degree of determination that the authorities have shown thus far is encouraging, and I expect that they will continue their adjustment efforts with vigor and perseverance. Therefore, the proposed stand-by arrangement is acceptable.

I am satisfied that all the criteria for compensatory financing have been met. Therefore, the proposed decision on compensatory financing should be approved.

Mr. Enoch made the following statement:

When the Executive Directors discussed the staff report for the 1987 Article IV consultation with Guatemala, in July 1987, they commended the authorities for their success in reducing the fiscal deficit and the rate of credit expansion and for simplifying the exchange system. Over the year since then, further progress has been made in reducing the rate of inflation and in simplifying the exchange rate system. However, the public sector deficit has increased significantly and is projected to increase further in 1988 and 1989. In addition, there has been a serious deterioration in the external current accounts. The proposed program is designed to address these problems.

The authorities' efforts to improve the revenue base are meeting with some success, as revenues are increasing despite the fall in tax revenue associated with the decline in coffee prices. What now needs to be addressed is the increase in current spending. The measures that the authorities have proposed go a considerable way toward meeting this end, but I agree with the staff and Mr. Grosche that it is important for the authorities to stand ready to adopt additional measures if they are needed to achieve the program's fiscal objectives. In particular, it is important that wages and salaries, which account for more than 40 percent of central government current expenditure, should not be allowed to increase excessively.

Good progress has been made so far in reducing the rate of inflation. However, it is important that adequate measures to keep the rate of inflation down be adopted. The increase in the ceiling on lending and deposit interest rates in June 1988 was a sound move, but I strongly agree with the staff that adjustments in the central bank rediscount rates are also desirable. Greater interest rate flexibility may also be necessary if the performance criteria are to be observed. It will certainly be necessary to maintain positive real interest rates, and the authorities should be prepared to adjust interest rates accordingly, if necessary.

The causes of the deteriorating external situation appear to be twofold. First, the fall in world coffee prices has left Guatemala with an export shortfall. This shortfall is expected to be made up in future years by ambitious increases in non-traditional exports and in the volume of coffee exports. This will obviously depend upon the continued implementation of sound domestic policies, as outlined in the proposed program.

The second cause of the external difficulties is of course the 50 percent increase in imports in 1987. The trade balance is expected to remain heavily in deficit in 1988 and in the medium term. Even on the assumption of continued private capital inflows, this deficit will require large-scale rescheduling and balance of payments support throughout the projection period. This conclusion suggests the need for substantial further external adjustment. The authorities' commitment to maintain an exchange rate policy that will reflect the balance of payments situation is welcome, as is the adjustment to the exchange rate that has already been made, but further steps might well be needed to redress the external imbalance. The authorities should be prepared to make further exchange rate adjustments as necessary to meet their balance of payments targets.

The balance of payments figures in the staff papers assume that rescheduling of both interest payments due to commercial banks in 1988 and of arrears will take place by June 1989. I welcome the staff's opening statement that some progress has been made in negotiations with the banks. I wonder whether the staff has any additional details on the negotiations, especially the timetable for making continued progress.

In sum, the authorities are to be commended for the steps that they have taken thus far. The improvement in Guatemala's domestic position since 1985 is impressive. But much remains to be done, particularly on the external side. Given the measures agreed under the program, I fully support the authorities' request for a stand-by arrangement. However, the authorities should stand ready to take additional measures--both on the external and fiscal sides--as necessary to achieve the program's objectives. Finally, Guatemala has met the conditions for compensatory financing.

Mr. Warner said that he welcomed the fact that the Guatemalan authorities had taken a number of measures on the fiscal and exchange rate front to respond to the problems with budgetary and credit policies as well as the deterioration in the external accounts earlier in 1988. The unification of the exchange rate was a particularly important step, and the authorities should continue the exchange rate flexibility. It was clear that further adjustment was required, and the adoption of the measures included in the stand-by arrangement was therefore welcome.

In the fiscal area, it would be important to keep slippages from recurring, particularly in light of the problems incurred in implementation of fiscal policy in 1987, Mr. Warner continued. In addition, the programmed reduction in the deficit as a percentage of GNP was small, and yet the fiscal element of the program would be a critical determinant of its success. That argues for close monitoring of the fiscal situation and the implementation of new measures in order to safeguard the achievement of the fiscal objectives. Close monitoring of wage policy in order to ensure wage restraint would also be an important element of containing expenditure and setting an example to the rest of the economy.

A reduction in the fiscal deficit would also contribute to the mobilization of domestic savings to be available for private sector use, Mr. Warner noted. An increase in private sector participation in the economy would make an important contribution to continued economic growth. The authorities should continue to develop ways of inducing additional private sector participation in the economy. A tight monetary policy would also be essential for the efforts to control inflation.

The action taken to increase interest rates was welcome, Mr. Warner said. However, greater interest rate flexibility might also be necessary to tighten the liquidity of the banking system.

The structural measures the authorities had taken in the area of reducing price controls were a positive development, Mr. Warner considered. Further efforts would be needed to ensure that the remaining controls were removed soon, so that resources could be allocated efficiently.

In the external sector, it would be important to make progress on efforts to enhance exports, Mr. Warner commented. That effort should include import tariff reduction and elimination of the export tax.

In addition, the authorities should normalize their relations with external creditors in order to eliminate all arrears as soon as feasible, Mr. Warner stated.

It appeared that Guatemala qualified for use by the compensatory financing facility and, therefore, he supported the request for compensatory financing and a stand-by arrangement, Mr. Warner said. However, his authorities suggested that Guatemala continue its adherence to the International Coffee Agreement, particularly its prohibition of selling coffee at a discount outside the agreement.

He continued to believe that a more definitive statement on the country's ability to repay the Fund would be constructive to the Board's decision-making process, Mr. Warner stated.

Mr. Ismael said that he wished to associate himself with the comments of Mr. Enoch and Mr. Grosche. The authorities were to be commended for the satisfactory overall performance of the economy in 1986 and 1987 despite adverse external conditions. The good performance was attributable to the comprehensive adjustment program that was introduced in early 1986.

He welcomed the authorities' continued determination to further strengthen the economy and provide the basis for future growth, Mr. Ismael commented. Guatemala's request for a stand-by arrangement and compensatory financing were appropriate, and all the requirements for compensatory financing had been met. In addition, the proposed decision to approve the retention of the exchange restrictions until the conclusion of the next Article IV consultation or the midterm review under the stand-by arrangement, whichever was earlier, was appropriate.

Mr. Al-Assaf made the following statement:

I have no disagreement with the scope and objectives of the adjustment program presented by the authorities. Nor do I have any difficulty in supporting the request for compensatory financing, which meets all the requirements.

The current adjustment program, which can be seen as a continuation of the comprehensive program adopted in 1986 by the new administration, has produced positive results, the most important of which has been the restoration of adequate growth and an impressive reduction in the rate of inflation. These achievements should facilitate the smooth maintenance of the adjustment process that is now under way.

For the medium term, the two main priorities of the present program are the maintenance of competitiveness and the achievement of a higher rate of savings and investment. The authorities should be commended for their early action on the exchange rate and for their determination to continue implementing a flexible policy--a goal reiterated by Mr. Ortiz in his opening statement. Raising the level of savings and investment represents a larger challenge. A steady reduction in the public sector deficit is the first condition to meet in order to increase savings. While not excessively large, the deficit may nevertheless prove to be somewhat difficult to reduce in view of the comparatively weak tax base. The tax base will be further weakened by the planned phasing out of the present export tax. Therefore, expenditure control will have a key role to play, at least initially.

An encouraging factor in the recent past is Guatemala's capacity to attract foreign investment. That trend will have to be continued in order to achieve the program objectives. In addition to maintaining an appropriate exchange rate relationship, maintaining a tight monetary policy will be important. In this connection, the flexibility shown by the authorities in the remuneration of savings is welcome. The steps being taken to deepen the market for government bonds should further facilitate noninflationary financing of government activities. However, in view of the limited room for maneuver, developments will have to be closely monitored, especially in 1989, when recourse to bank credit has been ruled out.

Mr. Morita remarked that there had been a visible recovery in the Guatemalan economy in 1987. Real GDP had picked up, and inflation had slowed to a reasonable rate. More important, a certain degree of business confidence seemed to have been established, as evidenced by the large private capital inflow and the further growth of investment in the private sector.

The authorities had made adjustment efforts along the lines of the Fund's recommendations, including exchange rate unification and an increase in interest rates, Mr. Morita commented. Although the very initial phase of their adjustment efforts seemed to have been successful, the authorities faced a widened external gap--owing to the precipitous decline in the coffee price and the sharp rise in imports--which required continuous cautious macroeconomic management. Therefore, the request for a stand-by arrangement was welcome.

The adjustment program was broadly appropriate, and he supported the proposed stand-by arrangement, Mr. Morita said. The wage increase should be monitored closely. A further widening of the gap between public and private sector wages might be inappropriate. An increase in domestic resource mobilization was necessary in the current situation of Guatemala. In that connection, the flexible interest rate policy and the enhanced efficiency of financial intermediation were important. In addition, he supported the authorities' export-oriented growth strategy. In that connection, the flexible exchange rate policy was a key factor. It would be useful to know whether that strategy also involved further measures to enhance export base diversification. He recognized that the authorities planned to emphasize promotion of nontraditional exports to new markets.

He hoped that the external arrears would be settled at an early date, Mr. Morita commented. Further information on the negotiations with the private banks would be helpful. Finally, the proposed request for compensatory financing should be approved.

Mr. Fogelholm noted that, on the external side, the program was aimed at achieving medium-term viability based on export-led growth. All the relevant measures under the program were designed to stimulate nontraditional exports. Traditional exports would still play a significant role over the medium term. Roughly 60-70 percent of total exports were traditional in nature. Therefore, the underlying assumptions for price developments and revenues from exports of coffee, bananas, sugar, and other items were important for the expectations for external viability. A complicating factor was the future impact of the International Coffee Agreement. It would be useful to know more about the sensitivity of the staff's calculations to revenue from traditional exports. He wondered whether the relatively low volume of revenues suggested under one of the staff's scenarios would jeopardize medium-term viability.

The staff representative from the Western Hemisphere Department remarked that one of the main concerns was the effects of the trade reform that was to be supported by the stand-by arrangement and World Bank loans. The effects of trade reform, including the reduction of import tariffs, on the current account and the balance of payments over time, would be balanced by the substantial flexibility shown by the authorities in managing the exchange rate. Accordingly, there was unlikely to be undue growth in imports following the reduction in protection in Guatemala. On the fiscal side, an important objective of the comprehensive tax reform that had been implemented in late 1987 was to move away from taxation on international trade. As a result, export revenue had become a small component of total revenue, and its share would continue to decline with the phasing out of taxation on exports.

The size of the investment budget in Guatemala had traditionally been fairly small, the staff representative said. Under the current adjustment program, there was to be a substantial increase in investment in 1988--some 30 percent if the program were fully implemented--followed by another increase in 1989 of approximately 18 percent. That increase in public investment spending was one factor behind the fairly small decline in the fiscal deficit in 1988 and 1989. However, the expanded investment program was to be financed from concessional external sources that would not unduly increase Guatemala's debt burden. In this regard, the World Bank was beginning to expand substantially its involvement in Guatemala: a $29 million loan for municipal development had been approved in June 1988; a $31.5 million loan for secondary roads was scheduled to be discussed by the Bank's Executive Board in late November 1988; a $30 million loan for primary education was scheduled to be considered by the Executive Board also in November 1988; and a mission was visiting Guatemala to negotiate an $80 million export development credit that constituted the balance of payments support from the World Bank that was included in the new program. In addition, a Consultative Group meeting had been scheduled for March 1989. Accordingly, while there was little decline in the fiscal deficit, with the increased external financing that was envisaged, the public sector would be able to make net repayments of domestic debt in an amount roughly equivalent to the buildup in net international reserves that was programmed for 1989.

The staff had projected a 12 percent increase in overall exports in 1989, the staff representative remarked. The projection assumed a substantial increase in nontraditional exports as a group, and was based on Guatemala's recent track record: in 1987, there had been a substantial increase in nontraditional exports--in excess of 30 percent--and the evidence for the first half of 1988 suggested that there would be a further strong increase, probably in excess of 20 percent for 1988 as a whole. Given the recent exchange rate measures and the structural reforms being implemented, the staff was confident that the projected increase in nontraditional exports would develop as expected.

The number of banks involved in the current negotiations was fairly small--some six or seven banks--the staff representative from the Western Hemisphere Department explained. They were considering whether a steering committee should be formed to deal with Guatemala's debt rescheduling. There was some question whether such a committee should be formed, given the relatively small number of banks involved. The next round of negotiations with the banks was scheduled for early December 1988. The staff hoped that, by then, with the stand-by arrangement in place and given the World Bank's involvement, an agreement on refinancing the outstanding principal could be reached.

Mr. Ortiz remarked that one of the key tables in the staff report was Table 3, which summarized the operations of the Central Government. It showed that public sector revenue had recently fallen, and that Guatemala had one of the smallest revenue bases in Latin America. As a result, imposing and collecting taxes had been a perennial problem for the Guatemalan Government. There was great resistance in Guatemala to financing the public sector. As a result, Guatemala had maintained essentially conservative fiscal policies and had not developed debt problems, but there was little revenue to meet the country's urgent social needs. As the staff had noted, the level of capital spending by the public sector in Guatemala, as well as the savings and investment ratios had been relatively low. One of the main accomplishments of the current Administration and one of the basic challenges for the future was to modernize the way in which the Government operated. It was essential for the Government to convince the various sectors of society that they needed to cooperate to create a civil conscience, to finance the need for increased capital expenditures, and meet long-standing pressing problems in Guatemala, including income and wealth distribution. The proposed stand-by arrangement would certainly help to support the authorities' modernization efforts.

There was some concern among Executive Directors about the need to contain government salaries, Mr. Ortiz remarked. Table 7 showed that, as a proportion of GDP, wages and salaries of the Central Government had not been increased since 1984; they had remained between 4 percent and 4.5 percent of GDP and had not increased as a proportion of total expenditure. There had been an increase in transfers to states and municipalities in accordance with the requirements of the new constitution. The transfers supported the efforts to modernize government operations and increase the autonomy of the regional authorities.

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

3. EXECUTIVE DIRECTORS

The Acting Chairman bade farewell to Mr. Donoso, Mr. Ortiz, Mr. Salehkhou, Mr. Sengupta, and Mr. Reddy on the completion of their service on the Executive Board.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/88/158 (10/24/88) and EBM/88/159 (10/26/88).

4. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 88/16 through 88/18 are approved. (EBD/88/291, 10/18/88)

Adopted October 24, 1988

5. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/88/253 (10/21/88) is approved.

6. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/88/255 (10/24/88) is approved.

APPROVED: April 27, 1989

LEO VAN HOUTVEN
Secretary