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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/173

3:00 p.m., October 24, 1986

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

Executive Directors	Alternate Executive Directors
	Mawakani Samba
C. H. Dallara	
J. de Groote	
	M. B. Chatah, Temporary
H. Fujino	M. Sugita
	B. Goos
	Song G., Temporary
	Jaafar A.
	H. A. Arias
	J. E. Hospedales, Temporary
T. P. Lankester	M. Foot
	I. Puro, Temporary
	S. Simonsen, Temporary
	D. McCormack
	A. Abdallah
	P. E. Archibong, Temporary
	M. A. Weitz, Temporary
	J. E. Suraisry
	G. Ortiz
	S. de Forges
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
	B. Tamami, Temporary
	A. S. Jayawardena
S. Zecchini	A. Vasudevan, Temporary

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

H. Brown, Governor of the Bank of Jamaica; A. Ally, Deputy Governor of the Bank of Jamaica. IBRD: A. Sonmez, East Asia and Pacific Regional Office; S. Voyadzis, Latin America and the Caribbean Regional Office. Administration Department: G. F. Rea, Director; C. Ahl, S. L. Chung. Asian Department: P. R. Narvekar, Director; H. Neiss, Deputy Director; M. J. Fetherston, D. J. Goldsbrough, E. Gurgen, A. Singh. Exchange and Trade Relations Department: E. H. Brau, D. Burton, G. Hacche, S. Kanesa-Thasan, D. A. Lipton. External Relations Department: A. F. Mohammed, Director; A. M. Abushadi, H. Puentes. Fiscal Affairs Department: T. Catsambas, V. P. Gandhi. IMF Institute: V. Quinbo, Participant. Legal Department: J. G. Evans, Jr., Deputy General Counsel; P. L. Francotte, J. K. Oh. Research Department: N. M. Kaibni, H. C. Kim, E. C. Meldau-Womack, M. A. Wattleworth. Secretary's Department: B. R. Hughes. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Berthet, J. E. Blalock, J. C. Corr, J. P. Caskey. Western Hemisphere Department: S. T. Beza, Associate Director; M. Caiola, D. A. Citrin, J. Fajgenbaum, J. P. Guzmán, M. E. Hardy, O. Roncesvalles. Bureau of Statistics: H. Flinch. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. Ouanes, G. Pineau, D. C. Templeman. Assistants to Executive Directors: O. S.-M. Bethel, J. de la Herrán, W. N. Engert, G. Ercel, G. K. Hodges, L. Hubloue, O. Isleifsson, S. King, K.-H. Kleine, M. Lundsager, W. K. Parmena, J. E. Rodríguez, G. Schurr, L. Tornetta.

1. PHILIPPINES - 1986 ARTICLE IV CONSULTATION; STAND-BY ARRANGEMENT; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors resumed from the previous meeting (EBM/86/172, 10/24/86) their consideration of the staff report for the 1986 Article IV consultation with the Philippines and request for a stand-by arrangement in an amount equivalent to SDR 198 million (EBS/86/222, 9/22/86; Cor. 1, 10/17/86; Cor. 2, 10/22/86; and Sup. 1, 10/23/86), together with a staff paper on a request for a drawing under the decision on the compensatory financing of export fluctuations (EBS/86/223, 9/22/86; and Sup. 1, 10/2/86). They also had before them a report on recent economic developments in the Philippines (SM/86/249, 10/1/86; Cor. 1, 10/17/86; and Sup. 1, 10/2/86).

Mr. Ortiz made the following statement:

At the outset, I would like to express our strong support for the request of the Philippines for a stand-by arrangement and for the use of resources under the compensatory financing facility. The program seems well balanced on the whole, and after the difficult years that this country has suffered, it is certainly appropriate and necessary to consider a program aimed primarily at restoring economic growth in an atmosphere of price stability. It is true, as the staff and Mr. Rye point out, that the basis for the economic recovery has been laid down. Most notable are the gains made with respect to inflation and the balance of payments which were obtained at great cost in terms of economic activity, falling consumption, and declining living standards in general.

The staff points out that despite the success obtained in reducing the inflation rate, several important weaknesses remained in policy implementation in 1985 and in the earlier part of this year, resulting in a larger than expected contraction of economic activity. Apparently, the staff is referring to shortfalls in revenue collection and other measures that tended to prevent a further reduction of the deficit. There may indeed have been weaknesses in policy implementation, but frankly I do not see how a tighter fiscal policy could have prevented the decline in economic activity that occurred, even considering that this would have reduced the pressure on financial markets and thus conceivably lowered interest rates.

The program's strategy consists of a two-pronged approach, and is based on price stability and the relatively favorable recent balance of payments outlook. On the one hand, the medium-term growth prospects are to be reinforced by a series of far-reaching structural reforms directed at reducing or eliminating economic distortions, facilitating the working of markets, and generally stimulating private activity and investment. On the other, the initial stimulus toward recovery is to be given by a boost of public investment expenditures, which are supposed to

lead to a resumption of private investment. The fiscal stimulus is expected to be withdrawn in 1987, at which time private activity should have gathered enough momentum to sustain the ongoing recovery.

As pointed out by the authorities and the staff, this strategy is not devoid of a high element of risk. First, one should note that the reactivation of private economic activity is to occur in the midst of a fiscal reform which, even if it does remove distortions and somehow provides investment stimulus, will have the effect of extracting real resources from the private sector in order to help balance the fiscal accounts. In these circumstances, the financing of private investment should come from higher domestic savings stimulated by the structural reforms and appropriate macroeconomic policies as well as from capital repatriation. Raising the domestic savings rate is a process that usually takes some time, and counting on capital repatriation as a source of finance would seem somewhat optimistic, since the return of flight capital normally makes its contribution after the economy is functioning again in good health. An important factor to consider in this respect is that the sheer size of the debt and of debt service, which represent 80 percent of GDP and 40 percent of exports, respectively, constitutes an additional obstacle to capital repatriation. Obviously, the implication is that the country remains extremely vulnerable to changes in external conditions, as the sensitivity analysis performed by the staff in the medium-term scenario confirms. In light of these considerations, a successful arrangement with commercial banks on the debt situation seems of the utmost importance. One area of preoccupation is the sluggish performance of both traditional and nontraditional exports. The improvement of the balance of payments has been mostly the result of a decline in oil prices.

Again, the two crucial issues for the success of the program are credibility and timing. I agree with the staff's view that it is fundamental that decision makers in the goods and financial markets perceive the strategy as viable and consistent, including belief in the Government's commitment to reduce public sector imbalances and to follow through with the implementation of the structural reforms. Timing is also crucial. If private investment fails to materialize in 1987, as envisaged, the withdrawal of the fiscal stimulus will jeopardize the growth objectives and thus the credibility of the program. Therefore, fiscal policy will have to strike a rather delicate balance. It is easy to understand why the authorities are exploring the establishment of growth contingency financing mechanisms.

The situation illustrates clearly some of the policy dilemmas that we will be facing in the future in the context of the so-called growth-oriented adjustment strategy. Just as the economic profession has engaged in recent years in a discussion of

the timing of real versus financial operations, we too are beginning to see a series of issues arising in connection with the timing of structural reform and stabilization policies.

Mr. Suraisry commented that reference had been made during the discussion to the fact, which seemed unusual to some, that the drawing under the compensatory financing facility was larger than the amount of the stand-by arrangement. Upon closer examination, any such comparison was seen to be flawed because it was based on the percentage of access--30 percent of quota on a 12-month basis under the stand-by arrangement compared with 50.9 percent of quota under the compensatory financing facility. Whatever reasons there were for the low level of access under the stand-by arrangement, and he felt sure that they were good reasons, they had nothing to do with the amount of the compensatory financing purchase.

There was a certain logic to the point raised by Mr. Foot with respect to the appropriateness of compensating for a shortfall of export of goods that consisted entirely of imported materials to which value was added in the form of processing, Mr. Suraisry said. However, many commodities fell in that category, and many developing countries exported such commodities, raising two problems. First, it would take the staff considerable time to trace the commodities, and the extent to which they were exported and at what gain. Second, and more fundamentally, detailed input/output tables would be required, and developing countries either did not have such tables or, if they did, they were generalized and would not be very helpful. The operation of the compensatory financing facility could be hampered by a requirement to quantify the value added of re-exports.

Mr. Polak said that he wondered whether it was necessary to take the time to discuss such general points in the context of a specific request for compensatory financing. Surely, those points could be taken up when the facility was reviewed by the Board.

The Chairman noted that such a review was included in the current work program.

Mr. Foot remarked that the sooner the review took place, the less need there would be to bring up such questions in the context of specific cases. The general point he had wished to make was illustrated clearly by the case of the Philippines; he had been attempting simply to set in perspective the question of quantifying the exchange rate effect. He agreed with Mr. Suraisry that the staff should not be condemned to fabricating input/output tables. The example he had cited--of exports of electronic equipment and oil imports--did however illustrate his general point. The Philippines had benefited to the extent of about $600 million from the reduction in the price of oil, but SDR 20 million of the SDR 50 million compensatory drawing was on account of an export shortfall in electronic components, which were for the most part re-exports of imports that had been processed.

Mr. Templeman remarked that it was incumbent upon the Board to draw attention to its concerns with various aspects of the compensatory financing facility, using specific examples, if only to enable the staff to deal with those concerns at the time of the review.

The Deputy Director from the Asian Department observed that the risks inherent in providing a fiscal stimulus in 1986 had been widely commented upon. One major problem in developing a proper fiscal stance was the large share of foreign expenditures in the budget, on behalf of public enterprises, that had no effect on domestic activity but claimed a large share of domestic financial resources. The Government had thus to strike a difficult balance between providing some domestic stimulus, which was justified by the need and the capacity for expanding investment as well as maintenance expenditures, and the restraining effect on the private sector of the higher financing requirements. In the event, the 1986 budget provided for a small net stimulus of about 2 percent of GDP while keeping the Government's financing need to an outside limit. How well that strategy would work remained to be seen.

The shift of the national government budget deficit to 4.4 percent of GDP in 1986 and back to a programmed 2 percent of GDP in 1987 was not so much a consequence of deliberate fine-tuning as of the timing of various policies. The 1986 deficit was high for a number of reasons: the unusually high first quarter deficit--equivalent to about 1 1/2 percent of GNP--was an aberration, as Mr. Dallara pointed out; much later payments to support the government financial institutions than originally estimated; and the push in investment and maintenance expenditure. On the other hand, the tax reform came too late to have a significant impact on the 1986 budget. In 1987, on the other hand, the tax reform will improve revenues by 2 percent of GDP, subsidies to the government financial institutions will be much lower as a result of reorganization, and investment and maintenance expenditures, after the jump to catch up in 1986, would increase at a normal rate. Those developments, taken together, would result in a substantial shrinkage of the budget deficit. From 1987 onward, developments in the public sector would in fact be much steadier, a desirable course, as Directors had noted.

Two related issues that had been mentioned as having a pronounced bearing on the budgetary outcome, the staff representative observed, were the status of the government financial institutions and the nonfinancial public institutions.

With respect to the reform of government financial institutions, substantial progress had been made in establishing a detailed reform program for both the Philippine National Bank and the Development Bank of the Philippines. Negotiations in this area have been difficult and prolonged. Eventually, the broad principles of the reform, as outlined in paragraph 31 of the letter of intent, had been agreed with the Fund and World Bank staff, and further agreement was reached with the authorities at the time of the Annual Meetings. A World Bank mission was currently in the Philippines to finalize details of the program that would form a main part of the Bank's proposed economic recovery loan.

As for the nonfinancial corporations, a major reform and restructuring is clearly an indispensable part of the medium-term growth strategy, both to improve the efficiency of their resource allocation and to reduce the burden of these corporations on the budget. However, actual implementation of the reforms is still at an early stage. The new Government has to establish in detail the financial, commercial, and managerial situations in those enterprises before it can develop individual rehabilitation programs for each enterprise. Various in-depth audits of major corporations were under way and will form the basis for establishing a detailed schedule of measures. The principles governing these reforms have been drawn up by the authorities in conjunction with the staff of the Fund and the Bank, and they are set out in paragraph 28 of the letter of intent. They include charging corporations the full cost of borrowed funds; the abolition of special tax exemptions; putting depreciation practices on a replacement cost basis; and an accompanying rationalization of tariff structures and expenditure program, as well as efforts to improve the efficiency of the collection procedures of several corporations. The establishment and implementation of the detailed reform schedules will be a major focus of the first review under the stand-by arrangement.

On monetary policy under the program, the staff shares the view of many speakers that there are great uncertainties surrounding the monetary targets that will require the close monitoring of monetary developments and flexibility in setting monetary targets, the staff representative continued. Indeed, as was pointed out, this was one of the reasons behind the establishment of performance criteria only through March 1987.

The monetary program was based on accommodating a strong resumption of growth while keeping the underlying inflation rate at about 5 percent, the staff representative noted. In deriving the corresponding targets, the staff was aware that monetary relationships were still somewhat out of line with historical performance. In particular, the demand for real M3 is substantially below--by as much as 20 percent--estimates based on past relationships, and velocity has been consistently higher than the historical level. On the other hand, the demand for currency has been relatively high, reflecting the lack of confidence in financial institutions, which in turn had reduced the money multiplier, changing the historical money supply relationships. The staff's projections have assumed an income elasticity of the demand for money of 1.5 and a gradual return to normalcy of the currency deposit ratio, but the assumptions will have to be assessed in the light of experience in coming months at the time of the first review.

If the demand for money grew less than programmed, the staff was confident, based on past experience, that the Central Bank would not exhaust the full scope for expansion, the staff representative said. If money demand should be higher than estimated, some upward flexibility was built into the reserve money targets, arising out of the adjustment of the target to the extent that net foreign inflows were higher than programmed and the Central Bank purchased the additional foreign exchange, thereby enlarging reserve money.

The various reforms in the financial sector had a bearing on the effectiveness of monetary policy, the staff representative added, in particular the streamlining of the financial system that the Central Bank was in the process of undertaking, involving bank closures and changes in management, as well as the removal of financial distortions such as the factors responsible for the high spread between deposit and lending rates that were mentioned by several speakers. Those included certain agricultural lending regulations for banks, the gross receipts tax, and the still high reserve requirements; for instance, although the reserve requirement on net deposits had been reduced by 3 percentage points in the past year, it was still 21 percent. The authorities were trying to mitigate those factors over the period ahead.

In the past six months, the consumer price index for the Philippines had declined by 3 percent, prices having remained flat in the past three months, the staff representative commented. However, most of the decline had been due to a fall in food prices that might be temporary and to a considerable fall in oil prices. Consequently, the staff expected that the rate of inflation would become positive again--perhaps to about 5 percent, the underlying rate projected in the program--when the impact of those once-and-for-all factors had worn off. Inflationary expectations were almost certainly still positive, as was evident from the high nominal interest rates and the positive interest differential vis-à-vis other neighboring financial markets.

Several Directors advocated an active and flexible exchange rate policy that would lead to a degree of competitiveness consistent with the emphasis placed in the medium-term scenario on export growth and on opening up the economy, the staff representative noted. The exchange rate policy of the authorities was that, subject to the reserve accumulation objectives of the monetary authorities, the exchange rate was genuinely determined by market forces. The net international reserve objectives had been selected so as to be consistent with the desired trend in external competitiveness. Nevertheless, uncertainty remained arising from developments in export markets, from import liberalization, and from difficulty in predicting the level of capital reflows as confidence returned. As a result, it was not possible to foresee exactly how market forces would interact to determine the exchange rate.

The staff recognized that, if capital reflows were large and a slower recovery contributed to lower than projected imports, there might in the short term be some possibility of a real appreciation, the staff representative remarked. If that were to occur, some re-evaluation might be necessary of how external objectives, and in particular the promotion of stronger export performance, could be achieved. One possibility was a further acceleration of trade liberalization and tariff reform efforts, as suggested by several Directors.

In referring to the medium-term viability of the balance of payments, as implicit in the medium-term scenario in the staff report, several speakers had drawn attention to the existence of a current account deficit

in the medium term and to substantial financing needs, the staff representative noted. In the base scenario in the main staff report, current account deficits of some 2 percent of GDP were foreseen as being sustainable, under two assumptions, as illustrated by Table 2 on page 64: continuation of substantial official inflows of SDR 1-1.5 billion a year, and the rescheduling of medium-term and long-term debt falling due. The residual financing gap would often be relatively minor and could largely be covered toward the end of the period by a resumption of voluntary lending. Also, based on a full restructuring of medium- and long-term maturities, the debt service ratio would fall from about 36 percent in 1986 to about 31 percent in 1991, as shown in Table 5 on page 70 of the staff report.

The interesting issue of developing monitoring and performance criteria for structural action similar to the traditional, quantitative performance criteria used to monitor financial performance had been raised by Mr. de Groote and Mr. Dallara, the staff representative recalled. In general, that practice had not been followed because by their very nature, structural actions were often difficult to quantify over a time period. In most cases, those reform measures had to be defined as specific actions to be taken at a specific time--in the Philippines, for instance, the removal of export taxes, the abolition of the coconut export monopoly, the lifting of the investment tax in processing industries. These actions became equivalent to performance criteria if they were clearly specified and if they were taken as prior action or as criteria for review. Indeed, a large part of the structural action in the Philippine program had been implemented as prior action: the whole tax reform, a substantial part of import liberalization, a substantial part of the sugar and coconut sector reforms, and part of the government financial institutions reform.

It was, however, possible to introduce quantitative criteria for structural action in some areas, and that possibility should be explored further, the staff representative stated. For instance, the timetable for import liberalization in Table 12 on page 35 quantified actions by the number of items to be liberalized by a certain date. For the nonfinancial public corporations, there were indirect performance criteria in the form of financial targets (page 21, Table 7), which could be achieved only if structural reform measures were in fact undertaken. In addition, a large part of the structural reform in public investment, in particular the change in its composition, had been quantified (page 57, Table 2). New methods would no doubt be evolved in that area in due course.

The growth contingency to which many speakers referred was still at an exploratory stage and not much concrete information could be given at the present time, the staff representative explained. The authorities had not yet formulated a comprehensive scheme, nor, as far as the staff knew, had they approached any institutions. The authorities had in mind arrangements under which loans that might produce the financing were triggered by deviations of the rate of growth of real GDP over the preceding six months from a 6.5 percent target, and the loan amounts would be proportional to those deviations. In its discussions with the authorities,

the staff had made some of the points that had been expressed by several Executive Directors, in particular that reasons for the shortfall in growth might be other than external events beyond the Government's control, and that the feasibility, as well as the productivity, of additional public investment to correct a growth shortfall would have to be established.

Finally, the staff representative from the Asian Department said that the relatively low access of the Philippines to the Fund's resources under the stand-by arrangement had been based on three considerations. First, the member had been a prolonged user of Fund resources. Second, the exceptional financing needs over the period of the stand-by arrangement were relatively modest. And, third, because the Philippines were likely to continue to have a close relationship with the Fund, including Fund-supported programs, its access to those resources should not be fully pre-empted.

Another staff representative from the Asian Department observed that in commenting on the medium-term prospects for the Philippines, Directors had questioned whether there was in fact any divergence of views between the staff and the authorities on the medium-term projections, in particular with respect to a comparison of the projections contained in the main staff report and those that had been called the alternative scenario in Supplement 1 to the staff report. There was little material difference between the projections for 1987; it was beyond that that the alternative scenario postulated the maintenance of growth throughout the period through 1991 at the rate targeted for 1987, namely, 6 1/2 percent, whereas the basic scenario projected a return to an average growth rate of 4-5 percent in that period. The fundamental difference between the two scenarios lay in the investment effort required to achieve them. The basic scenario called for an investment rate of about 21 percent in the period 1988-91, whereas the alternative scenario would require an average investment rate of around 25 percent for its achievement. Of course, the latter would require higher rates of public and private investment with consequences for foreign financing, as stated in the supplement to the staff report.

There were obvious constraints arising from the absorptive capacity of the economy that would have to be tackled and overcome if investment rates even higher than those required for the basic scenario were to be achieved, the staff representative added. If the assumed private investment rate implied by the alternative scenario did not emerge, there would be obvious dangers in trying to push public investment beyond the limits of absorptive capacity. The alternative projections were more optimistic on export performance; they also required a higher implied elasticity of imports with respect to GNP; but they did not in themselves imply substantially higher external debt to GNP, or external debt service ratios, than those in the basic scenario, although only because of the assumption of a higher export performance and a higher GNP growth rate. Under the alternative scenario, the economy would be left with an external debt at least 10 percent above that which would result in the basic scenario in 1991. If the better export performance and the higher GNP growth rate did not

materialize, the indicators of indebtedness in relation to GNP and exports would rise. Whether or not export growth rates beyond those in the basic scenario could be achieved was, of course, highly uncertain.

The alternative scenario incorporated ratios of non-oil imports to GNP at historically high levels, which would appear to be at variance with the import content strategy of the authorities. On balance, it was not that the staff found the alternative scenario unachievable; it would need to assess the objectives during 1987, in particular in light of the success in dealing with the absorptive constraints. At that time, the staff and the authorities would be better placed to assess whether a sustained 6 1/2 percent growth rate over the medium term was, in fact, achievable in an environment of financial stability and whether there were any additional financing requirements.

The prospects for exports were gloomy, the staff representative remarked. As had been noted, traditional exports had been projected to grow annually at only 1 1/2-2 percent over the medium term in terms of volume. On the other hand, the staff was optimistic that with a gradual restoration of investor confidence, continued import liberalization, a response to tax reform, and more flexible exchange rate management, there would be some improvement in market shares for nontraditional exports. Thus, the staff had projected close to 6 percent growth in terms of export volume over the medium term; it was highly uncertain at the present stage whether the additional growth required by the alternative scenario was possible.

On investment, another key aspect for the medium term and the alternative scenario, the World Bank and the Fund had worked with the authorities with the aim of developing a medium-term investment program that would redress some of the shortfalls of the past six or seven years and help the recovery effort, the staff representative noted. The objective was to reorient the investment program toward rural infrastructure and agricultural employment, and to attack precisely those infrastructural inadequacies that had inhibited export performance. In that sense, the investment program was designed to help the export effort. The World Bank assessment was that a public investment rate of about 5, 5 1/2, or perhaps 6 percent would be feasible, taking into account the absorptive constraints. The authorities were implementing some new procedures designed to improve and alleviate those constraints, by relying on greater decentralization of the investment process and the greater involvement of local authorities, together with quicker reporting and feedback and thus implementation. Nonetheless, the program had been designed in such a manner that, should the absorptive constraints limit the increases in capital expenditures below the projected levels, the new procedures would not allow budgeted capital expenditures to be diverted to other expenditures, thereby resulting in a reduced public sector deficit. The data for recent months pointed to some slowness in the ability of the authorities to accelerate public investment in line with the 1986 projections.

On the problem of export and import invoicing, the study mentioned by Mr. Foot covered a period through 1985, preceding which there had been serious problems of confidence, together with the imposition of exchange restrictions and other factors that led to a large differential in the black market exchange rate and, consequently, the problems cited in the study, the staff representative observed. At the present time, however, it was extremely unlikely that those activities were prevalent in any substantial sense. Incentives for false invoicing had been reduced by the substantial reforms. Problems with investor confidence had been reduced and, in particular, there was virtually no spread any longer between the official rate and the black market exchange rate. With respect to the calculation of the export shortfall, the overinvoicing and underinvoicing would have tended, if anything, to increase the shortfall, if exports for 1986 and 1983-84 were compared.

Finally, the staff representative from the Asian Department stated that it was too early to assess whether or not the new debt equity scheme announced by the authorities would become a major vehicle for foreign investment, and in particular, whether it would attract investment that would not otherwise have come to the Philippines during the two months of the scheme's operation. Thirty applications had been received by the Monetary Board for a total of $200 million, six of which had been approved for a total of $18 million. Certainly, the scheme had many features that might limit its attractiveness, among them the restrictions on profit remittances and capital repatriation and the distinction that had been made between priority and other sectors, with generally more favorable rules being applicable to the former. In addition, investors had to pay a fee to the Central Bank at the time of conversion, of 5 percent for priority investment and 10 percent for nonpriority investment. Investors were also required to fund at least 10 percent of the total investment involved in nonpriority investment with new foreign exchange.

The staff representative from the Exchange and Trade Relations Department observed that Mr. de Groote and Mr. Dallara had raised an interesting question on the monitoring of structural policy actions under the program and whether it could be done with advantage through additional performance criteria. The staff representative from the Asian Department had already pointed to the way in which the structural policy actions were being monitored under the current program of the Philippines, essentially through actions taken before the request had been presented to the Board and during the reviews. But there was the larger issue of the future monitoring of structural actions in programs that gave strong emphasis to structural policies. The present guidelines on conditionality enjoined the staff to confine the performance criteria to macrovariables and to use performance criteria for other policies only in exceptional cases when those other policies had a very strong macroeconomic impact. Of course, the staff had observed the guidelines in the relevant cases, and to date it had felt that structural policies were normally appropriately monitored during reviews. The Board would have an opportunity to discuss that general issue when it took up the staff paper on program design and performance criteria in which it was one of the specific issues mentioned for discussion.

The staff representative from the Research Department said that no attempt had been made to quantify the impact of exchange rate changes on the export shortfall, the specific manufactured export of concern being that for which the shortfall was greatest--electronic components. The exchange rate had appreciated in the preshortfall year, in 1984-85; it depreciated in the shortfall year itself. A proper accounting of the effect of the impact of the changes in the exchange rate on the shortfall would call for an estimate of the impact on both current and lagged exports for each year of the five-year trend period, namely, the shortfall year itself as well as the other four years of the trend period. Although the staff had not attempted to make such an estimate in the case of the Philippines, it had sufficient evidence to indicate that the exchange rate factor had not contributed to the export shortfall in electronics.

The staff had evaluated exports from the Philippines of electronic components and equipment, in relation to those of its competitors, to the United States, which absorbed roughly two thirds of exports in that category from the Philippines, the staff representative noted. The recession in the U.S. electronic industry in 1985-86 had affected certain sectors of the industry more seriously than others. The particular sector that was most seriously affected--solid state components--accounted for over 90 percent of Philippine exports of electronic products. U.S. imports of solid state components in 1985-86 had declined by about one third in value, or somewhat less than the decline in Philippine exports of 35 percent. Certain competitor countries had fared better even though the currencies of some had followed a similar pattern to that of the Philippines or had even appreciated significantly during the shortfall year. The conclusion to be drawn was that factors other than the exchange rate had been responsible; for instance, marketing arrangements between importers and exporters, the structure and strength of marketing networks, or whether the industry was vertically integrated or not.

On the question of whether the shortfall in Philippine exports could be considered temporary, the staff representative noted that exports were, in general, not projected to show much of a recovery. They were expected to decline in the first postshortfall year and to recover somewhat in the second postshortfall year, so that on average exports for the two postshortfall years were expected to be somewhat higher than in the shortfall year. However, under the formula used to estimate the trend, a recovery in exports was not a prerequisite either for a shortfall to occur or for a shortfall to be considered short term in character. There could be a shortfall from a declining trend in exports. If, for example, exports had been declining by 10 percent a year throughout the five-year period, there would be no shortfall in the center year, but if the decline in that year was more than 10 percent, then there would be a shortfall. That would still be considered short term for the following reason: the decision on compensatory financing required that a shortfall be temporary, which meant that the shortfall did not occur year after year; in that sense, temporariness of the shortfall did not necessarily imply an export recovery. In fact, countries almost never experienced shortfalls year after year because rates of growth changed from year to year. Only when

countries experienced rates of growth that accelerated over time would shortfalls occur year after year, and those countries were, for the most part, in the fortunate position of not needing to make compensatory financing drawings. For countries such as Brazil and Korea, which had for long periods experienced uninterrupted growth rates that accelerated year after year, shortfalls would appear in successive years. The more typical case was that of fluctuations in the rate of growth of exports from year to year which led one to conclude that shortfall years were almost always followed by, or alternated with, excess years. Therefore, strictly speaking, one was not required to make a separate judgment that the shortfall was short term in character once a shortfall was calculated. Because the calculations were based partly on projections, they could prove wrong; in fact, one of the difficulties in operating the facility over the years had been that if the projected exports did not materialize, the country would be in a position where it could also meet the conditions for another drawing a year after it had drawn. That outcome arose not so much because the export shortfall was not short term in character, but because the projections were not correct.

Mr. Goos said that as he recalled the decision on compensatory financing, one of its basic features was the concept of bridging temporary shortfalls, unrelated to the operation of the formula. There were a considerable number of deficiencies in the decision. To take the example cited by the staff representative, technically speaking, a country could have continuous shortfalls if exports were strongly accelerating, but that was not consistent with the spirit of the decision. Perhaps the matter should be left for the forthcoming review of the compensatory financing facility.

The staff representative from the Research Department agreed that it was rather anomalous when a country whose export growth was accelerating year after year recorded shortfalls in successive years; in a way, it was a matter of the use of the geometric average. Where the value of one of the five years in the trend period was zero, the use of the five-year trend also lost its meaning. It should be borne in mind, however, that in the former case, when the growth rate was accelerating, countries were unlikely to need or request use of the compensatory financing facility.

In response to a remark by the Chairman, the staff representative said that it could be argued that a country that knew its exports were on a declining trend had made its financial arrangements on the basis of a certain rate of decline. If the rate of decline accelerated in a given year, it posed additional problems that could be covered by use of the compensatory financing facility.

The Deputy Managing Director, in response to Mr. Dallara's question about the status of the negotiations with the commercial banks concerning the remaining issues that needed to be resolved between the commercial banks and the Philippine authorities, said that as Mr. Rye had noted in his statement, talks would begin on October 28. The aim was to negotiate a multiyear restructuring agreement, to consider the resolution of the balance of $350 million of the 1985 money facility, and the extension

of the availability and maturity of trade facility commitments. Based on a communication received earlier that week from the Chairman of the commercial bank Advisory Committee, he understood that the negotiations were expected to proceed relatively quickly, if they focused on those three issues. Information received on the previous evening indicated that there was a possibility that the authorities might raise the concept of a growth facility in the context of the negotiations. The Chairman of the Advisory Committee had indicated that to the extent that the concept added a new dimension to the negotiations, the discussions might be more prolonged than he had been expecting earlier in the week. Progress under the negotiations would continue to be monitored, in the expectation that both sides would work to conclude them as quickly as possible.

The Chairman, noting that Mr. Polak had advised the Philippine authorities against following what he called the Mexican example with respect to a growth contingency financing mechanism, observed first that Mexico's fiscal program was in fact not a stimulatory one. Second, as he understood some of the ideas that had been put forward in the case of the Philippines, the growth contingency might be linked to a steady 6 1/2 percent increase in growth over the period, with automatic triggers to achieve that growth rate. There was nothing of that nature in the arrangement with Mexico, which provided for a quantified, limited extra amount to be drawn in one quarter, and only if the actual rate of growth was even less than the moderate growth rate path that the Mexican authorities were aiming for. Any comparison with the so-called Mexican case was thus somewhat misplaced.

Mr. Dallara commented that he had some concern about the information provided by the Deputy Managing Director concerning the breadth of the discussions which the authorities intended to pursue with the commercial banks. It was up to them, of course, if they wished to engage in discussions concerning possible commercial bank support for their growth contingency mechanism. But the Board had an obligation to ensure that the programs that it gave effect to were--and with as much reasonable assurance as possible--financeable at the time the proposed arrangements became effective, particularly where commercial bank financing issues were involved. He recognized that the Philippine case was primarily a question of commercial bank rescheduling, together with the question of a disbursement of $350 million. The broad scope of the discussions, which had not really begun, suggested to him that the financing needed for the program would be unlikely to emerge as promptly as had been thought. He had taken heart in Mr. Rye's statement that "my authorities have expressed a determination to ensure that nothing distracts these negotiations from their proper focus." He wondered whether he could reaffirm that that continued to be the approach that would be taken, because it would give him greater confidence that the Board was taking the proper step in approving the program outright at the present meeting.

Mr. Fujino said that he confirmed the statement by Mr. Rye that the Philippine authorities did not intend to seek new money from the commercial banks. That intention was also consistent with the balance of payments projections and financing gap forecast by the staff.

Referring to the Deputy Managing Director's remark that the question of the contingency fund would be raised with the commercial banks, Mr. Fujino considered that such an arrangement should be made first with the multilateral institutions. The commercial banks would be somewhat embarrassed if they were confronted with the question and asked for an answer.

Mr. Foot inquired whether the financing arranged by the World Bank was conditional upon the commercial bank rescheduling.

The staff representative from the Asian Department said that as far as he knew the World Bank financing was not contingent on rescheduling arrangements, although it was generally assumed that eventually there would be a rescheduling of maturities. Certainly, there was no new money involved for the period of the stand-by arrangement.

The Deputy Managing Director confirmed that the Philippine authorities were not requesting any new money during the period of the stand-by arrangement. The possibility that the contingency growth fund might be raised with the Committee was not necessarily inconsistent with what Mr. Rye had said, because as he understood it, the contingency fund would apply for a period of years beginning in 1988, which would be beyond the program period.

Mr. Rye said that he considered the discussion to have been thought provoking; Directors had raised a number of well-considered issues, some of which would have to be considered in principle as well as in detail. It was a discussion that would be of considerable help to his authorities.

In his intervention, Mr. Fujino had referred to a degree of uncertainty in political life in the Philippines, Mr. Rye remarked. He was, of course, right, but it was necessary to underline the fact that the draft of the new constitution had been completed and the referendum to adopt that instrument was scheduled for January 23, 1987. There was a reasonable hope and expectation, assuming all went well, that its adoption would be of great help in reducing present political uncertainty. In the meantime, the new Government continued to get to grips with the administrative system, also dissipating uncertainty on that account. It must not be forgotten that the Government had been swept into office suddenly and without the benefit of transitional arrangements.

The point was also relevant to the expression of regret by Mr. Goos at the delay in reaching agreement on the program, Mr. Rye went on. Part of the reason was that the program was very comprehensive, but another part reflected political realities in the Philippines. After the extraordinary events of February 1986, the new Government had come to office surrounded by high expectations, internally and externally, and inevitably reality had come as something of a cold shower. The Government consisted of people from a wide diversity of backgrounds, with diverse views on ways to restore their country to economic prosperity. For the most part, they had little or no experience in government on the economic side, and

it had taken time for the authorities to "get their act together." Their achievements were all the more impressive, viewed against that background and measured against the depths to which the economy had sunk.

There was no need for him to reiterate the details of that background, Mr. Rye said, but one or two key points were worth mentioning: the 10 percent fall in output in 1984-85; the rise in unemployment to 15-20 percent and in underemployment to 35-40 percent; interest payments on foreign debt that had used up almost 50 percent of export earnings in 1985; the utilization of less than 50 percent of manufacturing capacity; the control of much of industry by monopolies, either state or private, "crony monopolies," as the new Government called them; and the fact that 70 percent of the population living below the poverty line compared with only 28 percent in 1965. Reference had been made to the fiscal excesses and tax collection leakages during the pre-election period, in the first quarter of 1986, the significance of which for the budget trend as a whole had been pointed out by the staff representative.

Seen against that background, the achievements of the authorities to date had been impressive, Mr. Rye considered. Again, those achievements had been set out in detail in the staff report and his own statement, but, in brief, inflation had been virtually eliminated; the current account had moved into surplus; a solid program of fiscal restraint and tax reform had been launched; and the beginnings of a massive structural revitalization had been put in place. The stage had been set for growth, and growth was rightly the priority target of the authorities. Of course, they recognized that to attain the central objective of the Government--to establish strong growth--it was the private sector, the sector hardest hit in the recession, and the resurgence of that sector, particularly in due course of private sector investment, which had a pivotal role to play. Whether the outcome with respect to growth over the years would live up to the hopes and goals of the authorities remained a matter for further consideration as the course of the program unfolded and beyond. It would be wrong to let it become a preoccupation at the present time.

On the question of the contingency fund, Mr. Rye said that he appreciated Directors' points of view, as no doubt his authorities would also, since they were currently in the process of exploring the matter. It was entirely possible that, in the search for ways to achieve growth, certain aspects of such a growth contingency mechanism might have been overlooked, and Directors' inputs in that regard, which he had found particularly apt, could be of assistance to his authorities in their further exploration of such policies. The details were nebulous and fluid for the time being. Mr. Polak's general comments, though not necessarily the comparison with Mexico, on the need for care in the matter were well taken.

The place of commercial banks in that context was again very much an open question, Mr. Rye remarked. As the Deputy Managing Director had said, there was a distinction in the time frames involved. The very preliminary discussions with the World Bank had been focused at the program period itself. As he understood it, his authorities had in mind,

with respect to the commercial banks, the period beyond the program, as reflected in his own statement. There was no intention of seeking new money from the commercial banks over the entire period of the stand-by arrangement.

In response to Mr. Dallara, Mr. Rye said that his authorities attached the greatest importance to the expeditious completion of the discussions with the commercial banks. To that end, there had already been meetings in Manila, and with the commercial bank Advisory Committee.

Finally, Mr. Rye made the general point that he shared a good many, if not all, of the reservations that various Directors had expressed about contingency mechanisms. The decision on Mexico had left numerous loose ends that needed to be tied up quickly before complications multiplied. Therefore, he joined those who had called for an early discussion in the Board of the principles of the approach to be adopted in future in respect of such mechanisms.

The Chairman made the following summing up:

Executive Directors warmly welcomed the authorities' adoption of a bold and comprehensive economic program aimed at creating the conditions for a sustainable economic recovery while preserving the achievements of the past stabilization program. They noted that the policies pursued since late 1984 had achieved a sharp reversal of the inflationary environment, a virtual elimination of the external current account deficit, the settlement of external payments arrears, and the buildup of external reserves to a reasonably comfortable level. They were concerned, however, by the further decline in economic activity during 1985 and early 1986, which, they noted, reflected delays in the implementation of key structural reforms, the general erosion of investor confidence, as well as an unfavorable international trading environment.

Directors therefore agreed that the restoration of sustained economic growth in an enviroment of financial stability should be a primary objective of the new program, and they welcomed the adoption of wide-ranging structural reforms aimed at dismantling restrictions that have seriously hampered private sector activity and distorted incentives for a long time. They stressed that the authorities' success in implementing these reforms fully and promptly would, to a considerable extent, determine the economy's growth prospects over the medium term. In particular, they drew attention to the importance of improving productivity and minimizing government intervention in the public financial and nonfinancial corporations and to the need for continued progress in trade liberalization.

Directors noted that the Philippines' economic program called for a temporary fiscal stimulus, stemming from a sharp increase in public investment and maintenance expenditures, that would initiate

the economic recovery in the second half of 1986. The public sector deficit would then be reduced as, beginning in 1987, the full impact of the structural reforms on investor confidence was expected to revive private activity, which would sustain the recovery. While accepting the case for stimulating a recessionary economy, a number of Directors commented that the authorities' proposed strategy involved significant risks. In particular, the financing of the 1986 public sector borrowing requirement would maintain the pressure on interest rates and might keep interest costs too high to stimulate a private sector recovery unless financial markets were convinced of the Government's commitment to reduce future public sector imbalances. Moreover, as had been observed by the World Bank, there was a question with regard to the economy's capacity to absorb a sudden large increase in public investment outlays. Furthermore, while Directors agreed that the timing and strength of a private sector recovery could not be predicted with any great accuracy, they emphasized that a prompt and comprehensive implementation of the remaining parts of the structural reform package would contribute to the recovery by reducing the uncertainty over key parts of the environment in which the private sector must operate. They therefore stressed the need for careful monitoring of the program.

Directors welcomed the structural changes that had already been implemented prior to the program. They particularly commended the authorities on the implementation of a tax reform package that should make an important contribution to narrowing public sector deficits in future years by strengthening the elasticity of the tax system while also improving incentives for investment and exports. The reorientation of public expenditures toward rural and labor-intensive projects would also make important contributions to improving income distribution and economic efficiency. Directors also commended the authorities for making further decisive steps in import liberalization and welcomed the decisions that had just been taken in that field by the Philippine Monetary Board. Import liberalization was indeed essential in raising productivity and the export potential of the economy. Directors also welcomed the long overdue reforms in the sugar and coconut sectors which would make an important contribution to improving supply and fostering growth.

Directors stressed the importance of institutional reforms in the public financial and nonfinancial corporations so as to reduce the burden they impose on the national government budget. They welcomed the steps that had already been taken by the authorities but pointed out that much still remained to be done. Many Directors stressed the importance of strong safeguards to overcome the present need for large budgetary transfers and to prevent any recurrence of large claims on public resources by the public financial corporations. Directors underlined the importance of cooperation between the authorities and the World Bank in these areas.

Directors believed that a continuation of a cautious monetary policy was needed to avoid any re-emergence of inflationary pressures while at the same time making room for more credit to the private sector. While recognizing that monetary policy needed to be sufficiently flexible to accommodate the anticipated recovery, a number of Directors emphasized that the pace of monetary expansion would need to be closely monitored in the light of developments in inflation and economic growth. Noting that interest rates remained high in real terms, Directors emphasized the importance of reducing the public sector borrowing requirement in 1987 and 1988 and of containing the central bank deficit so that interest rates could be gradually reduced to support the private sector recovery. Directors also stressed the need for further measures to reduce the wide spread between deposit and lending rates.

Directors observed that the sharp improvement in the external current account since 1983 was due primarily to a large drop in imports while export performance remained weak. They viewed a strong export growth as essential to support a sustained economic recovery as well as to a lasting restoration of balance of payments viability. Thus, they welcomed the measures already taken to shift the structure of incentives in favor of exports and a more efficient import substitution, and they urged the authorities to pursue further their trade liberalization and tariff reform efforts. Directors noted that, although the trade-weighted real effective exchange rate had depreciated substantially since late 1985, the depreciation vis-à-vis Pacific region competitors had been more limited. They stressed that a competitive exchange rate was a major incentive to the development of a more diversified export base and that foreign exchange intervention policy should be conducted flexibly to maintain external competitiveness.

Directors observed that the exceptional financing needed during the period 1986-87 in order to permit a substantial recovery in non-oil imports and a further restoration of gross official reserves could be met through a rescheduling of payments of principal to Paris Club creditors and to foreign commercial banks. They hoped that negotiations between the Philippines and its external creditors could be completed without delay. However, a number of Directors expressed reservations regarding the authorities' proposal for a contingency fund that would come into operation in the event that economic recovery fell short of target. In addition, it was hoped that such proposals would not delay or prevent a timely conclusion of the commercial bank negotiations.

Commenting on the medium-term prospects for the Philippine balance of payments, many Directors believed that the alternative scenario suggested by the authorities would require levels of external financing that might be difficult to attain and that would lead in any event to a significant increase in external indebtedness. Such a further accumulation of debt could adversely

affect the confidence of private investors and financial markets that was such an essential element of the recovery program. Directors emphasized that a more lasting contribution to strong economic growth would be made by the firm implementation of structural and financial policies that would contribute to improved economic efficiency, strengthened domestic resource mobilization, export diversification, and improved incentives to private sector activity.

Finally, several Directors welcomed the close and effective collaboration between the Fund and the World Bank staffs in the preparation of the economic program with the Philippines. Given the crucial importance of the supply side of the program, they urged the staff to closely monitor the implementation of the structural measures contained in the program.

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

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to the Philippines' exchange measures subject to Article VIII, Section 2(a), and in concluding the 1986 Article XIV consultation with the Philippines, in the light of the 1986 Article IV consultation with the Philippines conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund welcomes the maintenance by the Philippines of an exchange system free of restrictions on payments and transfers on current international transactions other than the recently introduced limitation on the remittance of certain dividends, in connection with the debt to equity conversion scheme, as described in the forthcoming report on recent economic developments, which is subject to approval under Article VIII, Section 2(a). The Fund urges the authorities to look into the possibility of achieving their investment aims by means other than those involving an exchange restriction.

Decision No. 8428-(86/173), adopted
October 24, 1986

Stand-By Arrangement

1. The Government of the Philippines has requested a stand-by arrangement for a period of 18 months in an amount equivalent to SDR 198 million.

2. The Fund grants the stand-by arrangement set forth in EBS/86/222, Supplement 3, and waives the limitation in Article V, Section 3(b)(iii).

Decision No. 8429-(86/173), adopted
October 24, 1986

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request from the Government of the Philippines for a purchase of SDR 224.1 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979 as amended).

2. The Fund notes the representation of the Philippines and approves the purchase in accordance with the request.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 8430-(86/173), adopted
October 24, 1986

2. JAMAICA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW OF DECISION ON COMPLAINT UNDER RULE K-1

The Executive Directors considered a staff paper on a review of Decision No. 8344-(86/120) G/S, adopted July 25, 1986, relating to Jamaica's overdue obligations in the General Department (EBS/86/239, 10/23/86).

Mr. Headley Brown, Governor of the Bank of Jamaica, and Mr. Asgar Ally, Deputy Governor of the Bank of Jamaica, were also present.

Mr. Brown made the following statement:

Once again I express my gratitude for this opportunity to address you on the issue of Jamaica's overdue financial obligations to the Fund.

The Government of Jamaica deeply regrets the delays experienced in fulfilling payment obligations to the Fund which have fallen due since April 15, 1986. Our record of payment in the past has been generally good. The current delay, therefore, must be seen as arising from exceptional circumstances. The debt servicing profile of Jamaica is such that our ability to remain current on all payments is critically dependent on the receipt of programmed loan inflows. As you are aware, the discussions toward concluding a new stand-by arrangement have been protracted. Consequently, program-related disbursements have been delayed, resulting in significant cash flow problems.

Notwithstanding these difficulties, the Jamaican authorities have been making every effort to harness the necessary resources so as to liquidate all outstanding arrears to the Fund. In this connection, an amount of SDR 28 million has been paid this week. Further, arrangements are being made to draw down nonrelated Fund program loan resources to provide the cash flow that will assist in clearing the balance in arrears of approximately SDR 61.5 million and facilitate negotiations on a program under a stand-by arrangement. The discussions in this regard have been continuing with the Fund staff, and have, in fact, involved interchanges between the Managing Director and the Prime Minister of Jamaica.

In these circumstances, the Jamaican authorities remain committed to the process of structural and relative price reforms initiated in recent years. Our overall objective is the pursuit of a set of macroeconomic policies which will address issues of: export profitability; improvement in the overall public sector performance; income tax and tariff reform; and, in general, macropolicies which will provide the basis for sustainable economic growth in the context of a viable balance of payments.

It should be noted that the economy has responded positively to these structural adjustment measures. Real GDP is forecast to grow by approximately 2 percent in 1986/87. Here I observe that we assess the performance of the Jamaican economy in growth terms slightly differently from the assessment outlined in the staff paper. Within the context of a growth scenario of about 2 percent for the current fiscal year, we target a current account deficit/GDP ratio of 5 percent and a relatively lower rate of inflation of around 13 percent. In the past six months of calendar year 1986, a current account surplus of US$15 million has been recorded, with inflation down by 10 percentage points on a point-to-point basis. Private capital inflows for the period April to August amount to approximately US$20 million.

The Jamaican authorities are desirous of eliminating all arrears and remaining current in payment obligations to the Fund. Further, every effort is being made to reach agreement with the staff of the Fund on the program parameters for the new stand-by arrangement.

It is hoped that these remarks will serve to clarify Jamaica's current and future relations with the Fund.

Mr. McCormack made the following statement:

I would like simply to emphasize two points. First, throughout this week the Jamaican authorities and the Fund have been engaged in particularly wide-ranging and intensive discussions with a view to working out an adjustment program that will grapple decisively with Jamaica's serious economic and financial problems. As Mr. Brown

has noted, these discussions have been conducted at the very highest level, involving both Prime Minister Seaga and the Managing Director. Discussions are continuing and there are grounds to be cautiously optimistic about their ultimate outcome.

Second, with respect to the arrears themselves, Jamaica has given concrete evidence of its intention to meet fully its financial obligations to the Fund by making three payments since the Board's decision of July 25, 1986. These payments amount in total to SDR 29.6 million and must be judged substantial in the light of Jamaica's very tight liquid reserve position.

Finally, commenting on the draft decision, it would seem to be unhelpful to adopt the first variant of paragraph 4 of the proposed decision. A decision which even hinted at the possibility of ineligibility could give precisely the wrong signal to all concerned at this delicate point in the continuing policy discussions. In both versions of paragraph 4 the staff has suggested a further review within a two-month period. I note, however, that a three-month period has been adopted in a number of other instances where substantial payments had been made prior to the first review. In the light of the factors mentioned earlier--the continuing discussions and the payments made--I would suggest retaining a three-month period in the case of Jamaica. This would be consistent with past practice and represent even treatment of members in similar situations, a policy to which this chair has always attached importance. There is an additional, purely pragmatic reason for preferring a longer interval. Two months would bring the review to the Board immediately before Christmas, a period during which, I understand, there can be a very significant backlog of work to which we would be somewhat reluctant to add.

Mr. Zecchini observed that in order to put the case in better perspective, it seemed necessary for the Board to know more about the status of the negotiations between the Jamaican authorities and the staff, and in particular, about the main stumbling blocks at present to an agreement.

The staff representative from the Western Hemisphere Department said that the main areas where there were problems were noted in the staff paper--namely, the stance of demand management policies and exchange rate policy. The main problem faced at the present time in designing an adjustment program was that net capital inflows were tapering off, particularly when account was taken of the Fund's own role in Jamaica, making a major adjustment in the current account of the balance of payments an urgent necessity. The stance of fiscal policy that would be consistent with delivering that current account outcome was still a matter of some doubt. The staff had had intensive discussions with the Jamaican authorities on the evolution of the overall public finances. There were still some areas where further clarification was needed to know whether the stance of public finances for the balance of 1986 was appropriate.

Bearing in mind the importance of securing rapid growth of nonbauxite exports, exchange rate policy and issues of structural reform underlay much of the discussion. As the staff had reported to the Board on the occasion of the last discussion of Jamaica, the authorities had been taking the position that the exchange rate should remain fixed throughout the duration of a program with the Fund. That issue had not yet been resolved.

Mr. Zecchini remarked that he did not know to what extent the difference of view might delay the reaching of an agreement between Jamaica and the Fund on an adjustment program. That point was highly relevant, not so much with respect to the wording of the two variants of the decision as with respect to the period for further review. As he recalled it, in the guidelines for dealing with cases of overdue obligations, and in light of recent discussions on overdue obligations, review periods were not to be understood as grace periods. Review periods had to be used with the degree of flexibility required to find an appropriate solution to the economic and financial problems of the country under examination. The explanations given by the staff representative were highly relevant to a decision on the appropriate review period for Jamaica.

Mr. Hospedales made the following statement:

> We remain deeply disappointed with the current overdue payment status of Jamaica, yet we appreciate fully the difficult economic and financial circumstances which have led to a net international reserve deficiency and to an accumulation of arrears in that country. We are, however, heartened by Jamaica's substantial payment of SDR 29.6 million, which is clear evidence of their determination to become current with the Fund; Governor Brown's assurances here today that Jamaica will liquidate the balance of SDR 61 million and remain current with the Fund thereafter confirm this commitment. We are confident, therefore, that on the basis of the current dialogue with the staff on needed adjustment policies, Jamaica should conclude a broad-based policy program which would meet the requirements of the Fund and initiate the process for resuming normal financial relations with the international financial community.
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> In the light of these positive developments and in recognition of the substantial recent payment by Jamaica, we would support the second variant of paragraph 4 of the proposed decision but with a review within a period of three months as requested by Mr. McCormack and for the reasons he has given.

Mr. Foot noted that his authorities had asked that where possible in the future--difficult though it might be when negotiations were going on--a short staff paper be issued a day earlier, followed by an oral update by the staff. However, the staff paper before the Board, together with the remarks made by Mr. Brown and the staff, had given a clearer picture, which was extremely helpful.

Mr. Brown's remarks about the urgency with which Jamaica viewed the problem and the fact of the recent payment were both helpful and positive factors, Mr. Foot went on. His chair, like many others around the table, he felt sure, remained most concerned that Jamaica should clear its arrears, and that if the Fund was to be further involved in Jamaica, its involvement should be on a basis which was both mutually acceptable and which offered a real prospect of viability in all its aspects.

The external position was particularly critical, as the staff representative from the Western Hemisphere Department had noted, Mr. Foot commented. From a brief remark in the staff paper, he had also noted that, under the current external regime, nontraditional exports had been stagnant in the previous year. As his chair had mentioned on a previous occasion, the most critical element of any future program must be the demonstrable viability of the external sector. It was in nobody's interest for another program to be blown rapidly off track through a design flaw in that area.

So far as the decision was concerned, a number of factors needed to be borne in mind, Mr. Foot considered. First, Jamaica had been in arrears in the not too distant past because of its external difficulties. Second, Fund exposure in Jamaica was very large both in absolute amount and relative to quota. Third, despite Mr. Brown's clear perception of the urgency of the problem, by definition there was no assurance of clearance of the arrears because the funds could not be found that easily.

All of those factors would argue for a reasonably early review, and for the first rather than the second version of the proposed decision, Mr. Foot added. However, two further points were relevant. First, the Article IV consultation discussions would surely be held soon and, as had been done recently with Romania, it was possible for the Board to discuss arrears in the context of its consideration of the staff report for the Article IV consultation. The timetable for the consultation discussion was one factor determining whether two months, three months, or some other period was appropriate for the review. Second, the Fund was now operating under a set of accelerated procedures with respect to overdue obligations, and to that extent, the timing of previous cases was less relevant. That aspect was not given much weight in the staff paper. On those grounds, if the Article IV consultations were not to be concluded in the near future, two months would quite clearly be more appropriate than three months.

His third and final point was that although the most efficacious wording of the decision was clearly worth discussing, if the Board opted for the second type of decision, from the point of view of his chair, the substance of the first type would be understood, Mr. Foot stated. In other words, if the problem were not resolved, as the Jamaican authorities hoped it would be, the process envisaged in the first version of paragraph 4 would not be delayed in any way. Thus, there was not much point in arguing about the wording of the decision; what mattered was the need to focus on the urgency of the matter, for the reasons he had established, and to find the most efficacious way of settling the problem.

Mr. Sengupta made the following statement:

We welcome the three payments made by Jamaica totaling about SDR 30 million since our last discussion on July 25. We also consider it a welcome development that Jamaica's external current account performance has shown a considerable improvement in recent months. There has been a recovery in tourism, helped by some other factors such as lower oil prices and lower interest rates. However, we are concerned about the way the overall balance of payments position has been developing, and at the sharp increase in external arrears since April and the fall in gross reserves. We are also concerned at the stagnation in nontraditional export performance. Official capital outflows and lower short-term capital inflows apparently have led to a deterioration in the capital account. The staff paper gives no indication of any likely flows from the World Bank in the near future, nor does it indicate likely developments in the flow of bilateral official credit. The present situation, however, suggests that Jamaica will have to improve its current account still further by improving export and tourism receipts and by pursuing policies that give confidence to external creditors, including multilateral institutions, of prospective external viability.

The staff paper, however, does not go into the details of trade prospects this year. Exports are likely to show a decline in value terms, given the fall in commodity prices of major export items. It is also likely that imports may be further reduced if Jamaica, owing to accumulating arrears, receives only limited credit support. But this would lead to a lowering of economic activity. Jamaica has to find ways of working out some interim arrangements enabling it to pay the arrears to the Fund and undertake comprehensive adjustment with Fund-Bank support. Such an approach could perhaps lead to some easing of the pressure on capital account. We wonder whether the staff or Mr. McCormack could give us an idea of the endeavors that are being made in this direction. In this connection, we are extremely concerned to note from paragraph 5 on page 4 of EBS/86/239 that "Jamaica has given no firm indication that it intends to settle fully the arrears in the immediate future." We would urge the authorities to make every effort to become current with the Fund at an early date. This is desirable not only from the point of view of the Fund but is also in the interest of Jamaica: the Fund will then be able to help the country to extricate itself from its present straightjacket, especially regarding capital flows in the balance of payments.

We support the staff suggestion to provide for a further review, within the next two months, as suggested by the staff in the second version of paragraph 4 of the draft decision. We do not support the first option mainly because the authorities have made a commendable effort by making a very substantial payment between the issuance of the complaint and the first review, amounting to about 84 percent of

the overdue amount at the time of the complaint. Also, the staff paper has stated that discussions with the Fund staff on the needed adjustment policies are continuing at this time. I do not think any useful purpose will be served by specifying that appropriate further steps will be considered unless the member becomes current in its obligations to the Fund in the next two months. After all, whatever steps we consider in the Board would be appropriate at any point of time.

Mr. Suraisry made the following statement:

As clearly brought out in the staff paper, the Jamaican authorities are facing serious economic problems, despite a noticeable improvement in the external economic environment. Further deterioration in the overall public sector deficit, net international reserves, and external payments arrears have taken place that clearly call for comprehensive adjustment measures. It is therefore unfortunate to note from the staff paper that domestic policies have been relaxed. I believe there is no room under the present circumstances to relax demand management policies, and I urge the authorities to adopt the necessary adjustment policies so as to improve the international competitiveness of the Jamaican economy and reduce domestic and external imbalances. In the absence of such measures, I am afraid the external payments difficulties could become extremely difficult to manage.

Notwithstanding the payments made by Jamaica, which I welcome, the overdue obligations to the Fund have, in fact, increased sharply since the issuance of the complaint. Further, as indicated in the staff paper, additional obligations of some SDR 200 million will fall due between now and the end of 1987. This is a cause for great concern. Taken together, these facts clearly show that there is an urgent need for timely implementation of a comprehensive adjustment program and prompt repayment of the overdue financial obligations to the Fund. I realize that this is not easy. However, in my view, this is the only way that will lead to durable growth with balance of payments viability. It is important to act now while the situation is still manageable. Further delay could, as the experience of other countries in similar conditions shows, make the situation extremely difficult to manage.

It was my intention to support the proposed decision, with the first option, and I based my conclusion on two facts: the reservations of the staff about the economic policies being implemented and the sentence quoted by Mr. Sengupta from the staff report stating that Jamaica has shown no firm indication that it intends to settle fully its arrears in the immediate future. But as I understood him, Mr. Brown indicated that his authorities are very concerned about the overdue obligations to the Fund and have tried to do everything they can to be current with the Fund. In that connection, Mr. Foot

has made the helpful suggestion that even if we opt for the second version of paragraph 4, the spirit of the first option could be communicated to the authorities by the Chairman.

Mr. Goos made the following statement:

Like others, I am pleased to note that after the Board's earlier discussion Jamaica has become current in the SDR Department, and I also welcome the recent payments to the General Department.

Nonetheless, the fact that Jamaica continues to be in arrears remains a matter of serious concern, for reasons that I do not have to spell out. We have repeatedly stated our views, which have been reiterated by others, on the detrimental impact of overdue obligations on both the Fund and the countries in arrears. But I would like to associate myself here explicitly with the strong disappointment expressed in the Managing Director's latest communication of July 31 to the Jamaican authorities in which he rightly recalled the high priority the Fund has given in the support of Jamaica's adjustment efforts over recent years, a priority which seems not to have been fully reciprocated by Jamaica so far. I would therefore urge, like previous speakers, the authorities to make every effort to promptly settle their arrears. Moreover, the repayments should be made without prior conditions, which would be bound to further strain the member's relationship with the Fund.

With respect to the proposed decision, notwithstanding Governor Brown's perception of the urgency of the problem, there is still no firm assurance that the remaining and actually growing arrears will be settled in the immediate future. I am therefore inclined to support the first alternative of paragraph 4 indicating that at the next review we will consider further steps unless the country has become current by that time.

It is true, of course, as Mr. Sengupta has said, that whatever decision is taken is up to the Board and that whatever steps it takes would probably be appropriate. However, I am a little concerned that if we take a more lenient decision than in other cases, the inconsistency would weaken our procedures. At the same time, I could be flexible with respect to the appropriate review period, and I could accept a three-month period instead of the proposed two-month period for review. Such a longer review period, which of course is not meant to provide for a corresponding grace period, appears justifiable in view of the quite substantial payments received so far, and it would also conform with the decisions taken in the cases of Guyana, Nicaragua, and Sierra Leone that have been mentioned in the staff paper.

Mr. Ortiz recalled that during the Board's last meeting in July, his chair had expressed its concern about the arrears of Jamaica in view of its large outstanding use of Fund resources, the continuous involvement of the Fund in Jamaica, and the fact that the problem of arrears had caused considerable hardship to other countries that were users of Fund resources. At that time, his chair had proposed a rather strong decision. In view of the payments that Jamaica had made, and also in view of Mr. Brown's statement, he was willing to take a less stringent view, although he remained concerned that, as Mr. Suraisry and Mr. Sengupta had noted, the authorities had given no firm assurances that the arrears would be cleared up.

On balance, Mr. Ortiz stated, he could go along with the second option suggested by the staff, namely, without providing for the possibility of ineligibility, but with a shorter two-month review period.

Mr. Dallara asked for a clarification of paragraph 6 on page 5 of the staff paper. First, he would like to know whether the welcome statements made by Governor Brown that Jamaica was making every effort to harness its resources in order to liquidate its arrears to the Fund, and that Jamaica deeply regretted the delays, were substantively different from the views that had been taken into account when the paper had been drafted and which noted the lack of firm assurances that the arrears would be eliminated at an early date. Any further comments by Governor Brown in that respect would help him in forming a judgment about the most appropriate approach in the circumstances.

Second, Mr. Dallara asked whether a correct reading of paragraph 6 was that, on balance, the staff's view was that the first version of paragraph 4 of the proposed decision was the most appropriate in the circumstances.

The staff representative from the Treasurer's Department responded that in the staff's view either version of paragraph 4 would be appropriate in the circumstances. It was a matter of judgment for the Board to decide. The staff had tried to indicate the considerations that might argue for a shorter review period. The commitment that had just been expressed by Mr. Brown was of course very welcome and added to the staff's understanding of the intentions of the authorities.

Mr. Brown said that the assurance given related to the specific arrangement on which his authorities had been working and which, when put in place, would provide the funds for the liquidation of the arrears. Both the steps involved and the time frame within which an effort was being made to put the arrangement in place had been explained. The related flows had been taken into consideration in the profile of the program which had been discussed with the staff in the past few days. Without knowing at what stage of the discussions the paragraph in question had been written, he could state that his authorities' plans were on the table in terms of the numbers built into the program profile.

Mr. Dallara made the following statement:

We appreciate Governor Brown's presentation of his Government's intention with respect to Jamaica's arrears to the Fund, as well as his brief review of the current policy stance and technical discussions with the Fund.

Let me add, like other Directors, that we welcome the payment to the Fund that the Jamaican authorities have made. Prior to that payment, only very small payments had been made since Jamaica fell into arrears in April. This payment, however, now reduces the arrears significantly. Nonetheless, as Mr. Suraisry and others have pointed out, Jamaica's arrears remain sizable and Jamaica has missed over 30 payments to the Fund in recent months. The arrears of Jamaica to the Fund are, of course, a matter of serious concern. Arrears to the Fund can undermine not only the Fund's credibility and damage its financial position in general, but in particular cases arrears can impose a financial burden on every debtor and every creditor in the Fund. And if my recollection of our nonaccrual practices is correct, should Jamaica's arrears persist more than another month and a half or so, every debtor in the Fund and every creditor would, as a result, have an additional financial burden. Obviously, these arrears are a matter of serious concern, and we would join others in strongly urging the authorities to eliminate them promptly.

In this connection, we have read with interest the information provided in the staff paper and the additional information provided by Governor Brown this morning on the external position of Jamaica and the foreign exchange position of the Government in particular. We wonder whether any additional information could be provided at this time, either by the staff or Governor Brown, concerning Jamaica's foreign exchange position.

We understand that the authorities have been engaged in intensive technical discussions with the Fund on their economic policies. We welcome the efforts by Jamaica to put into place a comprehensive program, but it is important and proper that arrears be eliminated promptly and that action not be delayed until all elements of an economic program are finalized. We appreciate, of course, the point made in the staff paper that, in the view of the Jamaican authorities, "in the absence of understandings on policies with the Fund, it would be extremely difficult for Jamaica to obtain the external assistance needed to clear the arrears," and we take it that that is implicit again in what Governor Brown has told us. But we would note that, while lack of a comprehensive program might certainly inhibit and constrain a country's ability to eliminate its arrears, it should certainly not in any way affect its intent or determination to eliminate those arrears at the earliest possible date.

We understand that Jamaica's external situation remains very difficult. As described in the staff paper, recent improvements in the current account have regrettably been more than offset by a deterioration in the capital account, which appears to reflect in part the expansionary domestic policies now being pursued. In our view, there continues to be a pressing need for a comprehensive program that would move Jamaica decisively toward sustainable real economic growth and a viable external payments position. Indeed, in outlining the broad objectives of the Jamaican authorities, it would be hard to improve upon or to disagree in any way with the basic policy objectives which Governor Brown has outlined for us. In fact, I would wish to associate myself not only with those objectives but with the particular reference to doing so through structural reform and relative price reforms. To be more specific, I would say that market-related pricing signals must be central to Jamaica's efforts to foster growth, promote investment, and ensure the competitiveness of exports.

As to the decisions which have been put before us, I would first say that we are prepared to agree with the staff's recommendation, if I understood it correctly, that the review period be one or two months, if, of course, it is necessary for the Board to review this matter further. I for one would like to say that we are hopeful that it will not be, and that the Jamaican authorities will indeed eliminate their arrears in the period ahead so that the Board will not be required to come back to the matter.

As for the two options in the draft decision, we have reviewed them in detail against three broad criteria: first, the Board's standing policies and procedures on arrears, strengthened as they have been over the course of the past year or so, against the background of a consensus that our arrears problem is becoming more serious; second, the handling of other particular cases which, although we need to continue to follow a case-by-case basis, we must keep in mind in order to ensure consistency; and third, the particular circumstances surrounding this case, many of which have been noted by other Directors. I would note among these particular circumstances, first, the significant payment which the Jamaican authorities have made in order to reaffirm and demonstrate financially their intent to eliminate their arrears to the Fund; and second, the helpful comments by Governor Brown conveying his authorities' concern with this problem and their regret that it continues, and outlining their efforts to eliminate the arrears.

Other factors must be taken into account, however. The substantial exposure of Jamaica to the Fund, which, at 415 percent of quota, is by far the largest exposure of any member in this institution, more than 60 percent of quota higher than that of any other member, and in addition, the fact that, in spite of the very helpful comments by Governor Brown, as the staff notes in its paper, we nevertheless do not have full assurances that these arrears will

be eliminated in the immediate future. In the circumstances, we do not have the luxury of the staff to consider these approaches equally appropriate. And taking into account the comments of Mr. Goos and others, I believe that, keeping in mind again the other cases we have dealt with, the first version of paragraph 4 of the proposed decision is somewhat more appropriate in these circumstances, although I would, if the majority of the Board wished, go along with the second version.

In closing, let me stress the importance we attach to Jamaica's prompt elimination of its arrears to the Fund, action which would restore its historically good position and relations with this institution. Let me stress at the same time the importance we attach to Jamaica's putting into place a comprehensive program that could command the support of the international financial community, including this institution, so that the objectives of growth and payments viability, which Governor Brown so helpfully outlined for us this afternoon, can be realized by the Jamaican economy in the period immediately ahead.

Mr. Zecchini stated first that he joined others in welcoming the recent payment made by Jamaica that had helped to reduce the outstanding amount of arrears, which nevertheless remained relatively large in prospective terms. Second, it was clear that the economic and financial difficulties of Jamaica had been increasing lately. He believed that there was a problem of confidence on the part of economic agents in the redressment of the economic imbalances. The adverse nature of capital movements in recent times was one of the several pieces of evidence pointing in that direction. A more forceful approach to adjustment policy was needed under the circumstances, and he hoped that the authorities were aware of that need. The sense of urgency had to be conveyed, not necessarily through the wording of the decision, but by any means--even the presence of Governor Brown at the Board's discussion--in order to make it clear that adjustment measures were needed and were needed rapidly.

To give some additional time to Jamaica for the repayment of its arrears, and also to leave some room for reaching a long awaited agreement with the Fund on adjustment policies, Mr. Zecchini said that he could go along with a review period of two months, and possibly with the second of the two versions of paragraph 4 of the proposed decision.

Mr. Suraisry remarked that if the last comments by Governor Brown were to be understood as conveying the authorities' view that there was a link between repaying the Fund and the success of the discussions they were conducting with the Fund, he would have to register his disagreement, on grounds of principle. Like Mr. Goos, Mr. Dallara, and Mr. Foot, he would in the circumstances have to support the first version of paragraph 4 of the proposed decision.

The staff representative from the Western Hemisphere Department said that the three basic sources of funding in the balance of the current fiscal year would be World Bank structural adjustment or sectoral adjustment loans, U.S. AID balance of payments support funds, and possibly other funds which were alluded to by Governor Brown. On an optimistic timetable, there was a possibility of disbursement by the World Bank of US$20 million under a public enterprise adjustment loan and of US$40 million to support a tariff reform program; both could possibly be disbursed before March, although it must be emphasized that in neither case were the negotiations complete. In terms of balance of payments support, there was not yet any firm indication from the U.S. Government of its level, although it would not be negligible under any circumstances. He could add little to Governor Brown's remarks on the third source, except to note that it could represent a significant amount of loan funds.

The latest date for the conclusion of the Article IV consultation by the Board was November 5, unless a postponement was requested, the staff representative from the Western Hemisphere Department said. It should be readily understandable to the Board, in the light of its discussion, that neither the Jamaican authorities nor the staff had felt that the consultation discussions, which had taken place in August, could be brought to the concluding stage under the circumstances. Therefore, the staff had been unable to complete the consultation discussions, pending a resolution of the issues outstanding. Neither the staff nor, he believed, the Jamaican authorities wanted a consultation discussion at the Board which would reflect a dialogue that had not been completed. Consequently, a request for an extension of the period within which the consultation was to be concluded would be submitted for the Board's approval. Realistically speaking, if negotiations were concluded in the near future, and taking into account the time for the preparation and circulation of the staff reports, the consultation would not be brought to the Board until some time in the early part of 1987.

Mr. Brown noted that as he had mentioned in his opening statement, the Jamaican Government was in the process of putting into place an arrangement that was not related to a Fund-supported program and on the basis of which resources would be provided for liquidating the arrears. Therefore, he had not at all established a link between agreement on a program with the Fund and the liquidation of the arrears.

The Jamaican authorities were fully cognizant of the critical role that exports must play, and that export-related investment must play, within the Jamaican economy in the medium term, Mr. Brown stated. As such, they attached as much importance as anyone else to the need for efficiency in production for export and to the critical importance of export profitability and export competitiveness. Thus, in referring to the staff representative's report on the main areas outstanding in the discussions on a program, and specifically to the mention of the discussion pertaining to exchange rate policy, he had simply been making the point that the ongoing discussion on exchange rate policy and the exchange rate regime should not be taken by members of the Board to indicate a lack of concern about the critical

importance of export profitability and export growth. His authorities were seeking the best combination of arrangements that would lead to the volume of exports required by the Jamaican economy at the present time. Their concern was that such arrangements should make for the greatest amount of effectiveness, and should take into account the basic environment in which they were going to operate.

On a factual point, reference was made in the staff paper to the position relating to nontraditional exports, Mr. Brown observed. It was stated on page 2 that "nontraditional exports have been stagnant following the appreciation of the Jamaican dollar in November 1985." Without wishing to claim that the exchange rate regime that had been obtained since then had necessarily removed the fears relating to such regimes, it was a fact that the performance of nontraditional exports was not shown in the data on merchandise exports, largely because a significant part of them took place within the free zone area of the Jamaican economy. Published data showed significant growth in garment exports and other exports from the free zone in recent times; in a balance of payments sense those exports would show up in net terms within the services account. In addition, the significant turnaround within the tourist industry could not be overemphasized. Merchandise exports in 1986/87 would show a significant increase over the previous fiscal year, and imports a decrease in current prices. He had already mentioned the factors that would serve to influence performance on both sides in his opening statement.

The Jamaican economy had in fact undergone considerable structural adjustment, Mr. Brown concluded. A structural adjustment program had been in place in Jamaica since 1981, as reflected in the data available at the present stage, including that on the movement of the fiscal deficit. All those developments must be taken into account in evaluating the prospects for the economy during the medium term, and in the program currently being considered, in which tax reform, tariff reform, and the reform of the financial sector loomed large.

He had taken on board the various observations which had been made during the discussion, Mr. Brown said, and joined others in expressing the hope that a meeting of minds would be possible in the very near future so that a program could be put in place as early as possible.

The Secretary said that the sense of the meeting was in favor of the second version of paragraph 4 of the proposed decision, with a two-month review period.

Mr. Sengupta asked how the Secretary had drawn the sense of the meeting since many Directors had not spoken. He recognized that silence normally indicated consent.

The Secretary explained that silence was considered consent on country items. The matter under discussion was, however, a policy matter, on which only expressed views were taken into account.

The Chairman said that he joined Mr. Brown in hoping that the ongoing negotiations would lead quickly to a meeting of minds. Considerable progress had been made, although a number of issues were still being looked at, including the fiscal position, specifically the need to clarify the situation of the public entities in 1986 and the competitiveness of the economy. Much would depend on the course of the discussions, in which the Fund would continue to show as much, but no more, flexibility than it could.

Finally, the Chairman said that he would as usual communicate the thrust of the discussion to the Jamaican authorities.

The Executive Board then took the following decision:

1. The Fund has reviewed Decision No. 8344-(86/120) G/S, July 25, 1986, in light of the facts described in EBS/86/239 (10/23/86), pertaining to Jamaica's overdue financial obligations to the Fund.

2. The Fund welcomes the payments that have been made by Jamaica. However, the Fund regrets the continuing nonobservance by Jamaica of its financial obligations to the Fund in the General Resources Account and notes that further substantial obligations will fall due in the near future. The Fund urges Jamaica to make full and prompt settlement of the overdue financial obligations to the Fund.

3. The Fund notes the economic measures implemented recently and calls upon Jamaica to adopt urgently a strong and comprehensive program that would result in necessary economic adjustment.

4. The Fund shall review further Decision No. 8344-(86/120) G/S within a period of two months, taking into account any further developments. Unless by the time of that review Jamaica is current in its financial obligations to the Fund in the General Resources Account, the Fund will consider the appropriateness of further steps, including the possibility of declaring Jamaica ineligible pursuant to Article XXVI, Section 2(a) to use the general resources of the Fund.

Decision No. 8431-(86/173), adopted
October 24, 1986

3. EDUCATION ALLOWANCE - REVIEW

The Executive Directors considered a memorandum from the Chairman of the Committee on Administrative Policies containing a report and recommendations of the Committee for the adjustment of education allowances for the 1986/87 academic year, which had been placed on the agenda at the request of an Executive Director.

The Director of the Administration Department reported that on August 19, 1986 the Executive Directors of the World Bank had approved a similar proposal.

Mr. Dallara said that he regretted the need to bring the item to the Board for discussion but did so because his authorities considered it an important policy matter that was relevant for all Fund staff, in a way, and because they were concerned about the administration of such policies.

According to General Administrative Order No. 21, Mr. Dallara recalled that the purpose of the education allowance was to assist eligible staff "in educating their dependent children in their home country or in a manner intended to facilitate their eventual return to their home country." He did not question the need for an education allowance policy designed for that purpose, and he fully supported the continuation of such a benefit for expatriate staff, which was a critical part of the expatriate benefit package. His concern related to the administration of the benefit, not to the benefit itself.

A principle that must guide the Fund in all of its expenditures--operational or administrative--was that in the end it was the Fund's responsibility to ensure that all expenditures were consistent with its policies and practices, Mr. Dallara continued. He hastened to add that that was very different from suggesting in any way that the Fund should interfere with parents' judgment regarding their child's education. The Committee had considered the matter, in his view, in a rather limited fashion on a couple of occasions and had concluded that the Committee should review the application of the education allowance policy with respect to education in third countries. He welcomed the decision by the Committee to conduct such a review and fully supported the Committee's proposed re-examination of the education allowance in respect to children studying in a third country. He hoped that that review would result in recommending changes that might be needed and appropriate in the not too distant future.

Concerns remained on the part of his authorities, however, about the application of the education allowance to schools within the duty station, Mr. Dallara added. The statistics included in the paper reviewing the education allowance policy (EB/CAP/86/3, 9/25/86, and Sup. 2, 9/10/86) at the very least raised some questions as to whether the choice of school in every case was a choice that "will facilitate the child's eventual return to the home country." Again, while it was clearly up to the parent to decide where and in what school his or her child should be educated, it was up to the institution to decide the circumstances under which its education allowance was applicable. The Committee's recommendations to have parents state in writing that "the education will take place in an institution which, in the staff member's opinion, will facilitate the child's eventual return to the home country" was, he believed, a helpful step toward improving the administration of the policy. But it did not go far enough. In fact, from an earlier discussion in the Committee, he understood that it would require simply a parent's signature over a typed, standard statement that the parent was, in effect, certifying that

the choice of school would facilitate the eventual return of children to the home country. His suggestion and hope had been that at a minimum parents could be asked to outline in their own words how they had reached a judgment that a particular education was consistent with the Fund's educational policy. In his view, such a procedure would have helped to ensure an appropriate application of the education allowance policy and equitable treatment of all staff. Fundamentally, it was up to the Fund to judge when its policies were being properly implemented; but on sensitive, difficult matters of an internal, family nature, the Fund inevitably found it difficult to make a judgment. What he had suggested in the Committee, however, was not--or at least not at that stage of the procedure for requesting an allowance--a judgment by the Fund, but simply a statement by the parents.

The matter under discussion was important to many Fund staff members, both American and non-American, Mr. Dallara recognized. Although he was not in a position to support the recommended increases in the education allowance on the basis of the Committee's recommendation, he was prepared to state at the outset that, if the Board would simply decide to ask the Committee to go back and take a thorough, comprehensive, broad look at every facet of the problem--and not simply circulate statistics periodically before proposing another increase in the education allowance--he would be prepared on that understanding to support the recommendations before the Board.

Mr. Goos said that he had several general reservations about Mr. Dallara's proposal, to begin with because it was not at all clear what he had in mind. The statistics presented by the staff in one of its papers had seemed to him to be quite telling; moreover, what kind of statistics could be gathered to show that a certain decision by a parent to send a child to a certain school was wrong or right? If Mr. Dallara could provide a yardstick or a general idea of what he had in mind, he could go along with his proposal.

Mr. Foot said that he wished to declare, following U.K. parliamentary procedure, that he had two children being educated in the United States under the Fund's education allowance procedures, in which he thus had an interest.

Second, as a member of another committee of the Board--the Committee on Executive Board Administrative Matters--he knew only too well that a subject came to the Board through a committee only after exhaustive study and discussion, Mr. Foot commented. However, Mr. Dallara had clearly evidenced a strong degree of dissatisfaction and desire for a review, and to provide for one would be the least that the Board could do to meet his needs. Essentially, the existing procedures seemed redundant or at least to serve a confusing purpose. Maybe the best way forward would be to have an examination, with complete anonymity, of cases that caused concern, to see whether or not there was any basic cause for concern. If not, the criteria could be dropped altogether. Whatever action was taken should be done in the first half of 1987. Unfortunately, the current academic

year had just started. Undoubtedly, the recommendations before the Board should be approved, and the Committee on Administrative Policies should decide what procedure it wished to follow so that a clear-cut decision was reached soon enough for the final decision to take effect for the next academic year.

Mr. Fujino noted that the Committee on Administrative Policies, of which he was a member, had had a very thorough discussion on the matter. In his view, the procedures had been strengthened, and it had been concluded that there should be a review, as was clearly stated in paragraph (2) of the Committee's recommendations. For many member countries, it was very important to have a highly equitable degree of geographical distribution on the staff. A child's education was a most important element in making a decision to accept a position as a staff member of the Fund. He had been glad to hear Mr. Dallara's confirmation that he did not object to the system itself but was only questioning the way it was administered. In that connection, the administration of the policy had been strengthened by requiring a written confirmation that in the staff member's opinion, the choice of the institution would facilitate the eventual return of the child to his home country. He felt sure that a review of individual cases, especially with respect to education in third countries, would reveal no apparent case of abuse. Decisions on the education of a child were a very delicate family matter, varying acording to the family background or even being dependent on the ability of the child. Attempts to explore in detail those individual family reasons would complicate the administration of the system even further, and for the time being he would prefer to rely on the conscience of the staff not to abuse the privilege. The purpose, as Mr. Dallara had rightly pointed out, was to facilitate the eventual return of the child to his home country. Mr. Dallara's proposed review was already included in the understanding reached by the Committee that its next review would cover the matter more deeply. That should be sufficient to meet the concern of Mr. Dallara.

Mr. Rye commented that as another member of the Committee, he had felt that Mr. Dallara's initial concerns about the matter had revealed some deficiencies in the administrative procedures that he was not entirely sure had been corrected by the Committee's recommendations. On the other hand, he was reluctant to go too much further; in particular, he had no enthusiasm for Mr. Foot's idea of a case-by-case examination, which would inevitably lead to deep involvement in the individual circumstances of particular families. The precise nature of the further review that Mr. Dallara was seeking was uncertain. Like Mr. Goos, he had thought originally that Mr. Dallara's concern was with education in a third country; certainly, that had been the main issue discussed in the Committee. But Mr. Dallara's latest remarks had extended his concerns much more broadly than that, making it more difficult to deal with the nature and significance of his remaining concerns. Some further elucidation of the kind of review that Mr. Dallara had in mind would help him to decide whether he could support the idea of returning the matter to the Committee.

Mr. Dallara said that, as he had indicated in his opening remarks, he welcomed the review provided for in paragraph (2) of the report from the Chairman of the Committee (EBAP/86/229). At the same time, as Mr. Rye and Mr. Goos and others had observed, he did not believe that that understanding covered the entire issue. There was the question of the application and adminstration of the education allowance as it related to schools within the duty station. It was difficult to be more specific without going into detail, but in essence it was a matter of finding a delicate balance between not interfering in inherently parental decisions about education and ensuring that education allowances were used in a fashion consistent with GAO 21 to facilitate eventual return to the home country. Although he appreciated the fact that the Fund should not and could not delve too deeply into family decisions, he wondered whether the Fund was not already in a certain sense injecting itself into such matters by agreeing to fund education, and to fund it for a certain purpose. If the Fund was to fund education for expatriate staff for a certain purpose, was there not an inherent obligation to ensure in some way that the use of the funds was consistent with the purpose of the education allowance?

He did not want to take the time, at the end of a long day in the Board, to try to articulate all the elements of what he believed would be a comprehensive and thorough review, Mr. Dallara added. The staff had provided information in the past that suggested that no effort whatsoever had been made to reach a judgment--consistent with previous Board guidance and Committee deliberations--as to whether or not the funds were used in the proper manner; prima facie, it was not entirely clear that all of the schools to which parents sent their children did necessarily facilitate eventual return to the home country. Perhaps the reason was simply an inability to understand the circumstances surrounding those parental decisions; if that was the case, all well and good, and in any event, the Fund owed it to its staff to give the staff the benefit of the doubt on these matters. But that did not mean that the staff, the management, and the Board had no responsibility for ensuring--if for no other reason than that a large component of the Fund's staff was not eligible for the allowance and yet lived side by side with expatriate staff who were--that the policy was administered in accordance with the guidance of the Board and as laid down in the GAO.

At the minimum, Mr. Dallara considered, the Fund should be able to justify to a U.S. employee the consistency of its education allowance policy, under which expatriate staff sent their children to certain schools and were reimbursed by the Fund, whereas Americans could not. The justification might be simply that expatriate children came from a different environment, and that cultural, linguistic and other differences needed to be taken into account. Obviously, it was important to all parents, American or non-American, that their children receive a quality education. But the desire and demand and need for quality education did not impose a special responsibility on the Fund, as was evident in the way in which the allowance was administered. U.S. employees in the Fund were not reimbursed for education of their children unless they were serving outside the United States. The Fund accepted no responsibility

for compensating all its employees for educational costs. The Fund did, appropriately, accept the responsibility for compensating part of the costs of appropriate education for the children of expatriate staff, because it might be inherently more difficult to obtain. He did not dispute the point, but he underscored that, in the interests of ensuring that the Board's own guidance was followed, it should at least exhibit a willingness to look further into the matter, which had not been explored as fully as it should have been to date.

Mr. Rye commented that it was perhaps not appropriate for the Board to discuss the nature of any review, which was more a matter for the Committee to take up again. If Mr. Dallara was satisfied with an agreement to return the matter to the Committee, he could go along with a decision to that effect. However, he did not find Mr. Dallara's concerns, while obviously very deeply felt, such as to lend themselves to ready review of the kind being sought. There had to be a basis for a review, and he did not know what that basis was at the moment.

The Director of the Administration Department explained, in response to a question by the Chairman, that the school year started at different times for different people, but that it had certainly already begun by now for all children. A partial payment had been made already based on the level of last year's allowance. The proposal before the Board was for an increase in the allowance.

Mr. Zecchini commented that he was a member of the Committee entrusted with the task of discussing the matter at length. He did not want to repeat the considerations he had put forward in the Committee, but hoped that Directors would have a chance to review the record of what he had said on the matter.

If he were to be brief, Mr. Zecchini added, he could go on to say that he associated himself with the position expressed by Mr. Fujino. But a few additional words might be helpful to those who were not familiar with the background to the discussion of the matter. He believed that he had been one of the first members of the Committee to raise the point that if an extensive, thorough review of the education allowance had to be carried out, it must be full fledged in order not to have any particular bias. It would also be necessary to have a clear idea of what was to be achieved, while standing ready to accept the conclusions of a scientific approach that could lead toward a significant enlargement of the education allowance for expatriates, if the objective was to be fair treatment. Many points made by Mr. Dallara needed extensive reflection but one was extremely difficult to accept, namely, that the education allowance lent itself to interpretation as discriminatory treatment of U.S. staff employees compared to expatriates. It was clear that an expatriate did not have all the privileges of a U.S. citizen in entering the U.S. job market. He strongly believed that the education allowance served the purpose of redressing an imbalance, which was to the disadvantage of expatriate staff members and their family members. In addition, he did not believe that the Fund should involve itself deeply in an analysis of the many motivations at

the origin of the decisions taken by families about the educational institution that best fitted its needs in order to facilitate the return of a child into the job market of the country of origin.

The Committee could take up the matter once again, Mr. Zecchini concluded, but he reiterated that he would oppose less than optimal analysis of the issue for the purpose of achieving predetermined conclusions.

Mr. Almeida observed that as shown in Table 5 of EB/CAP/86/2 (2/19/86), a maximum of 40 staff members received an allowance for education in a third country. In 14 of those 40 cases, there were identifiable traditional linkages between the staff member's home country and either the United Kingdom or France. In another 7 cases, there was an understandable linkage between the staff member's country of origin and Canada. Thus, only 19 cases were without a clear explanation. Yet the crucial point was quite different: there were only a finite number of reasons why a staff member might choose a particular school in a particular country to facilitate the return of children to the home country, and the Administration Department should not ask for those reasons; in fact, he did not know what use it could make of them. Would the staff member be told that he or she had made a wrong choice, and that instead of sending the child to school A in country B they should send him or her to another place? Those were private matters that should not be the concern of the Fund. It was obvious that the explanations would not be informative unless the Fund investigated each answer, something it should not do. He agreed with the statement in Supplement 2 to EB/CAP/86/3 that expatriate children's education was "necessarily accompanied by great uncertainty as to whether or not the children will eventually decide to reside permanently in the country of nationality," or live in the Unitd States. To state in written form the reasons for the choice of the country of the education, which were unlikely to be expressed in any precise fashion, was to ask too much. For those reasons, he supported the proposed decision in EBAP/86/229. However, he was concerned about the costs involved in the re-examination of the education allowance called for in paragraph (2), and asked the staff for any additional information it might have in that respect.

Mr. Archibong noted that from the various papers available on the education allowance policy it seemed quite clear that the Committee on Administrative Policies had realistically tackled the issue of the adjustment of education allowances for the 1986/87 academic year. The recommendations of the Committee were clearly consistent with the procedures followed annually since 1980. In its recent thorough review of education allowances based on the usual annual survey, the Administration Department's findings had indicated a rise in tuition costs averaging about 9.3 percent over the past year. Based on that fact and on the findings of the survey of schools and universities worldwide, and given the expected results of the UN Post Adjustment Index (UNPAI), it would be difficult not to support an increase in the education allowance if, as had been stated in EB/CAP/86/3, the objective was "to bring the Fund sufficiently close to the normal

objective of covering 75 percent of the tuition costs for at least 90 percent of the claims for children studying outside the staff member's country of assignment."

On the issue of statistics on the use of education allowances, Mr. Archibong said that he was satisfied with the data provided in EB/CAP/86/2. It seemed to him that that data would provide an overview of the utilization of allowances and should adequately meet any concern in that respect. He was also convinced that on matters concerning judgments on the choice of local schools best suited to the expatriate child's needs, there could be no substitute for the parents' judgment. He therefore strongly supported the recommendation for the abolition of any restriction imposed in that respect. The broadening of policy to include education in a third country certainly made the Fund fall in line with practice in other international institutions, notably the United Nations, and even the World Bank. With the redefinition of a qualifying educational institution as provided in paragraph 7 of Supplement 2 to EB/CAP/86/3, whatever concerns might have been outstanding on the issue would have been met. In that connection, he urged the Board to note the important statement in the same paragraph by the Administration Department on the matter, namely--"the planning by expatriate staff members of their children's education is necessarily accompanied by great uncertainty as to whether or not the children will eventually decide to reside permanently in the country of their nationality....Any international institution employing expatriate staff must recognize and be sympathetic to this uncertainty." He therefore strongly supported the recommendations set forth in EBAP/86/229 and urged that no action should be taken on the matter that would place the staff of the International Monetary Fund at a relative disadvantage vis-à-vis the staff of comparable international institutions.

Mr. Suraisry noted that he was a member of the Committee, which after substantive and long discussion on the matter had agreed to the decision before the Board. Like Mr. Rye, he considered that the agreement reached had met some, although obviously not all, of Mr. Dallara's concerns, so that he felt obligated to support it. He had become more convinced by the World Bank's adoption of a similar decision because in such matters parallelism was important.

Mr. Vasudevan said that he supported the proposed decision, although he had some concerns about the understanding in paragraph (2). He was also slightly worried about the way in which Mr. Dallara had changed the emphasis in his second explanation, which seemed to differ slightly from the first one in which he had raised only the issue of the administration of the benefit. That specific issue was one on which administrators had nothing to say because it was a matter of decision by the family. The Administration Department should not go too deeply into those matters.

Mr. Song expressed support for the proposed decision.

Mr. Simonsen stated that he could support the recommendations of the Committee both concerning the procedures to be followed and the adjustment of the education allowance for the 1986/87 academic year.

Mr. Chatah said that his chair could also support the decision. Referring to the suggestion by Mr. Dallara for a more thorough study of some of the apparently fundamental issues regarding the education allowance, he remarked that although he had not attended the Committee meetings, his understanding was that it had agreed on a change in procedure similar to the one sought by Mr. Dallara. Obviously, experience under the new procedures would have to be looked at before the Board re-embarked on a similar thorough examination. It still seemed unclear whether there was broad support for reopening the matter, either by a review of experience--not necessarily in the form of a formal consideration by the Committee--or by conveying the information gained either to the Committee or to the Board. In either event, the conclusion might be that no change was necessary or alternatively that a full consideration was warranted.

Mr. Toé expressed his chair's support for the recommendations of the Committee.

Mr. Dallara, reiterating his view that although it was neither the time nor the place to try to articulate the detailed parameters of such a review, explained that, in case he had confused or misled Directors, what his authorities had in mind was a review of the administration of the policy to consider whether the policy was being administered equitably and in a way that ensured, to the extent feasible, that use of the education allowance occurred in a manner consistent with the purpose of the education allowance--to facilitate eventual return to the home country--and that whatever changes might be deemed appropriate as a result of that review should be considered by the Board. That did not seem to be asking very much at all for a twofold reason. On the one hand, it seemed to him that it was important for him to recognize, as a Director for the United States, the importance of the expatriate benefit in question to the expatriate employees in the staff and to understand why it needed to be administered flexibly to take account of the many complex situations parents faced. He accepted both those points. On the other hand, it was equally incumbent on other Directors to understand that many U.S. staff members in the Fund questioned whether the policy was administered equitably, and it seemed to him that it was not asking too much for the question to be considered. He was not asking that changes be made at the present stage. He was asking whether there was a legitimate concern, and if so, why its legitimacy should not be considered. It struck him as rather unwarranted on the part of the Board not to be willing to consider whether or not there was a legitimate concern. He recognized that the bulk of the employees in the institution were non-Americans who faced complex decisions about the education of their children, and the Fund owed it to them to support them in a flexible manner. But he did not believe that it was too much, in light of the concerns that he knew existed on the part of U.S. staff members, to ask for a review to enable the Board to know with confidence whether the policy was applied in the most equitable and consistent manner that was feasible.

The Secretary stated that, on the basis of the views expressed, there was majority support for the decision proposed in EBAP/86/229.

The Executive Board then took the following decision:

a. The maximum allowance for tuition in the staff member's country of assignment shall be increased to $4,650 from $4,300 per annum.

b. The "base" maximum allowance for tuition and boarding for children studying outside the staff member's country of assignment shall be increased to $6,550 from $6,150 per annum.

c. When children are studying outside the staff member's country of assignment, the "base" subsistence grants at primary and secondary school levels shall be raised to $1,575 from $1,475 per annum, and at postsecondary level to $3,150 from $2,950 per annum.

Adopted October 24, 1986

Mr. Dallara said that he wished to make it clear that he felt under obligation to indicate to the U.S. employees of the institution what he perceived as the unwillingness of the Board even to look at the issue.

APPROVED: June 22, 1987

JOSEPH W. LANG, JR.
Acting Secretary