04

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/201

10:00 a.m., December 17, 1986

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

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
	Wang X., Temporary
C. H. Dallara	M. K. Bush
J. de Groote	H. G. Schneider
A. Donoso	J. J. Dreizzen
	M. Hepp, Temporary
M. Finaish	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	B. Goos
	Khong K. N., Temporary
A. Kafka	H. A. Arias
T. P. Lankester	M. Foot
	R. Fox, Temporary
H. Lundstrom	H. Fugmann
M. Massé	
Mawakani Samba	
Y. A. Nimatallah	I. Al-Assaf
	A. Ouanes, Temporary
G. Ortiz	L. Filardo
H. Ploix	
	J. de Beaufort Wijnholds
	I. Sliper, Temporary
G. Salehkhou	O. Kabbaj
A. K. Sengupta	
S. Zecchini	S. Rebecchini, Temporary

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

1. Mexico - Report by Staff . . . . . Page 3
2. Haiti - 1986 Article IV Consultation and Structural Adjustment Arrangement . . . . . Page 4
3. Administrative Expenses in FY 1987 - Midyear Review; and Budgetary Outlook for FY 1988 . . . . . Page 30

Also Present

IBRD: G. Koenig, Latin America and the Caribbean Regional Office. Administration Department: G. F. Rea, Director; H. J. O. Struckmeyer, Deputy Director; T. J. Hill, W. B. Hobbs, N. S. Jackson, P. M. McClellan, M. Oka, H. Wiesner, L. A. Wolfe. African Department: E. L. Bornemann. Central Banking Department: C. Madelin. European Department: H. O. Schmitt. Exchange and Trade Relations Department: M. Guitián, Deputy Director; W. A. Beveridge, Deputy Director; L. H. Duran-Downing, E. R. J. Kalter, M. R. Kelly. Fiscal Affairs Department: V. Tanzi, Director; A. A. Tait, Deputy Director; A. Tazi. IMF Institute: U Tun Wai, Deputy Director; A. H. Whitfield. Legal Department: W. E. Holder, S. A. Silard, J. V. Surr. Middle Eastern Department: K. Nashashibi. Research Department: P. R. Masson. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: D. V. Pritchett. Western Hemisphere Department: S. T. Beza, Associate Director; D. J. Andrews, M. Caiola, J. Ferrán, J. Gil-Diaz, A. S. Linde, J. P. Pujol, S. Umana. Bureau of Language Services: A. Wright, Director. Bureau of Statistics: J. B. McLenaghan, Deputy Director. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. A. Agah, P. E. Archibong, A. Bertuch-Samuels, M. B. Chatah, L. P. Ebrill, K. Murakami, P. Péterfalvy, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: J. R. N. Almeida, O. S.-M. Bethel, V. Govindarajan, A. R. Ismael, M. Lundsager, C. Noriega, S. Rebecchini, A. V. Romuáldez, D. Saha, G. Schurr, S. Simonsen.

1. MEXICO - REPORT BY STAFF

The staff representative from the Western Hemisphere Department made the following statement:

At the time of the last Board Meeting on Mexico, on November 19, 1986, the staff reported on recent developments under the Mexican program and the results achieved thus far. At that time, full information about all of the performance criteria for September was not available, and the staff indicated that some questions had arisen concerning the calculation of the operational balance. The mission that returned last weekend from Mexico City reviewed further with the authorities the performance under the program adopted last July and continued discussions on the economic program for 1987. I would like to take this opportunity to inform Executive Directors on the performance under the program through the end of September 1986.

As reported in the supplementary information provided to the Board on November 19, 1986 (EBS/86/161, Sup. 7), the balance of payments has been stronger than projected under the program after taking into account delays in the disbursement of external resources. As a result, the cumulative loss of international reserves from January through September 1986 was only $2.6 billion, compared with a loss of almost $3.8 billion expected under the program. These trends were maintained after September, and the cumulative loss in international reserves had been reduced to $1.8 billion by the end of November.

With respect to fiscal performance, the figures now available through the end of September indicate that the limit for the cumulative total public sector borrowing requirement was met with an ample margin, as was the case for the cumulative change in financial intermediation by development banks and official trust funds.

In the case of the operational balance, a new concept for Mexico that was introduced in the context of this program, it took considerable time to arrive at an appropriate measurement of performance because the original figures for the domestic debt used as a base for the calculations in the programming excercise had to be corrected and because account had to be taken of interest payment refunds from the central bank to the Government and of differences between effective flows of financing coming from the placement of treasury bills and the stock of treasury bills outstanding valued at market prices. After a thorough examination of the various factors involved, the staff is now in a position to certify compliance with this ceiling for September.

Discussions on possible refinements of the methodology for calculating the operational balance are continuing, and any results of such findings will be reported in connection with the review of the program that will be presented to Executive Directors early next year. It may be noted that the method adopted for measuring the operational balance in 1986 proved to be extremely sensitive to the behavior of inflation in any one month.

As regards the other variables subject to performance criteria under the program for September 1986, i.e., the cumulative change in net domestic assets, the net credit to the public sector by the monetary authorities, and the cumulative net foreign borrowing by the public sector, as reported in November 19, 1986 were all met with ample margins. Thus, the staff is now in a position to certify the compliance with the various performance criteria for September, so that the corresponding disbursement can take place.

With respect to the economic program for 1987, as already reported, the authorities recently presented to Congress their budget proposal for 1987, which incorporates the effects of the proposed realignment in public sector tariffs, the introduction of the tax reform, and substantial cuts in current outlays. Work is proceeding on the details and phasing of the economic program for 1987, and current plans call for Mexican officials and the staff to resume discussions in early January to reach understandings on the performance criteria for 1987.

Mr. Ortiz said that he fully agreed with the statement by the staff representative.

The Executive Directors took note of the statement by the staff representative.

2. HAITI - 1986 ARTICLE IV CONSULTATION AND STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1986 Article IV consultation with Haiti and a request by Haiti for arrangements under the structural adjustment facility (EBS/86/257, 11/21/86; and Cor. 1, 12/3/86). They also had before them a background paper on recent economic developments in Haiti (SM/86/294, 12/4/86).

The Chairman made the following statement:

There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the

matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their November 18, 1986 discussion in Committee of the Whole of a paper entitled "Haiti - Policy Framework Paper, 1986/87-1988/89."

The Executive Directors of the Bank and IDA discussed, in a meeting of the Committee of the Whole, a paper entitled "Haiti - Policy Framework Paper, 1986/87-1988/89."

Directors recognized the serious economic situation which the new Government had inherited in February 1986: economic stagnation, inflation, and pressures on the balance of payments. The Government's broad-ranging program (which includes financial stabilization, reforms of practically all aspects of public finance, trade liberalization, export tax reductions and agricultural credit reforms) was endorsed. However, a number of questions were raised about the balance between short-term measures and the longer-term program. The staff noted that this was a transitional Government, which will leave office in early 1988, and its focus was necessarily on the most urgent measures to restore services and economic activity. The medium-term perspective normally expected in a policy framework paper was less fully articulated in this case.

Questions were raised about the adequacy of the trade liberalization measures to stimulate exports. The importance of market access for Haiti's exports, including preferential trading agreements, was stressed. It was noted that the immediate prospects for expanded exports were for manufactures, principally those of the assembly industry. Of key importance was the textile subsector which should benefit from the recent new bilateral agreement with the United States; if Haiti were to meet its new U.S. import quota fully, some 10,000-15,000 new jobs could be created. Beyond the short term, aside from coffee which would benefit from the reduction in the export tax, the Government's policy of trade liberalization was designed both to reduce consumer prices and to encourage the relatively inefficient industries producing for the local market to become more competitive and turn toward exporting. A European Economic Communities mission was currently in Haiti exploring possible trade arrangements and other forms of future cooperation.

Many Directors stressed the urgent need to improve the low levels of literacy and health and to increase employment. It was pointed out that the Government was committed to human resource development through ongoing institutional reforms and the continuation of high priority projects in the social sectors. Most importantly, it had increased recurrent spending on both education and health by over 50 percent in the FY 1987 budget. As regards the social aspects of the adjustment program, the adverse employment effects from the closure of two public

enterprises involved less than 1,000 workers who had received nine months' severance pay. Private sector firms likely to be seriously affected by the trade liberalization numbered about 10-12, with an average employment of about 90 people. Against this, however, had to be put the short-term employment gains that should result from the U.S. textile agreement and, over the medium term, from a return of confidence; the real resource savings of some 2 percent of GDP resulting from the public enterprise reforms; the falling prices of basic consumption items; the impact on over a million people of the coffee tax reduction; and the equity improvement that would result from more effective income tax collection and through raising rents on state lands to intermediaries who at present subleased the land to peasant farmers at market rates.

Another concern expressed by Directors was the importance of aid coordination. It was noted that a meeting of the Haiti Subgroup of the Caribbean Group for Cooperation in Economic Development was scheduled for November 24, 1986; the Government had submitted a list of 26 projects and sought additional external financing of $44 million. Several speakers indicated that their authorities would seek to expand their support for Haiti's recovery and adjustment efforts.

Mr. Arias made the following statement:

The authorities are in broad agreement with the staff report. They are very grateful to the staff mission for their understanding and for the atmosphere of courtesy and candor in which the consultations were conducted.

Haiti's fiscal and balance of payments performance has shown substantial improvement in FY 1985/86. The fiscal deficit was reduced considerably, and, for the first time in many years, the public sector was able to reduce its indebtedness to the domestic banking system and external commercial creditors. After running deficits for six consecutive years, the overall balance of payments registered a surplus. The rate of price increase abated significantly, and in the parallel exchange market the discount on the gourde has receded to about 5 to 7 percent from more than 20 percent earlier in the year. Despite these achievements, the balance of payments would need to be consolidated, economic activity has yet to recover, and the problem of chronic high unemployment and underemployment continues to be the uppermost concern of my authorities. Underlying these difficulties, there are deep-seated structural weaknesses, perhaps most important being the erosion of agricultural land and the low level of education and health of the major part of the population.

To deal with this situation, the Government has embarked on a process of far-reaching structural reforms, major components of which have already been put in place. This offers proof of my authorities' determination to reorient the economy toward efficient endeavors that will create needed, productive jobs.

A process of trade liberalization is well under way, the tax system is being revamped, public enterprise reform has been started with the closing of two loss-making state companies, and actions have been taken to allow interest rates to be more freely determined by market forces. Substantial progress also is being made in strengthening administrative capabilities and expenditure control procedures in the public sector to ensure that available resources, both domestic and external, are used effectively.

The authorities' growth strategy seeks to improve the functioning of the more traditional agricultural sector and to expand further the light assembly industry while taking advantage of the competitive wage structure. My authorities believe that the quality of the program under which the required measures have already been taken set the basis for the restoration of confidence and new investments. In this respect, the support received by donors is viewed by my authorities as a well-merited encouragement to continue consolidating the growth strategy.

With regard to the fiscal area, what the authorities have in mind is widening the tax base while lowering income tax and duty rates and providing a more uniform income tax treatment for both individuals and corporations. This should result in a more equitable tax system that should yield additional revenue. By the same token, government expenditures have been lowered to a sustainable level and reoriented toward the provision of basic services and the development of human resources. In this sense, a better coordination between the Treasury and the Central Bank has been established.

A valuable element for the program, to which the authorities have attached particular importance, is monetary policy. The objective envisaged by the authorities is to maintain a competitive domestic interest rate structure to foster domestic savings and to encourage an efficient allocation of investment. At the same time, a prudent rate of growth of credit would be maintained. Public sector indebtedness to the domestic banking system would be reduced, thus allowing more resources to be allocated to meet private sector demand. The authorities are convinced that for the economy to be able to improve its external balance the achievement of these objectives is indispensable.

The authorities are convinced that to meet their macroeconomic objectives the maintenance of a competitive exchange rate is essential. Even more important, they recognize that such an

exchange rate policy is essential to foster confidence and convey the proper market signals for investment and production decisions. In this respect, the Government has prepared an economic program that will help improve the balance of payments position starting in 1986/87. This includes the settlement of external arrears with official creditors. The authorities have already indicated that they will continue to honor payments obligations to the Fund as these fall due.

Finally, I would like to refer to the medium-term balance of payments projections. The encouraging scenario requires a continued and strengthened adjustment effort, to which my authorities are committed. Also, they are grateful for the understanding and cooperation of donor countries.

Mrs. Filardo made the following statement:

The new Government is to be congratulated for the comprehensive and well-designed program of adjustment and structural reform that it began to implement in February 1986. As Mr. Arias stressed in his opening statement, the main achievements under the program are the correction of the fiscal and monetary imbalances, the surplus in the balance of payments, the sharp reduction in the consumer price index, and the substantial decline of the discount of the gourde in the parallel exchange market. The most sweeping reorientation of economic policies are the steps taken toward trade liberalization, the reallocation of and strong increase in public financial resources for health, education, and agriculture, the closing of inefficient state-owned enterprises, and the overhaul of the income tax law.

The core of the program should be a combination of prudent macroeconomic policies and structural reforms supported by increased concessional assistance. Appropriate donor coordination with the Government and multilateral institutions is fundamental to ensuring the efficient allocation of resources. Furthermore, perseverance and courage are required, as the nature of the problems confronting Haiti are such that they can be solved only in the very long run. The present transitional period is crucial, given the social and political unrest in the country. Some of the most striking figures of the economy are that 80 percent of the population lives in poverty, 65 percent of adults are illiterate, half of the labor force is unemployed or underemployed, and real per capita GDP has declined during the previous five years and is so low that it is itself one of the main structural problems facing the country and limits the possibility of domestic savings. Therefore, there is no alternative but for the economy to rely on external concessional flows to attain a certain level of investment consistent with sustained growth.

I agree with the authorities that the strategy should be to promote economic expansion through the improvement of agricultural performance and export-led growth. The steps that have been taken thus far are in the right direction, and the benchmarks under the proposed structural adjustment arrangement are justified, given the unreliable data for Haiti. Nevertheless, I would like to make some comments and pose some questions about the proposed arrangement.

Given the long-term nature of the economic problems facing Haiti and the fact that Haiti is beginning an election year, the implementation of the program and further perseverance by the elected Government are fundamental to achieving positive economic results together with political and social stability.

As to the trade liberalization approach, I have a question concerning the study of effective protection. Given the poor statistical base of Haiti, I wonder whether the study could be helpful. It might be better instead to combine low tariffs that will be implemented quickly with a competitive real exchange rate.

My second question concerns the management of exchange rate policy and the need to diversify and increase exports. According to the staff paper on recent economic developments in Haiti, the real effective exchange rate, measured by a trade-weighted index, appreciated steadily by 31 percent from 1981 to the third quarter of 1985, and in the third quarter of 1986 was still 28 percent above its 1980 level. Furthermore, Haiti's rate of inflation exceeds that of its trading partners. Nevertheless, in its background paper the staff mentions that "labor costs in Haiti are more competitive, and when the real effective exchange rate is calculated using relative wages, Haiti does not appear to have suffered a significant loss of competitiveness." Since there may be some doubt about the appropriateness of the utilization of this index to measure the real competitiveness of the exchange rate, I wonder whether the staff or the authorities have calculated a more appropriate exchange rate index for Haiti. According to Chart 3 in the background paper the cumulative real effective exchange rate seems to be overvalued in relation to 1980. The staff should comment on the evolution of the real effective exchange rate up to 1986. I wonder whether the staff feels that it would not be better to have a flexible exchange rate, given the commitment of the authorities to control inflation through the maintenance of fiscal and monetary discipline, the relatively low wages in Haiti, and the historically low rate of inflation.

My third question concerns production and export market diversification. Agricultural and light assembly industry seem to account for about 59 percent of GDP in 1986 and 92 percent of foreign exchange income. In the agricultural sector, coffee

production and exports have been declining substantially over the previous two years, owing mainly to the inefficient farming methods and the decline in the aging stock of coffee trees. The Government has correctly implemented tax incentives to increase investment. This takes time, but according to the staff's medium-term balance of payments outlook, coffee export volume is expected to increase by 17 percent in 1986/87. I wonder on what assumption that increase has been estimated.

Light assembly industry, which is expected to lead the recovery in exports and has been concentrated on products that are made from imported materials, accounts for 78 percent of total exports in 1985/86, while textiles account for about 60 percent of the total value added of exports by the manufacturing sector. Since 1983/84, the growth of manufacturing exports has slowed as a consequence of restricted access to foreign markets. Even though an agreement has been reached between the Haitian and U.S. Governments providing greater access for Haiti to the U.S. market, the vulnerability of the structure of Haiti's production and exports is very high. Therefore, the staff could usefully comment on what kind of measures are envisaged to tackle these problems, especially the need to diversify export markets.

Given the present transitional period of adjustment, in which state-owned companies have been closed while half the population remains unemployed or underemployed, the staff or Mr. Arias could usefully comment on whether the authorities are taking the problem of unemployment into account as a special case.

I support the authorities' request, and I hope that they will receive the full support of donors and multilateral institutions over the long term.

Mr. Massé made the following statement:

Within the context of a structural adjustment arrangement the authorities have developed an excellent program of adjustment and structural reform. I fully support in particular the wideranging measures that are designed to improve resource allocation, such as further trade liberalization to expose both public and private firms to greater competition, stringent controls over public expenditure, tax reform to simplify the tax system and to increase its elasticity over the medium term, and improvements in public enterprise performance. These measures are fundamental to restoring an environment that is conducive to sustained economic growth and that will eventually help to redress the basic problems of the narrow economic base and the widespread poverty.

In the fiscal area, the recent introduction of a system of expenditures by administrative sectors and the reassessment of expenditure priorities are welcome steps in the attempt to reduce the overall deficit to a level that is consistent with a stronger balance of payments position. The reappraisal of the investment budget and the restraint in public sector wage increases are necessary. They must be complemented by tighter financial controls over public sector enterprises, and I am pleased that the authorities are committed to monitor more closely the operations of the parastatals.

On the revenue side, the authorities have begun to implement a more equitable tax system with a broader tax base. I fully support the plan to replace quantitative trade restrictions with tariffs, reduce the burden of export taxes, and restructure the income tax system. Reductions in the top marginal tax rates and in the complexity of the tax system should improve administration and increase receipts over time. However, I noted the authorities' concern about revenue shortfalls, and I am encouraged by the formulation of contingency plans to adjust outlays to keep the budget within financeable limits.

Monetary policy is correctly focused on domestic banking credit and interest rates. The authorities have shown their determination to decrease their indebtedness to the domestic banking sector, thereby allowing a shift of financial resources to private enterprise. Saving should be encouraged by the authorities' widening of the permissible ranges for interest rates and lowering of the legal reserve requirements on long-term deposits. Action on interest rates should undoubtedly also result in further increases in private transfers from Haitians living abroad.

The private sector must be encouraged to invest, participate in the diversification of the economy, and support the strengthening of the external accounts. While the assembly industry has made tremendous progress, accounting for 58 percent of total exports in 1985/86, there is still a need to foster export-oriented industries and to pursue a wider range of foreign markets.

I agree with the staff appraisal that the implementation of a major import tariff reform is necessary to reduce price distortions in the economy. In this connection, reduced protectionism should release resources from noncompetitive import-substituting industries and should encourage a shift into production for export. The extent of Haiti's external public debt is a cause for concern. I welcome the authorities' commitment to reduce the amount of commercial borrowing and to meet their external obligations. Still, there is a continued need for concessional borrowing from both bilateral and multilateral sources.

I support the objectives of the medium-term policy framework, which is a positive first step along the lengthy road of adjustment. It is clear that Haiti's development problems are severe and will not be solved even in the medium term. Policies that are conducive to long-term growth--such as those contained in the program--and concessional financing will be needed beyond the life of the proposed structural adjustment arrangement if Haiti's capacity for self-generating development is to improve. In this context, I support the proposed decisions.

Mr. Ouanes made the following statement:

Despite assistance from the Fund, the performance of the Haitian economy in the first half of the 1980s was disappointing: growth faltered while unemployment increased sharply, the rate of inflation accelerated, and the balance of payments came under serious pressure. Furthermore, the growing encroachment of the public sector on the economy that characterized much of the first half of the 1980s has led to serious financial imbalances and widespread misallocation of resources. The result has been an erosion of confidence in both the private sector and the donor community. Faced with this rapidly deteriorating economic and financial situation and a drying up of foreign aid flows, the new Government responded quickly and decisively. It tightened demand management, emphasized financial discipline, and, more recently, committed itself to a path of restructuring and reform within the context of the proposed structural adjustment arrangement. The authorities are to be commended for these efforts.

Haiti is a small economy with a relatively large population. Its very low level of per capita income clearly precludes the generation of sufficient domestic savings to enable the country to break out of the vicious circle of poverty without heavy reliance on external financial assistance. Its openness and dependence on imports make it essential for Haiti to generate sufficient foreign exchange to sustain growth. It is in this context that I find appropriate the authorities' aim to promote economic expansion through an export-led growth strategy. Equally important, however, is the need to rebuild the confidence of both the private sector and donors. Maintaining such confidence will be critical, since concessional loans and grants account for about 30 percent of total public sector resources, 65 percent of public investment, and nearly 40 percent of import payments.

The thrust of the policy actions included in the structural adjustment program will go a long way toward restoring confidence. This is especially true since significant results have been observed. For example, in the fiscal area, overall fiscal

performance has improved, and significant progress has been made in restructuring public sector enterprises in particular. The decision to shut down two nonviable, major public enterprises is courageous and commendable. As Mr. Arias indicated in his opening statement, the public sector has been able, for the first time in this decade, to reduce its debt to the domestic banking system and external commercial creditors. Another indication of the success of the present demand management policies is the sharp reduction in the discount rate of the gourde in the parallel exchange market and the commendable decline in the rate of inflation from 18 percent in 1985 to nearly zero in September 1986.

The main task facing the authorities in the medium term is to maintain financial stability and confidence while pressing ahead to develop a competitive, labor-intensive export sector. The need to preserve the competitiveness of the economy cannot be overstressed. Haiti cannot afford to be autarkic; it has to ensure that its cost structure remains competitive with that of its trading partners. In this context, I have noted the desire of the authorities to adhere to a fixed exchange rate vis-à-vis the U.S. dollar. The fixity of the rate will clearly provide the Haitian economy with the needed monetary and fiscal discipline and seems to be appropriate in an environment of a depreciating U.S. dollar. However, if the present declining trend of the dollar is reversed, it would be advisable for the authorities to review the rigid link of the gourde to the U.S. dollar. It is equally important for the authorities to ensure that their costs, particularly labor costs, remain under control. In this connection, I welcome the steps that have been taken to expose domestic industries to increased external competition, as well as the authorities' intention to maintain their present cautious wage policy.

Given Haiti's proximity to the large, and mostly captive, U.S. market, and its abundant pool of unskilled, cheap labor, it is essential for Haiti to develop an export industry that extracts full benefit from this comparative advantage and in the process generates the much needed employment opportunities. In the longer term, it is important to strengthen education and to improve average skills to increase the domestic value-added content of exports. Equally important is the need to diversify export markets.

The potential for growth and employment generation of assembly industries is enormous and to some extent has been demonstrated in the earlier success of this sector. Therefore, it is encouraging to see that the authorities intend to develop this sector further through the encouragement of private free zones and industrial parks. However, the proposed timetable for this should be accelerated and should perhaps coincide with the present efforts to revise the 1985 Investment Code.

I welcome the impetus to agricultural exports that is being provided by the elimination of export taxes on coffee and all other agricultural products. Such moves are not only needed on economic grounds, but also make sense from an ecological point of view, since they would significantly slow the observed soil erosion.

As to the envisaged reform of the tax system, I agree with the objectives of improving the income elasticity of the system, reducing tax evasion, and making the system easier to administer. However, I am worried that the effects of the tax changes may lead to a significant drop in tax revenues, which in turn may compromise the authorities' budget targets. Given these uncertainties, the benchmarks used to monitor fiscal performance are appropriate.

Haiti cannot afford to increase its debt burden and to rely on nonconcessional capital flows. The authorities are clearly aware of this, and I commend them for their intention to adhere to the goal of reducing the public sector's nonconcessional debt.

The proposed structural adjustment arrangement represents an appropriate framework in which Haiti can restructure its economy and improve its growth performance. I support the proposed decisions.

Mrs. Ploix made the following statement:

Since the previous Article IV consultation with Haiti, important developments have occurred. Decisions have been taken, the initial results of which have allowed the formulation of a well-founded medium-term program. These developments place in a new context the relationship between Haiti and multilateral organizations and other creditors. I welcome the authorities' commitment to develop enhanced relations with the Fund and the World Bank. The deepening of these relations is already reflected in the request for arrangements under the structural adjustment facility, which seems to be the most appropriate form of assistance that this institution can provide to a country that is greatly in need of concessional flows.

I broadly agree with the staff appraisal and will comment on recent developments in the economy and on the framework for future adjustment and development.

The results achieved by the authorities over the previous year are impressive. In 1985, my authorities underscored the need to implement restrictive policies in the area of public finance, since the growth of the public sector imbalance during the 1980s greatly endangered the stability of the whole economy.

The measures that have been taken directly addressed this issue on both the expenditure and revenue sides. The reallocation of budgetary resources toward agriculture, education and public health, the reduction of subsidies channeled through public enterprises, the closing of two of those enterprises, the exhaustive sectoral allocation of the budget, and last but not least the recent reform of the tax system are all pieces of a commendable policy stance that is aimed at reducing the disruptive burden of the public sector on the entire economy. This coherent set of measures has been applied in the framework of a tight monetary policy, which has permitted only a moderate rate of inflation. If these policy measures, together with the first measures aimed at trade liberalization, continue to be thoroughly applied, they will establish the basis for sounder and more sustainable economic development than could have been hoped for last year.

I agree with the staff and the authorities that a key element for future growth is the restoration of confidence among private investors and the donor community. To this end, it is essential to ensure financial stability. The staff stresses that conservative estimates have been made of the final results. This caution is greatly welcome, since it is the proof of the authorities' determination to complete the difficult tasks facing them.

The various aspects of the medium-term policy framework appear to be both coherent and well founded. The shift of resources toward productive activities must be maintained together with the effort to promote expansion through export-led growth, provided that it does not lead to an overconcentration of the export base, especially in the agricultural sector. I also welcome the emphasis on liberalization of the economy. The progressive introduction of market-determined mechanisms is a demanding process that can succeed only if it is maintained with perseverance.

I agree with the way in which the program takes into account the financing constraint. The approval given by the World Bank to the public investment program recognizes this constraint. Given the debt service prospects, it is necessary to limit the overall deficit to levels that are financeable mainly with the help of donors and multilateral agencies. This policy, together with the reconstitution of domestic savings, provides room for a growth-oriented investment budget and places the recovery on a stable and sustainable footing.

That the commitment of the authorities has been largely recognized by the international financial community is reflected in the results of the meeting a few days ago of the Caribbean Group for Cooperation in Economic Development. On that occasion,

my authorities and other donors confirmed their confidence in the will of the Haitian authorities to reverse deeply damaging economic developments. I am confident that through a tight monitoring of developments the authorities will ensure that the assistance that richer countries can provide will be devoted to necessary and effective growth-oriented operations. Finally, the proposed decisions are acceptable.

Mr. Goos made the following statement:

I agree with Mrs. Ploix's positive assessment of recent economic developments in Haiti. In general, it appears that the authorities are embarked upon a broadly appropriate policy course, and it is reassuring to note from the staff report and Mr. Arias's opening statement that the authorities intend to maintain overall financial discipline in the coming years and to push ahead further with structural reform. I particularly welcome the commitment expressed in the policy framework paper to reduce the fiscal deficit below the projected levels in the event of a shortfall in concessionary finance while maintaining the efforts to strengthen and rationalize public revenue and to reinforce public expenditure control. If the level of external assistance should exceed current expectations, it might be appropriate to use, to the extent feasible, part of the excess for a further buildup of external reserves.

The intended close cooperation between the authorities and the World Bank in the design and implementation of the public investment program is particularly important and should help to mobilize the substantial inflows of grants and concessional assistance that are needed to ensure the viability of the adjustment strategy. It is somewhat disappointing that the World Bank was not in a position to give its unqualified approval of the investment program for 1986/87, owing to a disagreement about the viability of the airport project. The medium-term strategy--including the measures under the categories of "competition" and "production policies" in the policy framework paper--seem appropriately geared to correcting the legacy of previous policies that is reflected in the present low levels of productivity, growth, and employment.

The exchange rate policy is the only major area where the appropriateness of the proposed policy stance is questionable. I recognize that recent developments in the real effective exchange rate shown in Chart 2 are inconclusive. Nevertheless, given the critical need to maintain international competitiveness, the authorities would be well advised to keep the exchange rate under close review. This is essential because domestic wages might come under upward pressure during the expected economic recovery, particularly given the pronounced decline in real wages that has occurred in recent years.

The proposed program for 1986/87 seems to be consistent with the commendable objectives and understandings in the policy framework paper. However, the authorities should adopt a more flexible interest rate policy to improve the mobilization and reallocation of domestic resources. In addition, the operation of the state-owned bank should be kept under continued close scrutiny.

I support the staff appraisal, including the view that the authorities' adjustment program for 1986/87 and their medium-term strategy deserve the Fund's support. Moreover, I am confident that a forceful implementation of the proposed policies should enable the authorities to avoid a repetition of the regrettable and almost continuous delays in the discharge of their obligations to the Fund that occurred earlier this year. I have no difficulty in supporting the proposed decisions.

Mr. Fox made the following statement:

The transitional authorities in Haiti have made significant progress in a short period toward restoring vitality to Haiti's debilitated economy. They have acted quickly to reduce the size of the government sector; the closure of two loss-making enterprises is particularly courageous, and other nonessential expenditures have been cut. The fiscal deficit has therefore been sharply reduced, and partly as a result of this the overall balance of payments has moved into surplus. Some important structural measures have also been introduced, including significant import liberalization--which has reduced the rate of inflation--and some liberalization of interest rates. Therefore, the basic groundwork has been established to permit a recovery in private sector activity.

However, Haiti is not nearly as far along the road of adjustment as Dominica, the only previous case involving a structural adjustment arrangement without a stand-by arrangement. However, the circumstances in which it will be proposed to have a structural adjustment arrangement without a stand-by arrangement will differ from one case to another. In this case, the three-year structural adjustment arrangement seems to be a comprehensive one, and while its objectives, especially for growth, are ambitious compared to recent performance, the staff paper shows that they are attainable in the context of manageable fiscal and external debt service ratios, provided the program is vigorously implemented and concessional assistance is forthcoming on the scale envisaged.

If I have any reservations about the program, it is that the program depends upon a higher level of domestic and foreign confidence than seems to be currently evident. However, foreign confidence has undoubtedly increased, helped by the new authorities'

speedy formulation of sensible economic policies and by their efforts to remain current with the Fund over the previous year. Forthcoming obligations to the Fund are heavy, and the authorities must continue their efforts to meet them on time. It would indeed be unfortunate if their adjustment efforts were interrupted by problems in this area.

I commend the presentation of policies in the matrix on pages 45-47 of the staff report, which gives detailed information about the measures to be taken in each year and which makes it clear that the authorities recognize that most of the measures that they will be implementing in the first year will have to be actively continued throughout the entire three years of the structural adjustment arrangement.

The success of the program will depend greatly on the success of efforts to promote exports. Import liberalization has an important role to play in enhancing the efficiency and competitiveness of domestic industry. The success of the assembly industry--which has grown to be Haiti's biggest source of foreign exchange without the benefit of protection--is instructive. The present agreement on improved access to the U.S. market is a positive development. However, the authorities also need to take care that exports remain competitive. As previous speakers have noted, the various measures of competitiveness calculated by the staff painted different pictures: relative wages have fallen substantially over the previous year and are now back to the 1980 level, but relative prices show a sizable real increase. Relative costs have an important bearing on a country's competitiveness.

In the agricultural sector, the proposed reduction in export taxes will help to improve export incentives. However, I see no reference in the staff paper to the level of producer prices in the coffee sector, and I would welcome some assurance from the staff that the system of price determination is such as to ensure an adequate return to producers. The reduction in export taxes combined with the elimination of cereal import quotas should in the longer run encourage better use of Haiti's limited agricultural land and help to improve the supply of land by arresting erosion.

The authorities' fiscal objectives are also crucial to the success of the program. The deficit envisaged for this year and beyond is somewhat larger than last year's outturn, but this is more than accounted for by higher capital expenditure, which fell last year. However, the deficits are expected to be more than covered by external concessional assistance and should allow repayment of commercial debt and the elimination of external arrears by mid-1987. Still, as the staff notes, the attainment of the fiscal targets will require strict control of expenditure;

in this connection, I welcome the greater transparency of spending allocations that has accompanied the reallocation of spending priorities.

Vigorous enforcement of the new tax provisions will also be essential if a shortfall in revenue is to be avoided. Like previous speakers, I welcome the contingency plans to adjust spending and revenue. The proposed decisions should be approved.

Mrs. Hepp made the following statement:

The Haitian economy stagnated after 1980, and serious domestic and external imbalances emerged. After the change in government in February 1986, the new economic authorities took steps to improve the functioning of the economy. Some of the main measures that were initially adopted in the public sector were expenditure cuts and a reorientation of public spending toward health, education, agriculture, and internal security; a reduction of high prices charged by public enterprises; and the closure of some loss-making public enterprises that had been the source of significant fiscal imbalances. The first measures also included a first round of trade liberalization measures--the elimination of quantitative trade restrictions, the reduction of export taxes, and the widening of the bands for lending and deposit interest rates. I commend the steps that the authorities have already taken to correct the fiscal and balance of payments imbalances and to improve resource allocation.

The further steps to consolidate the recently achieved financial stability, strengthen the balance of payments, and establish the foundation for sustained economic growth in the long run involve some structural reforms, which the authorities intend to introduce over the coming three years. In particular, the adjustments and structural changes in the public sector include tax reform, expenditure reallocation, reduction of non-concessional financing for the fiscal deficit, improvements in public enterprises' efficiency, and a complete review of public investment policy. Furthermore, the monetary and credit policies are designed to improve allocation of credit by liberalizing interest rates and reducing the public sector debt to the domestic banking system, thereby allowing an expansion of credit to the private sector. The external sector policies are designed to promote exports, reduce tariffs, and eliminate most quotas while maintaining a competitive exchange rate to strengthen the external payments position. I broadly agree with the approach that has been chosen.

I noted the conservative approach to the 1986/87 budget estimates. If there is some uncertainty about the revenue estimates resulting from the new tax system and the revised customs

tariffs, could an excess of revenues be corrected in the next quarterly expenditure ceiling? Does a list of priority projects for the productive sectors and human capital development already exist, or are the resources available used to pay the domestic debt of the public sector and to allow an expansion of credit to the private sector?

In sum, the rationality of the proposed policy measures and the projections in the staff paper show that the economic program is viable. I welcome the authorities' decision to adopt an economic program with the support of the Fund under the structural adjustment facility. The proposed decisions are acceptable.

Mr. Dallara made the following statement:

I agree with the thrust of the staff appraisal and many of the comments by previous speakers. My authorities join others in commending the Haitian authorities for the efforts that they have already made this year and which they intend to continue making with the support of the Fund and the World Bank in coming years.

A key aspect of the adjustment effort to date and of the program for the future is fiscal adjustment. I particularly welcome the early action that was taken by the authorities to deal with what they perceived to be unnecessary budgetary expenditures as well as the continued fiscal adjustment that is provided for in the program. Quarterly ceilings on treasury expenditures are serving as benchmarks under this program, something that is appropriate in this case. Ceilings on nonconcessional borrowing will serve to contain the overall fiscal deficit, although it might have been useful to include an overall fiscal deficit benchmark in this as well as perhaps in other cases where budgetary adjustment is crucial to the success of both the stabilization and structural adjustment processes. We are still at an early stage in understanding how policy framework papers and structural adjustment arrangements can catalyze other lending, including lending by the World Bank. I wonder whether the World Bank staff could shed any light on whether the lack of data with which to monitor the budgetary and credit areas was a factor in the World Bank's decision to support Haiti's adjustment effort with a structural adjustment credit.

There has not yet been full agreement on the investment budget, particularly the priority that is attached to a certain project, and I urge the authorities to reconsider and perhaps even delay the project that is in question until the priorities have been sorted out. In general, however, I support the emphasis in the budget on the channeling of resources to the productive sectors in the economy, especially investment in human capital.

The authorities have also begun the process of tax reform. I welcome their reorientation in that area and encourage their continued implementation of what I perceive to be an important part of their overall effort to strengthen the prospects for strengthened investment and productivity in the Haitian economy over the long run.

The authorities have also taken some important initial steps in the public enterprise area. I welcome these steps and look forward to continued improvement and reform of the parastatal sector along the lines set out in the program. With the Government's improved fiscal performance, credit policy can be directed more efficiently toward supporting the private sector. The controls on interest rates have been relaxed--a welcome development--and real interest rates are positive. However, it is not clear to me whether adequate flexibility has been fully built into the system.

One element of credit policy that seems to require particular attention is the development of the rural banking sector. I hope that, with the reduction in the coffee export tax, farmers will have an enhanced incentive to save. I also hope that farmers will have the vehicles for savings that will strengthen their own sector, and that the ability of the economy as a whole to intermediate savings will increase.

A number of steps are being taken to improve the competitiveness of the economy. I welcome the move from quantitative restrictions to tariffs, but tariff levels will remain fairly high even at the end of the three-year program period. I hope that the authorities will review this area, because this is not necessarily the optimal position in which tariffs should be left.

While I can go along with the authorities' approach to exchange rate management, particularly in the light of the fiscal discipline in recent months and the authorities' commitment to continue that discipline in the coming period, I would have welcomed a somewhat clearer commitment to the maintenance of a competitive exchange rate. I hope that the authorities will monitor developments--particularly relative wages and prices--closely during the program period in order to ensure continued competitiveness.

I wonder why the policy framework paper was not brought forward earlier, perhaps together with the staff report on the Article IV consultation, so that comments by the Executive Board and the World Bank Committee of the Whole could have been taken into account in the negotiation of the structural adjustment arrangement. In addition, since the authorities stepped out ahead of the international community to demonstrate their initial

commitment before the international organizations had had an opportunity to reflect on their own prospects for support, I wonder whether it might be feasible to advance the approval of economic recovery credit by the World Bank to a date earlier than March 7, 1987.

I strongly support the comprehensive efforts that are being made by the Haitian authorities. Financial stability, which has received considerable emphasis, should help to foster and provide a sound framework for the structural adjustment that is under way. This effort, in its initial stages, has certainly gone some way in impressing the donor community of the authorities' commitment to economic recovery. It is important to note that this progress is taking place with the clear support of the Fund--although not in the form of a stand-by arrangement, but rather in the form of a broad policy framework paper, developed closely in conjunction with the World Bank, and a structural adjustment arrangement. This approach is appropriate, particularly in the light of the technical assistance that is also being provided.

The Haitian authorities' efforts over the previous ten months have demonstrated that, even when serious and deep-seated structural problems exist, it is not always necessary to conduct extensive, time-consuming studies before tackling some of the more serious problems. I know that this is not easy to do. However, given the time that is needed to tackle and eventually solve structural adjustment problems, I am impressed by the willingness and ability of the authorities to take initial actions in the context of a broad program that should continue the adjustment process that they have initiated. I hope that the staff will take this case into account when formulating its thoughts prior to the coming review of conditionality.

The staff representative from the Western Hemisphere Department said that the authorities had found the recently completed study on effective protection to be useful. They had had preconceived notions as to which sectors were benefiting from high levels of protection, and the study had confirmed their understanding of the situation. Although the data base was weak in certain areas, it had not been an impediment to the conclusion of the study on effective protection. Approximately a dozen firms would be affected by the planned reduction in effective protection. Most of those firms basically imported products in bulk form or requiring little final transformation, and then sold them at highly inflated prices in the protected domestic market.

The authorities had expressed their intention to maintain the fixed relationship between the gourde and the U.S. dollar, the staff representative noted. The conventional method of calculating real effective exchange rate movements showed that in recent years there had been a decline in the

real effective value of the gourde, which had been only partly reversed in the present fiscal year. The authorities and the staff had tried to find a more appropriate way to estimate the degree to which Haiti's competitive position might have deteriorated; to that end, the behavior of costs had been examined. It was determined that wages, which accounted for a substantial portion of total costs in the key light assembly industry, had remained fairly stable, while prices had risen. It became apparent that the cost structure had enabled that sector to continue to grow despite all the problems the country had faced in recent years. Therefore, the authorities had felt that there was no conclusive evidence that the behavior of costs was affecting the country's competitiveness. That was confirmed by staff contact with members of the business community active in the export sector. The general impression was that Haiti had remained cost competitive and that restrictions on access to foreign markets had limited export activities only somewhat. Some concern was expressed about political developments over the previous year or so and disruptions due to work stoppages. There were no remarks to the effect that the exchange rate seemed to be out of line or that expansion plans would be affected by present exchange rate policies. Nevertheless, the authorities intended to maintain a close watch on developments in the exchange rate area. They had indicated that they were not necessarily committed to maintaining the present exchange rate regime at all costs, and that they would review their stance if conditions were to change.

The authorities had not provided tax incentives to encourage coffee production, the staff representative explained. There had been disincentives in the form of an export tax on coffee; although that tax had been reduced in recent years, it was still fairly high. The authorities had reduced the tax on coffee exports to 10 percent recently, and intended to eliminate it later in 1986, provided the fiscal situation permitted them to do so. Accordingly, the export tax might not be in place by the time of the next harvest.

As to returns to coffee producers, there were about a dozen intermediaries in Haiti who received fairly high commissions for their services, which reduced the return available for producers, the staff representative continued. However, the intermediaries performed important marketing functions, as the coffee sector was highly fragmented among tens of thousands of producers. The intermediaries retained about 15-18 percent of total coffee export receipts, a share that did not seem excessive in the Haitian circumstances and moreover had diminished in recent months.

The diversification of export markets in Haiti had taken place in a relatively short period, the staff representative said. Diversification into light assembly had occurred over roughly the previous eight years. In the future, it would be more difficult to continue diversification in that particular sector, as further progress probably would require taking a step up the technological ladder. It was not clear what additional steps could be taken to diversify the economy other than to maintain a stable financial climate and a market-oriented economy, where investors would place their resources with confidence to take advantage of the

country's cost competitiveness. It would be costly for the Government to make a more direct effort--through fiscal incentives, for instance--to attract private investment, although some of the country's key donors, especially the United States, were devoting part of their assistance to promotional programs.

The authorities were naturally concerned about compounding the unemployment problem by closing two large loss-making public enterprises in the sugar and vegetable oil sectors, the staff representative remarked. However, the authorities' overriding concern was the need to reduce the fiscal pressures that had arisen from those operations. The immediate result of closing those enterprises was a substantial decline in the retail prices of vegetable oil and sugar, which benefited all consumers. At the same time, provision had been made for severance pay for the workers that were displaced by the closings, and some of those workers had been absorbed as expected into expanding light assembly activities.

The question had been raised whether the timetable for expanding the industrial parks and revising the investment code could be accelerated, the staff representative recalled. Accelerating the development of the industrial parks presented a budgetary problem: there was a delicate balance in the investment program between the various sectors demanding scarce resources, and accelerating investment in industrial parks would therefore require some reduction elsewhere in the investment program. Such acceleration would be possible if additional external aid over and above the already substantial increase that was being provided to Haiti were to become available. The investment code was being revised, but the version that was issued in 1985 was already fairly straightforward. However, until recently there had been a problem of uniformity of interpretation of the code by the various ministries involved in the process of review and approval of applications, and potential investors had sometimes been discouraged by the resulting red tape. The intention now was to simplify the process of applying for permits to invest in Haiti; fewer ministries would need to intervene in the process and, in the light assembly sector in particular, a concerted effort was being made by the authorities to approve as many applications as possible, provided that all the necessary safeguards were in place.

There seemed to be some concern among Executive Directors that the process of tax reform might involve some loss of revenues, the staff representative commented. The tax ratio was expected to decline in 1987, although not because of the tax reform itself. The expected decline was due mainly to the fact that the full-year effect of the tax cuts that went into effect in the second half of 1986, and which were accompanied by even larger expenditure cuts, would be felt in the current fiscal year. At the same time, safeguards against loss of revenue had been built into the plans to reduce income tax and duty rates. For example, the larger corporate taxpayers were not expected to see a major reduction in their effective rate of taxation; they would be favorably affected only to the extent that profits were reinvested. As to the individual income tax, the bulk of the receipts from that source came from withholding on public

employees who would not be materially affected by the tax changes; hence, little if any revenue loss was initially expected under the new income tax law. Still, the authorities had made very conservative revenue estimates; they expected that actual tax collections would exceed the assumptions used in the budget.

In the public sector, there was no expectation of further wage increases beyond those that had been granted in 1986 to teachers and health personnel, the staff representative explained. In the private sector, there had been minor wage increases in 1986, but there was no indication of wage pressure that might lead to any revision of the minimum wage. The large supply of unemployed labor had created a competitive situation in the labor market. Another development that had helped the competitiveness of the light assembly industry was the relative lack of collective bargaining.

One of the reasons for not having a benchmark on the overall fiscal deficit was the lack of monthly or quarterly data on the actual disbursement of foreign aid in Haiti, the staff representative said. There was a quarterly benchmark, however, on the nonconcessional financing of the public sector. The staff had agreed with the authorities that the overall fiscal deficit objective for the full year would be adjusted upward or downward depending upon the amount of aid that actually became available.

The authorities had already widened the bands within which interest rates on loans and deposits could move freely, and they intended to eliminate the minimum rate on deposits in the immediate future, the staff representative commented. They planned to keep only a maximum loan rate, which at present was 20 percent. Commercial banks in Haiti felt that a 20 percent ceiling on loans would not impede their operations or impose any constraints on credit allocation; most loans at present were offered at rates well below 20 percent. The prime rate was 14 percent, and the average loan rate was about 17 percent.

The question had been asked why the staff had not presented the policy framework paper to the Executive Board before it had undertaken negotiations with the authorities, the staff representative recalled. A staff mission had visited Haiti in May 1986, and the consultation discussions had taken place in August. During the mission in May the authorities and the staff had begun discussions on the possible contents of a structural adjustment program. With the benefit of those discussions the staff had been able to draft a policy framework paper before the August mission and had been able to discuss the paper with the authorities during the consultation discussions. Because the authorities had gone ahead with the implementation of the program, the staff had then felt that it was best to bring both the Article IV consultation report and the request for a structural adjustment arrangement to the Executive Board at the same time.

The authorities had established priorities for their investment projects with the assistance of donors, the staff representative said. The authorities had held informal meetings with donors in June and in August 1986. Hence, there was clearly a determined effort to channel resources to the priority projects.

The staff assumed that there would be a 17 percent increase in the value of coffee exports in the coming year following the substantial downturn in 1985 and 1986, the staff representative from the Western Hemisphere Department said. There was a relatively stable coffee production cycle in Haiti; coffee production usually peaked one year and fell the next. Sometimes, however, the low output period extended over two years before recovering in the third. The 17 percent increase projected by the staff would follow two poor harvests in 1985 and 1986. The volume of coffee exports in both those years was at close to record lows. The staff had projected for 1987 an export volume of 315,000 bags, a level well below the average for the preceding five-year period.

The Deputy Director of the Exchange and Trade Relations Department recalled that when the Executive Board had considered the proposal to establish the structural adjustment facility it had examined the option of presenting the Executive Board with a policy framework paper before the annual arrangements under the facility as well as the option of presenting the policy framework paper and the annual arrangements at the same time. At that time, the Executive Directors had agreed to take a flexible, case-by-case approach to applying those options. In Haiti, the new Government had implemented an important set of policy measures upon taking office. In a sense, since it had been possible to complete discussions of policies with the authorities in a three-year perspective, it had seemed best to present the request for a structural adjustment arrangement, which entailed presenting to the Board the policy framework paper and the annual program at the same time, together with the staff report for the Article IV consultation. One advantage of that approach was that it rapidly gave the authorities support for their policy actions.

The staff representative from the World Bank said that management's decision to refer to its proposed policy-based credit to Haiti as an economic recovery credit in no way carried a connotation that IDA was supporting a somewhat weaker structural adjustment program than it would under a structural adjustment credit. It was the World Bank's preference and tradition to use a series of structural adjustment loans or credits to support a country's long-term policy and institutional reform program. Haiti was scheduled to hold presidential elections in November 1987, and at the present stage it was impossible to predict the outcome of that event or of the policies that the new Government would introduce--including any possible further structural adjustments. Thus, IDA preferred to give its assistance to Haiti in the form of an economic recovery credit. Nevertheless, the program supported by the proposed IDA credit was one of self-sustained and strong policy reform. The timing of the IDA's credit was agreed in close consultation with the authorities. If they were to

decide to accelerate some of the measures, the date of the presentation of the economic recovery credit request to the Executive Board could be advanced accordingly. The present date of mid-March 1986 had been set at the request of the authorities.

Mr. Arias commented that the authorities recognized the substantial challenges that they would face in the future. The recent structural changes that they had made had established the foundation for meeting their medium- and long-term objectives. The effort to reorient the economy would involve a number of different stages, but the authorities felt that the implementation of the new measures had set the economy on the path to dealing with the structural weaknesses. The authorities were determined to consolidate the gains that had been made in the fiscal and monetary policy areas and to take advantage of the momentum that had permitted them to implement the new program. They attached special importance to the support that donor countries had provided. That support was a reflection of the confidence that donors had in the way in which the authorities had designed their program.

The Chairman made the following summing up:

In their discussion on the staff report for the 1986 Article IV consultation with Haiti, Executive Directors were in general agreement with the views expressed in the staff appraisal. Directors also supported Haiti's request for access to Fund resources under the structural adjustment facility.

Directors warmly commended the authorities for the substantial adjustment that has taken place in the past fiscal year, and they referred to the positive effects of the improvement in the public finances and the exercise of credit restraint: consumer prices are barely above their level of a year ago; the balance of payments registered a relatively large surplus, after six consecutive years of deficits; and the discount of the gourde has been reduced. Directors expressed disappointment, however, about the continued stagnation of the economy, the declines in per capita income in recent years, and the extremely high rates of unemployment. Directors noted that despite the progress achieved last year, the country's external position remained structurally weak.

Directors agreed that a key component of the strategy to create the conditions for sustained growth is the maintenance of the recently achieved financial stability. Thus, they viewed with favor the adoption of a financial program that is expected to enable the public sector to reduce further its indebtedness to the domestic banking system and to external commercial creditors. The overall external surplus that has been programmed should facilitate the elimination of external arrears and improve confidence.

Because of the severity of the structural weaknesses of the economy and in view of the country's low per capita income, Directors observed that Haiti will continue to require a significant volume of concessional external assistance for years to come. At the same time, Directors noted that for this assistance to be forthcoming the authorities would have to continue to strengthen the confidence of the donor community regarding the efficient use of these resources. Directors therefore welcomed the important actions that the Government has taken in recent months to restructure the economy, restore balance of payments viability, and lay the foundation for sustained growth. The expanded activities in Haiti by the World Bank, and the three-year policy perspective provided by the policy framework paper and its yearly updates were mentioned as factors that should encourage donors as regards the efficient use of the aid already pledged and facilitate future decisions on additional commitments.

Directors said that the emphasis given in the program to improved agricultural performance and export-led growth as a means of fostering economic expansion and employment creation seemed to be well placed. The policy instruments chosen to implement this strategy also appeared to be appropriate. The program of trade liberalization that is in progress and the planned rationalization and lowering of effective protection could be expected to encourage a shift of resources toward the export sector. The reduction and eventual elimination of taxation on export commodities were seen as actions bound to promote increased production. The recent textile agreement with the United States was welcomed. It should give renewed impetus to the light assembly industry, provided, of course, that highest priority continued to be attached to the maintenance of price and cost competitiveness.

The widening of the permissible ranges within which commercial banks are free to set interest rates on loans and deposits was viewed by Directors as another positive development. Several Directors urged the authorities to continue to move toward full market determination of interest rates and to develop the rural banking sector in order to encourage additional savings formation and improved resource allocation in favor of productive activity.

The tax, public expenditure, and public enterprise reforms that the Government has courageously set in motion can be expected to demonstrate to private investors and the donor community the Government's intention of improving the efficiency of resource use in the public sector. The closing of inefficient state enterprises, the elimination of waste in the budget, the comprehensive sectoral allocation of proposed budget outlays, and the reallocation of expenditure toward the provision of basic services and the development of human capital were viewed by Directors as important steps in the right direction.

Several Directors expressed concern, however, about the trend in government revenue and the possible complications that may arise from the recently enacted changes in the tax system, and they therefore attached importance to the undertaking to cut outlays in the event that budget revenue and external assistance fall short of the forecast. While appreciating the authorities' approach of basing the budget on a conservative revenue estimate, a number of Directors stressed that the new income tax system and the revised customs tariff would need to be administered and enforced strictly, and cautioned that revenue efforts should not be allowed to falter.

Some Directors made reference to the real effective appreciation of the gourde in the early 1980s, although it also was observed that the appreciation seemed to be considerably less from the side of costs--particularly labor costs--and that much of the earlier appreciation had been reversed since 1985. Since the authorities attached great importance to the preservation of the fixed relationship between the gourde and the U.S. dollar, Directors stressed the need for the pursuit of strict fiscal and monetary management and wage moderation.

It is proposed that the Article IV consultations with Haiti continue to be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Exchange Measures Subject to Article VIII

1. The Fund takes this decision relating to Haiti's exchange measures subject to Article VIII, Sections 2 and 3, in the light of the 1986 Article IV consultation with Haiti conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Haiti maintains a restriction on the making of payments and transfers for current international transactions, evidenced by external payments arrears as described in EBS/86/257. The Fund notes that the authorities of Haiti intend to eliminate these arrears in the course of the current fiscal year. In the meantime, the Fund grants approval of the restriction until September 30, 1987, or the conclusion of the next Article IV consultation with Haiti, whichever is earlier.

Decision No. 8479-(86/201), adopted
December 17, 1986

Structural Adjustment Arrangement

1. The Government of Haiti has requested a three-year structural adjustment arrangement, and the first annual arrangement thereunder, under the structural adjustment facility.

2. The Fund approves the arrangements set forth in EBS/86/257, Supplement 1.

Decision No. 8480-(86/201), adopted
December 17, 1986

3. ADMINISTRATIVE EXPENSES IN FY 1987 - MIDYEAR REVIEW; AND BUDGETARY OUTLOOK FOR FY 1988

The Executive Directors considered a statement by the Managing Director on the midyear review of expenses in FY 1987 and the budgetary outlook for FY 1988 in the framework of a three-year projection of expenses (EBAP/86/308, 12/10/86).

Mr. Massé made the following statement:

During the discussion on the administrative budget in spring 1986 this chair noted that the real reduction in expenditures that was planned for FY 1987 left very little margin for maneuver. At that time, this chair expressed its concern about the demands placed on staff, management, and the Executive Board within a shrinking pool of resources and concluded that we could have accepted the maintenance of the level of real expenditure that had been approved for FY 1986.

It now appears that many of those concerns were justified. The Chairman noted in his statement that the staff is already under severe strain and that it may be necessary to abandon, postpone, or reduce the scope of desirable projects and activities. This judgment is a cause for considerable concern, because we may have overconstrained the resources that are needed to do the job adequately at a time when the Fund is venturing into new fields, such as the growth-orientation of Fund programs, the structural adjustment facility, and the use of indicators in multilateral surveillance.

I would like to address two concerns in particular. First, as the Chairman indicated in his statement, it now seems that the continuation of tight budgetary restraint in FY 1988 would constrain the capacity of the staff to produce all the papers that the Executive Board has requested. Management will certainly need to set priorities and inform the Executive Board of the extent to which resources are lacking to complete the desired work, but it

is legitimate to ask whether we are practicing a form of false economy by denying ourselves studies that many of us feel are necessary.

A second and more serious concern is the impact on technical assistance of a cut in real expenditure. The demand for technical assistance has not declined, and we therefore seem to be overstretching our existing resources in the Central Banking and Fiscal Affairs Departments. Any suggestion to reduce further expenditure on technical assistance in future years would be counterproductive.

With respect to a user-pay approach to technical assistance, we must look carefully at all the possible options before implementing any system that levies charges on countries using technical assistance or sending participants to the IMF Institute. Developing countries with legitimate needs for such assistance should not be discouraged from using it for purely financial reasons. Perhaps a system based on some form of means test should be explored.

There has been a considerable shift over the previous several years to a greater use of temporary assistance of all types within the Fund. Apparently such assistance will account for almost 11 percent of the Fund's labor force by the end of FY 1987. I would like to know whether the international character of the Fund has been preserved in the shift toward greater use of temporary workers.

As to FY 1988 and beyond, I can support the projected administrative expenses and personnel level but I would also be prepared to increase those numbers if it can be shown that the situation merits such increases. There are a number of areas where we should be careful in either reducing expenditures or in failing to increase them enough. One of these areas is data processing, and the electronic data processing projects in particular. New information technology is being put into place now, and the possible increase in efficiency from investments in this field should not be discounted.

Another field to which attention should be drawn is statistics. If we fail to spend enough money developing the data base, we run the risk of making analyses that are incomplete. In a number of cases involving significant amounts of expenditure, a 1 percent improvement in the quality of a decision based on a data base is worth many times the amount of investment in that data base. Similarly, the improved efficiency in policy formulation and implementation in developing countries is often worth many times the amount of money spent on providing technical assistance to those countries.

Moreover, the Fund might have to consider increasing its expenditure on public information and education. The Fund has a negative image in a number of countries. Even in some industrial countries, including Canada, there are widespread prejudices against the Fund. The influence of a well-conceived program of public relations on the public and members is significant, and more care should be given to it in the future.

Given the importance of not reducing expenditure in fields where the rate of return is high, I wish to stress that I am prepared to consider an increase in the budgetary figures for the coming year. I do not believe that a priori maintaining the budget in nominal terms in FY 1988 is justified; the need for such an approach has yet to be proven to my satisfaction. The Executive Board should have the opportunity to examine fully any measures to contain the costs of providing special services to members.

Mr. Sengupta made the following statement:

I note with satisfaction that the current year's administrative expenses have up to now been well contained and may be only 0.2 percent over the revised budget ceiling. The revised estimate does not take into account the request for authorization of funds to undertake a major compensation survey by the Hay consultants for the Joint Compensation Committee. I understand the logic behind the intention to make a request for additional appropriations in February 1987.

The Chairman's statement on the program of activities in FY 1987 and FY 1988 is helpful in assessing the budgetary outlook for the coming year. The statement correctly describes the increase in the amount of work to follow up on the meetings of the Interim and Development Committees, the G-10 and G-24 proposals, other surveillance exercises, as well as issues related to the compensatory financing facility and the structural adjustment facility. The workload is undoubtedly large, and I agree with the Chairman that it would be helpful in the future to have statements to the Executive Board indicating the relative priorities among various work items and the extent to which resources would be needed to complete the desired work program. The resource constraint should not impede the policy development and research programs.

The Chairman's statement clearly shows that apart from regular operational and country work under Article IV consultations, the workload relating to the structural adjustment facility has increased sharply. In FY 1986 the facility accounted for 350 staff visits out of a total of 1,300--about 27 percent of the total--and this has obviously placed a tremendous burden on the existing manpower. As the Chairman indicated, the staff is already under severe strain,

and in order to avoid any loss of quality of work and of morale, a modest increase in manpower could be made even within the constrait of not providing for an increase in recurring expenses in the budget. I agree with this approach and would go further in stating that, given the problems of low-income developing countries, the Fund should provide the best possible services to them, particularly technical expertise and assistance in information and data collection.

The administrative budget includes a drastic cut in technical assistance, including the training by the IMF Institute. Under any system of priorities this item should get a very high rating. If we insist that developing countries adopt stringent adjustment policies, we should help them to eliminate the most important bottleneck in their ability to adopt such policies. The technical assistance programs have been found by the developing countries to be very helpful. In this connection, I would note in particular the excellent job of the Institute. Therefore, there is every reason to expand this program, and I would ask you to reconsider the relevant budget provisions and to restore the trend in expenditures on this item of the previous several years.

The existing policy on reimbursement of costs of Fund technical assistance is being studied by a Working Group, but I am afraid that a reimbursement policy would not help developing countries that need technical assistance and would not serve the long-run interest of the Fund in informing the policymaking bodies in these countries of the need for structural adjustment.

Irrespective of recipient countries' contributions, to the costs of technical assistance, the volume of such assistance should not be reduced for a lack of budgetary resources in future years. This is one area where the Fund has as great an interest as the recipient countries, since the effective use of the Fund's resources in these countries depends greatly upon the technical expertise available in these countries. It would be shortsighted to restrain expenditure on this account or to cut the salaries of the staff, whose quality and standard of expertise are necessary prerequisites for fulfilling the tasks for which the Fund was established by the international community. I wonder to what extent it will be feasible to contain total expenditure in FY 1988 below the expected annual rate of inflation of 3 percent.

Mr. Khong made the following statement:

I support the broad thrust of the Chairman's proposals. I agree that the FY 1988 budget should aim to maintain recurrent expenditure at the overall level for FY 1987 in nominal terms; any increase in the budget should be limited to certain essential

expenses of a nonrecurring nature. This objective is consistent with the commitment to maintain firm control over the growth of budgetary expenditure in the coming three years.

I agree that activity under the category of General Policy Development and Research in FY 1988 will be as intensive, if not more so, than in FY 1987, given the central role of the Fund in promoting the effective functioning of the international monetary system. I agree that management needs to suggest relative priorities among the issues that are to be examined and should provide an indication of the extent to which resources are lacking to complete the agreed work program. Like Mr. Massé, I would not object to an increase in resources to complete the program, since the Fund has an important role to play in promoting international adjustment.

As to the category Operations and Relations with Member Countries, I agree that a reduction in the cost of consultations should be actively explored by re-examining their periodicity, the size of missions, and the scope of discussions. It may also be possible to reduce the costs associated with the use of Fund facilities, given the vast experience of the staff in this field.

This chair calls once again for a larger budget for the category of Special Services to Member Countries, given the high returns accruing to recipient countries from technical assistance and training by the IMF Institute. These returns may not be tangible, but they are real and substantial in the long run. Many Executive Directors can attest to the catalytic impact of technical assistance missions in inducing changes in economic and financial management for the long-term benefit of member countries. I am disappointed that expenditure in this area will again be constrained in order to reduce the growth in total expenditure. To maintain the volume of assistance, I would support an examination of how some of the recipient countries could help to shoulder a greater part of the costs of technical assistance and training. I would support a re-examination of the publications program with a view to saving some costs in order to increase the level of technical assistance.

I welcome the improvements that will be incorporated in the administrative budget document for FY 1988, especially the presentation of two separate budgets for administrative and capital expenses and the identification of recurring and nonrecurring expense items.

The Chairman said that he hoped that Executive Directors would state clearly their position on the trade-offs involved in the budget. There seemed to be an inconsistency in agreeing with the proposed limit on expenditure in nominal terms while calling for an increase in technical assistance and other services. If Executive Directors agreed that expenditures should be stabilized in nominal terms, they should suggest how particular expenditure items should be constrained to reach that goal.

Mr. Nimatallah said that the Chairman's remarks suggested that additional details could have usefully been provided in EBAP/86/308. A separate paper would have made it possible for the proposals for FY 1988 to be handled separately from the review of expenditure in FY 1987. In the absence of additional information it was difficult to draw firm conclusions on the appropriateness of increasing expenditure on technical assistance. He had mixed feelings about the proposal to have recipients pay for technical assistance. At times, it seemed that countries should pay for at least some of the assistance--namely, assistance beyond the ordinary. Saudi Arabia had paid for technical assistance beyond the usual services. However, some poor countries simply could not afford to pay for the assistance, although he wondered whether the Fund should continue to pay for technical assistance to members that were in arrears to the Fund. On the one hand, it could be argued that those countries should be assisted as much as possible in order to place them in a position to improve their economic situation, even if that effort involved increased costs to the Fund. On the other hand, it could be argued that it was inequitable to provide technical assistance paid for by the Fund while a member was in arrears to the institution.

Mr. Nimatallah then made the following statement:

I have no difficulty with the proposed adjustment for FY 1987. It is reasonable and is consistent with the directive of the Executive Board to control expenditure. Management is to be praised for its success in that direction. I hope that that stance will be maintained in FY 1988.

A budget is normally looked at as a tool of expense control. Therefore, it should be made effective, and that can be accomplished through the following areas. First, from the accounting point of view, the budget should be better structured to identify the recurring items, and it should be separated from the capital, nonrecurring items. The Fund is finally on the verge of taking those steps. Second, there should be as many accounts as possible to coincide with the relatively important items of expenditure in the budget. Only the small, nonrecurring items should be listed under the category "miscellaneous." Third, all revenues should go to one central authority, which should be the one source for all expenses. No other entity should receive any revenues, no matter how small. Fourth, the timing of the preparation, approval, and midyear review should be such that they maximize the ability to meet such criteria as improving control and reducing the cumbersomeness of procedures and coinciding with the financial years of members and other institutions that the Fund deals with.

I have raised most of these points on several previous occasions, but unfortunately it takes a long time before changes are made with a view to using the budget as a tool of control over expenses. I still believe that the present timing of the approval of the budget is not appropriate, as it comes during the Interim

Committee meeting. I have written directly to the Chairman on this matter, but he has tried to convince me that the main constraint is the need to circulate the budget closer to the time of the Annual Meetings so that the External Audit Report will be presented to the Board of Governors during the Annual Meetings. This point is given more emphasis than it deserves. Governors will be pleased to see the External Audit Report and the Fund's financial statement separately, if they are sent to them, say, closer to the end of a calendar year, for approval on a lapse-of-time basis. When I was a Governor, I did not have time to look at that information during the Annual Meetings. I wished that I had had more time to examine the information.

Therefore, I suggest again that the budget either be advanced at least one month, to become effective April 1 instead of May 1, or even better, that it become effective January 1 and end on December 31. I also suggest that the salary review should be conducted either in January, if the budget starts on April 1, or in October, if the budget becomes effective on January 1. Discussing salary reviews in late October is much better, as Directors have more time for such matters and whatever is decided then will cover the whole fiscal year without any need for management to return to the Executive Board for additional allocations after the budget is approved.

I have no difficulty in reviewing the budget for FY 1987. However, the present document is not satisfactory for examining the budgetary outlook for FY 1988. The document is relatively concise, general, and, therefore, vague; it is not very helpful, particularly for new Executive Directors, who should be better informed about terms that appear in the document without explanation. For example, there should be a better explanation of why contracts are awarded to consulting firms as well as of data processing services, manpower data, contractual employees, cost information, tax allowances, the contents of the "miscellaneous" category, temporary employees, and other items. All these points are unclear to the reader and should be further explained. Therefore, there should be a separate document with greater elaboration and details if a discussion like this one is to give directives to management. For the time being, I would be satisfied with some elaboration from the staff on the points that I have made.

On previous occasions I have suggested directly to the Chairman and to the Executive Board that the Fund should appoint an Expense Control Committee. The Chairman promised to come back to the Executive Board on that matter and others after he and the Deputy Managing Director received the consultants' report with recommendations on how to improve control over expenditure. I wonder whether the Chairman can tell us anything about that matter at the present meeting.

The capital budget is mentioned in the final sentence of the second paragraph on page 10. I wish to record my understanding that, although a three-year capital budget is approved, only the funding for each year is included in each annual budget. That means that each year the amount for the next year will come to the Executive Board for approval; similarly, the amount for the third year must also be approved by the Executive Board.

I am impressed by the trend of hiring more temporary assistants, which would raise their percentage of the total from 3.9 percent to 10.8 percent. I encourage that trend and request the Administration Department, when possible, to increase that percentage without running the risk of jeopardizing security or reducing loyalty.

In FY 1985, data processing in general absorbed some $24 million, or approximately 10 percent of the budget. For FY 1988, $18 million is expected to be spent on that item. I understand that there is an internationally declining trend in data processing expenses, as both hardware and software are becoming less expensive and as more specialists are being trained. Therefore, I hope that this declining cost trend will be reflected in the Fund's budgets in a more pronounced way in FY 1988 and beyond. Finally, I have no difficulty in accepting the Chairman's proposed tentative budget for FY 1988 based on the proposed work program.

Mr. Salehkhou made the following statement:

The Chairman's statement contains a number of helpful innovations and improvements over similar statements in previous years. I fully support his determination "to demonstrate to the membership our commitment of maintaining firm control over the growth of budgetary expenditures, including the number of regular staff positions." I am concerned not about the magnitude of budgetary expenditures but rather the priority that is to be accorded to and the efficiency of the allocation of our limited resources. It is in this spirit that I will comment on a few specific areas that I feel are more important in the context of Fund performance and activities. However, I believe that the reforms and structural changes that the Managing Director has envisaged to reach the stated objectives should in no way be derived from this midyear review, which by definition is limited in scope and should serve merely as a point of reference. More specifically, such items as the pension system and the technical assistance program, including the IMF Institute, obviously are important and deserve full, individual discussions by the Executive Board on their merits before any changes are initiated. In other words, I would stress that these types of structural changes that have significant consequences for the staff and the membership alike should not be

introduced hastily and through papers that are purely administrative in nature. My apprehension stems from the increasing frequency of the use of such an unwarranted approach in the recent past.

In the area of general policy development and research I welcome the emphasis that the Managing Director has correctly placed on "research studies toward improving knowledge in particular areas of Fund interest." In this connection, I recall the emphasis that the Chairman so deservedly placed at the conclusion of the seminar discussion on Islamic banking on the need for further analysis of the Islamic financial system irrespective of "constraints on staff and time." He accorded priority to Fund studies of Islamic financial systems particularly with respect to a number of important questions such as monetary and fiscal policies, the exchange rate, international capital flows, and the potential impact of all these policy instruments on Fund-supported adjustment programs. Therefore, I look forward to the inclusion of at least some of these topics in forthcoming Executive Board work programs. This would understandably be of enormous interest to Muslim member countries, which comprise almost one third of the membership, as well as those non-Muslim countries that have shown interest in the subject for a variety of economic and political reasons.

With respect to "operations and relations with member countries," which in terms of resource allocation is the largest budget category, I welcome the proposal to re-examine the size, scope, and periodicity of Article IV consultation missions. I agree that in addition to the cost-saving advantages of such a re-examination, it would help to reduce the excessive workload of the staff and the Executive Board with respect to country items. As for missions for debt negotiations and meetings with lenders and commercial banks, the Fund may consider calling on the banks at least to partially absorb the cost of those missions and related activities, as they are the main beneficiaries of the activities in such areas as Fund monitoring and enhanced surveillance--provided, however, that the banks do not pass through such charges to borrowing members.

I wish to express my appreciation for the efforts made by the Central Banking Department to provide adequate training and expert help to some of the members in my constituency that have needed technical assistance. Staff from the Fiscal Affairs Department and the Bureau of Statistics have provided valuable services to many members, including some in my constituency. I am pleased to commend again the excellent achievements of the IMF Institute. Training courses offered by the Institute provide the best opportunity for disseminating Fund methods and practices among member countries' technical staff. However, the proposal to request payment of transportation costs by applicants may impose an undue burden on some of the members that are in particular need of technical training. Similarly, the proposal to share the cost of

experts with member countries would place the institution in competition with international private consultants and would be contrary to the cooperative nature of the Fund. This could lead countries to decide on requests for technical assistance on the basis of the costs involved rather than on the traditional cooperative relationship that members have enjoyed with the Fund staff.

In the area of general support services, I welcome the special attention that is paid to confidentiality and to reducing the risks of leaks of sensitive information by continuing to implement the Security Action Plan, the details of which are unknown to me. I wonder whether the plan is in some way related to the remedial steps that management decided to take in dealing with the unauthorized disclosure of information about the Fund's relations with a member country that, as the Chairman observed at the time, created considerable embarrassment for the Fund and complicated the institution's work with the authorities concerned. In this connection, management said that it was determined to conduct a full investigation in order to discover the source of the unauthorized disclosure by requesting the services of Professor Dugan, the former Ombudsman, who in turn was likely to require assistance outside the Fund. More than a year has passed since the incident, and I wonder whether the Executive Board could be informed of the type of external assistance that was used and of the results of the investigation, if it has been completed.

As another remedial step in this direction I would like to reiterate my call for the installation of at least one high-quality paper shredder in each Executive Director's office so that unneeded sensitive documents can immediately be disposed of rather than being left unattended for late evening pickups and subsequent disposal outside Executive Directors' offices. This is not a costly proposition, but it will go a long way toward helping to maintain the confidentiality of sensitive material.

The adjustment in expenditure in FY 1987 for data processing should be kept in line with future operational requirements in order not to completely offset the savings achieved through automation. Among the innovations to which I referred earlier, the adoption of two budgets for administrative expenses and for capital expenses will provide a clear view of investment outlays compared with current expenditure. The presentation of the capital budget for a three-year period will help to determine the extent of the commitment in value and time. In addition, I welcome the emphasis that is placed on providing Executive Directors with more expanded coverage of programs and operations of particular interest to members.

As to the revised budget estimates at the midpoint of the current financial year, travel and communication, together with miscellaneous expenses, constitute the largest increase in expenses

other than personnel expenses. As I have said during previous reviews of midyear expenditures, efforts could be made to secure more beneficial travel terms from outside services, particularly as the number of countries that are expected to request Fund resources and to require more frequent visits will be on the rise. Travel routing on the basis of the shortest distance and avoidance of expensive airports and layover cities would go a long way toward economizing on the travel budget. The cost of overnight stopovers in places where connecting flights are not immediately available should be borne by the airlines rather than by the Fund.

The increase in the category of miscellaneous expenses is again attributable to the investment management of the Staff Retirement Plan. In my view, this item should be autonomous and the cost should be supported by the revenues generated by the Plan.

I would like to have further information on the number of temporary staff members, which has more than doubled between FY 1984 and FY 1988. A breakdown by departmental position and by nationality of the temporary staff would be helpful. In addition, the staff should comment on the rationale for the large number--235 persons, excluding summer interns--of temporary staff members. This question stems from my concern about the validity of the restraint on the number of authorized staff positions and about the high percentage--15 percent--of temporary staff positions in comparison with authorized positions. I share Mr. Massé's apprehension over the possible loss of the international character of this institution because of the growing trend in temporary staff positions.

Mr. Nimatallah said that he agreed with Mr. Salehkhou that there should be a follow-up of the seminar discussion on Islamic banking and therefore continuous study of the matter. The Executive Board and the Managing Director had already agreed that the follow-up and study should take place. More than 40 member countries were connected with the Islamic banking system, and it would be helpful for the Executive Board and the membership to know more about that system. He wondered whether the staff had plans to devote a specific amount of resources to further study on the Islamic banking system.

Mr. Sengupta remarked that Mr. Salehkhou's suggestion to explore the possibility of recovering some of the costs of enhanced surveillance in Article IV consultations from commercial banks was useful and should be explored.

Mr. Ortiz commented that he too felt that Mr. Salehkhou's suggestion concerning the feasibility of recovering some of the costs of enhanced surveillance was attractive. However, as he understood it, the normal practice of banks was to make the restructuring country bear any expenses involved in a debt restructuring. Thus far, debtor countries that had

engaged in restructuring exercises had paid not only their own legal fees, but also all the costs incurred by the banks in the restructuring effort. Hence, it would probably be difficult to convince banks to reimburse the Fund for the expenses that it incurred in conducting enhanced surveillance.

Mr. Grosche considered that the Fund was serving the member concerned in providing Article IV consultation reports as a part of enhanced surveillance. The Fund should not charge the country for that service. Charging the commercial banks, however, might be impractical and add to the difficulties the country experiences with the banks.

Mr. Salehkhou said that an important element of his proposal was that the cost recouped by the Fund for enhanced surveillance should not be passed through by the banks to countries that were the subject of enhanced surveillance. If it were true that the debtor countries were the beneficiaries of enhanced surveillance, he wondered why some of them were not cooperating in the effort.

Mr. de Groote considered that it was important to avoid examining from too narrow an angle the various issues involved in charging members for services provided by the Fund. The Fund should avoid placing the burden of some of its expenditures on countries that appeared to benefit from the relevant operations or services. After all, the Fund's income was generated mainly by the members that used the institution's resources. In the past, industrial countries had appreciated that the Fund could assist them, and over time it was clear that the whole membership had contributed to the Fund's income. However, at the same time, the services that the Fund provided were used by precisely the same countries that generated the Fund's income. That situation was normal. There was nothing unusual about the Fund having to provide special technical assistance to certain countries or having to become particularly involved in a country that was in the process of rescheduling its debt. In that connection, the Fund acted like any other financial institution as the cost of its operations were borne by the users of its resources. Any attempt to create artificial categories to recover those costs would undermine the fundamental operating principle that the cost of the Fund's operations should be borne by the users of its resources.

Mr. Nimatallah remarked that it would not be easy to establish the kind of relations with commercial banks that would enable the Fund to recoup the costs of enhanced surveillance. The banks were contributing to the well being of the system and were helping members that rescheduled their debt. Members involved in such rescheduling usually covered the costs involved. Any attempt to recoup the costs of Fund operations and services should be confined to members. Commercial banks generally operated on the principle of quid pro quo; accordingly, banks that had to cover the cost of a rescheduling with a member that was the subject of enhanced surveillance would probably find a way in which to pass the cost on to the member.

Mr. Fugmann made the following statement:

I am pleased that management and staff have been able to control and limit administrative expenses to the extent that there have been only marginal expenditure overruns compared to the approved budget for FY 1987. This budget is very tight; it involves a cut in real terms. I continue to support this budget but I repeat my willingness, as stated in April 1986, to consider requests for additional funds under this budget where appropriate and necessary. The Chairman's statement contains no significant surprises concerning the FY 1987 budget.

As to the budget for FY 1988, this chair has consistently argued for a cautious attitude toward an increase in the number of staff positions. After the steep increase in the staff ceiling in the first four or five years of this decade, I welcomed the clear slowing in the growth of the ceiling in FY 1986 and the unchanged ceiling for FY 1987. I fully agree with the Chairman that "we will again need to demonstrate to the membership our commitment of maintaining firm control over the growth of budgetary expenditures, including the number of regular staff positions." This should be the rule rather than the exception. Therefore, I also agree that in future statements to the Executive Board--not only in relation to the FY 1988 work program--management should "suggest relative priorities among items and provide an indication of the extent to which resources are lacking to complete the program." I also agree that statements on money and staff costs should be provided in connection with proposals for new or expanded studies that are not included in the approved work program.

In April 1986, Mr. Wijnholds called the FY 1987 budget "a budget of consolidation after the previous years' strong increase in the budget in real terms." This chair, together with several others, agreed with this view but also advocated a more stable medium-term trend in the development of the budget.

Even within the present framework of continued cost consciousness, I doubt the necessity and justification of curtailing the Fund's activities in real terms--as measured by recurring expenditure--for the second year in a row. In addition to being a management tool the administrative budget is a reflection of the Fund's role, tasks, and obligations. It is from this general policy viewpoint that I wonder whether another year of budgetary reduction in real terms is consistent with the tasks that the Fund is expected to accomplish. Apart from perhaps a growing desire to reduce somewhat the resources spent both on the Executive Board and by the staff on certain Article IV consultations, the future work program implies an increase in activities by the Fund. My reading of the statements by Governors during the 1986 Annual Meetings and of the latest Interim Committee communiqué, as well as the decisions and

discussions of the Executive Board, do not point to a further reduction in real terms of recurrent expenditure. I would be pleased if the Chairman could dispell this concern.

At this stage of the FY 1988 budget process I prefer placing a cap on recurring expenditure in real terms. Even with such an objective, it will be "necessary to abandon, postpone, or reduce the scope of some desirable projects and activities, and to continue to reallocate staff positions from areas of lower priority to those where the priority and the pressure are the greatest." Even in an efficient institution like the Fund, such reallocation of staff is still possible, and I continue to support such efforts. Possible savings on nonessential expenditures in the future should of course be made. However, I do not wish to cut expenditures that are closely related to the staff's ability to fulfill its tasks at the same high level as in the past and I do not wish to cut expenditures that would lead to a deterioration in the daily work conditions of the staff.

I will now comment on the main assumptions behind the FY 1988 estimates. I am not convinced of the usefulness of the high level of temporary staff positions, which account for almost 11 percent of the Fund's total manpower. A fuller discussion of this issue might be helpful. I continue to believe that the number of outside consultants should be kept to a minimum.

I do not support the proposed reduction in manyears in the technical assistance experts program. This is an extremely valuable part of the Fund's activities and for a number of members is of equal importance to financial assistance provided by the Fund. However, I do support the other elements of the third assumption mentioned by the Chairman, including the two cost-sharing proposals. I agree with Mr. Massé that a means test for this purpose should be considered.

In the area of support services, I agree that savings can probably be achieved if guidelines were developed for translations activities. I continue to attach a low priority to automation of Executive Directors' offices, with the exception of word processors. As for business travel, I support the elimination of nonessential missions and the proposal to keep the size of mission teams as small as possible. I continue to support the idea of reducing the class of travel for appointments and separation travel, but only if such a provision would apply to staff and Executive Board members alike.

One area that is not explicitly covered by the general austerity under the budget is costs relating to Executive Directors' offices. If the Fund continues to adopt very tight budgets in the coming years, as I believe it must, it will be important for Executive Directors to show similar restraint. Such restraint may be possible in a

number of areas. A logical extension of what has been established for various departments in the Fund would be to establish a budget for each Executive Director's office according to certain guidelines--for example, the number of members in a constituency.

Mr. Finaish made the following statement:

It is clear that the program of activities for 1987 and 1988 is likely to remain heavy. It is expected that work on policy development and research in 1988 will be as intensive as in 1987. It is therefore envisaged in the Managing Director's statement that, in the light of the budgetary constraints, it may become necessary for management to suggest relative priorities and to indicate the extent to which resources would be lacking to complete the program. If budgetary restraints are to continue as envisaged, this may in fact prove necessary. In determining priorities we should not overlook, among other considerations, the special importance of certain research to particular groups of countries. For example, Mr. Salehkhou and Mr. Nimatallah have mentioned the work on Islamic banking and economics. Follow up on the staff's work in this area would, as a number of Executive Directors stressed during the seminar on the subject, be generally useful for the Fund and would be directly relevant to a large part of the membership. Another example is the work on planned economies that has been stressed by other Executive Directors in the past.

In a much wider field of activity, the operations and relations with member countries, work is expected to increase further in 1988. One welcome expansion of work is on structural adjustment programs, which are expected to cover 30 countries. This will certainly add to the heavy workload, especially in area departments that are most active in low-income countries. One way in which to reduce the workload and the costs suggested in the Managing Director's memorandum is to re-examine the frequency, size, and scope of consultation missions. Some Directors have argued that such cuts should not be applied in the case of countries with limited technical expertise and other resources or in cases involving countries that feel strongly about the frequency of consultations with the Fund. Some countries insist on holding consultations every 12 or 18 months, and it will probably be necessary to accommodate these members. However, a possible area of scrutiny is travel that is not deemed to be essential for members or the Fund. An example of such travel is informal visits and inspections of experts stationed abroad. It is difficult to pinpoint other examples, but there seems to be room in which to limit nonessential travel. Another possibility that has been mentioned previously is a reduction in the number of resident representatives; only a slight reduction is envisaged for FY 1988.

In the area of special services, the downward trend in activity is a cause for concern to me as well as others. Following a 6 percent reduction in expert manyears in FY 1987, a further reduction is planned for FY 1988. I and many other Executive Directors have strongly argued against such a reduction, as it affects members that have the greatest need for technical assistance. For countries that use the Fund's resources rarely if at all, as those in my constituency, it will be increasingly difficult to justify denying such requests for technical assistance, especially given the financial responsibilities that many of them still shoulder. In addition, technical assistance is highly useful not only for the countries receiving it, but also for the institution as a whole. Moreover, requiring members to absorb a greater share of the cost of technical assistance, as has been suggested by some Executive Directors and is mentioned in the Managing Director's memorandum, is not a viable way in which to maintain the size of the Fund's technical assistance. As has been argued on previous occasions, this approach will discourage poorer members from using the Fund's technical assistance resources. This will certainly happen if members have to bear the transportation costs of participants in the IMF Institute. Another possibility that is mentioned in the memorandum is for other international organizations to bear part of the cost of assistance to Fund members. This, too, is not a viable solution, as it will mean that other organizations will be asked to finance technical assistance by the Fund, which is perceived to be, and in fact is, in a better financial position than many other international institutions. In any event, any cut in the technical assistance program should not be applied to countries with limited technical expertise and other resources.

I have no comments on other aspects of the work program, but I wonder whether any additional cost is expected as a result of the presentational change endorsed by the Executive Board that will involve separate capital and administrative budgets.

The slight overexpenditure that is expected in FY 1987, together with the additional appropriation requested by the Joint Committee on Staff Compensation, can be regarded as a minor addition to the budget.

The section on the prospects for FY 1988 and beyond is of course more tentative, but it does raise some issues concerning medium-term budgetary policies. The most significant issue is the call to demonstrate to the membership our commitment to maintain firm control over the growth of budgetary expenditure, including the number of regular staff positions. To that end, it is proposed to keep budgetary expenditure in FY 1988 at the nominal 1987 levels and to provide for no increase in regular manpower. This is certainly a reasonable budgetary policy, provided of course that one can be confident that it will not hamper the fulfillment of the Fund's increasing responsibilities. It is already recognized,

as is indicated in Section 3, that the regular manpower will not be adequate and that resort has to be made to temporary or contractual assistance. However, as it appears from the projections for FY 1988-90, while the number of regular positions will remain constant, total manpower will increase steadily due to continuous resort to temporary assistance. This resort, which may extend even beyond FY 1990, will certainly raise questions about the temporary and nonrecurring character of this assistance. Previous speakers, especially Mr. Massé, made useful remarks on the issue of temporary recruitment.

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

APPROVED: August 5, 1987

LEO VAN HOUTVEN
Secretary