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Minutes of Executive Board Meeting 85/181

3:00 p.m., December 13, 1985

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

Executive Directors	Alternate Executive Directors
	K. Yao, Temporary
	M. K. Bush
	D. C. Templeman, Temporary
	G. Ercel, Temporary
	S. de Forges
	T. Alhaimus
	M. B. Chatah, Temporary
H. Fujino	M. Sugita
G. Grosche	B. Goos
Huang F.	Jiang H.
J. E. Ismael	
A. Kafka	
	M. Foot
	R. Fox, Temporary
	H. Fugmann
	G. D. Hodgson, Temporary
	G. W. K. Pickering, Temporary
	P. E. Archibong, Temporary
	B. Jensen
Y. A. Nimatallah	
P. Pérez	
J. J. Polak	
	A. V. Romuáldez
G. Salehkhou	
	A. Vasudevan, Temporary
S. Zecchini	N. Coumbis

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

Also present

Administration Department: G. F. Rea, Director; H. J. O. Struckmeyer, Deputy Director; J.-P. C. Golle, J. D. Huddleston, N. S. Jackson, M. Oka, P. J. McClellan, H. Wiesner, L. A. Wolfe. Exchange and Trade Relations Department: J. Berengaut, S. Kanesa-Thasan, M. R. Kelly. Legal Department: F. P. Gianviti, Director Designate; J. G. Evans, Jr., Deputy General Counsel; A. O. Liuksila. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer. Western Hemisphere Department: L. A. Cardemil, J. Fajgenbaum, J. C. de Sosa. Bureau of Computing Services: K. X. Nelick. Bureau of Language Services: A. J. Beith, Director. Bureau of Statistics: J. B. McLenaghan. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. A. Agah, W.-R. Bengs, M. B. Chatah, L. P. Ebrill, S. Ganjarerndee, H.-S. Lee, G. Nguyen, A. Steinberg, E. M. Taha, M. A. Weitz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, I. Angeloni, A. Bertuch-Samuels, J. de la Herrán, J. J. Dreizzen, O. Isleifsson, A. R. Ismael, Z. b. Ismail, S. King, H. Kobayashi, S. Kolb, D. S. Louzada, A. Murakami, J. E. Rodríguez, M. Sarenac, S. Simonsen, B. Tamami, L. Tornetta, H. van der Burg.

1. DEBT STRATEGY - REPORT BY MANAGING DIRECTOR

The Managing Director reported briefly on an additional joint statement that would be made with the President of the World Bank on the support expressed by the international banking community for the debt initiative. 1/

2. VENEZUELA - 1985 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/85/180, 12/13/85) their consideration of the staff report for the 1985 Article IV consultation with Venezuela (SM/85/308, 11/15/85), the second report prepared under the procedures for enhanced surveillance proposed by the Venezuelan authorities. They also had before them a report on recent economic developments in Venezuela (SM/85/316, 12/2/85).

Mr. Polak commented that the Venezuelan authorities had an understandable desire to impart some expansionary effect to the economy, which was in recession and suffering from a high level of unemployment. The fiscal surplus in 1985 was unwanted and need not be maintained in 1986. Nevertheless, he wondered whether the answer to those problems was a return to large-scale government investment spending modeled on the early 1980s. In view of Venezuela's difficult structural situation, the authorities should encourage private investment, but the staff papers did not indicate that they were doing so. In an economy like that of Venezuela, expansionary fiscal policies could easily exacerbate the problems of inefficiency, waste, and suboptimal allocation of resources, increase bottlenecks, and lead to inflationary pressures. He therefore supported the staff's view and urged the authorities to implement firmly policies aimed at deregulation of the economy and the elimination of controls.

Those policies could have a stronger impact on investment growth--including the return of flight capital, and on strengthening non-oil GDP--than would increased government expenditures, Mr. Polak continued. Venezuela could helpfully incorporate in its quarterly economic plans specific targets for the attainment of decontrol and deregulation, including a simplification of the exchange rate system. The exchange system was an extremely serious problem. Although the authorities had made progress toward unification of the exchange rate--the bulk of the import transactions were at the prospective unification rate of Bs 7.50 per U.S. dollar--when the movement in the free market rate was taken into account, progress was very limited. In 1983, the free rate had been about Bs 10 per U.S. dollar while the average controlled rate had been Bs 5 per U.S. dollar. At present, the free rate was about Bs 15 and the average controlled rate was about Bs 7.50. Thus, in the past two years, the authorities had not moved closer to the free market rate, and the

1/ International Monetary Fund, Press Release No. 85/41, December 15, 1985.

large gap, with a 1:2 ratio between the free and controlled rates, remained the same as three years previously. Moreover, since 1983, when a large depreciation had taken place, the bolívar had appreciated in real terms at a rate that was higher than the staff's figure if the rate were calculated on the basis of the GDP deflator, which had risen much more than the cost of living index.

Because of the need to revive non-oil GDP and to relax import controls and restrictions, it was important that the authorities move toward the free market rate, Mr. Polak concluded. He hoped that the difference between the controlled rates and the free rate would narrow as a result of the future implementation of a flexible exchange rate policy.

Mr. Chatah commented that the performance of the Venezuelan economy over the past two years had generally been good. Strong adjustment on the demand side, particularly in the fiscal area, had been the main factor behind the dramatic reversal in the balance of payments position, which was particularly significant and commendable given the country's external debt situation. However, the projected outcome of the 1985 economic program was mixed. On the one hand, viewed from a strictly financial perspective, the larger than targeted balance of payments surplus and lower inflation should be welcome. But, that outcome was associated with the substantial shortfall in investment expenditure that had also been a significant factor in the disappointing growth in employment. If the original targets of the economic program were considered an appropriate balance between financial adjustment and growth, the projected outcome for 1985 could be interpreted as a slippage, not only because of the importance of achieving growth and stimulating employment for the sustainability of adjustment over the medium term, but also because the projected outcome might induce a policy overreaction that would be inconsistent with a steady and stable course of adjustment. He therefore welcomed the fact that delays in investment outlays, which had been the main factor in the contractionary fiscal position in the first half of 1985, seemed to have been overcome in recent months.

He was not suggesting that a better growth and employment performance could be achieved simply by boosting domestic demand, Mr. Chatah continued. A sustainable increase in noninflationary growth was more fundamentally dependent on structural policies that induced robust private sector activity and efficient resource allocation. Steps relating to the exchange rate and pricing policies had been taken but did not appear to be as broad as desirable. He was aware of the constraints facing the authorities in speeding up structural reform, particularly as certain important aspects--for example, price controls--were viewed as integral to the social pact, which had been a key factor in wage restraint and other adjustment policies. However, while price controls might facilitate the continuation of nominal wage restraint, they might also unnecessarily inhibit increases in real wages, which in the final analysis were dependent on growth and productivity.

The economy's performance in 1985, the policies outlined for 1986, the strength of macroeconomic adjustment being achieved, and the opportunity created by the multiyear arrangement with creditors called for a more decisive and comprehensive approach to dealing with the structural problems within a defined time frame, Mr. Chatah stated. Price and trade controls--which were impediments to private investment--as well as the tax and exchange systems, should be addressed more comprehensively if adjustment with growth was to be achieved. The objectives of the 1986 recovery program were laudable, although the supply-side policies to complement demand recovery were not yet fully spelled out. He looked forward to receiving more details for the next consultation discussion on Venezuela.

He appreciated the staff's concern about the potential financial implications of the special investment program, but the magnitude of the deficit it entailed, as suggested by the staff--3 percent of GDP--seemed to be significantly less than that described by Mr. Pérez--1 percent of GDP--Mr. Chatah observed. The difference did not seem to be fully explained by the downward revision of the size of the investment program; staff clarification would be useful. The objective of the investment program should not merely be to increase domestic demand; perhaps more important, the selection and implementation of projects under the plan should be oriented toward increasing production and exports in a carefully assessed time frame. In addition, the investment plan should include a sufficient degree of flexibility to enable the authorities to respond to changes in circumstances, such as a further weakening in the international oil market. The sensitivity of the Venezuelan economy to changes in international oil prices was illustrated in the staff's analysis of the medium-term balance of payments outlook. Although the assumptions upon which that outlook was based, as well as the relatively comfortable reserve position, indicated that the external debt situation would probably be manageable, the risks associated with a possible significant drop in oil revenue should be fully taken into account in drawing up policy for 1986 and beyond. In that connection, non-oil exports should be encouraged by the Venezuelan authorities and stimulated by Venezuela's trading partners through increased market access for those exports.

In Table 7 of the staff report (SM/85/308), the rate of growth of non-oil GDP was projected as 2 percent for 1986 and 3 percent a year for the period 1987-90, Mr. Chatah commented. He asked the staff to comment on the implications of such a rate of growth for the unemployment situation. A 3 percent growth rate could be described as reasonable. However, when measured against a population growth of about the same magnitude and even a higher labor force growth rate, he wondered whether 3 percent growth could support a reduction in the current unemployment rate. The staff papers could usefully have included more information on the structural and sectoral aspects of the unemployment problem and of the labor market in general, which had important policy implications. Moreover, he wondered to what extent the sectoral shift away from construction was responsible for urban unemployment and to what extent the current policy of stimulating agriculture would help in facilitating labor shifts toward that sector.

The Venezuelan economy's performance over the past two years was cause for moderate optimism with regard to Venezuela's future, Mr. Chatah observed. A strengthened structural adjustment effort in the next year would heighten that optimism. He was interested in the staff's response regarding the introduction of quantifiable targets for structural policies; on a general policy level, there were a number of practical implications, and he suggested caution in moving in that direction.

Mr. Salehkhou stated that considerable progress had been achieved by Venezuela since 1983, as the external account and public sector positions had improved significantly in response to the authorities' comprehensive adjustment program. Fiscal and monetary restraint, a moderate wage policy, and substantial correction of price distortions had made a notable contribution to those achievements. However, unemployment had worsened as a result of continued negative real economic growth, partly owing to lower than projected public sector investment and tighter import controls.

The current fiscal and external positions of Venezuela should allow the authorities to take new corrective measures and to remove existing obstacles in order to cope with economic recession, Mr. Salehkhou commented. The authorities, however, should take into account the possible inflationary repercussions of excessive expenditure growth and of a relaxation of quantitative import restrictions, which would also adversely affect the existing favorable balance of payments surplus and the relatively high level of international reserves.

Because of delays in the implementation of the public investment program, the public sector position had shown a larger than projected surplus for the first half of 1985, Mr. Salehkhou remarked. To stimulate economic activity and employment, further efforts were needed to increase public sector investment expenditures and to foster demand; in that connection, the authorities' three-year investment program, starting in 1986, seemed appropriate. However, in view of the prevailing uncertainties in the oil market, the authorities would be well advised to maintain a flexible attitude in that respect and to adapt to changing circumstances as warranted. Increased excise taxes and improved income tax collection, along with higher operating surpluses in nonfinancial public enterprises, would allow some expansion in government spending. That diversification of revenues was essential, considering the sensitivity of the Venezuelan economy to developments in the oil sector.

While he agreed with the staff that action other than demand stimulation--such as progressive reduction in the scope of price and import controls--was needed to deal with the problem of economic growth, caution was necessary to avoid a setback in the process of adjustment, Mr. Salehkhou said. The unification of controlled exchange rates and the adoption of a flexible exchange rate policy should be implemented only gradually after a comprehensive restructuring of import tariffs, so as to cushion the effect on domestic industry and to preserve the medium-term viability of the external position and the favorable price performance of 1985.

Notwithstanding lower oil revenues, the external account's improvement had been greater than projected, largely owing to continued tight import controls, Mr. Salehkhou observed. As a result, official reserves had risen by $1 billion. The lower outflow of short-term capital recorded in 1985 seemed to reflect the positive differential between domestic and international interest rates. While the staff suggested that the pervasive application of controls and regulations had probably contributed to the export of capital, he wondered to what extent such controls had prevented a more massive outflow. He invited the staff to elaborate on the size of, and prevailing rates in, the free exchange market, and the effect of central bank intervention.

In view of the positive medium-term prospects of the balance of payments and the comfortable reserve position, it seemed appropriate to urge the authorities to complete the registration process of private debt, which was estimated at about $6 billion, Mr. Salehkhou remarked. While that action would facilitate the virtual elimination of private sector arrears by providing access to the preferential exchange rate, he nevertheless wondered to what extent nonregistered debts were serviceable through the free exchange market.

Mr. Nimatallah commented that Venezuela had adjusted successfully to a lower level of oil revenues in recent years. As a result of effective and broad-based policies, both the fiscal and external positions had improved substantially, international reserves had risen to comfortable levels, and the international community's confidence had been restored. The authorities deserved commendation for those positive developments. However, the improvement in the domestic and external positions had been accompanied by negative growth and high level of unemployment. As a result, the authorities intended to stimulate the economy and reduce unemployment through their proposed recovery program.

The objective of sustained growth within the proposed recovery plan was appropriate and probably attainable, although in a slightly longer period because of the time needed to implement the necessary supply-side measures, Mr. Nimatallah continued. A combination of demand and supply-side policies would be required to keep inflation down and to lay a solid foundation for sustainable growth. More emphasis should be given to supply-side measures in the period ahead, notably by the removal of structural bottlenecks and administrative controls so as to further improve resource allocation and generate the needed additional savings and investments. The supply-side measures should include the adoption of an investment policy that focused on basic infrastructure and the productive capacity of the agricultural, manufacturing, and services sectors. The measures should also include a flexible exchange rate strategy, a realistic domestic price structure that reflected economic costs, and a tax system that improved overall government non-oil revenues and provided incentives for private sector activity.

The initial expenditure targets of the special three-year investment program seemed ambitious, Mr. Nimatallah remarked. The staff had correctly cautioned that full implementation of the program could weaken the financial position of the public sector, intensify inflationary pressures, and undermine the gains achieved in the external sector. To avoid such undesirable outcomes, the investment program needed to be modified or implemented flexibly, within available resources and with regard for stability and sustainable growth. He therefore welcomed the revisions to the program described by Mr. Pérez, particularly because of the uncertainties surrounding developments in, and prospects for, the international oil market.

He agreed with the authorities that unemployment could be eased somewhat through public sector domestic expenditures, Mr. Nimatallah said, although higher public sector expenditures alone were unlikely to reduce unemployment substantially. Table 45 of the report on recent economic developments indicated that unemployment in Venezuela had been relatively high in the early 1980s when public sector expenditures had increased significantly. The private sector had a complementary and potentially more positive role to play in alleviating the unemployment problem. The authorities therefore needed to eliminate gradually controls that were impeding private sector activities--for example, in the area of imports and exports. The authorities should also move ahead with tax reform, which would provide incentives for the private sector.

The authorities' commitment to a flexible exchange rate policy was welcome, Mr. Nimatallah noted. Such a policy could help to promote non-oil exports and enhance their competitiveness. To improve efficiency, the quantitative restrictions on imports should be gradually eliminated.

With respect to external debt, the authorities had made commendable progress in containing public sector arrears, Mr. Nimatallah concluded. However, private sector arrears remained a problem, and the completion of the debt registration was a step in the right direction; he encouraged the prompt elimination of those arrears.

Mr. Fox remarked that the Venezuelan authorities had achieved remarkable improvements in the economy's internal and external finances since 1982, but the cost had been high, with per capita income falling by almost one fifth over the past four years and the level of unemployment continuing to rise. It was therefore understandable that with the adjustment effort having borne fruit, the authorities were now seeking to alleviate those costs by stimulating output and employment. There were differences of view between the staff and the authorities on how that could be achieved. But given the uncertainties in the oil market, whatever strategy was chosen should be implemented cautiously.

As to the form of economic stimulation, the staff had commented that the attempt to increase public expenditures in 1980-82 had had little permanent effect on growth and employment in the non-oil sector, Mr. Fox continued. In any case, he believed that capital investment was not best suited to the needs of short-term demand management as it required much longer-term planning. However, the Cabinet had approved a special investment plan which, although reduced somewhat in size from initial plans, was still ambitious, and he asked the staff for an assessment, with particular reference to the effect on the overall fiscal position.

The authorities might not be able to move as quickly as they would like, Mr. Fox noted, as witnessed by the undershooting of investment intentions in 1985. The more appropriate way to promote private sector growth and employment in Venezuela was through a concerted attack on the supply side, with a major dismantling of price controls--including the exchange rate--as well as liberalization of import and export controls and the trade and payments system. Because of the economy's current financial strength, the time was opportune to implement such a strategy.

The unification of controlled exchange rates, even at the rather high level--in light of the free market rate of Bs 14.50--of Bs 7.50 per U.S. dollar was long overdue, Mr. Fox commented, but he was pleased to learn that progress toward reaching the end-1985 deadline for unification continued. In the longer term, he urged the authorities to speed up movement toward complete market determination of the exchange rate. Combined with import deregulation, that would have limited inflationary impact and would help to promote the diversification of exports, which would be all the more important if oil prices fell further.

The current account position made it difficult to justify the continued existence of private sector arrears, Mr. Fox said, and he was therefore pleased that the registration of private sector debt would soon be completed; all arrears should be cleared quickly to help normalize relations with creditors. In the fiscal area, he asked the staff to include further information on individual parastatals in the report for Venezuela's next Article IV consultation.

The authorities should abandon the practice of fixing maximum lending and deposit rates and should encourage more interest rate flexibility in general, Mr. Fox stated. The staff had not described the general state of the domestic financial sector, which he understood had been troubled for some time; in particular, he would welcome the staff's views of the effect on financial stability of the recently created deposit guarantee fund.

Mr. Huang commented that over the past few years Venezuela had made remarkable progress in overcoming its internal and external economic imbalances. The Venezuelan authorities' efforts to implement restrictive fiscal and monetary policies, adopt a cautious wage policy, and impose strict import controls were impressive. By midyear, Venezuela had attained its objectives for the balance of payments and the control of inflation; government revenue had increased, and the overall balance of payments had shifted from a deficit to a surplus.

Not all of the objectives had been met, Mr. Huang continued. The ongoing decline in output of the non-oil sectors and the high unemployment rate were grave problems that merited attention. The Venezuelan authorities were therefore understandably eager to stimulate economic activity, and they had taken some measures in that direction--notably, the special public investment program. That program, which seemed to have top priority, would result in a sharp increase in public expenditure in 1986, thus leading to the recurrence of a budget deficit and inflationary pressures.

The uncertainty in the oil market must be taken into account, Mr. Huang added. If oil prices in 1986 fell further, the public investment program would be costly in terms of an elevated deficit and high inflation, which could have an adverse effect on the recent achievements of the Venezuelan Government. Therefore, more caution should be exercised in the short-term stimulation of the economy, more emphasis should be placed on medium-term structural adjustment, and more attention should be given to developing the nonpublic economy and the non-oil sectors.

Mr. de Forges commented that the close cooperation between the Fund and Venezuela under the procedures for enhanced surveillance had been fruitful and had led to a better mutual understanding. He commended the authorities for the significant progress achieved recently: as a result of determined policy implementation, the current account deficit had swung into surplus, as had public finances, and indications for 1985 pointed to a strong external performance and a deceleration in the rate of inflation. The authorities were thus in a better position to renegotiate their external debt and to reconstitute their foreign exchange reserves.

Nevertheless, there were deplorable side effects, Mr. de Forges continued, notably the negative growth rate for the third consecutive year and the increasing rate of unemployment.

Because Venezuela's receipts were highly sensitive to fluctuations in oil prices, any policy action on the domestic side should be set in a medium-term framework and remain open to adjustment in the face of changing circumstances, especially with respect to longer-term investment, Mr. de Forges noted. On the external side, it was necessary to move away from the dependence on oil and to diversify exports. Following the current stage of drastically limiting imports by administrative means and developing import substitution production, the authorities would have to find the appropriate sectors where Venezuela would have a comparative advantage. He asked Mr. Pérez if precise figures had been set under the special recovery program for the increase in the share of non-oil exports.

The authorities intended to stimulate the economy through the recovery program, Mr. de Forges observed. However, although the authorities' desire to tackle unemployment and the slackness of the economy was understandable, caution was necessary to prevent a rekindling of inflation. He therefore welcomed Mr. Pérez's assurances that the Venezuelan authorities were aware of those concerns and had reduced the size of the program. The chances for the program's success would be greatly improved if the impediments to the functioning of the economy--price and import controls, and a complicated system of export licensing--were progressively phased out.

Thanks to the joint efforts of both Venezuela and its creditors, satisfactory agreements had been reached with respect to most of the external debt, Mr. de Forges noted. However, the cumbersome process of the registration of private debt had resulted in substantial payments arrears. He welcomed Mr. Pérez's statement that the task had been completed and that settlement would soon follow. Table 5 in the staff report did not reflect adequately the situation for the stock of private arrears in 1985 and should be reworked.

Venezuela was enjoying the room for maneuver created by the emergence of a consensus on the policies to be implemented, Mr. de Forges concluded. However, the authorities faced the challenge of how to reflate the economy despite uncertainties on the oil front and the potential danger of renewed price increases and an external deficit.

Mr. Romuáldez stated that he was in broad agreement with the staff appraisal of recent developments in the Venezuelan economy. The authorities were to be commended for their determination in implementing the adjustment program, particularly for substantially reducing domestic expenditures. The public sector shift from a large deficit into surplus was noteworthy, although delays in the implementation of public investment programs had contributed to the improvement of public finances. It was remarkable, however, that Venezuela had been able to improve its overall balance in the public sector by 18.5 percentage points of GDP over the past two years. Effective implementation of demand management policies--supported by strict administrative controls of imports--had greatly helped to bring about a surplus in the external accounts.

Nevertheless, the price for improvements in the system had been high in terms of sluggish economic growth and unemployment, Mr. Romuáldez continued. The authorities were under considerable pressure to expand the economy, particularly in light of the substantial surplus in public finances and the relatively comfortable level of reserves. Indeed, there seemed to be some room for injecting stimulus into the economy, but fiscal stimulus should be administered cautiously if inflationary pressures were to be held in check and a significant loss of reserves avoided. Moreover, prospects in the oil markets remained uncertain. He therefore welcomed the information that the authorities had reassessed their three-year special investment program and had modified it downward. More important, the authorities should be encouraged to consolidate their gains and to firm the basis for sustainable economic growth in the medium term; they should also deregulate the economy in order to create incentives for private investment and employment generation.

He encouraged the authorities to move as scheduled toward unification of the exchange system--at least in the area of controlled rates--at a level that would improve Venezuela's international competitiveness, Mr. Romuáldez said, and to pursue greater flexibility in exchange rate policy. Export diversification and efficient import substitution should be accomplished. The protection of domestic industry could be achieved more efficiently through flexible exchange rate policies and import tariffs than administrative controls.

The social pact, of which the price control system was an important part, had been helpful in the adjustment process, Mr. Romuáldez commented. Nevertheless, the experience of those countries where temporary price control systems had tended to gain permanence and had led to distortions in price structures and to the misallocation of resources should be kept in mind by the authorities and should provide the incentive for them to take prompt and decisive steps toward reducing the scope of price controls.

Even the most conservative scenario projected a medium-term outlook for Venezuela's balance of payments that remained relatively favorable, with some moderate economic growth likely and a sustainable balance of payments achievable without recourse to net borrowing from commercial banks, Mr. Romuáldez remarked. Those results, of course, were under the assumption that appropriate policy measures were implemented.

He could go along with the staff recommendation of not approving existing exchange restrictions and multiple currency practices, Mr. Romuáldez continued. He concurred with Mr. Dallara's suggestion to establish quantifiable targets, and he recalled that his chair had made a similar point in the previous Article IV discussion for Venezuela (EBM/85/84, 5/30/85).

He recognized the achievements of the Venezuelan authorities, but significant differences remained between the authorities and the staff on a broad array of issues, particularly pertaining to structural problems, Mr. Romuáldez observed. During the previous discussion of Venezuela's performance under enhanced surveillance, his chair had warned of a possible clash between the Fund's involvement in enhanced surveillance procedures and its normal surveillance function, in that the adjustment accomplished in the context of enhanced surveillance, while satisfactory to the authorities and the banks, might not be optimal or ideal from the broader perspective required of the Fund under the Articles of Agreement. In view of that possibility, he had suggested at that time that in its consultations, it was especially important for the staff to identify the medium-term and longer-term costs associated with the adjustment strategy being adopted by the authorities that seemed to satisfy the banks. To a meaningful extent, the staff had undertaken that appraisal.

The authorities should take the opportunity offered by the improvement in their economic situation to continue or, where needed, to institute policy and structural changes that would ensure sustainable growth and financial balance, Mr. Romuáldez concluded.

Mr. Goos said that the guidelines for enhanced surveillance called for certain deletions in the reports to the authorities for transfer to the banks. In the present case, he assumed that the reference to the previous discussion and the names of the staff members would be deleted, but he wondered whether the staff could advise the Board of any other changes or deletions.

Mr. Nimatallah pointed out that the authorities had stated that after three years of adjustment efforts, the behavior of demand in the economy remained depressed and they wanted to emphasize growth. Because other countries shared that problem, the Board had discussed the design of programs of adjustment and had emphasized a policy of adjustment with growth. The Venezuelan authorities should be made aware of the Board's support and its recommendation for some emphasis on the supply side while consolidating recent gains. He looked forward to a Board discussion on program design.

Mr. Templeman said that while he was aware that the document was transmitted to the banking community through the Venezuelan authorities, he wondered how the Board's views, when they differed from those in the document, were conveyed.

The Chairman noted that the procedures adopted by the Board for enhanced surveillance in the case of Venezuela established that the reports to be sent to the banking community under enhanced surveillance would be without reference to the Board's views, and that summings up would not be included (EBM/85/84, 5/30/85).

The staff representative from the Western Hemisphere Department commented that the scaling down of the three-year investment program was a welcome development. Nevertheless, the expected relatively small increase in revenue indicated that the deficit of the consolidated public sector would be about 2 percent of GDP. The staff had forecast a deficit of 3 percent of GDP under assumptions excluding the delays in implementation of the investment programs of the public enterprises and the Central Government as had occurred in 1985 and including a similar level of capital expenditure by the public enterprises as programmed in 1985. Most of the projected 2 percent deficit would need to be financed by the domestic banking system because it seemed unlikely that additional public bonds could be placed in the market, given the large amount of bonds issued by the public sector to pay off the public sector's existing arrears. Therefore, the additional 2 percentage points of GDP in domestic bank financing, coupled with the need to avoid crowding out the private sector, implied strong pressures on prices and the balance of payments; for that reason, the staff considered the size of the special investment program still too large.

Increased public investment and a balanced public sector position would increase demand and encourage growth, the staff representative continued. However, the effects would not be lasting unless accompanied by strong deregulation measures and market-oriented policies. Nevertheless, unlike past investment by the authorities, which had tended to waste or underutilize resources, investment under consideration emphasized infrastructure and energy sector development--both highly productive.

The rates of growth of economic activity and employment have been traditionally closely related to public sector expenditure. Although there was no clear relationship established between GDP and employment over the past several years, the authorities' policies were mainly directed toward increasing the intensity of labor in output.

Venezuela had not been eligible for World Bank loans since 1974, the staff representative remarked. For that reason, the Fund staff had looked closely at areas of structural policies and problems. During the next mission, the staff would focus more on the labor market and would also discuss with the authorities the formulation of timetables for the deregulation of the economy. In several past discussions, the staff had discussed the possibility of designing timetables, especially for the exchange system.

In studying the exchange rates, the staff had decided not only to look at the purchasing power parity or the real effective exchange rate but to take into account other indicators, the staff representative explained. The depreciation registered by the U.S. dollar during the past few months had corrected most of the appreciation of the bolívar mentioned in the staff report. Nevertheless, decisive exchange rate action had to be taken because of the need to liberalize the economy, eliminate controls on imports, and diversify exports, given the uncertain outlook for the oil market. In the staff's medium-term outlook, full unification of the exchange rate was not assumed in 1986-87, but the staff did assume a flexible policy whereby, for example, imports were shifted from the controlled exchange rate to the free exchange rate, thus avoiding erosion of the real effective exchange rate.

The volatility of the exchange rate in the free market largely reflected oil market developments, which could have a negative effect on the economy, the staff representative reported. That volatility was due to the thinness of the market; the transfer of imports to the market should be accompanied by larger sales from the Central Bank to the free market, thus widening the size of that market and reducing volatility. The gap between the controlled rates and the free rate was widening significantly. However, the exchange rate of Bs 4.30 per U.S. dollar had been virtually eliminated, thus implicitly depreciating the average controlled rate. Using the GDP deflator as the basis for the real effective exchange rate would impart a vicious circle problem into the calculation because the deflator was heavily influenced by the exchange rate, especially in the oil sector. The exchange rate used for oil exports would affect the GDP deflator dramatically and would therefore constitute the wrong indicator.

Central bank intervention in the free market had followed a stable pattern, the staff representative continued: the authorities established a budget for the whole year and divided it according to weekly sales. As public sector exports were over 95 percent of total exports, the supply to the free market mainly came from the Central Bank. Access to the free market was open, and nonregistered debt could be serviced through that market.

The staff had assumed in Table 5 of its report that private sector arrears, in principle, would be eliminated by the end of 1985, the staff representative noted. That assumption had been based on the optimistic view that the registration process would be completed by the end of October and that the whole processing would be finalized in the ensuing two months. However, registration had not been completed, and the staff expected a sizable amount of arrears to remain in the system until their elimination early in 1986.

The social pact had imparted a number of benefits to Venezuela, the staff representative from the Western Hemisphere Department said, as it had been an important element in maintaining wage stability and containing inflationary pressures. Recent developments in the oil market increased the uncertainty in Venezuela's medium-term outlook as the dependence of Venezuela on the oil sector was very large. A $1 per barrel reduction in the price of oil would result in reduction of approximately $500 million in exports and of about 1 percent of GDP in public sector revenues. Of course, the uncertain medium-term outlook underscored the need to undertake the structural reforms and deregulation mentioned by Directors in order to promote growth and export diversification. The revival of private investment would take a long time, but the staff believed that the conditions should be created fairly rapidly.

The staff representative from the Exchange and Trade Relations Department recalled that a Director had noted that the enhanced surveillance process should be mutually beneficial to the Fund and the member in furthering the process of adjustment, and in that context he had expressed some disappointment with the progress achieved by Venezuela, particularly in the critical area of structural change in the economy. Mr. Dallara had suggested that it might be useful to include in enhanced surveillance reports quantitative targets for structural change, for example, with regard to the liberalization of import and price controls. That question had broader implications for Fund programs in other countries where structural adjustment was an important element.

During the Board's discussion on the Fund's role in assisting members with commercial banks and official creditors (EBM/85/132, 9/4/85) it had been recognized that the Fund's leverage on the member in furthering adjustment, even in the context of enhanced surveillance, would be much less than when the use of Fund resources was involved, the staff representative continued. At the same time, it had been recognized that the Fund's leverage in that situation could be more than in the case of regular consultations because the enhanced consultation process called for an adequately quantified policy program. Obviously, the Fund's leverage on the member's adjustment process would be enhanced if the level of quantification of the adjustment program were greater, including the area of structural adjustment. However, the specification of quantitative targets for structural change was difficult. In past programs, especially those where structural adjustment had been in the context of either an extended arrangement or a sequence of one-year arrangements, the staff had found it problematic to specify numbers to mark the path of progress in areas such as import or price liberalization. In some cases, such as the extended arrangements for India and Pakistan, however, there had been benchmarks for liberalization of import controls, and in other programs the staff had attempted to include ex ante a timetable of change in specific policies--for example, producer prices or parastatal reform.

The staff had attempted to deal with that area of structural reform mainly through prior actions or periodic program reviews, rather than through quantitative targets, the staff representative from the Exchange and Trade Relations Department noted. The Fund staff had also relied heavily on collaboration with the World Bank, both in the context of determining the level of adjustment that would be required in each one of those areas, as well as in the review process.

Mr. Pérez observed that Venezuela had corrected in record time the acute macroeconomic disequilibria that the economy had experienced two years previously. Furthermore, the country had clearly overshot the targets set for the public and external sectors, inflation, and the level of reserves. Although Directors had warned his authorities to be cautious regarding their economic intentions for 1986, the experience of recent years indicated that prudence was one of the most outstanding features of his Venezuelan authorities.

Table 5 in the staff report illustrated that Venezuela had steadily reduced total debt by 12 percent since 1983, Mr. Pérez noted. More important, the current level of reserves represented about 50 percent of total debt. That adjustment process had been carried out without resorting to the financial markets, and his authorities intended to maintain that course of action during the current phase of adjustment. Although many uncertainties existed on the international economic scene, and recent developments in the oil market gave cause for concern, current trends in Venezuela's economic variables supported the authorities' position.

Directors recognized the great strides that Venezuela had taken but urged his authorities to step up reforms in several areas: the fiscal sector, exchange rates, price controls, tariffs, and deregulation, Mr. Pérez recalled. Venezuela had made significant progress in those areas in recent years; nevertheless, a different perception existed between his authorities, on the one hand, and some Executive Directors, on the other, of the pace at which some of the reforms should be carried out. His authorities had demonstrated that the cautious manner in which they had conducted economic matters had yielded positive results; hence, he asked for the understanding of his colleagues with respect to the most appropriate timetable for carrying out those reforms.

The public sector had obtained a significant surplus for the second consecutive year, Mr. Pérez pointed out. The decrease in petroleum earnings had been compensated by a large increase in tax revenues, mainly due to improved tax collection. In addition, the public sector enterprises had improved their operating surplus through better management procedures. In that context, fiscal reform that would allow Venezuela to increase public revenues was not a matter of urgency, but his authorities were aware that some reforms were needed to modernize the existing tax structure, thus making the system more flexible and sensitive to changing economic conditions. His authorities were currently examining the report of the Commission for the Study and Reform of the Fiscal System of Venezuela with a view to implementing those initiatives leading to an improvement and modernization of the functioning of the tax system while avoiding whenever possible an increase in the tax burden.

The system of price controls was a cautious and preventive mechanism in an economy characterized by price setting under oligopolistic conditions, Mr. Pérez continued, and it should be seen as a counterpart of the wage policy. It was recognized that the wage policy adopted by his authorities with the collaboration of the trade unions had greatly contributed to the adjustment achieved so far. Those who attached particular importance to maintaining the wage trends registered by Venezuela in a stable social environment should consider the price control system as the other side of the coin.

As to labor market reform, Mr. Pérez added, in Venezuela labor relations were based on organized collective bargaining. The good labor relations were exemplified by the fact that throughout the adjustment period no strikes had taken place while real wages had declined continuously. The labor movement in Venezuela was strong and well organized, and it had collaborated rationally with the Government through the social pact.

As to the merits of the special investment program versus reforms as a mechanism to improve the economic situation of Venezuela, the experience of many countries showed that deregulation or the elimination of rigidities were productive only in the long run, Mr. Pérez pointed out. The unemployment situation called for more immediate action. Activity in the construction industry had declined persistently since 1980, and because of the sector's strong influence on employment the authorities had considered that a special investment program would help to improve both growth and employment prospects, while avoiding any inflationary effects.

He was unsure whether the suggestion to include a timetable for structural measures in the enhanced surveillance exercise applied to future requests or to current enhanced surveillance cases, Mr. Pérez said. In the latter case, he recalled that the enhanced surveillance exercise had arisen at the request of some member countries that saw the need for such a procedure in order to agree on a multiyear rescheduling arrangement with creditor banks. The terms of the agreements had been circulated to Executive Directors and the monitoring procedures had contained the elements that formed the basis of the exercise. Any modification of the contents should be negotiated with the member country in question before action was taken so as to avoid triggering undesirable results.

The multiple exchange rate system implemented during the present period was a transitional mechanism that allowed Venezuela to preserve the financial health of the private sector, Mr. Pérez stated. A faster depreciation of the exchange rate could have brought about a difficult situation for enterprises and financial institutions, thus possibly placing the adjustment process itself in jeopardy, with a negative impact on prices, interest rates, and wage performance. The authorities planned to move to a dual exchange rate system at the end of 1985; they would have to determine the modalities of the next step.

Venezuela was highly dependent on a tradable product--oil--where movements in the exchange rate would have only a limited impact on export performance in the short run, Mr. Pérez noted. He supported the suggestion to include in the next staff report a thorough assessment of the appropriateness of a unified exchange rate system in a country like Venezuela where uncertainties surrounding the international oil market led, as recent experience had shown, to wide movements in the exchange rate, which was clearly incompatible with an efficient resource allocation process.

Capital flight was a problem not only for Venezuela but for other indebted countries, Mr. Pérez remarked. If those countries wished to maintain an open capital account, they needed to adopt measures to prevent or discourage capital flight. Unfortunately, experience had shown that despite the adoption of suitable economic policies, including an appropriate exchange rate system, the uncertainties involved in any adjustment process, as well as adverse developments on the international scene, were sufficient in many instances to induce capital flight. A dual exchange rate system created problems for the marginal efficiency of the resource allocation process. The question was whether those inefficiencies or the consequences of massive capital flows were more devastating to an economy. Considering the difficulty of reversing the trend once capital had fled the country, the issue acquired special significance. In advising a country to unify its exchange rate system, the Fund should also recommend some options to help members prevent capital flight.

As a rule, the Fund staff and the Executive Board recommended the adoption of unified, flexible, and open exchange rate systems, Mr. Pérez observed. While there were strong theoretical and empirical arguments to support the idea that in general such a system was conducive to a better allocation of resources, there were instances in which a dual exchange rate system could provide a country with a better defense to cope with destabilizing capital flows. He suggested that the staff provide a paper on that important subject.

Mr. Goos asked the staff's opinion regarding the possibility that the contingency clause might be activated in view of the weakening situation in the oil market. With respect to the enhanced surveillance procedure, he asked whether, beyond the deletion from the report of the reference to the recent Board discussion and the names of staff members, any further information was withheld.

The staff representative from the Western Hemisphere Department explained that with respect to the contingency clause, the authorities had agreed with the banks about three weeks previously that the parties would enter into consultations as circumstances, such as a sharp reduction in oil prices, required; at present, it was difficult to assess future oil market developments and therefore whether the authorities would invoke the contingency clause. With regard to the staff reports that would be transmitted to the banks, the only passages eliminated were the names of the staff members who had participated in the missions and references to the summing up of the previous Executive Board discussion on Venezuela.

Mr. Templeman recalled that during the previous discussion on enhanced surveillance in general--and at least implicitly in the previous discussion on Venezuela--the Board had expressed the opinion that it was important to be able to adapt the commitments embodied in enhanced surveillance agreements over time. That aspect was particularly important since many speakers in the Board had voiced concern about the longer-term structural and institutional changes that the Venezuelan authorities themselves agreed should be made. The Board would not want an agreement that extended over such a long period of time to be unchangeable.

Mr. Pérez remarked that a distinction should be made between the contents of the enhanced surveillance document agreed between the banks and the authorities and the views of the Executive Board as well as its recommendations for the Venezuelan economy during the coming period. The contents of the enhanced surveillance document should be provided to the authorities for circulation to the banks, as specified in the monitoring procedures of Venezuela's agreement. If the Board decided that a schedule for structural reforms should be included, two documents should be approved: one for transmittal to the banks with the contents as specified in the monitoring procedures, and another as an Article IV consultation, including the advised schedule for structural reform. To do otherwise would be tantamount to a change in the terms of the agreement arising from the authorities' request for an enhanced surveillance exercise.

Mr. Templeman noted that although the present meeting was not appropriate for a general discussion of enhanced surveillance, it nevertheless was incumbent upon the Fund to convey the true position of the entire institution, including the staff and the Board. The staff had been responsible for conveying the message of the Fund, including that of the Board during its discussions, but he wanted to ensure that the procedure for enhanced surveillance included a method whereby the Board's message could be communicated in an effective manner.

The Chairman made the following summing up:

Executive Directors were in broad agreement with the thrust of the staff appraisal in the report for the 1985 Article IV consultation with Venezuela.

Directors commended the authorities for the substantial adjustment that had taken place since 1982. They noted the remarkable improvement in the public finances, the pursuit of restrained monetary policies, and the maintenance of a cautious wage policy. In the context of the fairly low rate of inflation that those policies had produced, relative prices had been shifted through a significant real depreciation of the bolívar. Those policies, together with the application of tight import controls, had resulted in a major improvement in the external accounts, which had enabled the public sector to reduce its external debt and the Central Bank to improve its reserve position.

Directors observed that the move in 1985 to a more expansionary demand policy was lagging, with the result that the public sector position and the balance of payments were showing more strength than had been contemplated by the authorities, and inflation was running lower than had been expected. In the circumstances, the authorities' concern about the prolonged stagnation in domestic economic activity and the sharp increase in unemployment in recent years was understandable.

Directors generally believed that there was room for some expansion in public sector spending in the light of the major adjustment in domestic expenditure that had taken place and the relatively favorable international reserve position. Nevertheless, most Directors considered that any move toward fiscal stimulation should be cautious, especially because of the risk that the policy might have to be reversed because of a further decline in oil revenues and of the Government's heavy debt burden. In this connection, Directors welcomed the recent scaling down of the three-year special investment program and noted that its financing would be entirely domestic. In particular, the development of sound supply-oriented investment programs, including careful project evaluation, was advocated as a way of correcting distortions, removing structural bottlenecks, and improving resource allocation patterns.

Most Directors argued that the sluggishness of the economy was in part the result of an excessive reliance on controls and regulations. To improve incentives for private investment and to help promote diversification and sustainable growth of the economy, a number of Directors encouraged the authorities to develop specific timetables to reduce the scope of controls, including price and import controls, and to expedite their plans to design and implement tax and tariff reforms. They expected that future consultations would focus on these structural measures.

Directors stressed the need for credit policies that would help to prevent the emergence of pressures on prices or on the balance of payments. They observed that the wage policy pursued thus far had played an important role in the adjustment of the

Venezuelan economy, and they commended the cooperative attitude of the social partners in wage determination. Directors emphasized the importance of wage restraint in the re-establishment of price stability, and they encouraged the authorities to continue their reliance on collective bargaining for the setting of wages.

The intention of the authorities to unify the controlled exchange rates by the end of the year was welcomed by Directors, and they urged them to do so at a rate that would improve the country's competitiveness. Directors also said that exchange rate policy should be handled with appropriate flexibility in the future in order to encourage export diversification and efficient import substitution, and to facilitate full unification of the exchange rate system as soon as possible. Pursuit of a flexible exchange rate policy together with an appropriate demand policy would provide the basis for the liberalization of import restrictions.

Directors noted that the latest developments in the world oil market increased the uncertainty surrounding the medium-term outlook for Venezuela's balance of payments, which underlined the need for continued implementation of cautious fiscal, monetary, and wage policies, supported by a realistic exchange rate policy. They stressed that the uncertainties in the oil market situation pointed to the need to create conditions that would foster domestic and foreign private sector investment and diversify the economy.

Directors welcomed the agreement reached between Venezuela and its creditor banks on a multiyear rescheduling of public and publicly guaranteed debts falling due in the period 1983-88. A number of Directors expressed concern about the large stock of arrears on private external debt servicing and emphasized the need to eliminate them without delay in order to restore confidence and normalize Venezuela's relations with its creditors and suppliers.

Directors commended Venezuela for its development assistance in financing part of the oil imports of several countries in Central America and the Caribbean area.

In response to the authorities' request, Directors agreed to a change in Venezuela's consultation cycle. Thus, the 1986 Article IV consultation with Venezuela is expected to be completed in about six months and the midyear consultation in about one year.

3. ADMINISTRATIVE EXPENSES IN FY 1986 - MIDYEAR REVIEW; AND BUDGETARY OUTLOOK FOR FY 1987

The Executive Directors considered a memorandum by the Managing Director on the midyear review of expenses in FY 1986, together with a preliminary budgetary outlook for FY 1987 within the framework of a three-year projection of expenses from FY 1987-89 (EBAP/85/297, 12/6/85).

Mr. Ismael observed that the program of activities outlined in Section I of the memorandum broadly reflected the Executive Board's discussion of the work program on November 12, 1985 (EBM/85/163 and EBM/85/164). From the specific features of the program, he considered that the highest priority should be placed on activities following up the issues taken up at the Interim Committee and Annual Meetings in Seoul. Among them, he would give particular emphasis to the study of the reports by the Group of Ten and the Group of Twenty-Four. Of equal importance, was the growth-cum-adjustment theme that had been widely commented on at the Seoul meetings, a new initiative that should be followed up in the form of a comprehensive review by the Fund of the design of its own adjustment programs. Carefully designed Fund-supported programs, paying greater attention to adjustment on the supply side, were particularly relevant at the present time, and such a review would help to determine whether or not the Fund could complement or supplement the efforts of the World Bank.

Referring to the activities for FY 1987, Mr. Ismael said that he fully endorsed the proposal to prepare the groundwork for the Ninth Quota Review. In connection with the likely work load in FY 1987 on country matters, he also supported the activities outlined in paragraph 13 of EBAP/85/297.

With respect to the Fund's relations with member countries, his authorities had found the technical assistance programs of the Central Banking Department, the Bureau of Statistics, and the IMF Institute extremely valuable in upgrading the quality of staff, information systems, and the design of policy, Mr. Ismael continued. They wished to make special mention of the benefits of IMF Institute courses, assistance to the SEACEN Research and Training Center, expert advice on tax administration, and the strengthening of financial institutions' organizational and supervisory capacities. The large errors and omissions in balance of payments statistics and the current ongoing Fund project on statistical discrepancies in the global balance of payments tended to suggest that the expertise of member countries in respect of balance of payments statistics called for improvement. Therefore, he had some difficulty understanding why the second course on balance of payments had been dropped. He hoped that it could be restored in 1988. The Fund should play a more active role in averting balance of payments crises in members by means of its technical assistance and policy advice. He would expect the scope for technical assistance to be widened, and he would support a much larger budget for special services.

On a related, although minor, issue, Mr. Ismael expressed his reservation about the change in the travel status of participants in the Institute courses from business to economy class. Participants who resided on the other side of the globe often had to make long and tedious journeys to Washington--sometimes in excess of 20 hours--that was tiring, both physically and mentally. He urged management to reconsider maintaining the privilege of business class travel at least for participants from remote regions.

The breakdown of expenses into recurring and nonrecurring items had considerably facilitated his analysis of the budget document, Mr. Ismael concluded. More detailed analysis of manpower requirements, the forthcoming development of quantitative-oriented work load indicators, and the completion of capital asset expenditure accounts should provide additional information that would prove beneficial to all concerned.

Mr. Kafka remarked that it was an occasion on which to pay tribute to the management and staff in all departments and bureaus for the excellent work they had continued to do during the first two thirds of the current fiscal year.

To list a few points of concern suggested by the Managing Director's memorandum, Mr. Kafka stated, first, it seemed fairly clear to him that the policy and research program in FY 1987 would be not merely "at least as demanding as in FY 1986" but almost certainly more so. Accordingly, he was concerned at the small growth of regular staff positions foreseen in Table IV. The Fund should certainly not rush to create jobs; but for several years he had noted steadily increasing and, to say the least, unrelentingly heavy pressure in some area departments. He was concerned about the effects on the staff and performance; some pressure was good but too much was not.

However, he was concerned at the prospective renewed increase in the number of resident representatives, Mr. Kafka added. The Fund had gone through a cycle of first having too many and then perhaps too few representatives and was about to have too many again. He was not necessarily opposed to a possible increase in the number of resident representative positions, but the fact that the slots authorized for FY 1986 would apparently not be filled argued for not increasing the number immediately. Perhaps the time had come for the Board to hold a seminar on the functions and qualifications of resident representatives.

More generally, it must be the duty of the Board and of the management to keep particularly close watch over expenditures at a time when the Fund was obliged to increase charges, Mr. Kafka continued. That was true even though the increase in charges had been brought about by other factors and not mainly by an increase in expenditures. Nevertheless, the Fund also owed it to its debtor countries to keep an equally close watch on charges.

He had been concerned for some time, Mr. Kafka remarked, about the lack of use of the Research Department in area work, particularly on missions. That had not always been the case. From his own contacts with economists in the Research Department, he believed that the Fund's area work would benefit greatly from the thinking and close participation of those economists on country work. The temporary transfer of Research Department economists into area departments under the mobility policy was not a satisfactory substitute.

The Chairman said that particular note would be paid to Mr. Kafka's final point.

Mr. Polak said that he joined Mr. Kafka in expressing appreciation for the heavy work load carried by the staff, the Deputy Managing Director, and especially the Managing Director.

The increase in temporary staff, in particular of a secretarial character, was large, compared even to a few years previously, Mr. Polak noted. He was glad that more systematic information would be provided in future on the numbers of temporary staff, which he hoped would provide some incentive to reduce the numbers. There must be pockets of less than full employment that could be exploited to the full, for instance, by the lending and borrowing of secretarial staff within and among departments, together with a rather restrictive policy of making temporary staff available.

Somewhat in the same vein, but of much broader importance, he supported Mr. Kafka's point that greater use could be made of economists in the Research Department on Fund missions, Mr. Polak added. His impression was that that was happening less often than in earlier years. The advantages were several: the unequal burden of travel that was the subject of so much complaint in the Fund would be lessened; economists in the Research Department would be brought into contact with real problems, enabling them to do their research work much better; and interesting ideas would be brought to mission work itself.

Finally, Mr. Polak observed that reference was made in paragraph 22 of the memorandum to the improved access of area departments to the Fund's database with the introduction of the new Economic Information System (EIS). In that connection, he would be very interested to know what progress was being made in resolving the perennial problem of use by area departments of the Fund's statistical base.

Mr. Nimatallah said that he, too, wanted to express his appreciation to management and the staff for their excellent performance under a constant heavy work load. He urged them to keep up the good work.

Referring to the first of the three major sections in the Managing Director's memorandum on activities in FY 1986 and FY 1987, Mr. Nimatallah said that he had been most struck, in the paragraphs on general policy development and research, by the work that would have to be done because of the effects of overdue financial obligations on the Fund's financial position. The same was true of operations and relations with members where the impact on travel, for instance, was mentioned. The burden on the staff and on the Executive Board would thus grow. However, he had no disagreement with the activities mentioned in those major areas, except to inquire what was meant by the sixth point in the paragraph assessing the work load in FY 1987, which referred to the growing work load in connection with financial transactions with members largely because of the high volume of repurchases falling due in that year, the steady volume of gross purchases, and work associated with overdue payments.

He believed that 30 should be the maximum number of resident representatives, Mr. Nimatallah continued. If necessary, a few resident representatives could be assigned to spend a certain proportion of their time in neighboring countries in order to keep within that limit. As for special services to member countries, he would encourage the provision of central banking technical assistance because of the important role to be played by central banks in the future, which the Fund could facilitate.

With respect to information and statistical services, Mr. Nimatallah suggested that the second audiovisual presentation on the Fund be delayed for another year. There was no need, as stated in paragraph 21, to start work on another presentation on the activities of the Fund if the first one proved successful; rather, the first one should be used for a longer period of time. Of course, if the first presentation was not a success, another attempt might have to be made. In carrying out work on improving external debt statistics, in cooperation with the World Bank, the OECD, and the BIS, further communication with development banks and funds, regional and otherwise, would be of benefit. For instance, the Saudi Development Fund certainly would be able to offer information and statistics on external debt.

On the subject of general support, Mr. Nimatallah said that he had been impressed by the additional activities to be undertaken, as mentioned in paragraph 27. Continued attention to the development of improved data security and improved building security was extremely important. Likewise, he welcomed the follow-up work to be done in the budget field subsequent to a consultant's review of various aspects of the Administrative Budget, including integrated planning and budgeting, and expenditure control and evaluation. For his part, he would prefer management to assemble a committee consisting, for instance, of the Director of the Administration Department and the Treasurer, among others. However, he could go along with any methods that might be found to make a start on expenditure control. While he recognized that the Fund was a lean and austere organization, there was bound to be some fat here and there. Such a committee would be able to demonstrate that the Fund was practicing what it preached before the opinion of the consultant was known; its assessment might prove eventually to have been unnecessary; but the quicker it was made, the better.

He had several general points to make on Section II on the midyear review of administrative expenses in FY 1986, Mr. Nimatallah stated. First, as he had mentioned on a previous occasion, all income from any source should be placed directly in an income account. In the staff paper on the midyear review on the Fund's income position (EBS/85/258, 11/20/85), the Fund's operational income was shown under three categories: charges; SDR interest; and other income. Under the latter category, there were two subheadings--regular facilities and enlarged access--to which he would like to add another--miscellaneous. Receipts from whatever source, however small, particularly if they were not recurring, should be included under miscellaneous. He had in mind such items as payments received from the World Bank, interest received from staff members on salary advances, payments for publications, or even for the sale of old furniture. Nothing to do with income should be set against any administrative expense, which should be accounted for separately.

He had noticed in paragraph 30 that immediately after the Administrative Budget for FY 1986 had been approved by the Executive Board on April 26, 1985, a supplementary appropriation had added approximately $3.3 million to the approved level of expenditure, Mr. Nimatallah continued. A few months later, roughly the same amount had been saved. He recognized that the pending adjustments in staff salaries had been partly responsible. Nevertheless, an initial supplementary appropriation could have been delayed, especially if some leeway was provided for making transfers of appropriations from one category to another within a certain percentage limit--say, of 10-15 percent--as was done by certain central banks.

It was also necessary to look again at the time of the financial year, Mr. Nimatallah considered. The date of May 1 was awkward, because it followed a period during which preparations were made for the Interim Committee meeting. There was no time to pay enough attention to the formulation of the Administrative Budget. Some leeway could be provided by moving the Fund's financial year to July 1, in line with that of the World Bank. If that did not provide sufficient time for the preparation of the Annual Report, among other things, an extension to June 1 or June 15 would give the Executive Board the month of May to concentrate on the Administrative Budget.

Expenditure would have to be watched carefully in the future because of the problems the Fund was facing with respect to its income position, Mr. Nimatallah added. He wondered whether it would be possible, in order to indicate to the world that the Fund followed a policy of austerity, to cap total expenditures at the level of FY 1986--namely, $250 million. If that was not possible for FY 1987 because of the extremely busy year indicated in the program of activities, then perhaps the aim could be to keep total expenditures in FY 1988 at the FY 1987 level. He was hoping that the consultant and/or the committee that he had suggested be set up might also want to see where expenditures could be reduced, and by FY 1988, the results would be known. The idea of controlling or capping the total amount of administrative expenses could be entertained more seriously at that time. The rate of growth of expenditure projected in Table III of EBAP/85/297 between FY 1985 and FY 1989 of 27 percent was high for only four years.

Mr. Archibong commented that the Managing Director's memorandum provided useful signposts of the direction of the Administrative Budget for the fiscal years from 1987 through 1989. However, it was difficult to analyze and reach a judgment on expenditure in the individual categories because the information provided was not sufficiently disaggregated or detailed. The outcome of the budget for the current financial year, as reflected in Table II of EBAP/85/297, indicated that of the ten categories of expenditure, seven showed estimated expenses below the amount approved in the budget and three showed higher expenses. Taken together, overall estimated expenses compared with the budget would be about $3 million less. Such a deviation suggested the need for some refinement in the estimating procedure, including the possible need for more detailed information on likely expenditures associated with the various elements of the work program. In that connection, he welcomed the staff proposal to improve budgetary presentation and analysis in the Administrative Budget in FY 1987. Nevertheless, the improvements along the lines highlighted in paragraphs 28 and 29 should also include cost estimates on proposals for new activities. Information on costs was crucial to a meaningful evaluation of a proposed project.

Although they were inevitably shrouded in uncertainties, the medium-term projections provided a useful perspective on expenditure trends for the three-year period ahead, Mr. Archibong added. However, year-to-year comparisons were difficult to make because certain categories of expenditure varied depending on, for instance, whether Annual Meetings were to be held overseas or in Washington, D.C., or on whether the biennial regular elections of Executive Directors were being held. The longer-term framework was, however, useful and would be more so if it were more complemented by separate capital budget accounting.

His comments on some specific proposals in the Managing Director's memorandum were influenced by both cost factors as well as the critical relevance of the proposals in existing circumstances, Mr. Archibong continued. The highlights of the program of activities in FY 1986 were consistent with the work program already approved by the Executive Board. The current year was a very demanding one, especially in light of the full program of activities arising from the reports of the G-10 and G-24 proposing improvements in the international monetary system. In recognition of the importance of staff studies on the issues raised by those reports, the Fund should not allow its predominant role to be influenced unduly by cost factors.

Adequate facilities must be placed at the disposal of the staff to ensure that the various studies to be undertaken were concluded on schedule, Mr. Archibong stated. His authorities expected that studies on the debt situation should indicate, inter alia, the relative positions of African debtors, the impact of external debt on the continent's economies, and economic solutions to the problems. He also supported the program on general policy development and research, as highlighted in paragraphs 8, 9, and 10 of the memorandum. However, even though the studies on the role of the SDR had been mandated by the Interim Committee, his chair reiterated its reservation on the relevance of continued study on a subject that had won a consensus on technical and economic grounds but that had unfortunately been the victim of a lack of political will.

Technical assistance by experts and staff in the current financial year had been pegged at about the same level as in the previous financial year, Mr. Archibong noted. Yet demands from developing countries for special services in the central banking, fiscal, and statistical fields were growing. To establish what looked like a ceiling on the number of expert man-years in the provision of such assistance was unacceptable. Both users and nonusers of Fund resources had obtained significant benefits from technical assistance, which should grow commensurately with the growth in demand for it. Equally important was the excellent work of the IMF Institute. The reduction in the number of balance of payments courses from two to one in FY 1987 conflicted with the interest of the member countries in his constituency, who considered that those courses were useful and should be maintained, or possibly further expanded. He asked what the rationale for the reduction was. There might be some merit in downgrading travel from business to economy class for participants' appointment travel, provided the money saved was utilized to expand the Institute's programs.

Provision had been made for establishing seven new resident representative posts for FY 1986 and FY 1987, raising the total number of such posts from 30 in 1985 to 37 in 1987, Mr. Archibong observed. On the face of it, he had no difficulty in supporting the creation of new posts. However, if the emphasis was to be placed on reducing the number of resident representatives in order to minimize costs, there should be a reduction in the frequency of missions in the countries to which they were posted. In that connection, he reiterated the position of his chair that operations with member countries should be streamlined to achieve the best possible results. For instance, by combining, where possible, Article IV consultations with review missions or with missions to negotiate the use of Fund resources, the frequency of missions could be reduced with a resulting reduction in costs to the Fund.

Finally, Mr. Archibong said that despite apparently growing criticism of the existing role of the Fund in the international monetary system, he wished to congratulate management and staff on the efficiency with which they had been meeting the challenges and pressures of a growing work load in recent years.

Mr. Pérez said that the three-year projection of expenditures and the item-by-item estimates were only two examples of the precise and useful organization of the memorandum on the budgetary outlook. It was also particularly constructive to be able to discuss on the same day the Fund's income position and the midyear review of administrative expenses and budgetary outlook for FY 1987. In view of the failure of the Board to reach an agreement on how members should share the burden of correcting the Fund's income position, he hoped that the discussion of the budgetary outlook would end with a proposal to defer some administrative expenses.

As an Executive Director for countries that were users of Fund resources, he could not but take a restrictive view, with the rate of charge to increase effective December 16, 1985, Mr. Pérez continued. Like any other public or private organization, the Fund had to face up to the need to carry out several projects in face of strong budgetary constraints. The Fund was suffering such financial constraints as a consequence of well known circumstances that he believed were of a temporary nature. The conclusion he had drawn, therefore, was that despite the urgency of the various items included in the budget, the Fund could not afford to implement the entire expenditure program for the time being. If it was generally accepted that the factor most responsible for the Fund's current problem with respect to arrears was of a temporary nature, the solution should also consist of temporary measures. He would not propose making specific cuts in administrative costs on a permanent basis but would favor postponing some of the expenses in the budget until there had been some improvement in the Fund's income position. In sum, as long as the Fund's financial difficulties were related to the deferral of its accrued income, measures should be taken to defer some expenditures.

In response to a question by the Chairman as to what type of measures he envisaged, Mr. Pérez commented that less urgent expenditure, for instance, on building occupancy and the EDP budget, could be deferred.

Mr. Salehkhou joined other Directors in welcoming the presentation of the budgetary outlook within the framework of a medium-term projection of the Fund's operations and expenses as a useful and forward-looking exercise. Such an approach was especially important because of the unavoidable relevance of the Fund's current activities to its future role and operations. Indeed, as the vitality and the effectiveness of the Fund's future role depended on its day-to-day achievements, by the same token, its current operations could be meaningful only in the context of a progressive projection of its activities.

Referring to the Managing Director's memorandum and to paragraph 6 on activities of the Board of Governors in particular, Mr. Salehkhou commended the Joint Secretariat for the Annual Meetings, under the direction of the Bank/Fund Conferences Office, for their outstanding performance. Its capacity to plan, organize, and administer efficiently were easily recognized when the Annual Meetings of the two institutions were held in a distant land, as the spectacular arrangements in Seoul amply displayed.

He would comment on the matter of when the separate paper on temporary secretarial help for Executive Directors was considered, Mr. Salehkhou continued. In general, he felt that Executive Directors' offices, especially those with multimember constituencies that also included borrowing members, were inadequately staffed. The lack of modern communication equipment and administrative facilities created undue hardship at times on the few assistants in those offices. Any attempt to correct that shortcoming would be welcome.

On general policy development and research, he had a procedural suggestion and two substantive comments, Mr. Salehkhou remarked. He looked forward to the Board's consideration of all the listed policy research in the work program but he was concerned, as he had indicated on other occasions, about the timing of the distribution of the related staff papers and the scheduling of Board meetings. He hoped that a more coordinated effort would be made to prepare and distribute the papers on each topic as early as possible in order to provide sufficient time for a more precise assessment and evaluation of the relevant issues by the Executive Board.

With respect to the substantive aspects of general policy development and research, Mr. Salehkhou said that he welcomed the attempt that had been made so far concerning research on the timely topic of Islamic banking that was gaining momentum among some member countries as well as in financial and academic institutions. However, if the Fund was to harmonize its activities with the end of economic and financial policy developments among many of its Muslim members, it should begin continuous planning for more in-depth research studies in that area, which would require hiring people with the necessary expertise in the field of Islamic economics and finance.

With respect to the proposal for enhancing the effectiveness of surveillance, an issue that had been discussed in great detail in the past in various forums, Mr. Salehkhou recalled that he had repeatedly emphasized that the Fund should direct its efforts at applying current surveillance policies in an evenhanded manner over the membership at large rather than enhancing its effectiveness over those countries already subject to a variety of enhanced versions of surveillance--namely, the borrowing and heavily-indebted countries.

Among the ways to reduce costs related to operations and relations with member countries, Mr. Salehkhou reiterated, were shorter staff missions, negotiations whenever possible at Fund headquarters, full-fledged and better prepared missions to member countries, a reduction in the number of staff participating in certain missions, no further creation of additional positions of resident representatives and advisors, and more coordination with members prior to the arrival of staff missions.

On special services to member countries, Mr. Salehkhou said that he had been pleased to note, first, that central banking experts' assistance to members during FY 1986 was estimated at approximately 100 man-years compared to 96 man-years in FY 1985 and, second, that the IMF Institute's program for FY 1986 included provision for 149 training weeks compared to 129 training weeks in FY 1985. A second Arabic course in FY 1987 was of particular interest to his authorities, and he also noted that there would be a new money and banking statistics course. However, he would appreciate knowing the reason for reducing the number of balance of payments courses from two to one. He wished it were due to a lessening of the balance of payments difficulties being encountered by a great number of Fund members. In any event, as always, special services in general, and the Institute's training courses as well as the Central Banking Department's technical assistance in particular, were among the most useful assistance that the Fund provided for its developing country members and the membership at large.

For the second phase of the new Economic Information System, which was to improve area departments' access to the new system, Mr. Salehkhou wondered whether the time had not come for Executive Directors' offices also to have access to information and facilities similar to those available to the staff. In the final analysis, papers produced by area and other departments were discussed and judged by the Executive Board. It followed therefore that members of the Board were entitled to have at least as much access to the information currently available to the staff if they were to contribute effectively to Fund policy decisions in the discharge of their responsibilities.

With respect to relationships with international organizations, Mr. Salehkhou continued, increasing collaboration with the World Bank was welcome, but appropriate and well coordinated measures should be taken to avoid overlapping activities and redundancies in all aspects of Bank/Fund relations. He was confident that in promoting collaboration with the World Bank, the staff would be conscious of the issue of cross conditionality, which appeared to be a source of apprehension on the part of many Executive Directors. Furthermore, given the increasing orientation toward growth of the adjustment programs recommended by the Fund, the staff should spare no effort to emphasize, in its contacts with the World Bank and other multilateral development institutions, the vital role of the supply side in supplementing demand management measures. In so doing, the staff should encourage those institutions to increase their involvement and lending activities in borrowing countries.

He had been glad to note the special attention being paid to the discussions with the GATT on protectionism and other trade issues, Mr. Salehkhou said. He had been especially heartened by the forthcoming discussions on world trade scheduled for an UNCTAD conference in FY 1987. Further cooperation with UNCTAD was certainly timely and very much welcomed by his constituency.

With respect to general support services, although he had been pleased to note staff attendance at a seminar recently in Chicago on controlling expenses, he was still anxious to see a more competitive system introduced in the Fund to reduce the Fund's substantial travel costs, as the Administration Department had promised him, Mr. Salehkhou recalled. Another relevant matter was that while Executive Directors and their Alternates and Advisors were at liberty to purchase their travel tickets outside the Fund, should the cost differential justify that practice, the staff--even those in the offices of Executive Directors--were still bound to obtain their tickets from Fund agencies. He failed to see the logic of that different treatment.

He took the opportunity to express the appreciation of his office for the professional services rendered by the Joint Library, Mr. Salehkhou commented. He also welcomed the particular attention to be paid to several personnel matters. Specifically, the Medical Benefits Plan needed to be reviewed, in his opinion, because it charged substantial premiums that hardly seemed to justify the limited and often inadequate coverage under the present system. In light of the statement in paragraph 42 that "medical costs will continue to rise at an above-average rate," he asked whether the staff had ever looked into other more beneficial options--on both medical and economic grounds--which might be available to the Fund staff in what was a highly competitive field and, if so, what the staff's comparative assessment had been. If they had not done so, the need for a review of the present plan seemed all the more urgent.

Given the importance that his chair had consistently attached to the issue of confidentiality, he welcomed the high priority to be given to the development of a comprehensive Fund-wide security program in the next financial year, Mr. Salehkhou stated. Particular attention should be paid to the accessibility of confidential materials that were easily available in various offices, many of which were not properly secured, had no safe cabinets, and lacked any means of instantly and directly disposing of unnecessary documents.

Among the presentational changes in the FY 1987 Administrative Budget document, he had been especially pleased to note that more short-term secretarial and clerical staff had been employed in order to meet the increasing incidence of peak work load pressure, Mr. Salehkhou added. As had been indicated, such temporary employment entailed no long-term budgetary commitment by the Fund, thereby reducing administrative expenses. However, he agreed with Mr. Polak that increased intra-office mobility within the Fund in that connection would prove an effective cost-saving measure.

As for the increased cost of communications, apart from the higher-than-estimated volume of cable traffic, he wondered to what extent the overrun in expenditure could be attributed to the frequent interruptions in long distance telephone calls that seemed to have increased greatly in numbers since the installment of the ROLM system.

Referring to paragraph 52, "miscellaneous items," Mr. Salehkhou asked why the Fund's Administrative Budget should bear expenses related to the Staff Retirement Plan, which generated substantial income of its own and was, after all, of direct benefit to the staff.

In conclusion, Mr. Salehkhou said that given the overall income position of the Fund and the heavier burden on borrowing members at present, he wished to note that the members of his constituency greatly appreciated the Managing Director's lean budget; its efficient orientation and cost-reducing effects were both welcome and timely.

Mr. Pickering said that his chair could generally support the broad work program and priorities underpinning the projections for expenses in FY 1987 and beyond. He wished to raise only six minor points.

In paragraph 13, mention was made of the increased work load projected in FY 1987 in connection with operations and relations with member countries, Mr. Pickering observed. It was noted, quite rightly, that increased efforts would be needed in several areas: the coordination of the Fund's work with agencies providing development assistance; country work arising from new Trust Fund flows; collaboration with the World Bank, which would be further increased by the Baker initiative; more frequent missions to countries with overdue obligations to the Fund; and the work load with member countries having a high level of outstanding purchases. He fully supported the need for increased efforts in those areas but found the viewpoint somewhat contradicted by the statement in paragraph 43 that the volume of the Fund's work over the past few years was beginning to level off and that the growth in manpower needs would also slow down. That statement apparently explained the recommendation for a very modest increase in regular staff positions for the two years ahead.

It was very important for the Board to get a better understanding of the work load pressures and staffing needs in various departments, Mr. Pickering considered. The new tables in the FY 1987 budget were welcome in that context. Only then could perhaps a better judgment be made on the adequacy of the current employment level of the Fund and on the appropriateness of the three-year projected increases in Table IV.

With respect to the Baker initiative, Mr. Pickering recalled that the Chairman had on a number of recent occasions mentioned the need for the Fund to be poised to analyze the impact of that initiative on the activities of the multilateral development banks and the lending activities of commercial banks. He would be interested in some preliminary views on where in the Fund the lead role would be taken in following up that initiative. For instance, he asked what share of the burden would fall on the Department of Exchange and Trade Relations, the Research Department, and the area departments.

He had noted that it might be necessary to convert some temporary positions into regular positions because "it is now evident that some of the functions performed by temporary staff had become a long-term requirement," Mr. Pickering continued. He asked for a brief explanation of the areas where that conversion would take place. On a related point, he had noticed in paragraph 28 that one of the major reasons for the growth in the number of consultants and temporary assistance had been the need to automate an increasing part of the Fund's activities. He wondered whether the staff could provide some information, if not immediately then in the budget for the subsequent financial year, on whether the move to automation had allowed some reduction in labor costs.

Reference was made in paragraph 44 to an increase in termination benefits to facilitate early retirement, related in part to the job evaluation exercise, Mr. Pickering commented. He asked the staff to explain what underlay its estimated cost projection of $1 million for that item.

In concluding, Mr. Pickering said that he wished to echo the commendations by others of the hard work done by the management and staff.

Mr. Fujino said that he particularly welcomed the opportunity to discuss the budgetary outlook for FY 1987 in a medium-term framework, together with the improvements and innovations to be incorporated in the budget for that year. His chair had been asking for some time for the introduction of work-load indicators, a more comprehensive presentation and analysis of total manpower and capital budgeting to permit the content of the budget to be captured more effectively. Another important proposal was the circulation of a draft outline of the budget in advance of the formal budget document. Such a procedure would help the Board to participate in the entire budgetary process in a more meaningful way and result in a budget that more appropriately reflected the views of Executive Directors.

The midyear review of the budget had been set at a very opportune time, Mr. Fujino noted. The discussion of the Fund's income position on December 6 and again at the previous meeting had shown a considerable deterioration that seemed to point to the need for further restraint in administrative expenditure. However, upon its completion, the job grading exercise, which had been discussed on December 11 (EBM/85/178 and EBM/85/179) should provide a solid and reliable basis for a fair and equitable distribution of work within the institution, an essential condition for its efficient operation. He had emphasized that latter point when the budget for FY 1986 had been discussed in April 1985, stressing the need to continue the effort to streamline and simplify the conduct of the Fund's business.

The work program in the coming months was indeed extremely demanding, Mr. Fujino remarked. In addition to the important issues raised by the G-10 and G-24 reports, work would have to begin on the Ninth Quota Review. Therefore, it would become all the more essential for the Fund to streamline its work and organization to meet those increasing demands with the smallest possible increase in costs and staff. He recalled that during the discussion of the FY 1985 budget, he had used the phrase "scrap and build." Insofar as it was practical, new projects should be started only when old ones were discontinued. Viewed from that perspective, the projection of increased manpower requirements in Table IV was somewhat disappointing but at the same time understandable to some extent. It was understandable because the increased work load would call for an increase in the number of staff in some areas, but it was disappointing that that increase would not necessarily be absorbed by savings in other areas. In that connection, he shared Mr. Kafka's cautious approach to the increase in the number of resident representatives in coming years.

On the basis of the information on the various jobs performed in the Fund under the job grading exercise, a more efficient allocation and use of overall manpower should become possible, Mr. Fujino said. In addition, the significant increase in expenditure on data processing for some years past should have resulted in some reduction in manpower requirements, although he recognized that the objectives of computerization were not necessarily limited to manpower savings. It was not his intention to add to the very heavy work load in some departments; rather, the "scrap and build" concept should also be applied to staffing requirements.

Manpower restraint should also have the effect of alleviating the shortage of office space, which had led to a proposal to rent 30,000 square feet of office space in FY 1987 and an additional 110,000 square feet in FY 1988, Mr. Fujino remarked. At the present stage, therefore, he wished to reserve his position on the question of expanding office space.

During the discussion of the budget in April 1985, Mr. Fujino recalled, he had also stressed the importance of economizing on travel expenses and had expressed some concern about the substantial increase in the number of IMF Institute participants. The proposal to downgrade the class of travel of participants from business to economy was relatively minor in terms of the actual savings but a welcome step in the right direction. He would welcome further efforts in that area.

Mr. Zecchini commented that it had been correctly emphasized in the first part of the Managing Director's memorandum that the work load, which was already rather heavy in many areas, would tend to remain high. Administrative expenses, which were a direct function of the work load, would move accordingly. Therefore, careful consideration should be given in the review to which activities should be expanded and which should be restrained in order to achieve the Fund's objectives while simultaneously minimizing costs. The attempt to distinguish recurrent expenses from nonrecurrent ones should offer further insights into that problem.

The high quality of the work under those programs constituting the core of the Fund's activities should be maintained by assigning them the highest degree of priority in the allocation of expenditures, Mr. Zecchini continued. The first ranking group of activities should be those mentioned under the heading "General Policy Development and Research." The preparatory work for the discussion of improvements in the international monetary system and for the analysis of the future role of the SDR appeared to be essential features of the Fund's activities in the years ahead. Equally important was the issue of conditionality and the review of conceptual aspects of Fund program design. The complexities and far-reaching implications of those matters made it necessary to devote increasing attention to the enhancement of the human resources involved in them. In particular, it was important not only to preserve the wealth of skills already brought together in the Research Deparment but to enlarge and develop them.

The second order of priority should be given to the program of operations and relations with member countries, described in paragraphs 11 to 14 of EBAP/85/297, Mr. Zecchini continued. The results of the work and decisions reached on the group of issues to which the first priority should be attached would affect the conceptual and legal foundations on which the operational activities would be based in the coming years. Other programs that deserved special attention were those which increased productivity, such as the expansion of data processing facilities.

In other areas which did not directly affect productivity or the quality of the Fund's work, a balance should be struck between maintaining a high level of activities and the need to contain adminstrative expenses, Mr. Zecchini continued. For instance, he had noted that, for FY 1987, participants in the IMF Institute courses would travel by economy class instead of business class, a measure which would guarantee annual savings of about $400,000. He had been pleased to note that administrative expenses had been kept, on average, somewhat below the ceiling in FY 1986, so that some savings could be achieved for the year as a whole. Of course, the outcome would depend on the budget implications of the job evaluation exercise and the impact of the Joint Committee on Compensation's recommendations. The only relatively large overshooting of expenses was expected to be under miscellaneous expenses, attributable in great part to higher costs of investment management and custodial fees for the Staff Retirement Plan amounting to $700,000. He would be interested in further clarification of the reasons for that unexpected cost increase; as could be seen from Table II, it seemed relatively large also in percentage terms.

As for the medium-term projections, Section III of the memorandum, in which preliminary estimates were made of expenses for FY 1987 within the framework of a three-year projection of expenditure, was particularly useful, Mr. Zecchini commented. As could be seen from Table III, after having increased at the yearly rate of about 10 percent during the three-year period from FY 1984 to FY 1986, total expenditures were expected to increase at a yearly rate of between 4-5 percent during the following three financial years. In that respect, he asked for confirmation of his understanding that those figures were expressed in nominal as opposed to real terms. He had inferred from paragraph 42 that those figures already implied a 4 percent annual rate of inflation; if so, the figures in Table III would project annual increases in real expenditures of less than 1 percent a year. Such a projection would appear to be in line with the fact that, as reported in the staff memorandum, the work load was tending to stabilize after having increased rapidly in the past few years, thereby contributing to the scale-down in the increase in personnel reported in Table IV.

He had also noted that some quantitative work-load indicators would be included in the Administrative Budget document for FY 1987, Mr. Zecchini added. He hoped that those indicators would be calculated for individual departments and divisions to make comparisons possible. The outcome would certainly be helpful in appraising the staffing pattern and could promote some reallocation of personnel among departments and divisions, thereby in turn offering a better perspective for assessing the need for hiring new staff.

Finally, Mr. Zecchini observed that the additional office space that was likely to be leased in the International Square building would increase annual costs by $1 million and $3.3 million in FY 1987 and FY 1988, respectively. Those requirements appeared at first sight to be rather large but the Executive Board would have an opportunity to revert to the matter in discussing the forthcoming paper on Fund space requirements.

Mr. Yao remarked that while the decision taken by the Executive Board on December 11 on job grading would inevitably have an impact on the budget, particularly on salaries and other personnel-related expenses, the management was to be commended for its efforts to contain the growth of expenditure in other areas. The use of less costly temporary employees instead of more expensive permanent positions was a good illustration of that restraint. However, he had noted in paragraph 32 of the memorandum that the vacancy rate had increased in FY 1986 and that there had been a decrease in expert man-years under the technical assistance program. He would be interested in learning the reason for the unexpectedly high vacancy rate, which would presumably affect the pressure on the staff of a growing work load.

The proposed increase in administrative expenditures for FY 1987 was consistent with the demanding work program outlined, Mr. Yao continued. It was encouraging to note that the Fund would develop guidelines for the use of resources stemming from the Trust Fund reflows and that more missions would visit countries having overdue obligations to the Fund in order to assist them in the formulation and implementation of policies that would allow them to resolve their economic problems. He also looked forward to the closer collaboration of the Fund with other agencies to increase the flow of financial assistance to members. Requests for technical assistance by many Fund members were likely to increase because of the difficult financial problems confronting most of them. In that respect, the increase in the number of resident representatives was appropriate. He welcomed the proposal to maintain the number of visits to member countries by the staff of the Bureau of Statistics as well as the technical assistance provided by panel experts at a level commensurate with demand.

As he had mentioned in the past, the countries in his constituency had benefited greatly from the IMF Institute courses, Mr. Yao said. The Institute had made a significant contribution to improving the relationship between the Fund and many members, while at the same time improving the operational skills of national officials. Thus, he welcomed the increase in the number of courses, and in particular the introduction of the new course on money and banking, which he hoped would lead in the long run to the publication of more current data.

Finally, he had found Table XV quite useful, Mr. Yao remarked, because it provided information on factors affecting changes in total expenditure in terms of their recurring or nonrecurring nature. For the next three fiscal years, the total changes would amount to $37 million, of which $26 million was attributed to salaries and benefits. He shared the view of previous speakers on the need to contain expenditures; Table XV showed that there was little room for maneuver in the medium term.

Mr. Kafka explained that although it was correct to note that he had counseled for caution in respect of resident representatives, he did not necessarily oppose an increase in the number of representatives. His suggestion was that the Fund should take a look, perhaps in a seminar, at the functions and qualifications of resident representatives, something it had not done for a long time.

Mr. Grosche said that he wished to join previous speakers in thanking the management and all members of the staff for their dedication in tackling the huge work load they had faced and would continue to face in the future, as was clearly demonstrated in the memorandum of the Managing Director. He agreed broadly with the preliminary outline of the program of activities for FY 1987.

The Fund should concentrate on the comprehensive work undertaken in the spring on the world economic outlook, Mr. Grosche considered, and try to scale back the autumn review. The update in the autumn could never be as thorough as the spring exercise, thereby incurring the risk of shedding doubt on the usual high quality of the Fund's work. Moreover, the autumn review overshadowed the Annual Report. For the spring 1986 world economic outlook exercise, the Fund should try not to go into greater detail in different areas but should concentrate on the interaction of the economic policies of major industrial countries.

Like Mr. Kafka, he too would welcome a seminar on resident representatives and a pause in the extension of posts, Mr. Grosche said. The high increase in temporary staff was astonishing, as Mr. Polak had remarked, and he joined him in urging more frequent exchanges between various offices.

He had been glad to note from the midterm review of the current budget that expenditures might stay below the approved budget figures, Mr. Grosche said. However, like Mr. Salehkhou, he had been puzzled by the increase in miscellaneous expenditure. He was aware that it was difficult to control miscellaneous spending because of the many different elements in that category, but some additional explanation might be useful. He had also had some difficulty understanding the explanation in paragraph 30 on the set-aside money and would be grateful for further details on the budgetary impact of its use.

Finally, Mr. Grosche said that he could go along in general with the outline of the budget for FY 1987, except perhaps for the increase in regular staff positions. Every effort should be made to reduce the number of 35 new positions; even though the work load would not level off in the immediate future, an attempt should be made to set the right priorities before reverting to the employment of additional, regular staff.

Mr. de Forges remarked that the memorandum on the midyear review of administrative expenses and the preliminary outlook for FY 1987 was of unusual clarity. Expenditures for FY 1986 did not appear to differ greatly from the figures forecast. It was fortunate that the changes were generally in the downward direction since expenditures would have to be watched especially closely for the reasons stressed by Mr. Kafka.

Focusing his remarks on the preparation of the administrative budgets for the years ahead, Mr. de Forges said that he broadly agreed, at the present stage, both with the programs of activities outlined and with the mentioned priorities. The linkage established between the programs and the use of a three-year projection were welcome. However, it would be difficult to understand the precise relationship between the activities foreseen and the budgetary figures until the future budgets were discussed. Nevertheless, at the present stage, it would be fitting to have some volume indicators that would give a more concrete idea of likely changes in the Fund's activities. Some indications of that kind were already provided with respect to wages; notably, Table IV clarified the overall manpower requirements during coming years. In other fields, the available information was derived exclusively from financial projections. He had noted the statement in paragraph 42 that "it is assumed that there will continue to be variations in the price movements between different items." For that reason, it would not be sufficient to take into account the 4 percent a year rate of inflation assumed in order to get an idea of the real changes. That point applied particularly to Table III, which would be much more useful if the figures were in constant terms, especially in subsections II and III containing expenses on travel and other items such as communications, books and printing, and data processing. Such information might round out the interesting figures in Table XV in which changes in costs were divided between recurring and nonrecurring factors.

He awaited with great interest the work load indicators to be provided in connection with the FY 1987 budget, Mr. de Forges remarked. More accurate data to evaluate manpower requirements would represent a significant improvement, along with the other proposed changes.

Finally, Mr. de Forges said that he supported Mr. Nimatallah's proposal to move the beginning of the financial year to June or July. More time and closer attention could then be paid to the important matters involved in preparing the budget.

Mr. Foot said that he very much agreed with those Directors who had voiced the need for cutting costs; otherwise, the Fund would face unavoidable difficulties. His experience in the Bank of England, which had reduced the number of its staff and real costs by 30 percent in the previous five years--only half the reduction having been associated with cuts in functions--was that cuts had to be made with care because they sometimes led, rightly or wrongly, to increased costs elsewhere.

He would be interested to learn from the staff some time whether it could bring to the attention of the Board the type of management controls available to it as necessary under certain conditions, Mr. Foot remarked. For instance, the Executive Board often requested that an additional study be made without having a clear idea of the possible costs. The simplest method would be to equate marginal costs with average costs. Yet it would be interesting to take a random selection of rather easily identifiable research projects and find out the actual overall costs associated with them in terms of personnel-hours and grades. The outcome might astonish the Board. If the present management control system could not readily provide that sort of analysis, perhaps it should be able to do so.

On a related point, Mr. Foot wondered whether the Fund was offering free service--which was never fully appreciated--where it should not. For instance, he had noted that several industrial countries had requested technical assistance in connection with tax reform. Perhaps such countries should be informed of the costs involved, if they were known, and be expected to volunteer a contribution to them.

Finally, Mr. Foot noted that Mr. Nimatallah's suggestions for controlling expenditure and appropriations would essentially amount to introducing cash limits, which had benefits and disadvantages. He asked the staff how well placed it would be to propose a scheme for cash limits on major departments within, say, one or two years' time, and how well placed it would be, if need be, to effect in two years' time a rapid reduction in running costs of, say, 3 percent in real terms within one year. He did not advocate that course of action but suggested that contingency planning was always worthwhile.

Ms. Bush said that the breakdown of recurring and nonrecurring expenditures was particularly helpful in analyzing the trend of ongoing expenses versus those that were temporary and nonrecurring. The three-year projections were also very useful. It was always advantageous to have a view of how the financial picture might look over time. In addition, as Mr. Foot had mentioned, such projections were also useful for contingency planning. She welcomed the fact that the three-year projections indicated lower increases in expenditures than had been experienced in the recent past.

She joined Mr. Nimatallah in welcoming the review being undertaken for management of various aspects of the Administrative Budget, as mentioned in paragraph 27, Ms. Bush added. That review was indicative of management's recognition of the need to continue to control costs, which had become particularly important in light of the financial problems being experienced by the Fund. Mr. Nimatallah's idea of a cap on expenditures also had some attraction in view of the need to hold down expenditures. She hoped that the possibilities in that area would be explored.

Referring to the desire of Mr. Nimatallah, and one or two other Directors, for a change in the timing of the budget review process, Ms. Bush recalled the suggestion by her chair on previous occasions to conduct the compensation review simultaneously with the Administrative Budget process. As Mr. Dallara had mentioned during the Executive Board discussion of the work program, it would be difficult to coordinate those two processes in 1986 because of the variety of pending changes in the compensation system. However, a coordination of the Administrative Budget and compensation reviews was warranted to permit the Executive Board to consider overall spending plans at the same time.

Finally, Ms. Bush said that she welcomed the further planned improvements for the budget's presentation in respect of capital budgeting and work load indicators. Informational and technical improvements of that kind should contribute to the planning and control of expenditures. The work load indicators specifically might be helpful in planning staffing requirements and in indicating that lower increases in staffing were warranted.

Mr. Alhaimus said that he had no difficulty with any of the three parts of the Managing Director's memorandum. The program of activities in FY 1986 and FY 1987 seemed to be broadly in line with the work program discussed by the Board; the midyear figures for administrative expenditure indicated a possible welcomed underspending; and the preliminary estimates for the three years to come showed a lower rate of growth of expenditure than for the previous three years, especially in real terms, as Mr. Zecchini had noted. That change was highly welcome, and he shared the heightened interest in cost cutting practices, especially in light of the Fund's income position. Of course, such cost cutting should not be at the expense of useful services provided by the Fund to members.

He wished to express the appreciation of his chair for the first Arabic course conducted by the Institute, Mr. Alhaimus concluded. Judging from the response of participants and the staff, it seemed to have been extremely successful and could be regarded as a good start for the future courses that were planned.

Mr. Romuáldez said that, like others, he wished to express his appreciation of the quality of the Fund management and staff. Overall, he had no difficulty in broadly endorsing the thrust of the Managing Director's memorandum. His only comment on the very preliminary estimates of expenses for FY 1987 in Section III related to the projected increase in real terms in salary costs of nearly 2 percent. As he understood it, that increase largely reflected proposed increases in manpower since it was necessary to assume that salaries themselves would stay constant in real terms. Admittedly, the already heavy work load was only likely to increase in the coming year or two, but he was not certain that that need always had to be translated into a demand for additional manpower. The Fund should be planning on the basis that its staffing was near the upper limit.

As to the midyear revised estimates for FY 1986 in Section II, it was disappointing that the revised budget ceiling seemed likely to be exceeded, Mr. Romuáldez observed, after account was taken of the likely use of set-aside money for the job evaluation exercise. In due course, additional appropriations would be necessitated, as well as some inter-category transfer of appropriations. With respect to the two main sources of that increase in spending compared with the budget estimates, he asked the staff for a more detailed explanation of the 6.6 percent increase for the books and printing category; apparently, the projected increase was accounted for largely by "unexpected technical difficulties in implementing and on-line composition system to produce the IMF Survey and a consequent delay in achieving the anticipated reduction in production costs." Had those problems been resolved?

It was suggested in the memorandum that the 20.6 percent increase for the miscellaneous category was due mainly to "higher costs of investment management and custody fees ($700,000) for the Staff Retirement Plan (because of the unexpectedly large return on SRP investments), Mr. Romuáldez noted. That was a large increase, although presumably it was offset on the income side of the Plan's accounts. Nonetheless, he wondered why the expense could not be shown on a net basis in the Administrative Budget. The inclusion of income elements was apparent elsewhere, as was illustrated by the information that miscellaneous expense increases had been partially offset by the expectation of higher income from interest-bearing salary advances to staff. In addition, he would be interested in knowing how the SRP management arrangements and fees compared with those charged against other comparable pension plans.

Mr. Vasudevan said that his chair was generally satisfied with the facts and analysis in the Managing Director's memorandum. He agreed with much of what Mr. Kafka had said.

The number of business trips that the staff had had to make in the past had increased to a high number, Mr. Vasudevan observed, putting the staff under considerable pressure. To ensure that the staff's efficiency was not impaired, he suggested that vacancy rates be eliminated and whatever provisions there were for employing consultants be utilized.

Finally, Mr. Vasudevan said that he had been interested in Mr. Nimatallah's suggestion for capping total administrative expenses. He urged that an attempt be made to implement that suggestion in a comprehensive way. The midyear review of administrative expenses offered the promise of a final budget outcome that was close to the initial estimates. The preliminary estimates for FY 1987 seemed quite reasonable.

Mr. Jensen said that he could subscribe fully to the general recognition by previous speakers of the response of management and staff to what seemed to be a never ending increase in responsibilities, work load, and pressures. Like Mr. Pickering, he was most interested in the effects of an active and effective implementation of the Baker plan on the work burden and its distribution. If the result was more travel and the need for a more appropriate staffing pattern, expenditures would have to increase, and the Executive Board should support such an increase. At the same time, concern about overall expenditure, and the issue of cutting or deferring spending on certain items, became crucial, as Mr. Pérez had said.

Mr. Fugmann said his chair supported the outline in the Managing Director's memorandum. The midyear review had revealed no major surprises compared to the budget estimates. Moreover, the successful efforts of management and staff in controlling expenditure were evident from the memorandum.

He supported Mr. Polak's point about the interchange of staff among divisions and departments, Mr. Fugmann added, although he would not necessarily limit that exchange to secretarial staff. He had noted the sharp increase in the turnover rate of staff and asked whether that was a return to a more normal turnover rate or whether it was a temporary phenomenon.

The Director of the Administration Department said that careful note had been taken of the observations made by Executive Directors. One issue that had been raised by several Directors concerned the importance of making the best possible use of available staff. Certainly, every effort would be made to review the current use of staff in order to overcome any inefficiencies. However, as long as the Fund continued to extend its activities, without cutting back other activities, it would be difficult to avoid a reasonable increase in manpower.

Two suggestions had been made for changing the timing of the budget review process, the Director noted. The first was to defer the process so that there was time in May, following the Interim Committee meeting, to consider the budget document. The second was to link the timing of the budget review with the annual review of staff compensation, which currently took place at an interval of a month or so. Further thought could be given to the timing of the budget review process in future years. In 1986 at least the timing of the general compensation review would be affected by the recommendations of the Joint Compensation Committee.

The Deputy Director of the Administration Department explained that the second balance of payments course had been dropped in order to offset the costs of the second Arabic course and the new money and banking statistics course. Likewise, the difficult decision to change the travel class for participants--which would save an estimated $400,000--had also been designed to offset other costs resulting from the expansion of the IMF Institute program in areas of high priority.

A common theme of the discussion had been the need to look for further savings in the budget projections, which were nevertheless conservative, the Deputy Director commented. As Mr. Nimatallah had noted, Table III showed that total costs would increase by approximately 27 percent during the five years from 1985 to 1989. That increase was in nominal terms and had to be viewed in the context of the rate of inflation during that period of almost 18 percent. In addition, the largest part of the increase was in the current fiscal year, for various special reasons, the most important of which being that the Annual Meeting had been held abroad. In fact, the projections for the four years from FY 1986 to FY 1989 included two Annual Meetings abroad, in 1985 and 1988. That was also evident from the real increase in expenditure projected for FY 1989 of 1.2 percent, following an increase of only 0.2 percent in FY 1988 and of 0.5 percent for FY 1987. A cap on expenditure in nominal terms as of FY 1987 or FY 1988, as Mr. Nimatallah had suggested, would mean a reduction in real terms. Consideration would have to be given to the possible consequences of a cap on expenditure, including the need to provide for contingencies, as Mr. Foot had suggested. Although some of the services being requested by Executive Directors would have to be cut back, an attempt would also be made to follow the guidance of the Board by exercising the utmost austerity when the Administrative Budget document was finalized early in 1986. Any excess of total administrative expenses over the estimates for FY 1986 would be on account of the set-aside amounts, which could not yet be factored into the projections in Table III.

With respect to the suggestion that certain expenditures be deferred, the Deputy Director remarked that there was no margin at all in terms of office space within the Fund building. In addition, most of the projects in the Electronic Data Processing (EDP) budget had already reached or were close to the production stage and were yielding the results for which they had been designed. To halt such projects could lead to losses rather than savings. However, the Executive Committee on Computing Services, under the chairmanship of the Deputy Managing Director, would soon be taking a very close look at the EDP submissions of individual departments. He had taken note of Mr. Nimatallah's suggestion to delay the second audio-visual course.

While the special effort being made to improve security might not yet come up to the standards required by some Executive Directors, the Deputy Director remarked, even the modest improvements foreseen in building security would call for a new desk, to be serviced by two full-time staff members, and would cost more than $100,000.

Many factors were responsible for expenses having been below estimates in the past few months, the Deputy Director continued. For instance, the rules relating to staff travel had been changed. A preliminary investigation of over 1,500 individual trips showed that the cost per trip had been reduced by 4 percent during the first six months of the current fiscal year, compared with the same period in the preceding year, even though fares had increased by 8 percent.

The structure of the Fund's budget was designed to avoid separate accounting for administrative income, the Deputy Director noted, and not only because the amounts were relatively small, compared with expenditures. Many costs--such as the costs of the Joint Library, which were shared with the World Bank--would show up as a much larger expense in the Administrative Budget if the share of the costs reimbursed by the World Bank was not deducted but was shown separately as income.

A competitive travel policy remained the objective of the staff, the Deputy Director observed. If access to the Adams Travel Agency had not been increased beyond the departments designated initially, it was because of certain deficiencies in performance. Negotiations were under way to improve the services of the agency. It was possible that the Administration Department would need to have a staff member in its own travel unit to verify the fare calculations of the travel agencies. Before the second travel agency had been introduced, it had been agreed that Executive Directors could make their own travel plans with an outside agency, if the fares were lower. He was not in a position to say whether the practice should be extended to cover the staff in Executive Directors' offices. Suffice it to say that the procedure entailed administrative costs, for instance, in processing the different travel authorizations and bills from various travel agencies.

In response to a remark by Mr. Pickering, the Deputy Director said that the Fund and the World Bank, as well as the U.S. Government, had concluded that there was no legal way of transferring to the employer the benefit accruing to individual travelers under the various frequent flyer programs.

The higher cost of communications in FY 1986 had been due entirely to increased cable traffic and not to telephone traffic, the Deputy Director said. The costs of managing the Staff Retirement Plan (SRP) had risen because the fees paid to the managers were not fixed but increased with the value of their portfolios. The Fund's costs were comparable to those of similar staff retirement plans, and the World Bank followed the same system. The costs were part of the Administrative Budget because the Fund was obligated to finance any experience losses of the SRP. Experience gains would reduce the losses to be amortized in the future. Thus, the question was one of when rather than whether the charges accrued to the Fund.

The Medical Benefits Plan was not designed like an insurance plan, the Deputy Director explained. In effect, the staff itself was the insurer, although the plan was managed by John Hancock. It was a non-profit, self-sustaining plan, although provision was made for accruing certain reserves to meet fluctuations in claims over time. A number of changes had been made in the Plan to improve the balance between payments and benefits, some of which had led to an improvement in the Plan's finances. The Staff Benefits Division followed up any complaints or suggestions, and John Hancock, with its expertise as an insurer, monitored costs closely.

Expenditure under the Termination Benefits Fund was normally kept in a certain ratio to the total cost of salaries, the Deputy Director explained. However, as a result of the job evaluation exercise, some downgraded staff members might wish to resign, or the Fund might wish to offer them an incentive to do so. The amount of $1 million included a first rough estimate of the likely costs, together with provision for financing outplacement services.

The number of vacant staff positions shown under Item 2(a) of Table III had to be offset by the number of temporary staff shown in Item 2(a), the Deputy Director noted. Although the positions might not have been filled by permanent staff members, temporary staff members were employed to perform the same services. One advantage was that costs were saved, although eventually the positions had to be filled by fully qualified permanent staff members.

It would not be possible to give any specific indication of the likely impact of the Baker plan on staffing needs, the Deputy Director stated, in response to Mr. Jensen's question.

The turnover rate had increased greatly in the year that ended November 1984, compared with the preceding year and the current year, the Deputy Director added. There might perhaps have been a greater number of staff members retiring in that one year. Whatever the reason, there had been a considerable recovery of salaries as new staff members were hired at lower salaries, thereby contributing to the financing of the annual merit increases.

Considerable work had been done among the departments on refining the concept of work load indicators, the Deputy Director of the Administration Department said. The budget document would include an addendum on volume and value indicators, similar to, but more detailed and more fully developed than, the one attached to the Administrative Budget for FY 1986. Those indicators were one instrument of control available to the Fund. In addition, cost estimates were also provided when special requests were made, either by the Executive Board or departments in the Fund, for major additional projects or services.

The staff representative from the Administration Department added that apart from the payment received from the World Bank for its share of the cost of operating the Joint Library, substantial sums were also received for other joint services, such as the Health Room, language training, and Annual Meetings. The total cost of the services provided by the World Bank, if it were set against the cost of the services provided by the Fund to the Bank, would reveal an inequality in the Fund's favor. There were various reasons why various types of income were charged to various categories and not accounted for separately. For instance, of the total income of $5 million--in a budget of $250 million expenditures--$2 million was income from operating the cafeteria and dining room. The cost of the food services shown in the budget would be that much larger if that amount was taken out and shown separately as income. The same was true of the income from fees for parking in the building of $1 million. Without the income from the sale of books and periodicals, which had reached well over $1 million, the total cost of Fund publications would also be much greater than shown.

The reference in paragraph 13 to the increase in the work load in FY 1987 in connection with financial transactions, which Mr. Nimatallah had mentioned, arose primarily from the expectation of the Treasurer's Department that the volume of financial operations in FY 1987, including those relating to the use of Trust Fund reflows, would be about 15 percent higher, the staff representative explained. In addition, the volume of repurchases would be about 18 percent higher, and so far in 1985, 65 staff papers had been issued on overdue obligations compared with 24 in the previous year. Those figures were not inconsistent with the statement in paragraph 43 that the relatively steady growth in the volume of the Fund's work over the past few years was beginning to slow down. Paragraph 43 referred to Fund activities as a whole and not only to operations. Operations and relations with member countries accounted for about 30 percent of the cost in dollar terms of the Fund's overall activities. Thus, it was correct to state that some tapering off was occurring.

Without the need to provide any further firm figures yet, the staff representative said, temporary positions might need to be converted into permanent ones in several areas. A large number of consultants on data processing activities, who had been hired to develop projects, might need to be kept to maintain those projects. There might be some temporary employees occupied with building maintenance and administrative services whose positions should be made permanent. In addition, as noted in the memorandum, certain positions had not been included in the FY 1986 budget because it had not been possible to foresee with precision the extra work load involved in certain projects. After a year's experience, it would be possible to determine the long-term requirements. He had in mind additional manpower required by the Bureau of Statistics in connection with the rapidly expanding statistical work on international banking and external debt.

The overhead cost of the Medical Benefits Plan, the staff representative explained, was the management fee of 4 percent of the total premium. The balance of staff members' contributions went to settle claims.

An effort had been made not to use an average rate of inflation in the budget projections, the staff representative commented. The projections had been made line by line, using different inflation rates based on the best information available.

The technical difficulties relating to the automation of the composition process for the publication of the <u>IMF Survey</u> should be completely resolved by the end of the financial year, the staff representative from the Administration Department said. The problem had been related to the standard software package being purchased.

The staff representative from the Bureau of Statistics said that the name of the new data system--Economic Information System (EIS)--was intended to indicate to users in the Fund and to members and the public at large that the eventual design and form of the system would involve a significant departure from, and extension of, the present system. In addition, the new system would be more than a statistical database; it would contain descriptive material--what was known as meta data--on individual data series. The system would reside in the new IBM computer that would provide the capability of easy on-line access for update and retrieval of data. International Financial Statistics and other statistical publications would be covered under phase 1 of the EIS; a test was being conducted for those purposes with the assistance of the Bureau of Computing Services. In moving from the present weekly update system to a daily one, the currentness and quality of the Fund's data should improve, as should the Fund's capability of receiving data from countries in electronic form, either on tapes or eventually on a computer-to-computer basis.

The question of the use of the data of the Bureau of Statistics by area and other functional departments had been receiving close attention for some time, the staff representative noted. A working group of senior staff had been developing procedures that would build on the first phase of the EIS in an effort to identify and enhance the scope for access to the new system. Those procedures would include, for instance, the identification of data series already collected and maintained by the Bureau of Statistics, but that might also be maintained by desk economists in area departments. Duplication of effort would thereby be avoided. There was also scope for additional key data series required at the area desk level to be identified, collected, and maintained by the Bureau of Statistics in the EIS, offering further scope for collaboration and avoidance of duplication. The new set of procedures would have an impact on the World Economic Outlook.

In designing the features to be grafted onto those in phase 1, in an effort to accommodate those objectives, it would also be necessary to increase the availability of electronic data processing facilities in area and other departments under the EDP budget itself, the staff representative from the Bureau of Statistics concluded. But another question that would have to be addressed was the different attitudes and procedures that area desk economists would have to adopt in their work on data.

The Deputy Managing Director commented that there were three data bases in the Fund that needed to be better integrated over time: the Data Fund System, which would be converted into the Economic Information System; the individual country records that desk officers kept; and the evolving database that was being developed in connection with the World Economic Outlook. The current effort on the part of the staff to integrate the elements of those databases eventually would be supported by the development of an integrated computer system, as well as by the office automation and economists work station components of the budget of the Bureau of Computing Services. Until the integrated computer system was fully in place, with the various databases linked, it would be difficult for any individual offices--those of Executive Directors or of staff--to be fully tied into the system. However, that development should become possible, as the various computer development projects were completed, within the next two years or so for Executive Directors' offices.

Mr. Salehkhou inquired whether it would be possible in the meantime for Executive Directors' offices to have access to terminals elsewhere in the Fund. He had in mind a joint facility for providing access to Executive Directors' offices.

The Deputy Managing Director replied that the Secretary's Department was conducting a survey of the computer needs of Executive Directors' offices. The outcome would be considered in the context of the budget review in the spring of 1986, including the technical as well as the possible procedural problems in tying Executive Directors' offices into the database.

The Chairman thanked Executive Directors for their words of commendation for the work performed by staff and management and for the comments that they had made. He agreed with Mr. Kafka and Mr. Polak that the input of the Research Department into the work of area departments should be increased, inter alia, by including the staff of that department on missions. Once again, Directors had called for more of an interchange of staff between and even within departments, and it seemed to him that the staff should provide information on effective changes of staff at all levels, and not only at the secretarial level, when the Administrative Budget was discussed on future occasions. Likewise, the rise in the number of temporary secretarial staff suggested the need for an effort to set up more active and effective contingency staffing procedures within the Fund.

Directors had drawn attention, as their main contribution to the discussion, to the need to control expenditures, the Chairman noted. The need was all the greater when the Fund was living through difficult times and when its members were called upon to increase their own contribution, in the form especially of increased charges. Mr. Pérez and others had made the point that the Fund's response should be further austerity in the organization of the budget. He would agree, although he would have some difficulty in an across-the-board capping of expenditures. Some of the operations and activities of the Fund could not be reduced without serious consequences for certain of the institution's functions. But he would be prepared to consider the suggestion by Mr. Nimatallah, which he had understood as a cap in nominal terms, or a reduction in real terms, of about 6 percent over the next, say, two years. As Mr. Foot had pointed out, in implementing such a cap, careful consideration would have to be given to the consequences of expenditure cuts for some of the Fund's programs. Not many new programs were being proposed, and large, arbitrary cuts in expenditure on equipment might put existing programs at risk or make them more expensive to administer. He would have no difficulty going along with Mr. Nimatallah's suggestion to postpone the second audiovisual presentation.

When the proposals of departments for new staff positions were scrutinized, job by job, the management and staff would have the need for savings very much in mind, the Chairman added. The figure of 35 positions mentioned in his memorandum was a global and preliminary one, intended as a guide in preparing the Administrative Budget.

If a cap were to be applied on administrative expenditures in nominal terms, Executive Directors would have to be aware of the hard choices to be made, the Chairman reiterated. Not only would recruitment have to be cut back, but certain programs that Executive Directors themselves saw as being essential and, in some cases, insufficient would have to be cut. In the final analysis, the Executive Directors would have to set the priorities. While there was a useful discipline in drawing up the essential elements of contingency plans for reducing expenditures before the Administrative Budget was finalized, he would be concerned about any drift toward accepting the idea that large cuts in the Administrative Budget represented a realistic option, should overdue obligations to the Fund not be repaid. Of the total budget of $250 million, the largest part was in essence for the work of the staff in the building. Although there was always room for cutting expenditure, he did not wish to leave the impression that enormous savings were possible that might eventually resolve the problem of overdue payments to the Fund. The Administrative Budget was not an adequate tool for that purpose given its limited size. Some action to reduce expenditure was advisable but it would have to be based on careful calculations and guidance from Executive Directors in full knowledge of the consequences in dollar terms and on the Fund's ability to fulfill its functions and responsibilities.

Mr. Kafka commented that while he agreed with Mr. Pérez on the need for vigilance in spending, he hoped that consideration would be given to his own observation that some departments in the Fund could not reduce their work load because they were at the center of the Fund's activities and the pressure of work on them was already too high.

The Executive Directors concluded their consideration of the memorandum from the Managing Director on the midyear review of expenses in FY 1986 and the budgetary outlook for FY 1987.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/180 (12/13/85) and EBM/85/181 (12/13/85).

4. HUNGARY - 1985 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1985 Article IV consultation with Hungary to not later than January 13, 1986. (EBD/85/309, 12/11/85)

Decision No. 8150-(85/182), adopted
December 13, 1986

5. AUDIT COMMITTEE, FY 1986 - COMPOSITION

The Executive Board approves the Managing Director's recommendation that the United States, Jordan, and Malawi be invited to submit nominations of persons to serve on the External Audit Committee for financial year 1986, as set forth in EBAP/85/301 (12/9/85).

Adopted December 13, 1985

APPROVED: AUGUST 7, 1986

LEO VAN HOUTVEN
Secretary