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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 99/99

10:00 a.m., September 7, 1999

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Executive Board Attendance

M. Camdessus, Chairman
S. Fischer, Acting Chairman
S. Sugisaki, Acting Chairman

Executive Directors

A. Barro Chambrier
T.A. Bernes
A.G. Carstens

B. Esdar

R. Faini

K.-T. Hettrakul
V. Kelkar

K. Lissakers
J.-C. Milleron

J.P. de Morais
A.V. Mozhin
S. Pickford

A.S. Shaalan

Wei Benhua

Y. Yoshimura

Alternate Executive Directors

S.M. Al-Turki
K. Kpetigo, Temporary
P. Charleton

W. Szczuka
S. Sharipova, Temporary

A.G. Zoccali
J.A. Costa, Temporary
P. Cabezas, Temporary
J. Spraos
G. Schlitzer, Temporary
O.-P. Lehmussaari

A.G. Karunasena
J. Prader
N. Burnashev, Temporary
A. Jacoby, Temporary

E. Jourcin, Temporary
S. Le Gal, Temporary
M. Daïri
M.R. Hajian, Temporary

L. Palei, Temporary
S. Collins
J.C. Estrella, Temporary
A.F. Al-Faris
I.M. Woolford, Temporary
A.Y.T. Wong, Temporary
Y.G. Yakusha
M. Takeda
M. Yanase, Temporary

S.J. Anjaria, Secretary
A. Mountford, Acting Secretary
P. Cirillo, Assistant
G. Nhkata, Assistant
S.T. Djumena, Assistant

Also Present

External Evaluation Group: F. Giavazzi, J. Honeyfield, F. Mishkin, T.N. Srinivasan. IBRD: L.L. Chu, Europe and Central Asia Regional Office; B. Horton, Africa Regional Office. African Department: G.E. Gondwe, Director; E. Hernández-Catá, Deputy Director; R. Abdoun, D.T. Coe, M. Katz, E.G. Kpodar, A. Tahari. European I Department: M.J. Fetherston, L.E. Kodres. European II Department: J. Odling-Smee, Director; J.R. Márquez-Ruarte, Deputy Director; E. Gurgun, G. Justice, B. Lissovolik, D.O. Robinson, M. Shadman-Valavi, C.R. Shiells. External Relations Department: M.W. Bell, C.N. Lotze, F. Mbotto, R.W. Russell. Fiscal Affairs Department: K.-Y. Chu, M.Z. Yucelik. Human Resources Department: U. Baumgartner, Deputy Director. IMF Institute: M.S. Khan, Director. Legal Department: I. Mouysset, S.C. Ho. Monetary and Exchange Affairs Department: V Sundararajan, Deputy Director; T. Olafsson. Policy Development and Review Department: J.T. Boorman, Director; T. Leddy, Deputy Director; L.J. Lipschitz, Deputy Director; I. Kapur, T.D. Lane, M.P. Mlachila, P.J. Perone. Research Department: M. Mussa, Economic Counsellor and Director; F. Larsen, Deputy Director; E.R. Borensztein, P.B. Clark, P. Isard, M.S. Kumar, P.R. Masson, R. Sahay, A.J. Tweedie. Secretary's Department: P. Gotur, B.A. Sarr. Treasurer's Department: E. Brau, Treasurer; K.M. Kenney. Western Hemisphere Department: V.B. Arora, R.K. Rennhack. Office of the Managing Director: M. Cross, Personal Assistant; D. Citrin, A. Coune, L. Alexander. Office of Budget and Planning: E.-A. Conrad, Director; T. Diamond, N. Sachdev. Advisors to Executive Directors: W.F. Abdelati, M.A. Ahmed, J.A. Chelsky, I. Dragulin, L.J.F. Erasmus, O. Himani, E.J.P. Houtman, A.R. Ismael, M.E. Kandil, B. Konan, W. Merz, H. Mori, J. Ntamatungiro, A.R. Palmason, J.L. Pascual, J.N. Santos, S. Thiam, T. Turner-Huggins. Assistants to Executive Directors: A. Abdychiev, A.S. Alosaimi, P.A. Brukoff, R. Burgess, S.P. Donovan, T. Elkjaer, M.J. Fernández, E. González-Sánchez, H. Hagan, B. Kelmanson, E. Kornitch, D.H. Kranen, Y. Moussa, D. Nardelli, M. Pérez dos Santos, C.-P. Schollmeier, C.A.E. Sdralevich, U.F. Seyidzade, R.J. Singh, P. Winje, I. Zakharchenkov.

1. FUND'S ECONOMIC RESEARCH ACTIVITIES—REPORT OF EXTERNAL EVALUATORS—FURTHER CONSIDERATION

The Executive Directors considered further a report on external evaluation of the Fund's economic research activities (EBAP/99/85, 7/15/99; and Cor. 1, 7/30/99), as well as a staff response to the report (EBAP/99/87, Rev. 1, 9/3/99). They also had before them the Managing Director's comments on the report (BUFF/99/109, 9/2/99).

The Managing Director submitted the following statement:

We have been asked by the Chairman of the Evaluation Group of Executive Directors to comment on the External Evaluation of Research (EER). Management welcomes the evaluation report, which provides much food for thought. We are grateful to the evaluators for the work they have done and for providing an opportunity for an in-depth discussion of the role of research in the Fund. The comments that follow are intended to contribute to the Executive Board's consideration of the subject, but they are not comprehensive. After discussing the EER's rationale for Fund research and its categorization of the types of research that should be conducted in the Fund, we take up the suggestion for a committee to set research priorities and provide funding for collaborative research with outside researchers, along the lines of the World Bank's Research Committee; we then comment briefly on the evaluation of staff performance and the evaluation group's remarks on the review process, which was also discussed in the external evaluation of surveillance (EES). We will not comment here on questions of a personal nature.

We of course share the view of the panel that high-quality research is critical to the successful operation of the Fund, in both its surveillance and its operational roles, and share the rationale for that view set out in paragraphs 24-25. The report defines (paragraph 21) three categories of Fund research: policy-foundation research, which develops basic analytic tools and frameworks (e.g., *Are Currency Crises Predictable?*); policy-development research, which creates the broad policy frameworks (strategy) that guide Fund operations (e.g., *IMF-Supported Programs in Indonesia, Korea, and Thailand: A Preliminary Assessment* and *Dollarization: Implications for Monetary Policy*); and policy-analysis research, which provides policy advice in the course of the day-to-day operations (tactics) of the Fund (e.g., *Inflation Targeting in Korea: An Empirical Exploration*).

In considering this categorization, it may help to think of Fund research as operating along a continuum: at one end using current analytic methods to analyze economic developments in the world economy and individual countries, at the other end undertaking abstract research, with no obvious immediate applicability to Fund operations. For convenience, we can

divide this line into four categories. The first is the analysis and reporting of current economic events and problems (such as the WEO and International Capital Markets Report as well as some of the work done for Article IV consultations that is presented in Recent Economic Developments papers) and other background documents. This could be called "surveillance-research". The second category is analytic and empirical work on cross-cutting policy issues confronting the Fund in its operations (such as the forthcoming paper on exchange rate systems, the work on dollarization, and many of the papers on capital account liberalization and inflation targeting). This corresponds roughly to the evaluators' "policy-analysis" and "policy-development" research. The third category is research on new ways for the Fund to think about or deal with problems, some of which may not yet have been encountered in the Fund's operations. This appears to correspond to the evaluators' "policy-foundation research". The fourth category is abstract research with no obvious relevance to Fund operations, but that if well done could be published in academic journals. Roughly corresponding to the movement along this line is a shift from research that would be expected or requested by the Executive Board, management, and non-Research Department staff to research that would most likely be motivated by the Research Department and by individual researchers.

Our own evaluation, shared by the EER, is that the Fund's surveillance research work, is generally first-rate. We have in mind particularly the WEO, the ICMR, the work presented at WEMD sessions, and the surveillance notes produced for different global and regional fora. Both the EER (paragraph 34) and the EES record that this work is very highly regarded outside the Fund as well. The analytic work that serves as an input to country surveillance and operational work is bound to be of more variable quality, but we believe that, too, is generally at a high level. The evaluators comment that Fund staff should be undertaking less of this work on countries in which good policy research is already being done in central banks or other research organizations. While we understand the motivation for this argument, and agree that Fund staff is likely to add relatively less to a policy discussion with a country where the policy debate is well advanced, we should also recognize that effective Fund surveillance requires the staff to form its own views on issues that will be the subject of Article IV discussions. Although the Fund will be only one voice among many in the policy debate in the advanced countries, Fund staff needs to have a well-informed and analytically sound capacity to undertake a policy dialogue with the authorities, both because such countries are systemically important and because it is important not to create a dual-track surveillance process. That is why staff will have to continue to undertake surveillance research on such countries. And having undertaken it, they should publish it.

The evaluators, after commending the Research Department's surveillance research work, focused their attention on the remainder of Fund research, with which they were less impressed. While it is natural for such an evaluation to focus on perceived weaknesses rather than strengths, the EER appraisal does not sufficiently recognize that surveillance research constitutes a large part of the output the Research Department is expected to produce. Further, as the Director of Research notes in his comments on the EER, he was explicitly charged on his appointment with shifting the output of the Research Department in the direction of this type of work. This has been done extremely well, and the value of the Research Department's work in this area is widely recognized among the Fund's membership, both by members of the Executive Board and by many other officials with whom we have spoken. Management, too, thinks the regular publications of the Research Department and Board briefings by the Director of Research, and the contributions based on this work that the Fund makes to policy discussions in regional and G-7 fora, play the central role in the process of multilateral surveillance and do so extremely well.

Our second category of research—cross-cutting issues confronting the Fund in its operations—corresponds to the EER's policy-analytic and policy-development categories of research. The EER devoted a considerable effort to the evaluation of this research, recording mixed views. Rather than express a view on that appraisal, we want to make three comments that might help set it in perspective. First, most research papers written in any institution or academic department have weaknesses; only a minority of papers that are written are accepted for publication, and of those, only a few have any shelf life. Second, one of the main reasons to write a paper is to gain a full understanding of a topic, which reading alone rarely achieves. It is for this reason that the Fund does not exercise much control over the papers that appear in the working paper series. In this regard, we do not favor curtailing the issuance of working papers; there should be a strong presumption in favor of publication, not only because researchers who have done the work deserve to have it see the light of day, but also because the staff's work benefits from being subject to public scrutiny. We do, however, share the evaluators' concern that such papers be clearly identified as working papers; we should avoid any implication that might inappropriately elevate the status of these papers. Third, we are not sure how to categorize an extremely important part of Fund policy work that may not have been sufficiently taken into account in the EER; namely, the policy papers (typically coming out of PDR) in which Fund staff develop a practical framework for implementing approaches or policies whose general nature has been prescribed or suggested by the Board. Examples include the papers on private sector involvement now before the Board or those written as the Fund developed the CCL. We regard Fund staff as unparalleled in this particular, critical skill, best described as policy-

development work, which frequently involves an iterative process with the Board.

Nonetheless, Fund work in both this second category of cross-cutting operational research, and that on policy-foundation work, needs to be strengthened. This requires (i) priority setting and (ii) strong researchers and the incentives for them to do the right work. We support the EER's recommendations both that the balance of Fund research should be tilted towards areas in which the institution has a particular need or should have a comparative advantage (such as cross-country research and that on emerging market and developing countries), and that the Fund should have a more systematic procedure for setting research priorities. We agree, too, that we should consider establishing a Committee on Research Priorities (CRP). The current Working Group on Fund Policy Advice (WGFP) serves more as a coordinating committee than as a setter of priorities. The proposed CRP could meet twice a year and should include the senior staff of departments in which research is demanded or supplied or discussed (most of those in the Fund). It could be chaired by management. If a meeting were to be held soon it would include on the agenda, for example, research on capital account liberalization, exchange rate systems, private sector involvement in the resolution of financial crises, and aspects of financial sector behavior. We would need also to consider whether the WGFP, whose membership includes staff more actively involved in research, should continue to exist. If it does, it could include on its agenda a discussion of progress in priority research areas.

We strongly welcome the EER's call for more interaction between Fund staff—not only those in the Research Department—and outside researchers, including more frequent attendance by Fund staff at academic conferences and attendance by academics at Fund conferences. We also need to seek closer interactions with researchers outside North America. We would like to see more joint research with the World Bank, but would not recommend institutionalizing this effort since coordination is a highly resource-intensive activity. We are also not yet convinced of the value of providing either the CRP or the WGFP with a budget to fund research by consultants, particularly if the research would not be done in the Fund. Before deciding whether to accept this recommendation, we should ask what marginal contribution to the creation of the desired knowledge would be made by such financing, and carefully evaluate the World Bank's experience with this approach. We agree that the Fund would benefit from having more visiting researchers, and the process by which they are selected should be transparent and uniform across departments.

Much of the EER is rightly devoted to what the Fund should do to attract, encourage, and retain high-quality researchers. We believe the incoming EP groups typically contain a good proportion of economists

interested in and able to do good research. We should expect graduating Ph.D.'s who choose the Fund as a career to be more interested in the applications of economics and in policy issues than those who choose a purely academic career, but that is all to the good since that type of research should be particularly valued in the Fund. No doubt in any EP class there will be some more interested in a longer-term research career, and some of these researchers will want to work on topics in the fourth category, which are of no obvious immediate relevance to Fund operations. Some research of this type should be permitted, provided the staff member is also doing other work more directly relevant to Fund operations. As the EER recommends, we should make it easier for those interested in and good at research to spend longer in the Research Department, whether on their first round in the department or after a period of mobility.

We need also to recognize that it is extremely difficult for a researcher to stay current in his or her field if not continuously involved in it. This implies at least that supervisors should enable such researchers to have more time for research. We note the ideal of setting aside continuous blocks of time suggested by the EER, but there are typically interruptions, even in academic life (for instance to teach classes). The problem faced by Fund researchers may not be so much the continuity of time available for research as the shortage of time, given the general work pressures to which staff—particularly the best staff—are exposed. Any initiatives in this area, as well as those discussed below, would need to take due account of the more general implications that are likely for the Fund's operations.

The Fund also needs to attract more established researchers, somewhat more advanced in their careers than are incoming EP's. Some mid-career researchers could come through the visiting scholars program, but we also need the capacity to appoint excellent researchers to a more permanent position at a high rank in the Fund when such opportunities arise. This reopens the question of finding a mechanism by which outstanding individuals (whether from outside or inside the Fund) who would not be placed in a managerial position might nonetheless qualify for a B-level appointment. While all these matters are under consideration, we should also bear in mind the Board's frequently expressed belief, which was supported by the EES, that we need to attract more mid-career individuals who have had policy experience.

As to the other incentives for research suggested by the EER, we agree that names of staff who contributed to a paper should be recorded in it, as is increasingly being done now. We would not, however, wish to remove the signatures of the heads of department in which a paper was prepared, for that provides an important element of accountability. As to the suggestion that papers should be presented to the Board by those who prepared them,

departmental practices on this point differ. We can see both the pro's and con's of the EER's proposal. Among the latter is the fact that when a policy position is proposed in a paper, we expect the head of the department to be responsible for and willing to defend that position. We have the impression that papers more in the nature of research (for instance, some of the recent papers on capital controls) are more often presented by their authors. Possibly this suggestion should be handled on a case-by-case basis.

The research evaluators suggest that annual performance appraisals should include an appraisal of research carried out by the staff member. We believe that is already being done. The EER's more wide-ranging suggestion that the grading on Fund performance appraisals should be tougher is under review, but it should be noted that managers tend to use the salary increase as a more accurate measure of performance than the numerical grade.

The EER, like the EES, believes too much time is spent on review and that the reviews are too formal. As noted in our comments on the EES, we also believe that too many resources are devoted to the review process and that departments should use the "No comment" option more frequently. It is also likely that review within some departments is too staff-intensive (too many people asked to review a paper, too many meetings to discuss the review), and resources could be saved there. But the review process is a critical input into the formation of a staff policy consensus, and the obligation of the initiating department to note divergences of view among departments when sending a paper to management for clearance ensures that major differences of view can be discussed and a choice among them made. A system of informal oral comments would not work and would leave open the possibility of disputes about who said what when. Writing down comments helps produce an appropriate degree of seriousness by both reviewer and recipient. Comments should be pointed, brief, and written.

We look forward to the Board's discussion of the EER and to following up on the recommendations that emerge from it.

Mr. Bernes, as Chairman of the Evaluation Group, submitted the following statement:

On behalf of the External Evaluation Committee, I would like to thank Professors Mishkin, Giavazzi, and Srinivasan for their excellent and provocative report. As I mentioned in my earlier statement on the external evaluation report on Fund surveillance, the mark of a good report can be measured in the extent to which it challenges the existing *modus operandi* and points us in new directions. I think it is important to stress that the purpose of this kind of exercise is not merely to pat ourselves on the back, although this may be appropriate at times, but to highlight areas for improvement or new

territory to be explored. In this context, I find the work of this evaluation group to be exemplary.

I am impressed by the scope and number of recommendations made in the report which indicate soundly that there is substantial room for enhancing the Fund's research activities. While the comprehensive nature of these recommendations aroused various sentiments among staff, I am disappointed by the extent to which staff's reaction has been defensive. While this may be unavoidable, I urge staff to be more open minded. Given the compelling and balanced manner in which the evaluators presented their views, I find it very difficult to argue against improving the accountability, quality, leadership, and performance evaluation of research staff.

On the issue of whether or not the evaluators went beyond their mandate, staff claims that the report strays "far beyond a strict look at research" in commenting on the Annual Performance Review (APR) process and issues related to the management structure of the Research Department. This is unfortunate, and I support the consideration of these issues by the evaluators to the extent that these issues were relevant. General management issues were flagged as well in the Evaluation Report on Surveillance, and these need to be addressed in the appropriate context.

Finally, I wish to reiterate my concerns made in my statement (paragraphs 4-6) on the External Evaluation of Surveillance regarding next steps, publication, and stock-taking. The same principles articulated there should apply here.

Mr. Mirakhor submitted the following statement:

I thank the evaluators for a stimulating and thought-provoking report. The recommendations contained in the report deserve careful consideration. I wish also to thank the staff for their response. The creative tension between the staff views and those of the evaluation report helps focus attention on the most critical areas of the Fund's research activity. What is significant is not the areas of disagreement between the two, much of which is judgmental in any case, but the common concerns they share.

Many of the differences between the two views are due to differences in perception and understanding of the role of research in this institution in general, and the question of what type of research is the most beneficial to the Fund and its membership in particular. The evaluators see the role of research in the Fund as (a) providing an "analytic foundation for policy advice," (b) strengthening "the Fund's reputation and enhancing its credibility," and (c) helping the process of "hiring and retention of best minds." The upshot of this perception of the role of research is that it seeks ways and means by which

research can become a front-line activity in the Fund. The staff, on the other hand, seems to conceive the role of research in the Fund as providing support for the front-line activities of the institution, i.e., surveillance and program operations. This conception of the role of research would require it to provide a clear understanding of (a) policy formulation and implementation in all member countries, (b) the external implications of these policies, and (c) what changes are needed in policies and what it will take to motivate the change. From this perspective, the spectrum of research topics and activities will need to be wider and more diverse than the research agenda in other institutions. To provide the analytic support base for the Fund to carry out its front-line tasks, the institution's research effort must address macroeconomic, institutional, financial, and policy issues.

The set of recommendations in the report is very useful, subject to the caveat that temporal, spatial, and expertise limitations may have affected the judgment base of the content of the set. First, time constraints did not allow the evaluators to consider the full dimension of research activities in the Fund itself, nor the full spectrum of the user side of research products. Thus, a number of departments and their research activities did not receive the attention they deserve. The same limitation also extended to the users of the Fund's research products in various parts of the world, most notably in Africa and the Middle East. Moreover, the importance of Fund research output to private sector users needed greater emphasis since, apparently, of the 86 people interviewed outside the Fund, only 3 were in the private sector.

Secondly, limiting the research output to be examined to 1998 may have created a biased impression. Clearly, the Fund's energies over the past two years were appropriately focused on the emerging market crises and, more recently, on the variety of policy initiatives to prevent or resolve crises in the future. One wonders if a longer-term perspective, perhaps over the past five years or so, would have modified the judgment base. Third, in hindsight, the diversity of Fund's research output would perhaps have required a larger team that had broader areas of expertise. As the report candidly admits, many of the Working Papers randomly selected "covered topics that were outside of the areas of expertise" of the Committee (paragraph 38, p. 22 of EBAP/99/85).

The above caveat notwithstanding, it is hard to disagree with the basic thrust of the report that there is room for improving institutional arrangements, providing a more effective incentive structure, making more time available for the staff to do research, improving knowledge transfer within the institution, and increasing efforts toward developing and transition country research. The key question here is whether all of these can be done without an increase in staff. Reduction in the operational workload, as the intensity of crises abates and efficiency increases, should focus on streamlining and improving the mix

between operations and research which would presumably help in freeing resources. However, given the significant expansion in the Fund's mandate and responsibilities and the need to strengthen the instruments of multilateral surveillance (including additional emphasis on regional surveillance), it is difficult to envision a relaxation of pressure on research resources without additional staff. The recommended increase in research assistants would certainly help, but this cannot be a substitute for increase in the number of economists.

The report suggests that less effort should be placed on industrial country research and more on developing and transition economies; even in case of developing countries, cross-country analysis is more beneficial than country-specific research. It also suggests that there should be more questioning of Fund orthodoxy. Perhaps there is some room for streamlining background studies on industrial countries, but care must be taken not to stretch the judgment on the added value of this effort. To argue that, given the vast literature available on the analysis of macroeconomic and structural issues confronting industrial countries, there is little value added to Fund research in these areas raises questions about the Fund's purpose and its end users. The ultimate objective of this research is to foster policy debates for surveillance purposes. It is the Board that will have to make judgments on policy issues based on the research's analytic underpinnings. A look at the contents of the references listed at the end of any background paper (e.g., fiscal and regional issues in Italy, labor markets in Europe, or potential growth and inflation targeting in the U.K.) reveals that, even if the work is not original, far from merely duplicating the material available elsewhere, the paper (a) focuses the coverage of the material toward an important policy issue, and (b) provides a clear analytic basis for the position of the staff on policy. Consequently, the background papers become an important and, often, indispensable organic ingredient of policy debate in the Board and the analytic basis of the Board's policy advice to a member country. This effort is of high value to Board members who are not deeply familiar with the economy in question and have very limited time to read all the published research on a given macroeconomic or structural issue the country is facing in order to make a judgment in policy debates.

Whereas the Fund's industrial country research is helpful in policy assessment, Fund research work on developing countries is most valuable in policy formulation and is highly appreciated by authorities. Often the Fund's country-specific research is the only work available to policymakers and market participants on many developing countries. The Fund's comparative advantage gives the Fund a unique edge in cross-country analysis that deserves to be taken seriously. Cross-country analysis can offer useful insights—and comfort—to country authorities about the experience of other countries that have adopted policies similar to those advocated by Fund staff.

The need for greater emphasis on this area, however, must not come at the expense of country-specific research.

The staff is correct in the assertion that the recent period has witnessed a significant increase in the quantity of research output on developing countries, and that this fact may not have been fully appreciated by the report. The current year has witnessed an increase in the number of Working Papers on developing countries, particularly in the African Department. These efforts should be strengthened. There is also a class of research on generic developing-country issues that properly belong to functional departments like the valuable past work of the Research Department on currency substitution and the work of FAD on the VAT, social safety nets, and institutional aspects. Currently, issues relating to capital accounts, financial markets, and measures of external vulnerabilities are examples of the type of research of interest to developing countries that needs emphasis. Finally, if one accepts that the Fund should focus on regions where good research is generally not available outside, then, even within developing countries, there should be greater emphasis on research on issues relating to countries in Africa, the Middle East, and South Asia.

One can agree with the recommendation of the report that there should be greater openness to new ideas and more original thinking, and that Fund research should be more questioning of the institution's orthodoxy. The Fund should not shy away from nor discourage topics that may generate fresh ideas, produce new results, or foster productive debate. Any perception that staff may have been, on occasion, actively discouraged from pursuing research topics that challenged the "orthodox" view in the Fund is unfortunate. There is, however, a need for an appropriate modality for constructive research dialogue within the Fund to avoid the risk of an external misperception or lack of clarity (particularly by market participants) regarding where the Fund stands on a variety of crucial issues. Perhaps a way could be found to strengthen the disclaimers that presently appear on the first page of the Working Papers that tentatively disassociate the researcher's views from those of the Fund.

The report makes very useful recommendations for wider external dissemination of Fund research products. The suggestion that the Working Papers and the Policy Discussion Papers could be usefully supplemented by some other vehicles (including nontechnical summaries) is welcome. It would also be useful to disseminate research findings to market participants. The value of the research work done at the Fund from the perspective of the private sector needs emphasis. Some in the private sector consider Fund research on many key issues as the only systematic source of analytic work available. While welcoming the suggestion that the Fund might publish a separate policy journal, it may be worthwhile to consider possible ways and

means of a more systematic publication outlet for many highly useful working papers on developing country issues that are not selected for publication in the IMF staff papers.

On internal dissemination of research, the report suggests periodic Board sessions on research topics. The staff has pointed out some valid reasons why this may not be possible. A more practical approach would be for Board members to attend various departmental research seminars that, generally, are scheduled for Tuesdays and Thursdays of the week. It is hoped that the Committee on Board Procedures and Schedule will succeed in blocking out these two days—with better scheduling coordination among departments—to allow the Board members to attend departmental seminars.

The report notes that outside experience is not sufficiently valued in the Fund, and this can deter mid-career economists from seeking positions in the Fund. This is certainly a valid point, but it relates not just to researchers but to anyone in policymaking positions in developing countries. Moreover, given the need to understand and evaluate developments in financial markets, it may be useful to attract people with private market background.

Regarding the report's coverage of the activities of the Research Department, the helpful remarks and disclaimers of the evaluators in the informal meeting cleared the air of possible misperceptions about the nature of Recommendation 7 of the report. Nonetheless, since the report is to be published, a few remarks are in order. First, as Mr. Bernes and other Directors pointed out in the informal session, the Director of the Research Department came to the Fund with a clear mandate, and he has fulfilled that mandate magnificently at a high cost to his own health. Time and again the Board has expressed its appreciation for the breadth and depth of knowledge and experience which the Counselor brings to bear in his presentations to the Board. Indeed, it is not easy to think of a more suitable Director of the Research Department. A post-informal-session reading of the report underscores the understanding of Mr. Bernes, Mr. Yoshimura, and other Directors that the important point of Recommendation 7 may be whether the passage of time has necessitated a change or a rebalancing of the mandate of the RES Director. To the extent that the WEO, the ICMR, the WEMD, and other products of the Research Department relate to that mandate, a rebalancing or a revision that reduces the quality, frequency, or modality of the presentation of these products cannot be desirable. If more is to be expected from RES, additional resources may have to be provided. The resource-saving recommendations (e.g., streamlining of the review process) can free up staff time only marginally.

Mr. Faini submitted the following statement:

Research is a fundamental activity in modern economies. Economists, practitioners, and policymakers alike often relate good aggregate economic performance to a high share of resources invested in research. At the micro level, corporations get high praise if they devote relatively large amounts of resources to research and development. Yet, despite its substantial contribution to economic growth and corporate dynamism, research as a whole is likely to get fewer resources than it should receive under a socially optimal pattern of allocation. The reason is simple: many of the benefits stemming from research are not reaped by the agents who have paid for it, detracting therefore from the incentive to invest in such an activity. A market economy will generally deliver a socially inadequate level of research.

Should a public institution like the IMF be involved in research? The answer is strongly affirmative on many counts. First, research generates a direct payoff with regard to the activities of the IMF by ensuring that the Fund's advice and its policy conditionality are based on sound economic knowledge. Second, the fact that IMF advice is known to rely on strong analytical foundations boosts its credibility and weakens critics' arguments. Finally, IMF research is likely to contribute to global knowledge on the working of the international economy and on the economic conditions in individual countries. It thereby provides an external and sizable benefit to the international community.

Is research at the IMF satisfactory? The report considers three different criteria to assess research: policy relevance, quality, and dissemination. The evaluators' verdict is that research at the Fund fails in all three criteria. It is not of high-quality (judged from a general academic standard), it does not provide an adequate contribution to the Fund's operational activities (both because of its insufficient quality and its inadequate focus), and it is not disseminated in an effective way either inside or outside the Fund.

Why do evaluators claim that research does not contribute effectively to IMF operations? The lack of operational impact of IMF research is perhaps the most surprising and disturbing conclusion of the report. It conflicts with a widespread perception, buttressed by explicit statements of the Economic Counsellor, that IMF research has been refocused in the last few years to maximize its operational impact. It is indeed true that research has been increasingly more focused on policy issues. The WEO, the ICM, and the WEMD sessions get high marks in both the research and the surveillance reports. According to the report, however, IMF research has suffered from lack of appropriate focus, reflected in the insufficient attention to a number of crucial issues, such as the link between the macroeconomy and the financial

sector and cross-country comparative analyses. There is, therefore, in the opinion of the evaluators, considerable room to enhance the operational impact of Fund research. This criticism, I believe, is fairly accurate. However, I am also convinced that the evaluators' critique should be cast in somewhat more general terms. The purpose of research is not only to provide guidance to the daily activities of an institution, but also to analyze issues that are likely to be important in the long run and in the strategic decision making of that organization.

Three main conclusions follow from this basic remark. First, research activities cannot be assessed by looking simply at their immediate operational relevance, but must be evaluated in broader strategic terms. Second, both strategic and operational research are essential. The often-mentioned conflict between basic (policy-foundation) and applied (policy-analysis) research is largely artificial. Third, and most crucially, seen in this light, the strategic impact of research at the Fund has been, at least in the recent past, quite limited. It is indeed fair to argue that more research resources, particularly in the Research Department, should have been devoted to strategic issues such as the reform of the financial architecture, the involvement of the private sector, the impact of capital controls, the effectiveness of traditional program designs during a currency crisis, and the incorporation of growth considerations in traditional monetary models, to name only a few that loom high among the Board's priorities. The limited role, if not the outright absence, of the Research Department during the last year on most of these themes is perhaps the most compelling demonstration of the need to refocus its priorities.

What should be done to correct this situation? The report not only provides an evaluation of research activities at the Fund, it also contains a set of detailed recommendations. The preliminary step is to understand why research at the Fund largely fails to achieve the objectives of quality and relevance. According to the evaluators, this is because the Fund's research is too decentralized and poorly coordinated, researchers are not given blocks of time to conduct research, research is largely a residual activity and gets easily crowded out by other commitments, the evaluation system of Fund staff does not adequately reward high-quality research, research resources are not used efficiently (due to shortages of research assistants, lack of transparency in hiring external visitors, excessive attention to the review process), and, last but not least, the collaboration between departments (and with the World Bank) is too weak to allow the definition of a meaningful research program. The proposed Committee on Research Priorities (CRP) is designed to address many if not all these problems. It would coordinate research, allocate blocks of time for research to staff, and allow staff to focus on research projects that are both policy relevant and of high quality. A positive assessment of a research project by the CRP could be used in the performance evaluation of staff. The CRP would also allocate funds for research assistants, external

visitors, and conference participation. The CRP could favor in its allocation decisions projects that optimize interdepartmental collaboration.

I believe that there is considerable merit in this proposal. It is essential, however, to be more specific about the way the CRP would operate. This would also allay some of the concerns that have been expressed in the staff response and in the previous Board discussion.

The CRP, while free to select priority research areas, would respond to researchers' applications for resources. It would not initiate proposals.

The CRP would evaluate proposed research projects on the basis of their academic quality and their policy relevance.

The CRP would rely on a network of competent internal and external referees for the purpose of evaluating research applications.

The CRP would be chaired by the Economic Counselor and include among its members representatives from area and functional departments (perhaps on a rotating basis) as well as prominent members of the academic and policymaking community.

The CRP would report annually to management and the Board on the status of research in the Fund.

These specifications should go a long way toward addressing some of the concerns that have been expressed about the CRP. It has been argued that:

1) *the CRP would jeopardize the freedom of area departments to channel resources flexibly toward their most pressing needs.* The argument is unconvincing. It is true that the CRP would control a substantial part of research resources, but area departments would still be free to allocate their staff to research tasks that were not financed by the CRP. Moreover, under an appropriate institutional design, area departments should get additional resources to compensate them for their staff whose research is being financed by the CRP;

2) *the CRP would stifle individual creativity.* Individual creativity will be strengthened by the existence of a competitive and transparent method to allocate research resources. The CRP, while free to indicate priorities, would respond to researchers' applications for resources;

3) *the CRP would add a layer of bureaucracy.* This is not necessarily bad if the new entity performs a useful role. Clearly, the CRP would play many valuable functions. For instance, it would help identify research

priorities, provide a convenient forum to discuss research activities in the Fund, and allow a more comprehensive assessment of research.

On balance, therefore, I support the creation of the CRP. I believe that it should be given the power to allocate an adequate amount of research resources. Overall, in this new environment, there would be three ways to conduct research: on a purely individual basis, at the departmental level, or through the financing of the CRP.

The report contains many additional recommendations. Many of these have already been discussed in the context of the surveillance report and have found broad support within the Board. At this stage, I would like to emphasize the supplementary recommendations on research evaluation. As in the surveillance report, the research evaluators propose to create an ongoing external review process of research. They also suggest closely monitoring the implementation of the report's recommendations. There are substantial analogies with the surveillance report's emphasis on implementation and the need for external reviews. In the absence of such steps, it would not be too surprising if the next report were to come to the same conclusions as the previous ones.

Concerning the other main recommendations, I agree that the focus of research should be shifted toward the areas indicated by both the research and the surveillance reports. I would add some of the areas that were indicated earlier in this statement. The incentive system should also be improved by giving more weight to research quality in the performance evaluation review (as noticed earlier, the CRP could provide some useful input in this regard) and giving relatively junior staff the opportunity to present their work to the Board.

Let me turn now to a controversial recommendation, namely that regarding the Economic Counsellor. As formulated in the previous draft, the recommendation did not do justice to the fact that the orientation of research is not mainly the Counsellor's decision. However, the revised recommendation addresses this concern and well describes the necessary changes in the mandate of the Research Department Director.

To sum up, all the most important international organizations devote a sizable amount of resources to research. They need research both to guide their operations and to lift their profile in the outside world. Enlisting the support of the academic community and, more generally, of the most influential opinion-makers in a borrowing country, can often be a decisive step in ensuring that the public opinion at large will not be hostile to the program. The chances, then, that the government will fully own the program will be greatly enhanced. More generally, the credibility of the IMF as a

policy institution can only be strengthened by the belief that the analytical underpinnings of IMF advice and IMF conditionality are sound and based on updated economic knowledge. The report provides an opportunity for confronting a pending issue that, if properly addressed, would increase the long-run impact of research on IMF actions and strengthen the Fund's reputation in the outside world. This opportunity should not be lost.

Mr. Morais submitted the following statement:

Overall, we found this report to be a useful piece of work. It contains a number of recommendations that could help the Fund improve its research activities. We do not see it as a critique against which the Fund must defend its current practices. In this regard, the staff's view that they found the evidence marshalled for reforming current practices unconvincing might be considered too strong a reaction. We would lose the rationale for such evaluations if the end result is simply to maintain the status quo.

There can be no disagreement that research has to be an important nerve center of an institution like the Fund and, therefore, that the output must be integrated into operational work and should be properly disseminated. We consider that there are some important areas where current practices, by and large, live up to this billing. The WEO exercise is a case in point. However, the recommendations of the external evaluators can still be a basis for making improvements. We see a number of broad themes in the report which are important: that the Fund should continue to strive to encourage creative thinking so as to be in a position to give the best advice to its member countries; that ways should be found to ensure a more efficient allocation of resources as a means of enhancing the contribution of research to the general work of the Fund; that, given the nature of the Fund's work, stronger collaboration between researchers in the Fund and the Bank would help to advance the work of the Fund; that the Board should be able to provide inputs into the priorities for research; and that improved dissemination of Fund research should contribute to a more meaningful dialogue between the Fund and the wider community. We believe that a work program could be developed around these broad issues as the basis for a report by the staff, within an agreed period, on specific suggestions for improving research activities in the Fund.

I will now comment on some of the specific recommendations:

Committee on Research Priorities. This seems to be a practical approach to give focus to the research work of the Fund. A CRP need not necessarily lead to an overcentralized system that would stifle initiative, one of the strong suits of a good research system. In fact, it has the potential to stimulate creativity by encouraging healthy competition and putting in place

the incentive structure to reward excellence. From an operational perspective, the need to have a system that allows sufficient flexibility to area departments to be able to meet specific needs of individual countries must be fully appreciated. In the final analysis, while there is a strong case for having a coordinated approach to doing research in the Fund, this should not become the tail that wags the dog.

Shift the Mix of Research toward Topics which Add Most Value. For us, the issue is not so much to shift the focus of research as it is to do more policy-oriented work. Here, one should note that the value of background research in the context of Article IV consultations policy-oriented research, even where the definition is not precise, is strategic for the Fund and deserves the necessary attention and resources. In this regard, the evaluators have pointed to the need for more research on African countries. We could not agree more. Given the Fund's role in Africa, it is imperative that much greater attention be given to research that deals with critical issues such as the relationship between program design, growth and poverty reduction, the application of monetary policy in a regional context, program ownership and the adjustment process, prospects for capital market development, and the like. Cross-country analysis could also provide useful inputs into the design of programs in Africa. The importance that the evaluators attach to this aspect of Fund research lends credence to our call for the lessons drawn from the evaluation of ESAF to be incorporated into the design of programs supported by the Fund. The fact that this is taking so long raises concerns about the operational impact of research.

Improve Collaboration between World Bank and Fund Researchers. We have already touched on this. The need to avoid duplication between the Bank and the Fund has been raised on other occasions. The evaluators' suggestions regarding joint seminars should be considered, if it is not already being done. But more than this, there must be a commitment to a culture that sees Fund/Bank collaboration in research as in the best interest of the membership and, therefore, something to be encouraged.

Improve Dissemination of Research to Nontechnical Audiences Outside the Fund. This could be seen as part of the transparency ethic, which has the added benefit of keeping national authorities informed about relevant findings in the field of economic and financial management. It also works to the advantage of the Fund for policymakers to be convinced that Fund advice is rooted in sound analysis and research. The idea of a policy journal should be explored.

Increase the Number of Research Assistants Relative to Economists. One can understand the argument that the lack of research assistants reduces the productivity of researchers. However, this does not translate into a policy

decision to trade off economists for research assistants. The Fund does not function mainly as a research institution.

Create Periodic, General, External Reviews of Research Activities.

This is a reasonable proposal. In principle, the Fund should have a regular process of external reviews of all its major activities. However, we may need to look at the review process itself to ensure its effectiveness.

Let me conclude on the evaluation process. We consider it a shortcoming that the evaluators did not hold interviews with any African policymakers. For an important evaluation such as this, every effort should have been made to have as representative a sample as possible. We also should be mindful to strike the appropriate balance between academic research and other types of useful analyses that promote dialogue with policymakers.

Mr. Barro-Chambrier submitted the following statement:

The fundamental importance of Economic Research to the Fund's activities is well recognized. The Fund can only provide advice to members if this advice is based on a sound analytical economic foundation, so there is a need for continuous research on issues that are of direct importance to the Fund's work. It is, therefore, important that we ensure that research activities in the Fund are properly focused and effective. In this regard, I find the report of the evaluators very useful and thought-provoking. It makes a number of important recommendations that deserve careful consideration. I wish also to thank the staff for their response which clarifies some issues, and management's statement which I find very constructive.

In their assessment, the evaluators find that while the Fund produces some excellent papers, there is room for improvement in the orientation, the overall quality, and the way the Fund's research is disseminated. They do present a number of facts that appear to confirm this assessment.

Overall, I agree that we need to do more to reorient our research toward operational work, although I would have no problem with "theoretical type" research on topics that are less well covered outside of the Fund and on which we need to improve our understanding. I also share the view that we need to focus our research activities on issues where we have a comparative advantage and to place more emphasis on developing and transition economies research.

On the reorientation of research work, I note that more studies on issues related to the Fund's operations are being produced, especially as regards the WEO and the WEMD. Nevertheless, as the evaluators note, quite

a large number of research that is being done is not as closely related to the Fund's work, and many of them are associated with doctoral dissertations. It is possible that there may be a misallocation of resources and that a greater effort is needed to set clear priorities and develop a research strategy in the Fund. In this context, the evaluators make a number of useful recommendation. I find appropriate their recommendation for the creation of a Committee on Research Priorities, which would centralize the research process and enable a better allocation of resources. However, in setting up such a Committee, it would be important to define clearly its responsibilities, as I think that departments should retain some flexibility to conduct research of a more specialized nature.

The evaluators make another interesting recommendation regarding a shift in research away from industrialized countries and toward developing and transition countries. There is some merit in this suggestion, as the Fund does have a comparative advantage over other institutions in this regard. Also, for many of these countries the work done by the Fund may be the only work available, and it fills an important knowledge gap. In this context, the importance given to African issues in the recent WEO was highly appreciated, and the staff is encouraged to continue their work on African economic and financial issues, especially those that relate to program design and the lessons learned from the implementation of policies in the framework of ESAF programs in Africa. Moreover, cross-country analysis can also be an important area where the Fund can bring much value added. However, I do not think that we should completely eliminate research work on industrial countries, because much research is being done on these countries outside the Fund. While I agree that there is no need to repeat this research, I also recognize that there is some need for in-house research on industrial countries, especially when it relates to our surveillance exercise and underpins the staff's policy recommendations.

I also favor greater collaboration with the World Bank on account of the large potential synergies between research activities. However, I agree with the Managing Director that we should not institutionalize this collaboration. The suggestion of an annual research conference organized by both institutions is quite interesting and can be useful. I would recommend that more thought be given to it.

On a similar note, I agree with the evaluators' recommendation for a wider distribution of Fund research products. Here also, while I agree that much is being done, I think that the evaluators make a number of useful suggestions that merit careful consideration, especially regarding improved communication links across departments. I also welcome the suggestion to create a more appropriate vehicle for the dissemination of the various technical staff studies, including the suggestion that the contents of the papers

be made more accessible to a nontechnical public. The latter should prove very useful to policymakers who very often are unaware of the basis of certain policy recommendations. However, I am not sure that I agree with the suggestion for periodic Board sessions on research topics. As suggested by Mr. Mirakhor, I think that a more practical approach would be for departments to organize regular seminars which could be attended by Executive Directors or their staff.

An important suggestion made by the evaluators is in regard to more interaction between the staff of Research and other Departments as well as with outside researchers. This could be another way to disseminate the Fund's research but can also help to exchange views and create new thinking. I definitely agree that Fund staff should be given more opportunities to attend conferences and seminars where they can be active participants. I would add that participation should not be limited to North America and Europe, but should also include conferences and seminars in developing countries.

Regarding the function of the Research Department, as the Managing Director reminds us, this department, in the past few years, has reoriented its work much towards what the evaluators recommend, and the papers produced by this department have been of a very high quality and recognized as such both internally and outside of the Fund. Moreover, the Director of Research has very well fulfilled his mandate and has made excellent contributions to the Board discussions. Nevertheless, I would add that there might be some room for improvement in the culture inside the department, something that may not be apparent to insiders but is more visible to outside observers, on the assessment of research papers or in ensuring the dissemination of other important work besides the WEO and the ICMR. To improve the quality of research, it may also be worth considering allowing graduating Ph.D.'s who are more inclined to research to spend, early in their career, a longer period of time in the Research Department, where they might be involved in research activities that are considered appropriate.

In conclusion, I would like to thank the evaluators for their excellent work, which has helped to bring some useful insights to the workings of the Fund. At our informal meeting, I noted the lack of consultation with scholars and policymakers in Africa in the preparation of the evaluation. I would like to note my appreciation to the evaluators for the steps they have taken to consult with several African policymakers in the past month. I think that this will certainly improve the study as well as give it broader perspective.

Mr. Shaalan and Ms. Abdelati submitted the following statement:

While not the central function of the Fund's activities, research has a critical role to play in optimizing the effectiveness of the Fund's operations,

and therefore this subject deserves our careful scrutiny. We would emphasize in particular the role identified by the evaluators that "Research is the means by which the Fund ensures that the approaches it takes to the issues confronting its members are the best that the current stock of knowledge and state of the art in policy design can offer." Research activities that are relevant to the Fund's objectives and of a sufficiently high quality would also enhance the Fund's operations and functions in an indirect way. The evaluators rightly point to the important role that Fund research has in lifting the profile of the Fund in the outside world when noting that "Research acts as a marketing tool to help the Fund sell its ideas and develop an external constituency for its work." From these perspectives, the evaluators conclude that, while some of the Fund research is of a high quality and great relevance, the overall quality of most research is not as high as might be expected, that the subject mix of research is not optimal, and that the link between some of the Fund's research and its operational work is weak. Of course, there is always room for improvement, but our sense is that this is probably a somewhat overcritical and, in some cases, unwarranted assessment. It would be particularly important to clarify the yardstick or criteria underlying this judgment and, in particular, whether the quality was assessed in relation to academic-style research. Having said that, we will take a constructive approach to the report and divide our comments on (i) how the evaluators arrived at their assessment of research output, (ii) how the inputs that go into the research activities explain their findings, and (iii) our views on their main recommendations.

Evaluation of Research Output

At the heart of the report is the evaluation of the quality, relevance, and cost-effectiveness of the Fund's research, and, as such, the section on research output arguably deserved more prominent treatment than the seven pages (pages 21-28) allocated to it. The evaluators pointed to the high quality and great relevance of some of the Fund's research outputs, most notably the WEO and ICM reports, and the fact that the latter is considered by academics to fill an important niche. They also reported that the WEMD discussions were highly valued by the Board as they provide an excellent overview of the world economy, are candid, and, on occasion, challenge prevailing views in the Fund. As regards other research output, however, their views were more qualified, and they would appear to be based on a reasonably broad, if not comprehensive, review of the various research outputs we outline below.

In terms of its quality and relevance for the Fund's operations, the evaluators believed that there was significant room for improvement. Out of 22 papers that departments selected as their very best work, the evaluators believed about half of these to be excellent products, while the balance was judged to be either "of dubious value to the Fund's operations" or analytically weak. This is a subjective judgment and, as noted above, a comparison with

academic papers (if that were the basis used) would probably not be the most appropriate yardstick. As the papers reviewed represent a selection of what the departments considered their best products, an assessment of the total universe of papers would most likely yield a bleaker picture. In addition, based on a detailed review of a sample of 30 (out of 182) working papers produced in 1998, the evaluators concluded that "most of the papers had one or more serious weaknesses." The weaknesses found include a lack of innovative thinking, poorly specified or designed research, conclusions that were not well drawn, or papers appearing to be too hastily put together. The best analytical research work, in their view, consisted of rewritten chapters from Ph.D. dissertations, mostly not directly relevant for the Fund's work. This is not entirely surprising, and indeed it may be difficult to nurture the continued development of excellent analytical research work by recent Ph.D.'s in an organization such as the Fund, but we would hope that the specialized skills of new recruits will be applied to research topics that are of more relevance to the Fund. It is possible that less research which is more focused on Fund-related work may contribute to higher quality.

The evaluators did not identify any neglected areas, but rather found that the Fund's research covered a wide spectrum of topics. Nevertheless, they called for a shift in the mix of research to better exploit the Fund's comparative advantage. This finding, which is consistent with the views of the external evaluators of Fund surveillance, stemmed from an intensive review of 12 research papers on the topic of inflation targeting as well as collating a comprehensive list of research output from 1995-98. In the latter, they found that over a third of research was on topics of interest to industrial countries, and often the research was country-specific rather than focused on "developing appropriate general frameworks for policy." As the staff rightly point out, the fact that much of the Fund's operations with countries are of a bilateral nature explains the high proportion of country-specific work. Nevertheless, the recommendations are similar to those of the Surveillance team—namely, we need to shift the mix of our analysis more toward a developing-country focus, broader country comparisons, and more financial sector work. We find these recommendations reasonable and encourage a shift in that direction.

There is also a call for strengthening the impact of the Fund's research within and outside the organization. Within the organization, the need to better integrate the research of functional departments in the operational work of area departments is consistent with the findings of the Surveillance team, and we endorse that wholeheartedly, as we have on previous occasions. Outside the Fund, academics and policymaking economists reportedly "often admired the Fund's work," but many said that it is not contributing to economic ideas, as in the past, and was "too shy to challenge conventional wisdom, particularly the Fund's internal wisdom." The evaluators also called

on the Fund to engage the Fund's critics in more serious debate. Caution would be needed to avoid directing our scarce resources to futile arguments with the Fund's critics. It is also well worth noting that, as shown on page 90, the number of citations of articles published in the IMF staff papers compares favorably with citations of the Brookings Papers and World Bank Economic Review, and that the decline in the number of citations is evident in all three publications and not limited to the staff papers, which may suggest that the nature of economic science is such that there is less scope for pathbreaking work in the 1990s than there was in the 1950s and 1960s.

Evaluation of Inputs

With respect to the evaluators' exploration of the resources, incentives, and organizational inputs that underlie their findings, we will comment briefly on four main elements they highlight: the decentralized structure of research activities, the structured decision-making process, the perception that the institution does not adequately value research, and the inadequacy of the time available to staff for carrying out creative research. Regarding the first of these, while the evaluators agreed that the Fund's decentralized structure is appropriate for the institution, they saw a need to strengthen, in a centralized way, guidance on the subject mix and coordination between departments. This view led them to the recommendation to upgrade the role and responsibilities of the current Working Group on Fund Policy Advice by renaming it the Committee on Research Priorities. We note from the Managing Director's statement that management is favorably considering the establishment of such a committee, and we do not have a strong position on the mechanism by which we achieve the objective of improving the research mix.

We are rather concerned by the perception that the organization emphasizes generating consensus at the expense of deeper debate, and that alternative views are often met with hostility and research papers on controversial issues are discouraged. The evaluators found that the Fund's clear and well-structured decision-making process facilitates the fact that the organization speaks with one voice and makes its decisions quickly; however, by emphasizing consensus, it discourages the production of good thinking and innovative research and their absorption into operational work. We believe this issue deserves some considered reflection, but we recognize that it will be inherently difficult to balance the two objectives.

It is not at all surprising that the Fund staff have insufficient time for research activities, and one aspect that probably affects the quality of research is that research activities are often treated as a residual. Only staff at the IMF Institute reported having sufficient time for research, while staff working on program countries find that they often spend most of their time on "fire-fighting" and find it difficult to find blocks of time because operational duties

keep interrupting them. In the evaluators' view, this would suggest a need to allocate more resources on program countries and to research that compares similar countries or similar policy issues with relevance to developing countries and away from individual industrial country work. On this score, we would refer to the findings of the Surveillance team, who report that by expanding our focus to many non-core, tangential (though important) areas, we are spreading our staff resources too thin and are already observing a weakening of the quality of the research in the areas that should constitute our core activities. We hope this factor would reinforce the Board's commitment to avoid widening the Fund's mandate into broader areas that could and should be carried out by other institutions.

The perception that the institution does not value high-quality research was based on what the evaluators viewed as a deliberately non-controversial approach to controversial issues, limited participation of staff in outside conferences, and the perception by Fund staff that highly visible operational work, rather than the quality of research, received more weight in the organization and formed the basis for promotion. In exploring these issues, they were informed by some researchers who left the Fund that "they did not believe the quality of their research was sufficiently valued in annual performance reviews, and that this was an important reason why they chose to leave the Fund," and frustration was expressed that some senior staff claim coauthorship for research. It is difficult for us to gauge the pervasiveness of these staff complaints and the weight that should be given to them, and it would have been appropriate to identify in the report the number of interviewees who expressed these views. Staff may wish to comment on these findings and related conclusions.

Regarding the dissemination of the Fund's research, we share the evaluators' emphasis on the need to build public support for the Fund's work and to help convince policymakers and the public in member countries of the soundness of Fund policy advice. In this regard, we welcome the decision to publish an annual volume of Policy Discussion Papers this year which would facilitate identifying Fund research to interested readers. We also welcome the shift in the in-house academic style economic journal to be more policy-oriented and less technical.

Recommendations

We share a number of the recommendations stemming from this work, and in particular those that overlap with the recommendations of the Surveillance team, including the desirability of:

- increasing the number of research assistants, especially short-term research assistants, to free up economists from doing data

collection and entry, preparing tables, and spreadsheet manipulation. We are pleased to note that this process is already under way, freeing up time from nonresearch activities such as the review process which is also under way;

- encouraging greater integration of the research in operational work and greater focus of research topics on operationally relevant work;
- shifting, to the extent feasible, some research resources to areas other than those associated with background work for Article IV consultations with industrial countries and more toward country comparisons, financial sector work, and developing general frameworks for policy; and
- providing guidance (possibly through a committee) to staff to shift toward topics which add most value and on the priority areas of research that are more directly related to the Fund's research objectives.

There are a number of other recommendations, not shared with the Surveillance evaluation report that are marginal in nature but could be deserving of consideration, if they are not already pursued:

- using only the names of significant contributors on Fund publications;
- further improving the dissemination of research outputs, including to the Board by providing some vehicle for nonsenior staff to occasionally present their work to Board members; and
- greater interaction between Fund staff and outside researchers, including through participation in reputable conferences where they can benefit from the commentary of and debate with other researchers.

In other areas, however, and in particular as regards the organization of the Research Department, we do not share the recommendations of the evaluators. Rather, we share the views expressed in paragraph 5 of the Managing Director's statement regarding the positive evolution we have recently observed in the Research Department's work. We are pleased that the initial unfortunate choice of wording of Recommendation 7 has since been amended. The recommendations that we found little merit in include:

- centralized hiring of consultant research through a research committee;
- setting explicit departmental targets for staff time allocated to research, as this could mean squeezing out essential operational work;
- a broad review of the performance evaluation process may well be warranted on its own merits, but should not be done with reference to research activities in particular. This appears to be under way, and the quality of research is receiving more prominence in individual evaluations; and
- hiring a portion of YPs with a research interest who promise to work in the Research Department.

Finally, we hope that this report will enhance the value of research in the Fund by drawing attention to its role as an important input into the Fund's policy formulation and members' acceptance of its advice. We thank the evaluators for their probing report and far-reaching recommendations, and we extend our thanks to the staff for their comprehensive and well-reasoned response.

Mr. Bernes submitted the following statement:

I welcome this formal discussion on the work of the External Evaluators on Research (EER) here at the Fund. I also welcome the response of staff and thank them for their equally candid, albeit feisty comments. Further, I appreciate the encouraging statement by the Managing Director to tackle the need for improvement in the Fund's research activities. The EER report and the "creative tension" provided by staff, as noted by Mr. Mirakhor, should help us focus on the most critical issues. As I share many of the concerns expressed by Mr. Faini in his preliminary statement, let me only add the following comments on some of the key recommendations.

Recommendation 1. My views on the proposed Committee on Research Priorities (CRP) are, frankly, mixed. While the CRP could be a key mechanism for ensuring that the appropriate mix of research (Recommendation 3) is conducted based on an integrated assessment of overall Fund research requirements and objectives, I am concerned about the risk that it could become another layer of hierarchy and may overly centralize the research process. While decentralization might seem chaotic at times, a centralized committee runs the risk of making greater mistakes in allocating research priorities. Decentralization, I feel, is more likely to favor original

thinking and allow the greater flexibility that is required in an organization that has to respond quickly to outside events beyond its control.

However, to ensure an effective operation of the CRP, the five ideas proposed by Mr. Faini are appealing, and on balance I can go along with the proposal. To his list, I would add that suggestions for research topics should also come from the Board. The CRP should operate together with an improved system for directing research resources towards identified priorities, particularly on a cross-departmental basis, so that perceived research gaps can be addressed using existing resources. To this end, a policy to reward staff for services rendered to other departments in performance appraisals and the development of the necessary infrastructure, such as placing requests for assistance of the Fund's internal website (Recommendation 4), could prove useful. However, appropriate incentives for department heads to encourage collaboration are also needed.

Recommendation 2. Explicit Departmental Targets for Research.

The idea that fixed blocks of staff time should be allocated to research seems problematic, as it does not address the underlying pressures which lead the "urgent" to overwhelm the "important." This issue may be more effectively addressed by increasing the incentives for senior staff that will encourage them to dedicate resources to appropriate, high-quality research, perhaps by developing a league table of departmental research performance or by including such an assessment in Directors' performance appraisals.

Similarly, improving incentives for research staff to produce appropriate, high-quality research by adding assessments of research quality to annual performance appraisals (Recommendation 5) could be a major way to ensure that identified research priorities are addressed. Measures of quality would include not only technical and analytical content, but also relevance to the Fund's overall research agenda. Furthermore, there is a need for encouraging research staff to undertake critical assessments of Fund policies towards particular issues or countries. This type of research will usually be interdepartmental, involving area and functional departments. The need for input from, and the potential for conflict with, multiple departments will discourage this type of research unless there are sufficient extra incentives to pursue it. The CRP and the performance evaluation system should explicitly encourage such work.

Recommendation 3. Shift the Mix of Research. In my view, this is the most useful recommendation. I agree that the focus of staff's research, in the context of scarce resources, should be in areas for which the Fund has a comparative advantage and that are closely related to the Fund's mandate. I also agree that the most promising fields to explore are research on developing countries with respect to the framework and conduct of sound macroeconomic

policies, cross-country research on policy issues and experimentation, and research on the workings of the domestic sector in member countries and the global financial system. The emphasis on developing countries and small states, where appropriate, cannot be overstated as these members lack the internal capacity to carry out this work themselves. In these cases, value added is maximized. Moreover, the focus of the staff's research should be considered in the light of the external review of the Fund's surveillance activities and the Board's assessment of its recommendations.

Recommendations 15 and 18. Nontechnical Summaries and Timely Dissemination. Measures to improve the dissemination of the Fund's research, both within and outside the Fund (such as treating working papers as preliminary [Recommendation 16] and preparing nontechnical summaries of research) should be considered part of a comprehensive review of publication vehicles and strategies. This is particularly important since ways to improve the stability of the international financial system are being examined in a growing number of fora, thereby underscoring the importance of timely dissemination of Fund research and the publication of user-friendly, nontechnical summaries.

Recommendations 8, 13, and 19. Performance Evaluation, Flexible Hiring, More Research Assistants. Recommended changes to the human resources policies of the Fund, such as increasing the number of fixed-term research assistants and facilitating the hiring of more research-oriented economists, seems desirable. On the issue of reform of the evaluation system, I suggest that this needs to be reviewed in the broader context of human resource management issues.

Finally, I would like to see more Fund staff collaboration with researchers in treasuries or central banks on special projects. Temporary (two-way) secondments might also be considered to foster closer ties and promote quality research.

Mr. Hansen and Mr. Palmason submitted the following statement:

In a bureaucracy such as this one, outside views can be a breath of fresh air, and the exercise in evaluating the Fund's research activities does not disappoint. I found the evaluators' report and their earlier presentation objective and to the point. To have such highly distinguished and experienced outsiders evaluate internal practices with respect to research, and offer alternatives to present practices, is an opportunity for advancement. Among other things, it offers the Board an opportunity to reflect on the present state of affairs. With regard to substance, I found most of the recommendations very interesting, illuminating, and even provocative, but not necessarily flawless and not necessarily the only conceivable solution to the issues at

hand, as was fairly argued in staff's response although the tone was unnecessarily defensive. The challenge is to sort out these recommendations that are conducive to progress and not compromise the high quality of existing research and research practices.

Organizational and Human Resource Issues

The recommendations related to the organizational structure and human resource management practices are probably the most difficult and contentious ones. But they also appear to be a reflection of the organizational structure and cultures and are not necessarily specific to research activities. Nonetheless, I see a good reason to endorse the concept of introducing explicit departmental targets for time allocated to research activities (2), to create incentives to improve collaboration among departments (4), to give juniors the opportunity to present their research (6), and to create a more effective performance evaluation system (8). Moreover, I am attracted by the idea of creating a committee on research priorities (1) to give a clear mandate to the Director of the Research Department (7) and to streamline the review process (9). Together, those recommendations are generally conducive to increasing efficiency and accountability.

With regard to the proposed committee on research priorities, Fund research would probably benefit if a small number of clear, medium-term research programs could be defined in such a way as to give research a more strategic role in the development of Fund policies and day-to-day activities. The benefit would be the greatest in the policy foundation and policy development categories. The third category, policy analysis, is more ad hoc and less in need of this kind of strategic framework. On the other hand, the concrete remedy of setting up an interdepartmental committee may be debated and should, in the end, not distract from the idea of defining a strategically sound research program, which I believe is exactly what the Economic Counsellor has been doing an outstanding job of for the last few years.

Regarding participation on the committee, the evaluators were a little imprecise in suggesting that it would "normally" be chaired by the Director of Research and that staff should be chosen primarily for their "strong research interests" (not seniority). Management seems to agree that the committee "should include senior staff of departments ... and could be chaired by management." I think I prefer Mr. Faini's proposal that the committee be chaired by the Economic Counsellor—who in my opinion should be accountable for research activities—and include representatives from area and functional departments on a rotating basis, plus prominent members of the academic and policymaking community. As a final point on this topic, the chairman should encourage researchers to "rock the boat" and distance the research work from "clientism," which appears to be a problem at present,

according to the evaluators. I certainly have faith in the current Counsellor's abilities to "tell it like it is." In fact, that quality should be included in the criteria for hiring future Counsellors.

Regarding researchers' interaction with the Board, I am not persuaded by the recommendation to create a new vehicle for nonsenior staff to present their research (17). However, I would welcome the practice that nonsenior staff present their work during the course of regular Board meetings and that their names be rightfully attached to the work for the Board's attention; there is room for more flowers to bloom. It would seem perfectly reasonable that the one who is accountable (department head) delegates responsibility to the one who is responsible for a certain piece of work (his staff). Isn't that what management does effectively with respect to department heads? Management's claim that it is essential to have department heads in the lead for the sake of "accountability" is not fully convincing. This claim is probably more relevant with respect to non-working papers, but that does not necessarily mean that the department head should claim ownership of most work in their department or that the review process needs to go through many hands.

The recommendations to alter the skill mix are generally excellent. I can certainly support the idea of introducing more flexibility into the hiring procedure for entry-level economists (13).

The Research Focus

The present research focus is broadly appropriate, although, as the evaluators clearly indicate, there is always room for improvement. I would certainly not want to sound too critical about the excellent work that is done by the Research Department and others in the Fund with respect to research, but I would like to offer some food for thought. I can certainly endorse the recommendation that the research mix should shift towards topics that add most value (3). I also agree that the comparative advantage and the highest marginal value of Fund research is in developing and transition country research, cross-country research, and financial sector research to the extent that it is relevant to the Fund's mandate, is of macroeconomic importance, and is done in collaboration with the World Bank (12). On that last point, I am not persuaded by management's claim that "coordination is a highly resource-intensive activity." At least with respect to financial sector issues, the World Bank staff should not be "luggage." That is the impression that was created by the external evaluators on surveillance, which bodes well for the assessment that there are "synergies" between the Bank and the Fund with respect to research. It must also be less resource-intensive to walk across 19th Street than to develop expertise in social sector and poverty issues.

The evaluators assert that Fund research (Fund researchers) does not have as high a profile in the outside world as it did in the past. I think this is an unfair point, particularly when I think of people like Mr. Mussa and Mr. Fischer. But I still think it is healthy to discuss it. From the point of view of developed economies, it is probably the case that the kind of intellectual leadership the Fund enjoyed in the 1960s has faded. As an example, I could mention the invention of the monetary approach to the balance of payments. Today many central banks no longer rely on monetary targets as their guiding light in a new age of inflation targeting and multivariable monetary policy. On the other hand I would argue that Fund research is very important for policy development and analysis in some developing and transition countries. Thus more research should be focused on examining the analytical basis of Fund programs, as is indicated by the evaluators.

Regarding the World Economic Outlook, which I agree is the flagship of Fund research along with the International Capital Markets Report and which no doubt serves a useful purpose for the membership, I am tempted to argue that the evaluators missed the notion that the WEO can be somewhat overwhelming and that it could be more to the point. This is more a question of quantity than of quality. As a matter of fact, I see it as a question of how extensively staff should write in order to hedge their bets and cover all bases when discussing the upsides and downsides of the world economic outlook. The advantage of this approach is that the WEO produces an excellent account of current affairs and hence of history—in retrospect the WEO is always right. Something along the lines of the Interim Assessment of December 1998 would be more to my liking. I also think that the special issues are not always so acute for the world economic outlook, and hence they might be published separately. I also think the surveillance evaluators had a good point by suggesting that, instead of negotiating the outcome of point forecasts between the research department and area departments, it would be healthy to expose the differences up-front, which might also help draw the readers' attention to the extremes.

The Fund's working papers are another area of interest. I was not surprised by the evaluators' findings that working papers, albeit sometimes excellent and to the point, often lack organizational focus and do not contain analyses that are superior to what is being produced outside the Fund. I agree with the evaluators that the working paper output should better exploit the Fund's comparative advantage and fill the gap in underrepresented areas. However, I fear that the evaluators' recommendations (particularly 15 and 18) may be too ambitious and perhaps will not contribute to solving the problem that working papers often lack policy orientation and are often too technical to be digested by policymakers and non-Ph.D.s. On one extreme, the authors may be motivated by the purpose of proving their analytical abilities—perhaps partly in order to gain promotion within the organization. While such

exercises may also be conducive to advancing the science of economics, they are probably better placed in universities and should certainly not be motivated by internal hierarchy. With respect to the reader, I do not believe it is sufficient to summarize a fraction of research papers as is recommended (15). Neither do I think it would be good allocation of resources to throw more research at nontechnical audiences outside the Fund. It is also a little ambitious to consider creating a separate policy journal; I would be willing to consider it, however, if it to a large extent replaced working papers and it also offered a venue for qualified outsiders to debate Fund policies. But, short of that, my main point about working papers is that they should be more applicable to the core activities of the organization, and not every staff member should be devoting their time to this kind of activity. I was very puzzled by management's argument that "one of the main reasons to write a paper is to gain full understanding of a topic, which reading alone rarely achieves." If this theory was widely employed, we would not get much done and there would not be many trees left in the world.

A related issue which has long puzzled me is the production of extensive Selected Issues papers on industrialized countries. Most of the time this reading is interesting but probably rarely very original. More often than not it appears to duplicate existing work, often on issues outside the core mandate. Meanwhile, issues like cross-country analysis and regional analyses of macroeconomic importance have been slow to materialize, although that is hopefully changing. On the whole, I believe the production of selected issues could be cut substantially, even beyond the group of highly industrialized countries, and the resources put to better use closer to the core mandate of the organization. Selected issues could also be more selective and better integrated into the actual Article IV consultation process to serve the purpose of deepening the analysis in the Article IV report rather than being stand-alone studies. Management warns against creating a "dual-track surveillance" in this context as a reason why the status quo must be preserved. Well, the membership is heterogeneous, and we would have to find a better reason than a principle of homogeneity to justify employing massive amounts of resources in areas where the impact is low, particularly where good research already exists. I was astonished to read in Box 1 that "it can take up to three months of an economist's time to produce a piece of research to appear in a selected issues document."

The evaluators have rightly focused on encouraging researchers to contribute to policy work (4), improving the assessment of research quality in performance reviews (5), and to give juniors opportunities to present their research (6). But they have not come up with an incentive structure in which staff is rewarded for doing no research when no research is needed. This is probably a question for management to think over.

Finally, on the research focus, I suspect the evaluators are a little off the mark when assessing quality by assessing analytical innovation in theory and empirical analysis, because quality in Fund context may be little things like data and graphs. The benchmark is not necessarily output in academia but rather the strategic and ad hoc needs of the Fund.

Resource Implications

On the question of resource implications, I would beg to differ with those who have argued along the lines that the somewhat ambitious multidimensional tasks suggested by the evaluators (including improving institutional arrangements, incentive structures, internal knowledge transfers, developing and transition country research, and cross-country research) would inevitably lead to additional resource demands. It can be viewed from the point of view of reorientation and reorganization. Surely the Fund is trying to achieve equally complex goals at present. The wise words of Professor Mishkin, who previously carried out the task of reorganizing research in a broadly comparable setting, were certainly encouraging. At the preliminary session he said something to the effect that "one should look at how far current resources can go before throwing more money at it." I also believe he said that "no public policy institution is ever going to compete with Wall Street and that motivation must come from getting involved with the public policy process." Put those things together and perhaps it is possible to motivate the troops—who are here because they want to be here—and reach an even higher peak at the given level of resources.

Future Evaluations of Research Activities

The recommendation to create periodic external reviews of research activities (22) is a very good one. There is simply no better way to assess the state of affairs, which needs to be done from time to time in any organization. Citation and publication records, which in some institutions are used to monitor performance, are not very informative in an institution such as the Fund, which is not and should not be academic.

Mrs. Hetrakul and Mr. Peh submitted the following statement:

We thank the evaluators for a candid assessment of the Fund's research activities. Staff response to the report is equally frank, and we appreciate very much their direct and explicit remarks. As the saying goes, "iron sharpens iron"; it is hoped that the end results of this process will be beneficial to the Fund. At the outset, we must add that it is rather difficult to assess the various recommendations in the report because there is doubt lingering in our mind about whether the evaluation was comprehensive and wholesome enough to arrive at findings which we could accept

wholeheartedly. Our reservations are mainly based on the number of limitations faced by the evaluators, which are well mentioned by Mr. Mirakhor in his preliminary statement. These include the time and resource constraints, the limited choice of research output under evaluation, and the small team of evaluators. We also fully agree that the evaluation should have adopted a longer timeframe, rather than focusing on research outputs in 1998 when staff were more than occupied with the financial crisis.

Given the limited mandate of the evaluators, some recommendations are deemed to be rather far-reaching, such as those which will help address the morale and accountability of staff and foster greater collaboration between the Fund and the World Bank. While the rationale underlying these recommendations is understandable, we do not find the basis for the recommendations very convincing, although improvement in each of these areas is certainly desirable. For example, on the recommendation to create a more effective performance evaluation system, we tend to agree with staff that that the suggestion goes beyond the evaluators' terms of reference.

Nevertheless, we do see merit in some of the recommendations. First, we support the idea of creating a Committee on Research Priorities to assist in strategic planning and to support research activities in the Fund for the reasons stated by the evaluators. However, we would agree with Mr. Faini on the need to be clear about the way the CRP would function. We believe that the CRP would help prioritize the Fund's research activities and help in the coordination of activities across departments. The CRP would also be the body responsible for the ongoing status of research in the Fund and its continual assessment.

We also welcome the recommendation to introduce departmental targets for staff time allocated to research, but taking into account the competing activities and resource constraints. While the targets should not be followed rigidly, they would serve as useful guides for departments in assessing the amount of time devoted to research activities.

On the recommendation for more developing country, cross-country, and financial sector research, we can see that this is already the direction staff is moving towards. We agree with the Managing Director that surveillance research should be continued in advanced economies as staff should have its own perspective on issues under discussion in Article IV consultations. While it is true that research papers on these economies are abundant, it would be in the Fund's interest for staff to make public its views on various issues and, more importantly, the underlying analytical foundations of their views.

We have no problem with the recommendation to increase the flexibility of the hiring exercise for entry-level economists, provided that

these economists are also adequately involved in the operations of the Fund. Given the limited talent pool of strong researchers, the Fund should continue to make itself an attractive place for economists with excellent research skills. In the same vein, we welcome the suggestion to recruit more mid-career staff who can help expand the knowledge base of the Fund. However, on the point that staff should be given uninterrupted blocks of time to conduct research, we find that desirable but not realistic. As pointed out by the Managing Director, even in academic institutions, researchers would still have to teach and be involved in administrative matters. Nevertheless, we would agree with the evaluators that the Fund should recruit more research assistants to free staff to do more sophisticated research.

On the recommendation to streamline the management structure in the Research Department, we felt that the argument is not convincing enough. Certainly, there will always be alternatives to the present organizational setup which could help enhance intellectual exchanges. We would appreciate it if the evaluators could further elaborate on how the current structure has stifled interaction and creativity.

We welcome some of the changes suggested for improving the dissemination of research, especially the preparation of nontechnical summaries of highest quality and relevant research which will help raise the visibility and credibility of the Fund. We can also go along with the recommendation to treat the working papers as preliminary, but are not too keen on the idea of creating a new vehicle for junior staff to make presentations before management and the Executive Board. Rather, we prefer Mr. Mirakhor's more practical suggestion of holding departmental research seminars.

We thank the evaluators again for their hard work and staff for their response to the recommendations. We believe that the discussion of the issues raised in the report will help improve the research activities of the Fund.

Mr. Portugal submitted the following statement:

We welcome the External Evaluators' report on the Fund's economic research and wish to thank them for producing a comprehensive, far-reaching, and thought-provoking paper, as it is the function of an external evaluation exercise. We also appreciate the staff's response and management's comments (which add both an in-house perspective of the role of research and a deeper cognition of the constraints and trade-offs faced by the institution) and the interesting and diverse comments contained in the preliminary statements.

Research plays a vital role; creating basic analytical frameworks, adapting or improving existing frameworks, and generating specific and

thorough country knowledge are required for the development of policy strategies and policy advice in which the Fund has to engage. As the evaluators pointed out, research helps to ensure that the approaches the Fund takes "are the best that the current stock of knowledge and state of the art in policy design can offer." Like Mr. Shaalan and Ms. Abdelati, we think that is the major role of Fund research.

Therefore, we agree with the evaluators that, while the Fund should not try to produce all the research that is relevant for its operations, it is absolutely essential that it maintains a strong and high-quality in-house research capacity. Contracting outside research and making use of good research done elsewhere, while important, are no substitute for the Fund's own research capacity.

Research in general and Fund research in particular are not ends in themselves. The Fund's research activities are inputs into many other policy and operational activities and, as such, need to support, contribute to, and be integrated with these other activities. This is a point that is recognized by the evaluators and stressed by both staff and management in their comments, and with which we concur.

We agree that this operational policymaking focus of Fund research should, overall, be maintained and that research which cannot be linked to policymaking should be best left for academia. We feel, however, that this is not incompatible with also using research activities as a mechanism for constantly updating the Fund's thinking, challenging the conventional institutional wisdom, and bringing in fresh and creative ideas, a role which is even more important in the area of what the evaluators call policy foundation research.

With respect to the evaluation of the Fund's research output, we share the evaluators' positive impression and the high regard that policymakers, academics, and market participants have for the WEO and the International Capital Markets Reports, which are the flagship research products of the Research Department.

The evaluators also reviewed other research products—a random sample of 16% of the working papers produced in 1998 as well as 22 papers considered by all departments as the best produced in 1998—and, with some exceptions, were not favorably impressed. With respect to the sample of working papers, the evaluators felt that, in some cases, the papers were not particularly innovative, lacked depth, appeared to have been hastily produced, or were insufficiently developed. The evaluators rated as excellent more than half of the 22 papers that were selected as best by the departments and indicated that these could be accepted for publication in top academic

journals. But they also pointed out that, in their opinion, the remainder were either of dubious value for the Fund's operations, were analytically weak, or did not sufficiently challenge the Fund's thinking. The evaluators also reported an overall unfavorable outside opinion that the Fund's research activities were not currently contributing as much as in the past to the stock of economic ideas, that they were too orthodox, and that they fell shy of challenging the Fund's internal wisdom. While not having elements for either endorsing or disputing these opinions, we find the mere fact that they are expressed by a distinguished and experienced panel of evaluators quite disquieting, given the importance we attribute to the Fund's research activities.

Turning to an evaluation of research inputs to try to find out possible causes for the shortcomings they detected, the evaluators examined issues relating to the institutional culture, organizational structure, resource allocation, incentives, and accountability. Many of the issues examined in this analysis, as the evaluators recognized in paragraphs 16 and 17 and the staff stressed in their response, are more general and not specific to research activities.

Among the various issues examined, we are particularly concerned by the evaluators' opinion that there is evidence of a culture of conformity which makes staff sometimes reluctant to express their views or undertake controversial research, and which emphasizes generating consensus at the expense of deeper debate.

We do not think there is a contradiction between the Fund's need to make quick and firm decisions and speak with one voice, on the one hand, and the objective of encouraging a diversity of views and being open to new ideas, on the other. Both objectives can be reconciled by making the distinction between the debates that can take place before policy or operational decisions are made, and the discipline that should exist in the operational activities after decisions are made. The Fund must speak with one voice, but should not think with one mind. Research activities in particular, by their very nature, should not be stifled by hierarchical discipline. They should encourage debate and new ideas, including those that challenge the internal conventional wisdom. We agree on the need for greater openness to new ideas, including those that challenge the institution's orthodoxy.

We also agree with the evaluators that the Fund does not place sufficient value on outside experience when hiring mid-career staff—an issue that again goes beyond research activities.

Turning to the recommendations referring to the allocation of Fund resources in research activities (Recommendations 1, 2, and 3), we agree with

Recommendation 1 and partly concur with Recommendation 3, but remain unconvinced about Recommendation 2. It is important to maintain the current decentralized research approach, whereby research is carried in area and functional departments in addition to the Research Department, while at the same time strengthening coordination. For this the evaluators propose the creation of a Committee on Research Priorities (CRP), with the role of setting research priorities, providing resources, and making Fund-wide decisions with respect to inviting visiting scholars and hiring outside consultants. We support this recommendation. Some departments are concerned that this might add another layer of bureaucracy or stifle individual initiative and creativity. Although the risk of the CRP becoming bureaucratic exists, as with any other body, this should not necessarily be the case, and to guard against this risk the evaluators propose that it be staffed with members with strong interests in research. Regarding the argument about stifling individual creativity, as Mr. Faini pointed out, staff would be able to present proposals to the CPR, individually or in partnership. In addition, Mr. Faini's suggestions for the operation of the CPR might also help to guard against these risks.

However, I share the staff's views about Recommendation 2 that suggests explicit departmental targets for staff time to be allocated to research. While I agree that research is a special intellectual activity which requires the devotion of uninterrupted blocks of time, and that in many cases staff are too stretched to put additional time aside for research, I am unconvinced that time earmarking is the best way to solve this problem. A better solution seems to be, on the one hand, to free up more staff time by not trying to expand the Fund's activities into areas covered by other organizations or which are tangential to the Fund's core activities, as suggested by Mr. Shaalan and Ms. Abdelati. On the other hand, one could increase the incentives for departments to allocate more resources to research, along the lines suggested by Mr. Bernes.

We agree with the recommendation of shifting the research mix towards cross-country research and the financial sector (Recommendation 3). However, we share management's and staff's positions against reducing research in industrial countries. As the Managing Director argued, the Fund needs to have a well-informed and analytically sound capacity to engage in policy dialogue with these countries because of their systemic importance, and one should avoid creating a dual-track surveillance process. We also feel, like Mr. Mirakhor, that this research has an important value to Board members that are not deeply familiar with these countries and do not read all the published research needed for informed policy debate. We feel that this type of research should continue to be done and to be published.

We also agree with most recommendations designed to improve incentives and the accountability structure (Recommendations 4, 5, 6, 8, 11,

20, 21, and 22). These involve giving research staff credit in their annual performance review based on input from departments using the research output; advertising major research projects and missions on the Fund's internal website; improving the assessment of the quality of research, not only number of papers; allowing primary authors of papers to present them to the Board; putting on Fund publications only the names of significant contributors without the presumption of co-authorship based only on seniority; contracting outside experts to read and comment on research output; preparing annual follow-up reports to the Board on the implementation of the measures approved by the Board; and undertaking external evaluations of research activities at least every five years.

On the recommendation concerning the review process (Recommendation 9), we agree with the suggestion for reducing the amount of reviewing, since too many resources seem to be devoted to this activity. As regards the suggestions of avoiding written communications and making the review process more informal, we share the Managing Director's concerns about the importance of written opinions to increase accountability.

We agree with the recommendation for preparing short, nontechnical summaries to disseminate research to all departments, management and Board (Recommendation 15), as well as with the recommendation of treating **working papers** as preliminary results which do not represent the Fund's view and adding the suggested disclaimer (Recommendation 16). Screening for minimal quality, confidential information, and problematic language should continue. However, as the evaluators pointed out, working papers in most organizations are intended to elicit comments and criticism and represent the whole spectrum of research from the strongest to the weakest. While the former should be further polished, the latter should be abandoned. A complementary and/or more practical alternative to the proposal of creating a new vehicle for nonsenior staff to make presentations to management and the Executive Board (Recommendation 17) is Mr. Mirakhor's suggestion for Board members to attend departmental seminars. The suggestions for improving dissemination of research to nontechnical audiences outside the Fund (Recommendation 18) perhaps could wait for the opinion of the external consultants, who we understand are currently undertaking a wider review of the Fund's external communications strategy.

We strongly support the recommendation of hiring substantially more research assistants on fixed-term, nonrenewable contracts, especially among young college graduates, even if this is not budget neutral as the evaluators assume (Recommendation 19).

We are pleased that the initial misunderstanding referring to giving a clearer mandate to the Director of the Research Department

(Recommendation 7), which we support, has been dispelled and the corresponding wording amended. We do not support Recommendation 14 for streamlining the management structure of the Research Department. As explained in the staff's response, this structure is essentially the same as other departments and is essential for the delivery of high-quality products such as the WEO, the International Capital Markets Report, and related materials.

The Chairman of the External Evaluation Committee on the International Monetary Fund's Economic Research Activities made the following statement:

Our role in this meeting is to clarify the issues that have been raised in the preliminary statements and in the course of discussion. The first issue concerned the benchmark we used for evaluating the staff's research; in particular, there was concern that the benchmark might have been too academically focused.

The first point I should make is that all three members of the committee have been actively involved in public policy and believe strongly that public policy institutions should not be doing the same thing as academic institutions. The second is that, in the report, when we discuss the evaluation of research, we continually state that relevance to the mandate of the Fund is critical. That consideration was very much part of the criteria that we used in evaluating the Fund's research. Third, some Directors raised a question as to the academics we consulted. We talked to academics who have been actively engaged in public policy debates of concern to the Fund. Almost all of them have had contact with the Fund, either as former Fund staff, as visitors to the Fund staff, or as active participants in Fund conferences. I cannot provide names, but they are the people the Fund would have wanted us to consult. We did not talk to ivory-tower theorists; we talked to people who had relevant knowledge of the Fund's research program, and some had even been involved actively in that program.

The second issue, associated with the point raised by Mr. Morais, is the issue of in-house capacity for research. We mentioned that there could be a greater use of consultants rather than visitors. We have to be clear as to what we meant. We were very careful to say that these consultants would be people who would conduct research with the staff. The view of the committee is that research conducted independently of the staff would not be particularly valuable in this organization. On the other hand, when we think about how we want to involve outsiders, we might consider the value of a visitor who is actually on site and the value of somebody who is off-site but working actively with the staff. The difference between the two might be somewhat limited. That was what we meant by a consultant. There are clearly cases where it is more efficient to have somebody off-site and communicating electronically, rather than having them at headquarters where they may not be writing with the staff. We agree with the view expressed in several preliminary statements that research should not be farmed out to the outside; it should be conducted in-house.

However, a judicious use of consultants, in the way we describe, can help that process.

On the issue of World Bank and Fund collaboration, we feel that collaboration needs to be a bottom-up process and not a top-down process. A process of cooperation that is simply directed from the top usually will not work. However, we have to create a framework to encourage a more productive interaction. We felt that there were two ways of doing this. One suggestion was that an adequately resourced seminar, featuring good outside speakers and run by junior staff members, would attract good people from both the Fund and the Bank. Just sitting people in a room and having them discuss research ideas generates a remarkable degree of collaboration. In that sense, the seminars need to be given a formal framework, but we stress that it should not be institutionalized as a top-down process. Similarly, a joint conference, which is a somewhat more complicated enterprise, could have many of the same features. Something needs to be put in place as a way of getting people to sit in a room together.

The final clarification is on the issue of departmental targets. We were thinking of these as a means to help set priorities for different departments. The targets were a way of ensuring that research not be treated as a residual responsibility, which has been a problem in recent years. We understand that completely uninterrupted blocks of time for research do not, in practice, exist; so we were thinking of these targets as being flexible, indicating the department's commitment to research and giving staff an idea of how much time they should devote to this function. Also, such targets should be flexible within each department so that it would not be necessarily appropriate to set the same target for every individual. There are staff who are more productive when conducting basic research, and staff who are more productive contributing to the bread and butter policy work of the Fund. That should be a decision for department heads. I should mention that, in the report, the Economic Counsellor's discussion of a departmental research target was consistent with our view.

Mr. Yoshimura made the following statement:

As was the case on surveillance, the external evaluation of Fund research has provided insightful information and useful recommendations. As Mr. Faini has pointed out, a freely operating price mechanism would not provide the correct incentives to invest in research. Therefore, we should seriously look into the evaluators' recommendations. However, that does not mean all the recommendations should be implemented. Today's discussion will help clarify the feasibility and desirability of each recommendation, and will help determine which recommendations should be implemented.

I welcome the Managing Director's comments. Specifically, I urge management to move forward as quickly as possible on those recommendations that

they agree with, such as the establishment of a Committee on Research Priorities (CRP) and greater interaction between Fund staff and outside researchers. Management has expressed reservations on a number of other recommendations, such as cutting back on industrialized-country research, allocating a budget to the CRP, and providing continuous blocks of research time for the staff. Such concerns are understandable, and I would like to respect their judgment on these recommendations, given the wish of this Board not to micromanage the decisions of the management.

The evaluators' recommendations on the annual performance appraisal have either been implemented already or are under review. For the moment, I would like to leave these to the discretion of the management until the performance appraisal is reviewed as a part of a future external evaluation of the Fund's internal management. Given the tight resource constraints under which the Fund is operating, management might wish to take advantage of opportunities to reduce research in areas where there is relatively less value added. For example, a cutback on industrialized-country research might free some resources that can be used for research in areas where the Fund has a comparative advantage.

It is not clear from the Managing Director's comments how to improve the internal review process. An announcement by management that this review should not be excessive might not be very effective, so perhaps guidelines might help. I will leave the details of such guidelines to management, but an example would be to narrow the range of departments consulted, or perhaps limit the amount of comments that a department can submit. These constraints should differ, depending on the nature of the paper to be reviewed—for instance, whether it concerns an Article IV consultation or the use of Fund resources. A mechanical guideline has obvious drawbacks, but might be unavoidable.

I would like to discuss a number of issues not mentioned in the Managing Director's comments. In the informal Board meeting in July, the Economic Counsellor challenged the Board and management to provide a clear evaluation of his performance. The Counsellor's performance, as a Counsellor, has been outstanding. However, it is difficult for me to judge whether he has been an effective Director of the Research Department, as this aspect is not clearly visible from the Board. Still, even if he were not an effective research leader, that would not necessarily reduce his value as Director of the Research Department. The task of providing appropriate advice to the management and the Board and the task of leading the Fund's research activity do not have to be carried out by the same person. As long as senior management within the department are successfully performing these two types of tasks, there is no problem. If a particular Director has a comparative advantage in the role of Economic Counsellor, he can spend more time on that task while other senior staff take the role of research leader for the Fund. In any case, the important point is that management should make sure that the functions of both Economic Counsellor and effective research leader are guaranteed under the new CRP framework.

Under the directorship of Mr. Mussa, the Research Department has deliberately increased its contribution to the operational aspects of the Fund. Mr. Mussa was asked to achieve this, and he succeeded. However, the evaluators are asking if the shift in direction might have been achieved in a different way and if the shift might have gone too far. As I pointed out during the informal Board session, and as Mr. Mirakhor emphasized in his preliminary statement, these questions should be taken seriously by the management, who gave the mandate to Mr. Mussa. It should also be taken seriously by Board members, who are the biggest beneficiaries of the services provided by the Research Department.

I recognize and appreciate that surveillance research through the WEO, WEMD, and the ICMR has contributed significantly to the discussions of the Board and the Fund's operational work. However, it would be a cause for concern if the resource requirements of these activities were to crowd out more basic research. More generally, the staff has been working very hard, especially over the past couple of years, but the fact that they have been preoccupied with fire fighting might have made it difficult for them to step back and reflect more deeply on research issues. On this point, I agree with Mr. Shaalan and Ms. Abdelati that we should not spread our staff resources too thinly.

So far, the staff has not completed their deliberation on the problems of the Fund's traditional program design. This is one of the strategic issues facing the Fund. A new program design should be firmly based on the current state of the art in economics and, in this sense, would be the ideal policy development research topic coming out of the Fund's operational work.

Having said that, I think spontaneity is very important in research, so it is neither possible nor desirable for the Board to try to guide research activity in too much detail. I believe the following steps would be appropriate: the CRP should discuss research priorities and questions thoroughly and agree on a list of priorities for the coming year or half-year, and the list should be submitted to the Board for information. Board members are free to comment on the list through memoranda, and in exceptional cases they could meet and discuss the matter, but in principle, the Board would be expected to endorse the list submitted by the CRP. Finally, I agree with Mr. Bernes's sentiments that the same principle articulated in the evaluation of surveillance—as to the next steps to be taken, publications, and follow-up assessment—should apply in this case.

Mr. Faini commented that the role of the CRP needed further clarification. Listening to Mr. Yoshimura's remarks, it was unclear as to whether the committee should have a purely consultative role, or whether it would be in a position to allocate research resources.

Mr. Yoshimura stated that the issue of resources needed to be considered carefully. He was suggesting that, initially, the CRP not be given control over research resources. Over

time, however, the Board might come to the view that the committee could manage the Fund's resources profitably. However, that would be a matter for discussion at a later date.

Mr. Bernes stated that he understood that the evaluators had recommended that the CRP be given control over at least some research resources, to ensure that it could exert an influence over the direction of research. The question then arose as to who would chair that committee.

The Chairman invited Directors to express their views on the issue. Either approach was acceptable to management, as the difference would be limited in practice and the scarcity of resources would ensure that research priorities would be determined by the Board.

Mr. Carstens made the following statement:

I welcome the report on external evaluation of research. It has received a considerable amount of attention from staff, management, and Directors, which is a clear sign that the exercise was a success. The evaluators, therefore, should be commended for their thought-provoking work. For the sake of brevity, I will limit my comments to a few issues that have not been emphasized sufficiently.

Research at the Fund is not an end in itself, but rather a very important instrument to achieve broader objectives. The institutional influence on research has been strong, especially over the past few years, and from this point of view, the track record of research has been positive. Most of the time, research has provided a timely response to the needs of the institution, reflecting well on the flexibility of the staff. Some major issues were not caught in time, but as an analogy, even in a well-functioning hospital many patients will present themselves at the emergency room.

However, we should keep in mind some key binding constraints. Research has to reflect the geographic diversity of country members, and the readership of many of our research products are neither fully trained economists nor academicians. It would be useful to make this clear in the terms of reference for future evaluation. It would also have been useful to have had more a systematic comparison of Fund research with that of other institutions facing similar problems, and also to have investigated the impact of Fund research in less developed countries. Having been the President of the Association of Central Bank Researchers in Latin America, I must say that for more than 75 percent of the association's member countries, the research of the Fund was the most significant body of research available, and that will continue to be the case for many years to come. Therefore, most of the country studies that are produced add considerable value, even if they do not appear to reflect original thinking or to challenge the Fund's view. Having consulted with my authorities, there is clear satisfaction with Mr. Mussa's performance as the Director of the Research Department and Economic Counsellor.

Having said this, I would like to mention that the report is extremely valuable in pointing to avenues for improvement. The most important avenues include the

following: incentive structures that in many instances hinder the research process, a lack of accountability at the research level, inefficiencies stemming from the review process, and wasteful use of resources owing to lack of interdepartmental coordination. All of these issues require immediate attention from the Board and management.

On coordination, I support the creation of the CRP along the lines proposed by the Managing Director, but with two important additions. First, the Board should be a more active participant; and second, the CRP should incorporate a consulting committee of outside experts, through which the expertise of academicians and policymakers could feed into the design of the Fund's broad research agenda. I sense that the Inter-American Development Bank and the World Bank are better than the Fund at staying in touch with the research directors of various ministries and central banks. My general view on coordination is in line with the solution hinted at by Mr. Bernes: department heads should be given the right incentives to encourage collaboration.

Two additional issues—first, it would be worthwhile to consider the possibility of modifying the structure of the Research Department; second, we should pay more attention to reform. We seem to want increased research on developing and transition economies without reducing the amount of resources devoted to industrialized-country research. The proposals of the evaluators on a greater role for consultants were appropriate.

Mr. Milleron made the following statement:

I. What Does Research Mean?

Back to the report, there are three tiers as defined by the evaluators.

1. Policy Foundation Research

- Conceptual framework; elaboration and clarification of concepts.
- Generally policy oriented.
- Most of the time normative in the good sense of the term.

2. Policy Development Research

- Fact-finding is crucial and time consuming.
- The output should be evaluation/assessment with a strong empirical background.

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- Such an analysis is close to the idea of prescription, in particular as a basis for operational activities in the Fund.

3. Policy Analysis Research

- In general it is an analytical and more country-oriented type of descriptive analysis.
- It has to be related to day-to-day operations in the Fund.

It has to be read as useful monographs on specific matters.

Such a classification is very useful, but we should be aware of the fact that there may be many overlappings; for instance, most of us would agree that an Article IV report is a piece of policy analysis research, but some boxes in it could be more of type 1 or 2. For example, this kind of work with two equations and a bit of clean econometrics could sometimes be sent to the American Economic Review for publication.

As a consequence, I fully agree with the view of research as a continuum, from foundations to policy analysis.

II. Policy Analysis Research

As a matter of fact, it is mainly the responsibility of the area departments. However, there are difficult issues related to the overall global consistency of the message coming from the IMF. There is a need for a real synthesis that calls for specific instruments and judgment.

The consequence could be to reconsider the title of the Research Department; it could become the "Department of Global Synthesis and Research."

As is clearly reported by the evaluators, this part of our production is of a high standard and highly regarded outside the IMF. Should one want to improve our work in that field, one could suggest (1) more "auto-evaluation" of the work, especially from an ex-post point of view; and (2) the development of stronger links with other international organizations and perhaps some national institutions, as proposed by Mr. Bernes.

According to me, this work is always professional; it is generally intelligent and, most of the time, interesting.

The quality of this part of research is mainly the responsibility of the heads of departments. They do a good job. They should continue. It is

evidently the result of the efforts of the economists in the concerned departments. They do it well; my proposal would be to "let them work in peace."

III. Policy Foundation and Policy Development Research

In these fields, there is no monopoly. However, as you can see from the annexes to the report, there are some great landowners or "latifundia."

It is clear from the report that among the functional departments, three great landowners emerge: Research, Fiscal Affairs, and MAE. In the area departments, there is research everywhere, but two prominent departments have to be mentioned: Europe I and Asia Pacific.

I am not fully convinced by the idea of a possible trade-off between operational responsibility and research. For instance, considering Table 3 on page 86, the line concerning Asia Pacific is very interesting. It shows that in 1995, 1996, and 1997, the average number of research products was 30. In 1998, it was more than 90. There is a kind of mystery in the way economists in the Fund allocate their time between operational activities and research.

As a matter of fact, it is their responsibility, we should trust them, and they should be encouraged to do as much as possible, as long as there is no consequence to their health or welfare.

In the definition of a research policy for the Fund, it seems to me that there are two principles we should keep in mind: (1) you should not fetter the feet of racehorses; (2) as little top-down process as possible and no more bureaucracy.

About the motivations for research of the Fund economists, my assumptions are that they do it because:

- it is necessary for their professional activities;
- it is good for their mental health; and
- they just like it.

IV. On the Proposals by the Evaluators

On Proposition 1, I am in favor of a Committee on Research Priorities (CRP), but I see it as a different kind of animal than what has been proposed up to now. In a few words, I would suggest a small group of just seven people, with the following characteristics:

- Chair—the chair should definitely be with management.
- I would suggest the participation of six topnotch academic economists, three of them being closer to policy foundation research, the other three more to policy development research.
- It would be a good idea to invite the members of the External Evaluation Group of the Board to participate as observers.
- Three departments—Research, Fiscal Affairs, and MAE—would have to present an annual report on their research activities, summarizing the main findings and presenting possible strategic orientations. Such a report should not have more than 10 pages. It should be sent in advance to the members of the Committee and should be the basis of a two-hour discussion. For such a meeting, the head of each department should be accompanied by the three or four staff who are the most concerned with the research issues covered. The idea of having one or two young staff members participate in the meeting could be considered.
- The other departments would be requested to produce such a report only every other year, approximately in the same spirit.
- Overall, such an organization would represent something like a two-hour meeting every other month or, overall, two or three days per year. I do not have any proposal concerning the detailed timing for such meetings to take place.
- The Committee would write a report for the Board's attention. In my view, it would be sufficient to have such a report every other year or after a full cycle of such consultations. Such a report should be compact and clearly strategy-minded.

With such a proposal, the CRP would be more of the nature of a catalyst. It should certainly not play the role of the heads of departments. It should be careful using the word "coordination."

In the same spirit, I am very skeptical on Proposition 2 concerning departmental targets for staff research. As was mentioned by many colleagues in the Board, such an orientation would create rigidity and probably more bureaucratic work for the concerned staff because it would immediately imply an associated system of reporting.

As discussed, in Proposition 3, it is certainly essential to find the right blend for Fund research activity. From that point of view, it seems to me clear that there is a broad consensus for trying to do more for cross-country analysis. Perhaps management has some initiatives to take, to make sure that such an orientation is effectively taken on board. I fully agree also with the idea of doing more in the field of financial sector analysis and developing countries' economics, but I am afraid that, saying that, I am preaching to the converted as expressed in staff's comments.

Concerning the right incentives, such as discussed in Proposition 4, my view is that we should take into account the fact that IMF research is more of a team sport than an individual activity. From that point of view, it is maybe a little different from what happens in academia. About the weaknesses of our performance evaluation system, such as reported in Proposition 8, we are fully convinced, but I am not sure that it is the right channel to really improve the working of Fund research.

I certainly do not object to the orientation in Proposition 5 to improve research assessment, and I am looking forward to the future meetings presenting interesting pieces of research by young staff members as a result of Proposition 6.

V. Other Considerations

I will not comment on the details of the other propositions by the evaluators. I just would like to make three points on some of them.

The issue of recruitment is certainly an important one. There are many ideas that could be envisaged. As general orientation, my advice would be to keep our recruitment process as open as possible. Going back and forth between academia, other multilateral institutions, various institutions in the member States, etc., is certainly a good idea, and there is a lot that could be proposed along these lines.

The dissemination of research output has to be discussed carefully. I am convinced that an internal journal is a kind of useful window for international institutions. However, a publication in international journals with a serious referee process should remain an essential criterion in the assessment of both the quantity and the quality of research.

Finally, I would like to repeat that surveys on various issues relevant to IMF activities are very important, both for staff and for the Board. I would not hesitate to say that it is true research if it is done in a really professional way. From that point of view, one could mention the generally excellent surveys of the *Journal of Economic Literature*.

Extending his remarks in response to a query from the Chairman, Mr. Milleron noted that the surveys contained in the *Journal of Economic Literature* maintained a difficult balance: remaining accessible to a general readership while simultaneously providing a valuable service to a more technical, professional audience. Similar surveys would be useful for both the staff and the Board.

Mr. Palei made the following statement:

The evaluators have prepared a rather comprehensive report on the research activities of the Fund and have come up with a number of useful proposals. After participating in the preliminary discussion and reading the statements of the other Directors, I would like to comment very briefly on a few issues raised by the evaluators, staff, management, and previous speakers on the shortcomings in the evaluation methodology, internal IMF reviews as a prerequisite for external reviews, the next steps; the Committee on Research Priorities, and the role of technology in improving research.

Some Directors have already commented on the shortcomings in the methodology used by the evaluators and the resource constraints they faced. I would add here that, in my opinion, some of the disagreements—real or imaginary—between the staff and the evaluators come from the differences in institutional knowledge of the IMF. The evaluators have provided a snapshot of the current state of research activities in the Fund, while the staff in their response, and especially Mr. Mussa in his comments, have paid more attention to deep and desirable changes that have taken place in the Fund in recent years. I agree with the Managing Director that the shift in the Fund's research toward top quality surveillance-related work, while being the main improvement as far as research is concerned, did not receive enough credit from the evaluators.

Based on our experience with the ESAF and surveillance evaluations, I believe that this shortcoming in the methodology of the evaluators' report could be prevented by the prior preparation of an internal review of Fund research. If the evaluators had access to the internally prepared report on research and to the staff's written response to it, their time would be spent more efficiently.

Despite my reservations about the approach taken by the authors of the report, I find many of their recommendations worthy of further exploration, and, given the emphasis on implementation of the recommendations of this review, a short follow-up paper from the staff with an action plan would be a good way to proceed.

I am attracted to the idea of establishing a Committee on Research Priorities (CRP). It could become an efficient conduit for the Board and management to guide part of the research activities within the Fund. If properly designed, such a Committee could influence the composition of research, an area where there is room for improvement and where the problem is mainly with implementation of the earlier recommendations to the staff. For example, the Board and the management have pointed repeatedly to the desirability of cross-country research. Hence, a similar recommendation by the evaluators is hardly a surprise for the Board. In my opinion, some of the existing coordination problems could be addressed through the proposed committee. We certainly have to come back to the specific features of such a Committee and to take into account the many proposals already aired by Mr. Faini and other directors as well as by the management. This chair is open to discussion of the funding for such a committee and its membership. As for the chairmanship, I am inclined to side with the Managing Director. It seems to me that if the management chairs this committee, the Board could better contribute to the prioritization and coordination of the research. The activities of such a committee should be limited in scope to the gaps identified in the Fund's research and should in no way hamper the creativity of Fund employees.

The evaluators came up with a number of recommendations with respect to dissemination of research within and outside the Fund, better communication between employees of different departments, and improvements in accountability. I am more attracted to the recommendations to improve existing forms, including working and policy papers, conferences, and department seminars. I have to admit that I am more skeptical about some of the proposed innovations, such as allocating special time for the staff to do research work or a new format for the summaries of the papers.

Furthermore, I believe that many of the valid concerns expressed by the evaluators could be addressed through other means—for example, through a better use of modern technology. Technology has to be a part of the Fund's work on improving its research, and consequently a representative of the newly created Technology and General Services Department should probably be a member of the proposed Committee on Research Priorities. To illustrate the potential of technology to affect research in the IMF, one can refer to the working papers, one of the main research vehicles of the Fund. One can recall that just a couple of years ago researchers in the United States had to pay for IMF working papers, and for interested parties in developing countries or transitional economies access to them was extremely limited. Now most of the working papers written in the last three to four years are easily accessible through the Internet. In the area of technology, the Fund should definitely do more. For example, drafts of the papers could be posted on the Intranet for informal discussion and comments. For the final versions of the working

papers, feedback could be solicited by creating an opportunity for anybody easily to post their comments on the working paper of their choice. The quality and popularity of particular working papers could be monitored by the use of counters of hits or downloads. On this basis, a list of the most popular research papers could be posted on the Fund's Internet site and chosen for adaptation for publication in *Finance and Development* and *IMF Staff Papers*. An apparent benefit of using the Internet for communication purposes is the elimination of time constraints for participation in the research discussions and the ability of the staff to better manage their time. The staff would be better motivated in their research when they see that somebody actually cares about their papers. I use the working papers as one example of how research could be improved through more creative use of technology.

Mr. Collins made the following statement:

Like other speakers, I am grateful to the evaluators, as well as to the staff and the management for their response. Several speakers have picked up on the creative tension between the staff's views and the views in the evaluation report. This report, like the external evaluation of the Fund's surveillance, demonstrates the value and insights that external analysis can provide. I agree with Mr. Hansen that outside views are often a breath of fresh air in a bureaucracy such as the Fund. Therefore, I also agree with Recommendations 20 and 22 that we should create an ongoing external review process for the Fund's research products and commit to periodic external reviews of the Fund's research activities at intervals of no more than five years. More generally, I can also support the next steps on publication and assessment, as suggested by Mr. Bernes.

Turning to the substance of the report, I share many of the concerns raised by Mr. Faini, Mr. Bernes, and Mr. Hansen. I will therefore briefly focus on the most important recommendations.

I agree strongly with Recommendation 3, which argues that the mix of research should be rebalanced in favor of cross-country studies, financial sector issues, and developing and transition countries. The external evaluation of surveillance also called for a resource allocation along similar lines. These are areas where the Fund has a comparative advantage and where there is the greatest scope for adding value. However, I do not agree that in cases where there is adequate research being undertaken by other institutions, the Fund should limit its research in core areas. The staff gave the example of research into the fundamental equilibrium of exchange rates. In that circumstance, we might be better advised to ask those other institutions to redirect their resources, instead of expecting the Fund to do so. On the other hand, I agree with Mr. Hansen that there is probably some scope for trimming the resources currently devoted to the production of Selected Issues papers for each and every advanced economy. I do not think that we should be too concerned about

the possible creation of dual-track surveillance, as it strikes me as entirely reasonable to shift resources to where they will have the most impact.

One area in particular where I think the Fund should be doing more is on the analytical basis for Fund programs. It strikes me that Fund research has lagged behind in this area. Recent programs for Brazil and Mexico have highlighted that we do not yet have an adequate program design for countries that have adopted inflation targets. I understand that the Monetary and Exchange Affairs Department is working on these topics, but it surprises me that the Research Department is not also involved.

I can support the idea of a Committee on Research Priorities. Although I share Mr. Bernes's concern that it might overcentralize and bureaucratize the research process, such an outcome is not inevitable. For example, we have a similar committee in the Bank of England that successfully enables an internal market for research. I can support Mr. Faini's proposals on the CRP's operation, and I think we might also consider whether the World Bank should be represented on this committee. That would be a good way of ensuring better research coordination between the two institutions, as called for by Recommendation 12. I also support the other detailed suggestions set out in that recommendation, and I hope the staff will be able to explore other ways to enhance collaboration with researchers at the Bank. Like Mr. Hansen, I am not convinced by management's claim that coordination is a resource-intensive activity.

The evaluators have argued that the staff should be given uninterrupted blocks of time to conduct research. Mr. Mishkin argued at our informal meeting that this was the easiest way to integrate research into the budget process; otherwise, research would tend to be a residual activity. I accept that there is a tendency for research to be crowded out by other, more pressing activities, but I agree with Mrs. Hettrakul that such a recommendation is probably not realistic. A better way to address the problem is through the appraisal system. As Mr. Bernes notes, the priority that the Fund attaches to research should be reflected in the performance appraisals of departmental directors, who need to make time for their staff to undertake research.

I think the report also raises a number of institutional issues which are not necessarily specific to research. First, the report argues in paragraph 59 that the lack of a zero-based budgeting process undermines the efficient setting of research priorities. The report also argues that a head-count approach to budgeting creates a bias toward hiring Ph.D.'s over research assistants. This, of course, is a particular example of a more general problem in the Fund's administrative budget process, which I have raised from time to time in the Budget Committee. Second, the evaluators argue for a staff appraisal system that deliberately influences the staff's incentives and accountability concerning research. Third, the report argues that the Fund should recruit more specialist research economists. I take the point that these issues are not central to the report's terms of reference, but I understand why the evaluators felt they were relevant. Some of these general management issues were

also raised in the external evaluation of Fund surveillance. I agree with Mr. Bernes that we need to look into these issues to see if the evaluators' concerns are particular to research or are instead relevant to the Fund as a whole.

Turning briefly to some of the recommendations on the dissemination of research, I would support the provision of nontechnical summaries of the Fund's most relevant work. I also see no reason why such products should not be disseminated to nontechnical audiences outside the Fund. I am less convinced of the need for a new avenue to enable nonsenior staff to make representations to the Executive Board, but I agree that nonsenior staff should have opportunities to present their research to management and the Board as a routine part of our day-to-day business.

On a separate point, I endorse the view set out by Mr. Mishkin that some of the budget for visiting scholars might be more productively used to finance carefully specified research outside the Fund, in collaboration with Fund researchers.

Finally, I would endorse the comments made by the Economic Counsellor about the appropriate role of the Research Department in an institution where research is also carried out in a number of other departments. If conducted properly, these activities should complement rather than compete with each other. I suspect that the evaluators also shared the Counsellor's analysis, but their findings might have been colored by the fact that such principles are not always met in practice. Incidentally, I do not read the revised version of Recommendation 7 as a criticism of the Counsellor and would not subscribe to the recommendation if I considered it to be critical. I associate myself with Mr. Mirakhor's comments in this regard.

Mr. Esdar made the following statement:

I would also express my appreciation for the very interesting and thought-provoking study of the external evaluators on the Fund's economic research activities. Together with the response of the staff and your very balanced remarks, Mr. Chairman, this provides a very good base for profound discussion. Today there can be only a first exchange of views on the various proposals. We also have to come back to some of the suggestions later as, in my view, they should be discussed in a somewhat different or broader context. I will come back to those issues later.

While there are many very interesting proposals, I share the concerns of staff and some of my colleagues that the evaluators, when suggesting priorities for research, obviously had, in particular, academic considerations in mind. This should not be seen as criticism. However, we have to have this in mind when drawing our own conclusions. Academic objectives are certainly a very important criterion for research; however, we also have to pay due regard to the fact that the Research Department has special responsibilities within this institution, which is not an academic one.

The Managing Director in his statement referred to the Fund's research role as operating along a continuum starting at one end with analysis of and reporting on current economic events and problems, going then to analytical and empirical work and cross-country policy issues, shifting to the research of new approaches for the Fund in dealing with its responsibilities, and finally, at the other end of the spectrum, conducting abstract research which might be more or less unrelated to the Fund's original business.

There can be no doubt that the Fund's research activity has to be focused predominantly on the left side and on the center of this spectrum, i.e., on the guidance for our policy advice in lending programs and bilateral and multilateral surveillance. To come straight to the point, in my view, here the Research Department and the Economic Counsellor have done a very good job. The World Economic Outlook, the World Economic Market Developments, the Capital Markets Report, and the integration of research in surveillance are all outstanding examples.

I was somewhat irritated by recommendations with regard to the Director of the Research Department, which seem to focus only on the right end of your "continuum," Mr. Chairman, and neglect the crucial responsibilities and the outstanding performance in the three other fields.

That does not mean that I do not share those recommendations which focus on the need to better coordinate research in this institution, especially between research and country and the other departments. I also share the view that the division of responsibilities in setting the points of emphasis for research and the cooperation not only between the Fund and the World Bank but also to the OECD and other international institutions could be improved.

I also share the view of the evaluators that research and publication on industrial countries, in particular if it is outside the Fund's core mandate and covered accordingly by other institutions, could be reduced. The argument that such research would be an important input to generate staff's views neglects a little bit that research should also accept the advantages of the division of labor.

I will refrain from commenting on those issues which should remain within the responsibility of management or in the Research Department, like the selection process for articles which are published in working papers, the way working papers are distributed, or the general publication policy. I have to admit, however, that I am overwhelmed by the number of Fund papers I receive every day.

I am also hesitant to follow the evaluators' recommendations to introduce explicit departmental targets for staff time allocated to research

activities, not only because in my view this is an issue where Board involvement hardly is required, but also because it seems to be somewhat on the bureaucratic or fine-tuning side. As you all know, this Chair in general favors medium-term guidance.

But there is another aspect to the involvement of the Board. I favor the idea of creating a Committee on Research Priorities, and I was encouraged by the fact that the Fund has already established a Working Group on Fund Policy Advice. Such a committee would not only provide a good framework to discuss research priorities among the different departments of the Fund, but also to draw the link between research and strategic policy priorities of this institution. I very much share the emphasis which Mr. Faini has placed on this point. Even more importantly, the Board could be informed on a regular basis of the outcome of these meetings. Indeed, the interaction with the Board on research priorities could be significantly improved.

Finally, many suggestions refer directly or indirectly to the human resources requirements for research. I am somewhat reluctant to discuss human resources requirements only for certain departments or functions of the Fund. To focus such a discussion only on the demands of research would neglect the fact that we have different demands for skills in country and policy departments in the external relations process or for policy dialogue, just to name a few. In my view, we need a more general discussion on the skill mix that is required for this institution in the framework of our general human resources strategy. Such a discussion should also take up questions like incentive structure, hiring procedures, and the flexibility of the working contracts.

To conclude, Mr. Chairman, I would like to thank again Messrs. Mishkin, Giavazzi, and Srinivasan for their marvelous efforts, and also Mr. Bernes in his role as chairman of our evaluation committee.

Mr. Wei made the following statement:

I welcome today's discussion and join the previous speakers in our appreciation of the external evaluators' arduous efforts in completing this comprehensive and pointed report in such a limited time. Like others, we are of the view that its thought-provoking recommendations for an improvement in research activities deserve serious consideration by the Board, management, and staff. Meanwhile the Managing Director's statement is well balanced, and the staff response to the report has provided us with insightful explanations and their candid views. Both statements are very helpful and welcome.

Even though the evaluators and staff hold different views on the definition of the Fund's economic research activities due to their different perceptions and understanding of the role of research in the Fund, no one downgrades the sheer importance of such activities in the overall functions of the Fund. In my view, the current research activities led by Mr. Mussa serve the operations of the Fund quite effectively, rather than the assertion made by the evaluators. I share the view of the Managing Director and some Directors that the Fund's research activities in many areas are generally first rate, as evidenced by the flagship research products such as WEO, ICMR, and WEMD, which are highly valued both within and outside the Fund. Efforts made by the staff to maximize the research contribution to fulfill the Fund's mandate should be appraised. However, I agree, too, that there is always room for improvement as the Fund's activities face the daunting challenges arising from the rapid globalization of economies and the increasing integration of financial markets. This being said, I would like to make a few comments on some major issues:

The global economic environment has changed rapidly in recent years, and the Fund, as the central institution of the international financial system, needs to react to critical and systemic issues swiftly. As the Fund's research activities have an explicit strategic bearing on its policy formulation, the research should reflect the above changes in a forward-looking manner. Given resource constraints, the decentralized format of research activities may not be able to fully satisfy the need to mobilize resources across departments and address the Fund-wide strategic issue appropriately. I see the merit of a more centralized and well-coordinated research arrangement across departments. Therefore, I am in favor of the proposed Committee on Research Priorities. This point has been well articulated in Mr. Faini's preliminary statement with which I associate. In this respect, I share Mr. Bernes's view that the voice of the Executive Board should be reflected in this Committee: at least, I can see the importance of the Board conveying the requests and views of the authorities to the Committee.

With regard to the issue of the mix of research activities, I echo the evaluators' proposal of shifting more of the Fund's research resources toward developing and transition economy, and cross-country and financial sector research. For developing economies, in particular, their increasing weight in the world economy, the systemic implications—as vividly illustrated by the recent crises—and the policy options for their economic development and adjustment deserve efforts which will not only benefit Fund surveillance but also facilitate effective negotiation and the successful implementation of Fund programs. It should be noted that the Fund has directed more research projects to developing countries and emerging economies in recent years; however, more focus should be placed on the areas that badly need it.

I have some difficulty with the evaluators' recommendation that less research work should be undertaken by the Fund on advanced economies where good policy research is already being done by relevant institutions. On this issue, I share the Managing Director's and Mr. Mirakhor's arguments that these research activities do contribute to Fund surveillance and benefit Board policy discussions. While we emphasize the importance of research on country and regional issues, the other issues of systemic significance cannot be neglected. The critical issues in the international financial system, such as its weaknesses, stabilization of major international currencies, monitoring of highly leveraged financial institutions, empirical studies of capital control, and convertibility of the capital account should remain on the Fund's research agenda. Further efforts in these areas are needed, despite the fading crises.

To encourage staff to produce high-quality research papers, an open-minded attitude should be given to new ideas, and sometimes even the opposite conclusion should be allowed. Meanwhile, I also share Mr. Mirakhor's concerns on the risk of external misperception or confusion about different voices stemming from research products, so some remedial measures should be considered.

Lastly, I welcome the set of recommendations pertaining to streamlining the research review process and enhancing research incentives by administrative and personnel arrangements. In this regard, I support the recommendation of increasing research assistants so that economists can focus on research. Like others, I understand that Research Department staff have been overstretched by the workload and should be increased by a reasonable number if additional responsibility is to be allocated to them.

Mr. Al-Turki made the following statement:

I join others in thanking the evaluators for a candid and stimulating report. I would also like to thank staff for their response and the Managing Director for his insightful comments. It is to be expected that views will differ on the specific findings and recommendations of the study. Such differences, however, should contribute to a healthy debate and enable us to enhance the benefits of the Fund's research activities.

This Chair has been a strong supporter of both policy-oriented and basic research as long as it directly pertains to the work of the Fund. I believe that most of the Fund's research adheres to these principles. However, there is room for a more focused approach that eliminates work on research projects that are marginal to Fund work, increases cooperation between various departments on research projects, and reduces costs. In this regard, I will make a few comments.

First, the creation of a Committee on Research Priorities should help achieve these objectives. It could set broad outlines of the most relevant research topics and then evaluate and approve the most suitable research proposals presented by the various Fund Departments. Of course, Departments will need to continue to have leeway in undertaking some country-specific research and some basic research that may be deemed desirable. Moreover, if we are to accept that the Fund's economists are of the highest caliber, we must also accept their need to maintain some latitude in their research activities.

Second, research activities of the Fund are of particular value to developing countries. In fact, the Fund may be the only institution where macroeconomic research is consistently conducted on some developing countries because of staff's substantial access to data and first-hand knowledge of these economies. Therefore, while I agree with the evaluators on the benefits of cross-country research, this should not come at the expense of single country research on developing countries.

Third, I fully agree that Fund staff, in undertaking research, enhance their credibility with member countries while also improving the institution's prestige. Thus, I am reluctant to support proposals to fully outsource some of the Fund's research.

Fourth, while I agree that there should be an improved incentive for research, the Fund is not a research institute per se and I would be wary of putting more value on research than on operational work.

Fifth, it will be useful to give junior staff the opportunity to present their research product to management and the Executive Board. In this regard, I agree with Mr. Mirakhor that the practical approach would be for Board members to attend departmental research seminars.

Sixth, it is a concern that research findings are not disseminated and incorporated in Fund policy advice. I believe this is a major issue that must be addressed. The lack of incorporation of research findings may reflect, however, the time constraints and work pressures that staff faces. Indeed, discussions with a number of staff members give the impression that there is little time to read research papers, let alone incorporate their findings. Thus, if we plan to move research activities to the forefront, which I believe the evaluators are suggesting, then we either need to provide more resources or cut other activities. Prioritization and streamlining could help, but are not going to solve this issue.

Finally, I fully agree on the need to streamline the review process in the Fund.

Mr. Kelkar made the following statement:

Like other Directors, I want to thank Professor Mishkin and his distinguished colleagues for preparing an extremely thought-provoking report on the Fund's research activities. I also want to thank the staff and the management for their response to the report. We share the view of the evaluators that high-quality research is critical for the Fund to implement its responsibilities effectively, particularly in surveillance, providing technical assistance and policy advice, preparing programs, and providing financial assistance. The volume, coverage, and quality of research is crucial to the Fund's role as the peak institution in the international financial system. Here, we would like to place our appreciation on record of the high-quality policy research embodied in the Research Department's reports such as the World Economic Outlook, the International Capital Markets Reports, and the WEMD reports. In this context, we would like to commend the Economic Counsellor for his outstanding efforts in improving the quality and depth of analysis and the coverage of the reports.

The evaluation report has somewhat mixed feelings about two other research categories, i.e., policy foundation and policy development research. The report has identified a number of important areas where there is room for improvement. Accordingly, they have made a series of recommendations to improve the quality of the Fund's research activities and have identified specific issues. Most of their recommendations have been very illuminating and useful. I would like to associate myself with the views expressed by Mr. Yoshimura and Mr. Faini, except in one regard. I differ slightly from Mr. Yoshimura's views on the Board's involvement with the proposed Committee on Research Priorities. We accept the suggestion of the evaluators to establish the committee, as it will help coordinate research activity within the Fund. It is encouraging that the management has also agreed to consider the proposal favorably. However, we would like to underscore the need to develop a system that incorporates the Executive Board's contributions before finalizing the research priorities. This could be achieved through the proposed annual or biannual Board discussion on the CRP.

Since the time constraints have become lighter, particularly in the operational departments, the proposal to set aside continuous blocks of time may be a useful way to ensure sufficient opportunity for research. We strongly support the recommendation to shift the mix of research toward topics that are of greatest relevance to the Fund's activities. We agree with the panel's recommendation to shift research efforts more toward developing and transition economies, cross-country studies, and financial sector issues.

I would like to identify two research areas which the Fund, with its distinct responsibilities for multilateral surveillance and policy advice, could perhaps emphasize. First, the Fund should pay more attention to the issues of policy coordination among large developed countries. Second, the Fund should focus on

issues relating to the institution's policy advice, particularly on the sequencing of reforms.

We agree with the recommendations on incorporating research into the annual performance evaluation. Also, providing formal recognition only to major contributors and expanding opportunities for young researchers to present their work to the management and the Board would both be useful ways to improve the quality of output. I would also like to add one suggestion. I understand that we have research seminars in the Research Department, but we do not have similar seminars in the Fund's geographical departments. Perhaps we could encourage such seminars where younger staff members could present their research to a larger body of core researchers and receive feedback.

We understand the difficulties in improving the research flexibility of a framework that has been developed to cope with the various responsibilities and day-to-day activities of the Fund. However, we believe that some flexibility in the functional departments would improve the level of creativity and encourage researchers to challenge some of the existing Fund policies and strategies, taking into account developments in the world economy. We support the proposal to strengthen interdepartmental communication and to improve the collaboration of research activities between the Fund staff and outside researchers. Perhaps it would be useful to emulate the success of the World Bank, which has access to researchers from developing and transition economies through a network of research institutions. Such collaboration would not only improve the staff's understanding of the prevailing circumstances in particular economies, but would also foster improved research skills in member countries, generating positive externalities that would help in the Fund's surveillance work. Furthermore, it would facilitate the Fund's efforts in attracting more researchers with policy experience.

We believe that an effective review process is crucial in maintaining the quality of research. The evaluation reports on surveillance and research, together with the views of the management and staff, consider that reviews are becoming too time-consuming and formal. A system of informal oral comments might be useful, even though it may have some limitations for the review of surveillance and policy advice. We also support the important proposal to expand the number of research assistants. Similarly, greater integration of the Fund's research and operational work is crucial in improving the effectiveness of our research activities.

Finally, we need to make necessary arrangements to implement this report's acceptable recommendations, as Mr. Yoshimura remarked. However, I agree with him that we should defer to the management's views as to the tactics of implementation, and not become mired in the micromanagement of this task.

Mr. Costa made the following statement:

This report has highlighted the importance of research for the successful operation of the Fund and the need for improved staff incentives. We agree with the general findings of the report; however, that does not mean that we can agree with every one of its many specific recommendations. The report is somewhat unclear as to the type of research it considers to be in need of upgrading. It should provide more explicit detail on what it considers to be surveillance research, as well as the particular policy analysis and policy development research that it judges should be given high marks.

Another area of ambiguity in the report is that policy foundation research is presented as aiming to provide the best analytical basis for Fund programs, strengthening the membership's acceptance of the Fund's policy conditionality. At the same time, however, policy foundation research is presented as the appropriate instrument to generate fresh thinking and challenge the conventional wisdom. This latter view seems to be shared by Mr. Bernes, who sees merit in critical assessments of Fund policies, and who would even suggest instructing the CRP to give higher marks to staff daring enough to mount such a challenge. Mr. Hansen and Mr. Palmason are even more emphatic, suggesting that the Chairman of the CRP encourage researchers to rock the boat, notwithstanding that we are in the middle of a storm. These are strong statements and are full of interesting implications. However, as no specificity is offered, either by the evaluators or by the above Directors, as to what they have in mind, we are left with more questions than answers. I am sure, for example, that Mr. Bernes would not consider research supporting a fixed exchange rate system for a small open economy to be fresh thinking, even in an institution whose staff largely advocates the contrary view. Perhaps this may be the meaning of "rocking the boat" envisaged by Mr. Hansen. In any event, it would have been an important contribution from the evaluators if more detail had been given on this point, particularly considering Mr. Collins's comments on the weak analytical foundation of some recent and important Fund programs.

We agree with the recommendation to shift the mix of research efforts toward developing and transition economies and also to cross-country issues. However, we share the staff and management's position that in-house research on industrialized economies is important, as it allows the staff to engage in an analytically sound dialogue with their authorities. Moreover, given increasingly integrated global markets, developments in industrialized countries now have a greater influence on emerging market economies. As management states, it is important not to create a dual-track surveillance process. In fact, if we were going to pinpoint some of the weaknesses of the Fund's surveillance work, one is that not enough attention has been paid to the interconnections between policies in advanced countries and those in emerging countries.

Additionally, on the question of the mix of the research efforts, I would like to bring to the Board's attention the opinion of a former staff member of the Research Department now working with a leading commercial bank. Commenting critically on some of the proposals for involving the private sector, he said that the Fund should multiply by several times the staff resources devoted to understanding developments in financial markets so as to be able to provide sound advice on these matters. I would add that we need to understand more fully the phenomenon of contagion and to detect the main vulnerabilities of particular economies, as the stability of global financial markets should be our utmost goal. It is revealing, for example, that none of the models analyzed in the paper on currency crises were characterized by the evaluators as policy foundation research, including the efforts to look into the role of political variables or banking system soundness. These weaknesses are perhaps related to data problems, but they may shed light on how much we should expect from this type of research.

On the recommendation to specifically emphasize the preliminary nature of Fund working papers, this seems to be a second-order problem. Each paper is valued for what it is, not for the title it carries. Moreover, I share management's view that research represents an effective learning method. Therefore, I do not see any advantage in downgrading the status of working papers, which may end up curtailing some types of research when we are trying to encourage more research.

The recommendation for more joint research with the World Bank is somewhat at odds with our view that the Fund and the Bank should be more dedicated to their own specific mandates. The problem, therefore, is more substantive than the high resource cost of coordination mentioned in the Chairman's statement; it relates to our previous decision on core and noncore issues in the context of the external report on surveillance.

Although the need for a more systematic procedure for setting research priorities seems to be acknowledged by management and most Directors, including this chair, some aspect of the CRP proposal may actually hinder the research process. If only CRP-approved research projects are granted higher points during performance evaluations, the interest in conducting some types of useful research might be weakened. I would agree, however, that there is a problem of knowledge transfer between the research and the operational departments and that a more centralized research planning mechanism might help. The responsibility for knowledge transfer falls directly on management and department heads and is closely linked to a prevailing Fund culture that gives excessive respect to individual departments. This is the only way to explain the fact that, while the Research Department claims to have provided ample warning of the looming Asian crisis, Article IV consultation papers for those countries did not seem to raise an alarm. Moreover, even when countless papers have been written on the importance of the capital account as a critical determinant of developments in emerging market countries, we often find that Article IV reports emphasize the importance of current account deficits, and discuss the

difficulties of financing such deficits as if they were independent of the capital account.

Regarding the recommendations that targets be introduced for the time allocated to research activities, the statement of the Economic Counsellor clearly makes the case that this necessarily requires an overall increase in the total available amount of staff time. Moreover, it presumes that there is a high correlation between the time devoted to research and its quality. Greater emphasis on research quality within the annual performance evaluation system should highlight the importance of research, though the staff has stated that this has already been done through the salary increase mechanism.

Mr. Szczuka made the following statement:

Like other speakers, I welcome this external evaluation, and although I have doubts about the validity of several suggestions, I would note that the report provides a useful basis for discussion and improvement. The evaluation sheds light on a number of broad issues that have appeared previously in the context of the evaluations of Fund surveillance and external relations—for instance, the culture of not challenging the orthodox position, the perceived lack of recognition of junior staff, the need to pay greater attention to outside experience when recruiting new staff, and the need to improve communication within the Fund. All these issues are extremely important, even if the staff is correct that some of the recommendations extend slightly beyond the narrowly defined mandate of the external evaluation.

There is a need to clarify the role of research at the Fund. The evaluators acknowledge the existence of a trade-off between research and other activities, but they try to push research more to the center of the Fund's agenda. The Fund is clearly not a research institute, and the quality of its research should be assessed mainly in light of its contribution to our core operations, either in improved program design or in sound and generally accepted policy advice. I do not have the impression that this aspect has been fully appreciated in the report. For example, a paper reviewing the literature on a given topic may not appear to be original or to be suitable for publication in an academic journal, but it may nevertheless contribute significantly to Fund operations by focusing our discussion with the authorities.

On the recommended Committee on Research Priorities, the evaluators admit that the decentralized structure of research at the Fund has served our institution well, but they see a need for improved coordination. Given the broad spectrum of issues covered by the Fund's research, there is a need to establish certain priorities. However, the key question is whether prioritization or coordination is the more important problem. I think that coordination is a bigger problem, so I am skeptical about the proposed committee. In a general sense, I do not believe that centralizing and administering creative thinking is the best way to promote research. There are also other issues. First, we have already a working group on Fund policy advice

which has been in existence since 1989. This group could be upgraded. Second, research priorities should not be set independently from the work program decided by this Board. Third, the mix of products should be decided with a view on how best to serve our institution and its membership, and we consider that the individual departments are better suited to address that choice. As a solution I would propose upgrading the existing working group on Fund policy advice by giving its chairmanship to the director of the Research Department, and charging the group with implementing the agreed set of recommendations from the evaluator's report.

Second, on Recommendation 2, I am somewhat skeptical as to whether allocating a specific portion of time for research would lead to better research output, or whether it could be implemented without additional budgetary resources. On the other hand, I agree that the Fund's research should be exposed to the outside world by increased attendance at conferences and symposia, but this sort of activity should be considered in the context of the Fund's available resources. We welcome the proposals to free resources for research activities such as streamlining review procedures and recruiting more research assistants.

On Recommendation 3, we should note that the Fund is a monetary institution, not a development institution in a narrow sense. This should also be taken into account when setting research priorities. In that light, I disagree that the focus should be mainly on developing countries or transition economies. First of all, developing countries are covered by the World Bank, so there is a conflict with the recommendation that there should be no research duplication and better coordination with other institutions. The transition economies are important, but this is a kind of transitory phenomenon so the Fund should continue to give first priority to the broader issues of the international monetary system. As for the call for a greater focus on the financial sector, steps to address this problem are progressing already, as has been acknowledged in the evaluators' report.

On the recommendation for an internal market for research services, I agree that the services provided by research to other departments should be recognized and valued; however, I wonder whether an internal market for research would be appropriate. The World Bank is experimenting with such a model, and we may wish to consider the results of that experiment before adopting a similar structure.

On Recommendation 5, it is hard to disagree that quality of research, rather than just quantity, should be taken into account when evaluating the performance of the staff.

On Recommendation 7, I welcome the evaluator's modifications to their puzzling finding, as their previous comments would seem to apply to a situation that no longer exists. While expressing our appreciation for the work of the Research Department, we nevertheless have to look at the broader question of the Fund's culture, i.e., whether it discourages staff from challenging the orthodoxy and whether

it promotes conformity. Also, if a decentralized structure is appropriate for the Fund's research in a broader sense, there is a question as to whether it might also be appropriate for the Research Department itself. Finally, while research may not be the most important activity for the Fund, it is clearly the most important activity for the Research Department, so the department's energies should be focused wholly on research.

Moving to more specific recommendations, there is a need for greater recognition of the staff's achievements; therefore, papers should be signed by the authors, and only by the authors. Exposing junior staff to the Board would also be desirable, but owing to the heavy Board agenda, that objective could be best achieved through the holding of seminars, with Board members as participants. While supporting the need for an increased focus on outside experience when recruiting new staff, I do not agree that the Fund should recruit candidates whose only career goal is to conduct research. This type of candidate should remain in academia. The Fund is not a research institute and needs candidates with a broad mix of skills.

On the recommendation concerning the working papers, staff should be encouraged to voice divergent views; however, the quality of this product should not be sacrificed. Working papers are an important instrument for our institution's external relations and its research reputation. Should a more preliminary instrument be needed, I would suggest that we use the discussion paper format more extensively.

Finally, on Recommendation 20, I fully agree with having the product of our research subject to external reviews.

Mr. Yoshimura noted Mr. Szczuka's suggestion to upgrade the working group on Fund policy advice, and observed that the operation of the upgraded working group seemed to be the same as that of a new Committee on Research Priorities. Whatever format was decided, he considered that it was important that the group have the task of setting research priorities, rather than simply aiding in coordination.

Mr. Szczuka remarked that, by upgrading the working group and having it responsible for setting priorities, he was suggesting a way of avoiding an additional unnecessary level of bureaucracy. If the working group did not prove satisfactory, then the Board might consider creating a new committee.

Mr. Woolford made the following statement:

We should not lose sight of the fact that the process of evaluation is important in its own right. All important functions of the Fund should be subject to independent, thorough scrutiny, and the Fund staff and management should work in the knowledge that such scrutiny is to be expected. This evaluation has fulfilled that requirement very well.

The report itself provides a thought-provoking assessment of the Fund's research activities. It is also one of the clearest and more accessible documents we have seen in a while. However, we believe that many of the evaluators' recommendations relate to internal organizational issues, and so it is our view that the management is best placed to address the recommendations in greater detail. By straying into management issues, we consider that the report does not pay enough attention to whether research has contributed to the Fund's overall objectives. In general, we are in agreement with the staff response.

I would like to add some minor comments from my authorities. One area of research that might be reduced concerns the Article IV background papers for the smaller industrialized countries. Research in this area is sometimes superficial and could be undertaken by the authorities themselves if they felt it was necessary. Background work for Article IV missions in general should be more focused on those issues where the Fund can add value. For example, for some developing countries, a background report that surveys issues of interest to the authorities can provide considerable value, as the authorities are often not in a position to conduct such research themselves. We also support more cross-country studies, not just at the developing country level, but in general.

Finally, although we don't see a pressing need for a research committee, we can go along with the Managing Director's suggestion as outlined in his statement.

Mr. Prader made the following statement:

Like others, I read the EER with interest and learned a lot from it, as well as from the question and answer session with the external evaluators on July 20.

It is not the role of the Executive Board to tell management how to organize its research activities. Our role is limited to determining whether the Fund's research stays within its mandate, and whether the Fund's research product is useful in satisfying that mandate. Within these limits, I would like to offer the following remarks:

First, do we share the evaluators' generally critical view of the quality and quantity of the results of the staff's research activities? In other words, do we agree that the quality of the Fund's research has fallen behind the standard set by economists like Mundell and Fleming, and behind that of comparable institutions like the World Bank? Since the evaluators have reported only their impressions and have provided no proofs in support of their negative assessments, we cannot examine their reasons.

On specific issues directly pertinent to their conclusions, the evaluators have given us no convincing answers. The unanswered questions include: Did the Fund miss any of the critical issues? Was the Fund wrong? Did it

inadequately address any of the relevant issues? These questions are not even asked in the EER. Nor did the Question and Answer session shed any light on them.

The report on the Fund's surveillance, on the other hand, makes a very positive assessment of the Fund's research, in particular the work of the Research Department proper, in this respect. The evaluators' point that Fund research should shift towards issues of the emerging markets and the transition countries is well taken, but is it really true that the Fund is not devoting sufficient time to these issues? Indeed, might not a further shift in that direction accentuate the already existing perception that the Fund as an institution is useful only to developing and transition countries, and has gradually become irrelevant to the industrial countries as a source of advice and interest? I am aware that a number of industrial country Directors have supported a proposal to cut research on industrial countries, but does this proposal apply to work on their own countries, in particular the major industrial countries and especially G-7 related work?

For my part, I would have expected the evaluators to offer their reactions to such issues as whether the international financial crises of 1997/98 demonstrate a need to redirect the Fund's research orientation away from its quantitative approach and towards institutional economics and the like.

As to how many research papers are produced by the Fund, I could cite a recent comparison of the output of internationally known academic institutions such as the University of Chicago, the LSE, a number of IFIs, and the EU. This comparison shows that, since 1990, the Fund has been among the most productive research institutions, having more than held its own with a relatively small number of researchers, and in particular with other IFIs. This level of output was accomplished while the Fund staff was also shouldering the burden of work on financial crises and the costs of increased institutional transparency, i.e., its ever-increasing involvement in public relations activities such as patiently answering questions from the media, various officials, politicians, etc.

My last remark on this complex of questions, aimed at whether the Fund's research lives up to its potential and can bear comparison with other research institutions, is that the EER may be too preoccupied with the idea that the Fund's research is not as well regarded in academia as it used to be. Even if this were true, it might be the outcome of the Board's exhortations, following previous reviews of Fund research, that it should be more operational and policy oriented. The truth is that the Fund's research has to strike a careful balance between the ever-changing expectations of academia, the member countries, and the NGOs, and its own need for a modicum of freedom of research in an environment where the Fund is seen as extremely relevant and powerful by the media and the public. Can the Fund's research, and for that matter its activities in

general, satisfy all expectations? It is significant that the external review of surveillance came to a different view than that of the EER.

One point on which the two reviews agree, however, is the need for more cross-country studies. We also feel that this is an area where the Fund has a great comparative advantage in terms of knowledge accumulated as the most universal international institution with the highest concentration of macroeconomists.

Second, on the recommendation for creating a Committee on Research Priorities (CRP): in principle, we share the doubts expressed by several speakers at our informal meeting on a new committee. The Fund already has too many committees, and we don't really see what value would be added by this one, but we could accept it as a replacement for the present Working Group on Fund Policy Advice (WGFP) operating under the mandate suggested by the Managing Director and chaired by the Director of the Research Department.

Third, no one can oppose the EER's proposal to allow researchers, whether junior or senior, to present their studies to the Board and management. This would be one of the ideal and truly unbiased (in the sense that it would be free of foregone conclusions) testing cases for one of the Fund's pilot projects.

Fourth, with respect to the improvement of the annual performance appraisals of Fund staff members, management should make sure that any changes in the present policy do not come at the expense of creativity and freedom of research.

Fifth, on the issue of farming out (outsourcing) more research to external consultants, I have reservations based on the potential implications for the size of the implied staff and the international composition of the Fund staff. We are not in favor of increasing the Fund's staff, directly or indirectly, by employing more economists with a special research orientation. In fact, the Fund is already unique for its ambition that its staff members are everything, capable of filling every imaginable role—that is, as economists, researchers, financial market specialists, civil servants, etc.

Ms. Lissakers made the following statement:

Many of the issues raised in this interesting and useful evaluation go beyond the Research Department. Instead, they raise broad organizational questions, many of which were also raised by the surveillance evaluation. Some of those questions concern the integration of work between various departments, the relationship between individual country research and policy advice, and the encouragement of cross-country perspectives. There is also the question of staffing—both the configuration of the Fund staff and the Fund's internal incentive and organizational structure.

On the distribution between basic research and operational work, the evaluators seem to suggest that we have struck the wrong balance, i.e., that there is too much emphasis on operational work and that the Research Department is no longer perceived as a place of cutting edge, basic research. However, in the academic glory days of the Research Department, the member countries did not think that the emphasis on basic research was an optimal use of its resources. There was a specific request by members that the department focus more on operational issues and that there be a greater emphasis on the World Economic Outlook, the International Capital Markets Report, and on WEMD discussions. The evaluators and members seem to agree that these latter tasks have been met superbly, and that also seems to be the weight of opinion outside the institution.

On the question of the operational work itself, the evaluators suggest that the output of the Research Department, and by implication the Fund in general, is not what it might be. On the question of focus, while I would not go so far as the evaluators, I have some sympathy for the view that the Fund should focus more on areas where it can add the most value. The EER notes that the staff may not add much on specific industrial countries, and that is one of the reasons our chair has advocated greater use of succinct selected issues papers along the lines of that prepared for the United States. However, it is not fair to say that the Fund staff has nothing to offer beyond what is being done outside. I sympathize with the views of the management and staff that the Fund, if it is to do an effective surveillance job, must form its own opinion on key issues for the individual countries it is surveying. But, in the end, the Fund must choose which issues to focus on, and it seems to me that there is room to modify our current stance. For example, in the U.S. case, my authorities are probably more interested in the Fund's views on current account, exchange rate, balance of payments, and capital market issues, rather than social security issues. Saving social security is certainly a crucial issue in the budget debate, but it is an area where exhaustive work is being done within the U.S. policy arena. In contrast, many balance of payments issues are treated as residual topics and do not receive the analytic focus they deserve. The Fund has a clear advantage in this area and can add tremendous value.

Similarly, we have often mentioned that the Fund can and should do more cross-country analysis, and this is something also raised by the external evaluation of surveillance. The issue does not just concern the Research Department in itself; the issue also concerns the relationship between the work of the Research Department and that of other departments. The evaluation report notes the presence of separate fiefdoms and that interaction among these fiefdoms is not what it should be. That is also my impression from my years on the Board.

On the organizational recommendations of the evaluators, I agree that it is up to the management to adopt those measures they consider to be useful. However, I would like to make some brief comments. On balance, a research coordination committee is a good idea. While I agree with Mr. Milleron that there is a risk of

increased bureaucratization, and while there is a general desire for a simpler review process, having a body that forces the various departments to communicate with each other would be very useful. The interaction between the Research Department and the area and functional departments is something of a mystery. I would welcome any comments or impressions on this issue. My impression is that a more structured cross-departmental planning process could be a way of breaking down the barriers between the departments.

On the question of who is to do the research, I am not absolutely opposed to the use of consultants. I tend to think that for an organization like the Fund, it is crucial that we accumulate sufficient human capital within the institution. However, there are going to be specific issues where interaction between the research staff and the outside academic community, as well as the research departments of central banks, will be important. I think there is a fair amount of interaction already, but perhaps there could be more.

The suggestion that research staff should have the opportunity to present their work to the Board is appealing in principle, and I can see how it would be a valuable incentive for the staff. However, we have to consider the reality of the Board's already burdensome schedule. If the added presentations could be accommodated, I would certainly be willing.

The problems faced by junior staff are issues for the management. We hear complaints from junior staff about the Fund's hierarchy and pressures to repeat the party line, but I am not convinced that the problem is worse here than in any other large organization. Encouraging the junior staff to challenge orthodoxy would be useful, but I am not sure how we can achieve that goal. The benefit of a hierarchical institution is that it is also disciplined and efficient, compared to other institutions operating in the international arena. Striking the right balance is somewhat difficult.

The evaluators make some useful suggestions on the publication and outreach of the Fund's research efforts. Rather than setting up a new research journal, we might use *Finance and Development* as a vehicle for presenting, in a less abstract manner, some of our important research. Similarly, on the question of research assistants and dollar budgeting, as we have mentioned repeatedly, it makes sense to have the research assistant-type work being conducted by actual research assistants, rather than by senior Ph.D. economists.

Finally, I welcome the revision of Recommendation 7, as I had strong objections to the original unfair formulation.

Mr. Yakusha made the following statement:

I thank the evaluators for their candid report. We wholeheartedly support Recommendation 22 on conducting periodic external reviews of research and other

Fund activities. Like other Directors, I believe that our global surveillance products are of very high quality, as confirmed by the evaluators themselves as well as the great majority of outside observers. I also consider that the Research Department's emphasis on this activity is entirely appropriate, so I would not approve any shift in focus that would tend to take resources away from these activities.

The proposal to establish a Committee on Research Priorities is interesting. I believe there is a role for such a board, but I do not see a need to give it the authority to allocate resources.

Regarding the mix of research, the Fund has already started to devote more attention to financial sector issues. I also agree with the Managing Director's statement on the need for the Fund to be able to provide an independent opinion on industrial country issues. Perhaps future work might focus more closely on matters where the authorities and staff diverge in their views. Having said that, the Fund is uniquely placed to perform high-quality cross-country research, which may provide broad-based policy lessons.

I agree with the recommendations to focus more on the quality of the Fund's research and to set aside more funds for participation in conferences and for hiring more research assistants. I am also enthusiastic about the recommendations on disseminating the Fund's research. Abstracts and introductions of working papers may be sufficient for internal dissemination, but we should seek vehicles, such as the IMF Survey, that can reach a nontechnical audience. We should also give more thought to disseminating our research papers on a more regular basis, perhaps in a larger and more frequently published version of IMF Staff Papers. I like Mr. Milleron's proposal to consider giving more attention, if not resources, to producing surveys of existing research relevant to the Fund's mandate.

In conclusion, while we consider that external reviews provide a valuable service to the Fund, that does not mean that we should accept all their recommendations. Before any publication of the report, we should be clear about what we do and do not agree with. For those recommendations that we do agree with, we should move toward implementation as soon as possible.

The Chairman of the External Evaluation Committee on the International Monetary Fund's Economic Research Activities thanked Directors for their comments and reiterated that research was a key activity of the Fund. The task of the evaluation report had been to identify ways in which research could play an even more valuable role in helping the Fund fulfill its mandate.

Mr. Srinivasan commented that the evaluators had not meant to imply that the Fund should devote no resources to industrial country matters. Instead, the suggestion was that the Fund should make use of the extensive resources that were already available. However, it

should retain the capacity to form an independent view in those cases where such resources were inadequate.

On Mr. Szczuka's comment that the Fund was not a development institution, the evaluators' point had been that there were developing country issues that inevitably emerged from within the Fund's mandate. Mr. Srinivasan commented that those issues required more attention than they had received in the past.

On the comment that the views of the Evaluation Committee on Research differed from the Committee on Surveillance, both committees were in broad agreement, Mr. Srinivasan remarked. Both had found that products relating to surveillance, such as the World Economic Outlook, were excellent.

Mr. Srinivasan commented that the evaluators agreed with those Directors who felt that research did not need to be original to be valuable. That point had been made explicitly in the report. Mr. Milleron's suggestion on research surveys on topics related to Fund operations was well taken.

Mr. Bernes remarked that the first two external evaluation exercises had been valuable. The Board would have to decide at a later meeting how to proceed. The first step should be to publish the evaluation reports, thus underscoring the Fund's commitment to transparency. The next stage would be to agree on an action plan and then to follow up in one year to assess the plan's implementation.

The Director of the Research Department and Economic Counsellor made the following statement:

I would like to take this opportunity to address some possible misunderstandings as to our current practice. For example, our seminar program in the Research Department is conducted jointly with the Monetary and Exchange Affairs Department, is organized by a committee that is chaired by a junior member of the senior staff, and involves economists from each of the divisions. So we already have a mechanism through which the staff most actively engaged in research have an important role in shaping the seminar program. The same is now true of the editorial board of IMF Staff Papers, which used to be dominated by more senior staff. Partly on the urging of Mr. Kahn and myself, that has changed over the years so that more junior people are now in important decision-making positions under a new editor.

As for concerns about the authorship of papers, Research Department papers certainly have the author's name rather than the supervisor's name, except where it states that the paper is approved by the supervisor. I think the main complaints stem from the papers that go to the Executive Board, but this is an issue of responsibility rather than authorship. For papers presented to the Board, it is important for the department head to take responsibility for the discussion. Published papers, on the other hand, generally have their authors listed according to their relative

contributions. On these issues, while there are still some complaints now and then, I do not believe there is a major problem across the Fund.

The first main issue I wanted to address is how we can stimulate and sustain high-quality research that is relevant to the Fund's mandate, activities, and operations. It is important to distinguish two types of research. One type can be characterized as operationally related research and is driven by the activities of the organization, the WEO, the International Capital Markets Report, and so on. Operationally related research would also include the various country papers and policy papers written in other departments, as well as policy papers written within the Research Department. For this type of research, the challenge is to ensure that the papers are of high quality in and of themselves. A more difficult challenge, however, is the process of stimulating research that is not operationally related. For this type of work, top-quality research is conducted by a few researchers deciding among themselves what is a feasible topic and implementing that research protocol. It is not done by having a committee decide what topics are appropriate. A large amount of research in the Fund is already operationally directed owing to the nature of our activities. The fundamental problem, and I think the evaluators agree, is that the operational workload has increased, crowding out the time available to pursue staff-selected research.

Looking forward, one of my concerns is that I do not want to see a committee that operates as an overall clearinghouse for staff-selected research. At present, if a researcher wants to write a paper, they go to their division chief, who thinks about the proposal. If the chief agrees, he writes up a brief statement so that they can describe the research topic on the working group research list. There is no clearance from the front office, no clearance by committee, no waiting three or six months for the research project to be approved, and the researchers do not have to write an elaborate research proposal that might take five days of staff time. We have an efficient process so that staff-selected research, some of which may ultimately be presented to the Executive Board, is left to the initiative of the people who have to conduct that research. I would not want to see this organization cut further into the freedom and flexibility of high-quality staff to select their own topics—subject, of course, to the constraint that research has to be relevant to the institution's mandate, mission, and operations. If we look across the range of research carried out in the Fund, very little could be characterized as not relevant to the Fund, and that mostly stems from the staff's previous Ph.D. dissertations. The key problem is that we have cut too much into the flexible time available for the staff to pursue their own self-directed research.

The second main challenge is how to make research, broadly defined, more effective in the organization. This is related to the concern about whether dissenting views are given adequate attention. There is a tension between having a well-disciplined organization that speaks with a single voice on certain key policy issues and having a reasonable amount of internal discussion and occasional dissent. There is no clear-cut solution to that problem. I was somewhat surprised, however, by the

way in which this issue was discussed in both evaluation reports, as well as by this Board. The review process is supposed to be the fundamental mechanism through which the differing views of the staff and departments come to bear, not only on country issues, but also on policy papers. In the Research Department, the comments that we receive from other departments are very important in shaping the way we develop the WEO, the International Capital Markets Report, and policy papers that come before this Board. They go through an intensive process of interdepartmental comment and, in most instances, are revised substantially as a result. We find the review process to be very important. If the process is failing generally to do a good job, then that is a concern that merits attention. Perhaps it is consuming too much time. Economists in the Research Department report that they spend 14 percent of their time on the review process, and maybe that could be cut to something like 12 percent.

However, I think these questions tend to sidestep a more important issue, which concerns the process through which policy and country papers are presented to the Board. A staff member can write a number of fine research papers, and over time they may have an impact on operations, but that staff member will have the most direct impact when she is asked to comment on country or policy papers that are coming before the Executive Board. In this area, the need is not to truncate the review process, but rather to strengthen its effectiveness. I can assure you that the comments of the various departments are often quite vigorous. In the end, however, the staff needs to agree on a consensus view that can be presented to the Board. That will not always be the view of the Research Department, or the view of the Policy Development and Review Department, or the view of the area departments. Usually management gets its way, but sometimes we manage to slip an alternative view past them, within limits. For instance, on a number of international financial architecture issues, including the CCL, I personally have had significantly different views from that of the management and other staff. It would not be appropriate, however, for me to have given a complete public airing of my views on that instrument, though events seem to have borne out my early reservations. It does not serve the best interest of the institution to have the Economic Counsellor publicly disparage new policies or initiatives. The point is that there has to be a balance between an appropriate degree of internal discussion and dissent, versus the need to present a reasonably united view to the outside world.

The Executive Board recessed at 1:00 p.m. and reconvened at 2:30 p.m.

Mr. Faini asked for further clarification on the role of the Committee on Research Priorities. His understanding differed from that of the Economic Counsellor, who seemed to imply that the committee would be a central planning body responsible for allocating resources among different research projects. Instead, he understood that the committee would be more flexible, determining some research priorities but also responding to staff initiatives.

Mr. Takeda questioned whether the Board should necessarily become more involved in the staff's research function. Aside from the risk that the Board might stifle the staff's spontaneity, many research products (such as the WEO) were published as the views of the staff, rather than the views of the Board. However, the Committee on Research Priorities might be a useful channel for sharing information vertically as well as horizontally. For example, staff researchers looking for topics might benefit from a vehicle that exposed them more directly to the Board's interests.

On the question of the Fund's internal review process, that was a matter for the management, Mr. Takeda continued. However, complaints about the process had been raised on a number of occasions, suggesting that there might be a problem. He encouraged the management to look into the issue.

Mr. Esdar reiterated his understanding that the responsibilities of the Committee on Research Priorities would not include providing formal clearance for different research topics. He suggested that perhaps the name of the committee was misleading. The committee should be seen as a vehicle for exchanging information across departments, thus helping to avoid unnecessary duplication. As for the committee's relationship to the Board, he strongly supported Mr. Takeda's sentiments that the Board was not the appropriate body to make research decisions. However, the Board had a strong interest in keeping informed about the Fund's various activities, including its research efforts. The role of the Directors was to pass on that research to their authorities and to be able to explain how the Fund was addressing various policy issues. He appreciated the reservations of those who felt that the Fund already had too many committees, but he felt that increasing the exchange of research, perhaps by transforming an existing committee, would be useful.

The Fund's review process was an important mechanism for building consensus within the institution, Mr. Esdar continued. In order to be fully convincing, the Fund needed to be able to speak with one voice when giving public recommendations. Though the process had been criticized as too cumbersome, it was the responsibility of the management, not the Board, to investigate ways to make it more effective.

Mr. Bernes commented that he agreed with the evaluators that, currently, the Fund's research function was highly decentralized. The challenge, therefore, was to guarantee that key issues were not inadvertently ignored. The evaluators' recommendations had attempted to ensure that the different parts of the institution agreed on what those key issues were and that adequate resources were set aside to address them. There were many different ways to promote coordination, but a powerless committee of equal department heads was unlikely to be effective. One model, therefore, was to give such a committee the power to decide on the allocation of a marginal amount of resources and to have it chaired by a senior member of management. The committee would not attempt to clear or control all research within the institution or attempt to micromanage the activities of the staff, but would instead suggest useful topics and provide an opportunity for focused discussion. He agreed with Mr. Esdar that the committee should only report to the Board every 12-18 months.

The review process consumed too many resources, Mr. Bernes continued. Although it was an important mechanism for ensuring coherent policy advice, not all issues considered by the Fund required the same level of concentration. The challenge was to search for potential resource savings while maintaining the essential features of the process and not unduly constraining the thought processes of the staff.

Mr. Collins expressed his understanding that the Committee on Research Priorities would consist of department heads and would have the ability to direct resources to those projects it considered most deserving.

Mr. Giaviazzi clarified the evaluators' concept of the committee. They had identified two main problems that needed to be addressed. First, they considered that the flow of information across the institution could be improved. Second, and more importantly, the Fund was having difficulty retaining talented staff members. The best researchers were being coaxed into the private sector, into prestigious academic institutions, or into important policy positions within their own governments. The role of the committee was to introduce an added degree of flexibility. The body would be able to identify the institution's best research talent and would have the resources and authority to provide them with incentives to stay within the Fund. The committee would not be directing the staff to work on topics of its own choosing, but would instead respond to the ideas and suggestions of the Fund's best and brightest. The committee, with its own resources and consisting of senior managerial staff, would also have a degree of flexibility that would be unavailable to division heads.

The evaluators considered that the review process was important, as it was one mechanism through which the ideas of different staff members could be challenged, Mr. Giavazzi commented. However, they felt that too much weight and time was being given to the process and that it could be reorganized in a more efficient manner.

Mr. Szczuka remarked that, as far as the second problem was concerned, the Committee on Research Priorities was unnecessary. The task of attracting and retaining talented staff was the responsibility of management and did not require another bureaucratic institution. As for the exchange of information, the evaluators had not been clear as to whether the committee was to provide better coordination or improved prioritization of Fund research.

Mr. Esdar commented that the Fund should not be too concerned that it was not known as an overly free research environment, as that was not the reason people chose to join the institution in the first place. The Fund could not match the salaries of the private sector, the freedom of academia, or the celebrity of being a well-known personal economic advisor. The key attraction of the institution was that it provided a somewhat unique opportunity not only to research academic topics, but also to implement them.

Mr. Giavazzi commented that the Committee on Research Priorities would be important in that it would enable managers to provide resources to staff with the most promising research projects. At present, the evaluators had observed that staff members often

had good ideas, but did not have the time to pursue them properly. Such resource constraints were sometimes apparent in the quality of the final product.

As for Mr. Esdar's comments, it was true that the Fund should not be aiming to compete with purely academic institutions, Mr. Giavazzi continued. However, the evaluators had found that, over the past few years, young professionals with a genuine interest in policy-related research had been dissatisfied with the institution because it had not provided a sufficiently attractive path to policymaking positions or had not afforded enough time to pursue research. The end result was that they were choosing to leave.

The Acting Chairman, in response to questions and comments by Executive Directors, made the following statement:

In response to this discussion, there is a problem that we need to recognize. The staff has been criticized for being too defensive, both in the external evaluation of surveillance and the external evaluation of research. These reports are going to be published and the staff needs to address, with full seriousness, the evaluators' views and comments.

We will have to determine, within the management and staff, our views on the best way to move forward, and then come back to the Board. We had not yet made up our minds on the issues raised, as we were interested in hearing the views of the Board and the further comments of the evaluators. However, one response of the management that received general agreement was that we need a group to set research priorities. At any moment in the Fund, there is a variety of cross-cutting issues that affect a range of departments. We need a committee that can highlight to all departments which issues, in terms of the Fund's activities and the Board's interests, must receive high priority. The precise research plan and division of labor can be worked out within the group and will vary from time to time, but the first requirement is to ensure that the work is being done and to make sure it is being done in a way that meets the institution's needs. We had not envisaged micromanagement of research projects or that all projects would have to first receive permission. Research is an activity that is driven by individuals, as is the relatively informal process of cross-institutional coordination. As such, it is an activity that is unlikely to respond well to micromanagement by committee. However, we need to ensure that the basic research requirements of the institution are being met, so we need some way of setting priorities. Department heads will have to tell the group what they are doing, and then after some discussion, if it is determined that the project is promising, the group will help ensure that it has the necessary resources and that any cross-institutional or cross-departmental synergies are exploited.

There are two more questions that arise from the discussion on the Committee on Research Priorities. One is whether we should fund external research, along the lines of the World Bank's research committee, and whether we should have a budget for that purpose. To some extent, we use consultants already, and some of the

resulting research papers have been somewhat famous. However, beyond that, we need to consider whether we should formalize the process of delegating research proposals to outside consultants. There are two arguments in favor of such a process. One is that it might allow us to address more effectively the questions we want answered. The other is that we would be providing a valuable public good. The second objective clearly requires agreement by the Board, and it could take the Fund into a variety of areas where we might not want to go. The World Bank funds a considerable amount of such research, and it is a worthy objective. We have cooperated in the past with the Bank in this area when we helped support the African economic research consortium. We should probably be doing more of that, but I am not convinced we should have a formal budget for funding research. We would need to determine whether providing the Committee on Research Priorities with a budget for funding outside research would represent an improvement on the methods we use currently.

The management will look at the results of the World Bank funding efforts, as well as the various projects the Fund has sent to outside researchers. As I mentioned, some of those projects did make an important contribution. There was, among others, a large 1980 study of trade liberalization that was somewhat successful. However, we have also funded research that did not provide much of a net contribution. As for the other question raised by the external evaluation committee on whether we should be interacting with outside researchers, there is little doubt that we should be doing more. That need is reflected in the management's comments on the external evaluation report, and also by the fact that we occasionally have outside researchers review drafts of Board papers on policy matters where there is clearly valuable expertise outside the institution.

It has been suggested that greater interaction with the outside community might help young researchers conduct better research. Implicit in that suggestion is an assumption that such interaction would make a position within the Fund more attractive. I think we need to find ways of enabling good researchers to stay within the Fund while conducting rewarding research. Our mobility requirement sometimes appears somewhat counterproductive; if somebody is good at research we move them to something that they are not so good at, as this is supposed to be good for them. We need to find ways of fostering mobility while still ensuring an efficient use of our staff resources.

As an operational issue, by trying to establish a research career path in the Fund, we would run into the problem that B-level appointments are all supposed to require some demonstrated managerial skill. Possibly we might have a limited number of B-level nonmanagerial promotions, but as soon as we open that door, we would open it not only to researchers, but also to many other experts, so it is not a trivial issue. We need to solve that incentive problem. Professor Giavazzi suggested one possible answer, but there may be others.

However, we should not delude ourselves. Good researchers in academia earn as much as they would earn here, and they receive a three-month summer vacation. They get to determine precisely what topics they want to pursue, when they want to pursue them. They can also consult with international financial institutions, particularly the World Bank, if they wish, so they can have access, by and large, to much of what the Fund has to offer. We may never be first choice among such people. However, we can do much better than we have in the past, and there always will be some who choose to stay if given the right set of incentives.

On the other issues raised in the discussion, Ms. Lissakers' suggestion that we use *Finance and Development* as a dissemination vehicle for our research is something we should definitely explore. The *Staff Papers* is being revised, and the new editor is interested in trying to give greater weight to those areas where the Fund has a comparative advantage. For instance, he has talked about having a section on applied Fund-related issues. Very recently we received an interesting, well-written paper on pyramid schemes in Albania, which I am sure nobody on the outside knows about. Although it is a working paper, it would be perfect for that sort of publication. We should be able to move the *Staff Papers* in this direction, so that people who want to know about some of the more unusual events and practices in the world economy can learn about them through the *Staff Papers*. In this context, Mr. Esdar's remarks about the Fund are absolutely true. We see more pathologies here than we would ever have imagined from the outside.

On the issues raised on both the external evaluation of surveillance and the external evaluation of research, we propose to provide our reactions and a suggested action plan at a future date. I would imagine, for instance, that the Committee on Research Priorities would report to the Board on its discussions, if it meets once or twice a year. Management will probably also suggest that any requests for a paper that are raised during Board meetings be submitted in writing and circulated to all Board members the next day. We will return to these issues some time after the Annual Meetings. I would like to conclude by once again thanking both the external evaluators, who faced a formidable task, and the staff, which has taken the recommendations seriously and has given a full and honest response. I am sure that with some fine-tuning for the purposes of publication, we could make the staff response look somewhat less defensive. The critical objective, however, is to have an honest discussion. I think that has been done, and we should thank both the evaluators and the staff for their efforts.

The Acting Chairman then made the following summing up:

Executive Directors expressed their appreciation to Professors Mishkin, Giavazzi, and Srinivasan for their fresh perspective and their wide-ranging review of the contribution of research activities to the achievement of the objectives of the Fund. Directors agreed that research makes an important contribution to all areas of the Fund's work—oversight of the international

monetary system; multilateral and bilateral surveillance; policy and financial support for members' adjustment programs; and technical assistance, cooperation, and training. In all these areas, strong in-house research work is essential to ensure that the Fund can learn from experience and both generate and absorb ideas. As the evaluators suggest, such research support is necessarily multifaceted and encompasses policy foundation, policy development, and policy analysis research. Research needs to be conducted by high-quality personnel in a supportive but inevitably demanding environment and needs to be free to challenge accepted wisdom.

Directors considered that the evaluators had done a valuable job in judging whether the Fund's diverse economic research output met the multiple expectations placed on it. While welcoming the overall usefulness of the external evaluation, several Directors considered that a longer-term perspective and inclusion of a fuller dimension of research activities in an institution with the unique role of the Fund would nevertheless have provided a richer basis for the evaluation. In this vein, these Directors questioned some aspects of the methodology evaluators had been able to employ in the time available for their study. In these Directors' views, this meant that the recommendations needed to be carefully reviewed, as the evaluators had themselves suggested, not least because several of the recommendations raised significant questions of resource allocation in an institution already characterized by rising work pressures and binding resource constraints.

The evaluators saw no major omissions in the Fund's broad research agenda in recent years and praised the quality of much of the Fund's research output, including the World Economic Outlook and International Capital Markets Reports, but they also saw substantial room for improvement, particularly in the areas of policy development and policy analysis research. Executive Directors concurred in this broad judgment. They agreed that it was important that the environment be supportive of research and of researchers, while holding them accountable for their work. It is no doubt true that improvements can be made in the quality, focus, and dissemination of Fund research. Directors therefore encouraged the staff, management, and Board to accept the challenge of achieving such improvements in the research activities of relevant departments, and to examine and follow up on the recommendations of the evaluation report in that light.

Turning to the nine key recommendations of the report proposing organizational changes in the Fund or changes in the emphasis of current practices:

Directors agreed that the existing decentralized structure for conducting research in the Fund (where over half of the research output is from departments other than the Research Department) should be maintained,

as it encouraged appropriate specialization in research among departments. Nevertheless, a greater degree of coordination than exists at present—in the form of the Working Group on Fund Policy Advice—should be provided to help direct research more toward high-value activities, including the analytical underpinnings of the Fund's policy recommendations. Several Directors said that they would welcome greater Executive Board involvement in periodic reflections on the Fund's research priorities, although they did not envisage the Board having a major role in this area. However, any solution should not add another level of bureaucracy or constrain the freedom of departments to channel resources flexibly to their most pressing research needs.

In this light, Directors generally saw merit in the creation of a Committee on Research Priorities (CRP) that would elaborate research priorities for the Fund (Recommendation 1). The Board expressed differing views on the structure, modalities, and chairmanship of the CRP, while agreeing that it should not operate in a top-down manner to specify individual research projects because this would stifle creativity.

A few Directors thought that the introduction of explicit departmental targets for staff time allocated to research activities (Recommendation 2) could reinforce the Fund's commitment to research by ensuring that it did not remain the residual activity it so frequently becomes when operational work takes precedence. This would also be in the staff's professional interest by assisting them to maintain their human capital. However, a number of Directors noted that it might be difficult to put this recommendation into effect without adding to the size of the staff, especially given the frequently pressing operational demands on their time.

While broadly agreeing with the evaluators' finding that there had been no major gaps in the coverage of research topics in the Fund in recent years, Directors agreed that there was a strong argument for shifting the mix of research toward topics that add most value (Recommendation 3) and minimizing duplication of work done outside the Fund. Several Directors endorsed the evaluators' view that the Fund's comparative advantage was in cross-country analysis, in research on developing and transitional countries, and on financial sector research—although several others cautioned that continued attention was required to the Fund's core areas as well as to specific country issues essential for effective surveillance, including for industrial countries. A few Directors thought that more attention could be focused on political economy issues concerning institutional arrangements in countries and program ownership by country authorities. Directors also noted that a refocusing of research work as proposed by the evaluators was already under way, especially concerning financial sector research, and Directors were in broad agreement that this shift should be strengthened. Several Directors also

suggested that greater attention was needed to promote research into policy design issues underlying Fund programs.

Directors considered that the recommendations concerning improved collaboration among departments, encouragement to researchers to contribute to policy work (Recommendation 4), and improved assessment of research quality in the annual performance evaluation of staff (Recommendation 5) merited the attention of management and departmental managers.

A number of Directors were inclined to support the recommendation to give junior staff greater opportunities to present their research products to management and the Executive Board (Recommendation 6).

Directors expressed their appreciation for the excellent work of the Research Department of the Fund in recent years. They supported more Research Department attention to policy foundation research, as compared with policy analysis and policy development research (Recommendation 7), where the generally high quality of the department's work is widely recognized. Directors thought that the Research Department should attempt to do this, but also thought that a large rebalancing of work between present research and operational activities was probably not possible within existing resource constraints.

Concerning improvements to the Fund's performance evaluation system (Recommendation 8), several Directors considered that further thought should be given to performance differentiation and related issues. In this connection, we can look forward to the results of the ongoing study of personnel management practices in Fund departments by the Office of Internal Audit and Inspection, alongside related work by the Human Resources Department.

With respect to improvements to the internal review process for all staff papers and recommendations to management and to the Executive Board (Recommendation 9), Directors felt that this was a matter for management to address from the broader perspective of the role of the review process in the Fund. Several Directors agreed that it was often considered that this internal review process was one of the particular strengths of the Fund as an institution and that a formal review process is indeed critical for the formation of staff policy consensus. Nonetheless, all opportunities should be taken to ensure effective review procedures while keeping resource costs as low as possible. The issue of how to feed research findings into operational work was among the several considerations that should be brought to bear on any proposals for changes in the review process.

Executive Directors also commented on several supplementary recommendations. While recognizing that most of the areas fell within the purview of management's responsibilities, there was broad support for a number of these recommendations: the encouragement of participation in relevant external conferences (Recommendation 10), the identification of significant contributors to Fund publications (Recommendation 11), the improvement of collaboration with the World Bank and other researchers in central banks and Treasuries (Recommendation 12), the writing and dissemination of nontechnical summaries of the most important research (Recommendation 15), the suggestion to treat working papers as preliminary (Recommendation 16), improving the dissemination of research to nontechnical audiences outside the Fund (Recommendation 18), and the creation of an ongoing external review process for research products (Recommendation 20). Directors considered that these recommendations needed to be examined further and that considerable discretion should be given to management on these issues.

Concerning the introduction of more flexibility into the hiring process for entry-level economists with a view to attracting research-oriented economists (Recommendation 13), Directors had mixed views. They invited the Human Resources Department to consider this suggestion in conjunction with a contemporaneous suggestion by the external evaluators of Fund surveillance that the Fund needs to hire more economists with relevant policy experience.

Regarding the recommendation to increase the number of research assistants relative to economists (Recommendation 19), Directors supported this policy change, which is currently being implemented but which will need time to spread throughout the Fund because of its resource implications.

Concerning periodic general external reviews of research activities (Recommendation 22), Directors noted that this matter would be taken up as part of the upcoming review by the Board of the evaluation function of the Fund.

Directors recommended publication of the evaluation report, together with the response by management and staff and this summing up of the Executive Board discussion.

After the upcoming Annual Meetings, management will propose for Board consideration details on how to follow up on the report of the external evaluators.

Let me conclude by noting that, while management said at the start of this discussion that the meeting should be directed at the evaluation of the

Fund's overall research activities, we were impressed by the strong vote of confidence we heard around the table today in the work of the Research Department and its leadership by the Director of the Research Department, as well as the Board's confidence in the high quality of the staff.

**2. CAMEROON—ENHANCED STRUCTURAL ADJUSTMENT FACILITY—
THIRD ANNUAL ARRANGEMENT**

Mr. Barro Chambrier made the following statement:

Under the first two annual ESAF-supported program arrangements, Cameroon's economic and financial performance has shown significant improvement. During this period, progress was made toward fiscal sustainability, including notable revenue consolidation through increases in non-oil receipts. Also, important structural reforms were launched, including a large-scale privatization of the parastatal sector and significant actions to liberalize the energy and transport sectors. These results are the reflection of the strong commitment shown by the authorities in implementing their adjustment program, as well as a great sense of ownership, putting as a priority the benefit that the country can draw from adopting a set of difficult measures. My authorities consider that the challenges in the period ahead will be to achieve further fiscal consolidation and also to improve productive expenditures in the social sectors and deepen structural reforms.

Despite the adverse impact of the sharp deterioration in the terms of trade experienced in the first half of 1998/99 that constrained growth output, real GDP growth for 1998/99 remained strong at 4.5 percent, thanks to better performance and recovery of oil and non-oil exports from the third quarter. Progress was also achieved on the inflation front, with the annual increase in the average national consumer price index being contained under 3 percent in 1998/99. The widening of the external current account deficit (including grants) from 2¾ percent of GDP to 4.5 percent in 1998/99 stemmed mainly from a weakening of both oil and non-oil export receipts relative to 1997/98, as the increase in volume of exports in both sectors was more than offset by the decline in export prices.

Monetary developments were characterized by a less rapid expansion of credit to the private sector and an improvement in the net foreign assets position of the banking system. As was the case in many other CFA countries, developments in early 1999 indicated a recovery of deposits as the speculative/anticipation behavior prior to the launching of the euro and the fear of a devaluation of the CFA franc abated.

On the fiscal front, encouraging progress continues to be made, with the primary budget surplus and the overall budget deficit for 1998/99 reaching

4.6 percent of GDP and 3.4 percent of GDP respectively, almost as programmed. Thanks to the gradual recovery of oil prices in the second semester of 1999, total revenue attained about 15.5 percent of GDP, slightly higher than programmed; however, the overall contribution of the oil sector to the budget was about 9 percent lower than the initial target amount of CFA 157 billion. Overall, the average oil prices realized by Cameroon declined by about 21 percent in 1998/99 compared with 1997/98. Non-oil revenue was on target, reaching 13 percent of GDP, thanks to the strengthening of the administration of the tax department, the smooth implementation of the value-added tax, and the recovery of customs revenue in the second half of 1999. The overall expenditure increase of 1 percentage point between 1997/98–1998/99 was mainly on account of increases in investment spending, as the primary current expenditure declined by the same magnitude. Outlays on the wage bill, goods and services, and transfers were in line with the program provision for 1998/99.

With regard to structural reforms, despite the heavy agenda, limited administrative capacities, and the socially demanding measures, the authorities made notable progress in accelerating the process in the latter part of 1998/99. Tangible results were achieved in the telecommunication sector with the selection in early May of the successful bidder to negotiate for the second cellular network, the completion of the audit of the national water company (SNEC), and the validation of the decision to liquidate CNR, a government-owned insurance company. In the agro-industrial enterprise sector, a successful bid for the conclusion of the sale of the palm oil company (SOCAPALM) was also realized. With regard to budget management and transparency, the terms of reference agreed upon with the Fund staff for an independent audit of the system of public procurement and of the ten largest public procurements was completed, and an auditor was selected from a list of four independent and internationally reputable accounting firms on the basis of competitive bids. Also, adequate budget appropriations were made to take into account the need to increase social spending over time. In the refined petroleum area, the government adopted the recommendations to liberalize petroleum distribution margins. Important headway is being realized in other structural areas, including addressing the Y2K problem.

In light of the achievements indicated above, and taking account of the progress made under the first two years of the ESAF-supported program and the need to tackle remaining impediments to growth, my authorities have updated the medium-term framework in the context of the third annual arrangement under the ESAF-supported program. Based on the encouraging results achieved so far, the economic program for 1999/2000–2000/2001, in support of which Fund assistance is requested, seeks to improve the external and internal financial situation, bring the economy into a sustainable growth path, and substantially reduce poverty. Focus will also be put on improving

governance and accountability and on implementing efficiency-enhancing structural reforms through the completion of reform measures already initiated.

In view of the gradual recovery of oil and non-oil export prices in the second half of 1999, and despite the projected fall in oil production, my authorities are confident that economic and financial prospects will improve in the medium term. Therefore, consistent with the medium-term objectives, it is projected that real GDP will increase to about 5 percent during the 1999/2000 program. Inflation will be limited to 2 percent, and the external current account deficit will be contained at 3.5 percent of GDP. To achieve these objectives, total investment is expected to increase by about 1 percentage point of GDP to almost 20 percent in 1999/2000, while the projected strengthening in the government saving-investment balance would allow for the narrowing of the external current account deficit.

Fiscal policy contemplated in the medium term will focus on increasing government savings from 0.4 percent of GDP in 1998/99 to about 2.5 percent of GDP in 1999/2000 by expanding the non-oil tax base while strengthening tax and customs administration. The main elements of the strengthening of non-oil revenue are directed at improving customs, tax administration, and combatting fraud. The broadening of the tax base should be helped by strengthening the value-added tax (VAT) collection and extending the responsibilities and coverage of the large taxpayer unit to all taxes. At the same time, all export taxes will be eliminated except those on forestry products.

The taxation of the forestry sector is an area of concern and will continue to be reviewed, with the objectives of preserving the environment, rationalizing forestry taxation, and promoting the development of processing industries with high value added with the assistance of the World Bank. On this basis, forestry tax policy will be rationalized to shift the tax effort from exports toward "upstream" activities.

These measures should help raise non-oil revenue by one-half of 1 percent of GDP to 13.5 percent of GDP, while oil revenue, reflecting higher oil prices, would rise from a projected 2.5 percent of GDP in 1998/99 to 3.2 percent of GDP in 1999/2000 (including a one-time payment of CFAF 10 billion carried over from 1998/99). Thus, total revenue would increase to about 17 percent of GDP. Overall, a primary surplus of 5.2 percent of GDP would be attained, and the overall fiscal deficit would be reduced to 2.9 percent of GDP, excluding grants, below the 1998/99 outcomes.

The higher revenue target, along with improved expenditure management and governance, will support the government's planned increase

of expenditure on social services and the rehabilitation of physical infrastructure, as well as some decompression of public sector wages. The education and health ministries' shares of outlays in total expenditure will increase to 3 percent of GDP in 1999/2000—up from 2.5 percent in 1998/99. In addition, a civil service reform that entails enhancing incentives and performance and further reducing its size through the privatization of government services will be pursued. The reform will include decompressing wages and modernizing the remaining civil service. To this end, and in order to better manage the overall government wage bill, the authorities are committed to complete, before end-March 2000, a comprehensive physical and legal census of all civil servants.

As a member of the BEAC, monetary policy in Cameroon will continue to be conducted according to the general principles set at the regional level, consistent with balance of payments and inflation objectives. In this framework, the authorities will play an active role in consolidating the use of indirect monetary policy instruments and will contribute to the strengthening of the common pool of international reserves. Thus, the program for 1999/2000 aims at enabling Cameroon to contribute CFAF 45 billion to the increase in the net foreign assets position of the regional central bank (the BEAC) and to keep net bank credit to the government at its end-June 1999 level. Credit to the private sector is projected to rise by about 10 percent. Broad money is expected to increase slightly in 1999/2000 relative to 1998/99, with the gradual buildup of confidence in the domestic banking system and, more generally, in the reform program. In early May 1999, the regional central bank raised its key interest rate by 0.6 of 1 percent to 7.6 percent.

The structural components of the program will focus on consolidating and deepening the ongoing reforms in agro-industry, public utilities, petroleum, transport, and financial sectors. These reforms are essential for creating a favorable environment for private sector activity and for safeguarding Cameroon's external competitiveness. In the agro-industrial enterprise sector, the second phase of bids for the privatization of the Cameroon Development Corporation (CDC) is to occur by end-December 1999. In the cotton sector, where privatization is pending the resolution of legal problems and the establishment of an appropriate competitive and regulatory framework, steps will be taken to accelerate reforms. As regards public utilities, the selection of the successful bidder for the government-owned cellular company, CAMTEL-Mobile, is to take place before end-January 2000, and the second round of tenders for the privatization of CAMTEL is to be launched before end-December 1999. In the electricity sector, the privatization of the Electricity Company, SONEL, will be launched before end-October, following the publication of the prequalification bids. In the water sector, the second round of bidding for the privatization of the water

company (SNEC) is to take place by end-September 1999, and the selection of the successful bidder is expected before end-February 2000. In the transport sector, a number of critical measures are being prepared. These include strengthening the Road Fund, an action plan for restructuring the Port of Douala and reducing delays for international trade operations, and the launching of the rehabilitation project for the newly created railroad company (CAMRAIL).

In the petroleum sector, a strategy defining the respective role of the national oil company (SNH) and the private sector in the production and distribution of oil and petroleum products to provide the basis for further deepening of the reform and liberalization of the sector is being defined. As a first step, the distribution segment of the market has been liberalized, and a majority of the shares in the management of the petroleum storage facility are to be transferred to the private sector in 1999/2000. A third financial annual of the SNH is to be completed in December 1999 and will assess the implementation status of the key recommendations of the first two audits. In addition, the authorities are committed to undertaking a managerial and operational audit of SNH by end-June 2000 in order to improve its efficiency, reduce operating costs, and increase transparency in its activities. Finally, in the context of regional integration, the authorities will speed up their efforts to complete the Chad-Cameroon pipeline, now that most of the obstacles that have impeded the project have been addressed.

In the financial sector, the authorities will work in a concerted effort with other members to strengthen the regional banking commission (COBAC) and enhance its independence, including reinforcement of its surveillance capacity and recruitment and training of qualified staff in its supervisory unit. In addition, the authorities reiterated their commitment to withdraw government participation in the banking sector, with the expected conclusion of the privatization of the BICEC in the period ahead. Ultimately, the government's participation in the sector will be limited to holding minority shares in only three of the eight commercial banks that operate in Cameroon. Attention is now being focused on nonbank financial sector reforms, including the cooperatives, development of a national securities market, and the completion of the privatization process in the insurance sector, with the expected privatization of SOCAR and the liquidation of CNR—the two remaining public insurance and reinsurance companies—in 1999/2000.

Finally, as a member of the CEMAC, Cameroon will continue to participate actively in a number of initiatives aimed at accelerating economic and financial integration, including the implementation of trade reforms that will entail the elimination of remaining import surcharges and further reductions in the common external tariff.

As a signal of commitment to achieving the ambitious program objectives described in their Letter of Intent, my Cameroonian authorities have put issues of economic governance and transparency at the center of their reform strategy, particularly as regards central government activities and the privatization process. In this context, the authorities are taking a number of steps aimed at improving public expenditure management, including reinforcement of the audit function of the Ministry of Finance and improving transparency and governance through the continuation of the audit of the procurement system and the establishment of expenditure control procedures for a number of public entities and special funds.

The current external account is expected to improve over the medium term, declining from a deficit of 4.4 percent of GDP in 1998/99 to 2.4 percent of GDP in 2001/02. In view of the anticipated flow of private capital in the context of the privatization program, as well as the higher levels of project aid, the capital account balance is expected to improve in the program period. Nevertheless, these projections will result in a financing gap of about CFAF 523 billion in 1999/2000, which should be met through the London Club restructuring operation and the non-Paris Club rescheduling. Bilateral agreements have been signed with almost all the remaining bilateral Paris Club creditors. The authorities also intend to pursue a debt and debt-service reduction (DDSR) agreement with London Club creditors, as well as various nonbank creditors. On the basis of the updated DSA indicating an NPV of external public debt relative to exports of goods and services at about 190 percent in 1999/2000, Cameroon meets the eligibility criteria under the enhanced HIPC Initiative. In view of their strong commitment to the adjustment program, and in light of the social needs, the authorities are hopeful that Cameroon will be declared quickly eligible for assistance under the new HIPC Initiative. This will ensure better targeting and improved efficiency in the delivery of the expected resources in the priority areas of health, education, and poverty alleviation. To this end, a national poverty reduction strategy based on sectoral plans will be adopted and implemented starting in March 2000.

My authorities remain concerned by the low quality of social indicators, although tangible efforts have been made. But beyond these measures and pending the possible assistance that the HIPC Initiative could bring in this area, Cameroon's objectives in the social area will be targeted through the continuation of adjustment policies that will foster higher economic growth combined with targeted improvements in primary health and education and access to safe water and affordable drugs. In addition, investment in roads and the measures to reduce transport costs will help improve the situation of the rural sector.

Progress has been made in improving Cameroon's database, but the authorities will continue to need important technical assistance in a number of areas, including the definition of a set of social indicators in preparation for the HIPC Initiative.

Finally, I would like again to reiterate the strong commitment of my Cameroonian authorities to the adjustment process, as mirrored by the positive results achieved so far. As I noted above, the program underlying their request for Fund support is ambitious and socially demanding. However, based on the difficult measures already implemented, they are confident that they will successfully pursue adjustment policies during the years ahead. However, to achieve the above targets, my authorities will need the continued support of the donor community. Particularly, adequate debt relief under the enhanced HIPC Initiative and concessional financing will be crucial to the success of the program and the achievement of the objectives in the social sectors and poverty alleviation. I would like to request the support of my colleagues for the proposed decision and to confirm that my authorities have agreed to the publication of the Memorandum on Economic and Financial Policies, the Policy Framework Paper, and the report on the Experimental Modular on the Implementation of Standards and Codes included on the IMF website.

Mr. Barro Chambrier, extending his remarks, said that the authorities had also agreed to the publication of the Letter of Intent (LOI). In addition, they had taken strong actions on governance issues. In particular, they were determined to improve public expenditure management and fight corruption. In that context, strong administrative actions had been taken against some senior officials, and one minister had been dismissed.

Mr. Jourcin made the following statement:

Just a few words to say that, like the staff, I am pleased to note Cameroon's good performance under two successive annual ESAF-supported program arrangements. Overall, program implementation has remained satisfactory, as shown by the respect of all quantitative and structural performance criteria and benchmarks. This outcome is commendable, given the unfavorable international and regional environment. Indeed, despite a temporary slowdown in economic activity and international trade during the previous fiscal year, real GDP growth remained relatively strong and the economic prospects are now quite positive. Terms of trade are improving, investments in Cameroon are expected to increase, and the private sector appears to be confident in the context of an ambitious reform and privatization program which is well on track.

This being said, and as I approve the proposed decision, I would only like to underscore the two following issues:

First, pursuing the structural adjustment process with determination will be crucial to allowing increased international financial support for Cameroon, notably within the framework of the HIPC Initiative. In this regard, France and other donors will certainly consider governance issues as a major aspect of the program performance. I note that, as recalled by Mr. Barro Chambrier, actions are currently undertaken by the authorities in this area, but a lot remains to be done in order to enhance transparency and accountability as well as to combat corruption. Such progress is particularly necessary in the budgetary area to improve the efficiency of public expenditure.

Second and last, concerning the foreseen negotiations with London Club creditors, I would like to underline the importance of reaching agreements consistent with the new framework of the HIPC Initiative.

With these remarks, I wish the authorities a successful implementation of the program under this third annual ESAF-supported program arrangement.

Mr. Al-Faris made the following statement:

The Cameroonian authorities are to be commended for the steadfast implementation of the reform agenda. Despite unfavorable conditions in the oil market during last year and early this year, which led to some decline in real GDP growth, the authorities persevered with the reform efforts and all of the 1998/99 performance criteria were observed. In order for the significant progress achieved over the past two years to lead to internal and external viability, the authorities need to continue the pursuit of ambitious reforms in several areas over the medium term. In particular, further fiscal consolidation—mainly through improving revenue performance and enhancing the efficiency of public expenditures—and deeper structural reforms aimed at enhancing the role of the private sector are essential to establish sustainable macroeconomic stability and higher growth. The 1999/2000 program is appropriately focused on these areas, and given the authorities' demonstrated commitment to undertake reform measures, we support their request for the Third Annual Arrangement under the ESAF-supported program. We believe that strong adherence to program targets would help Cameroon reach the decision point under the HIPC Initiative, given its apparent eligibility for debt relief. In this regard, we look forward to a formal declaration of eligibility.

A meaningful fiscal consolidation can only be attained through the enhancement of non-oil revenues. In this regard, we are pleased to note that concerted efforts by the authorities to strengthen the tax administration and to implement the VAT in 1998/99 have led to some increase in non-oil revenues. To build on this success and maintain the momentum of budgetary reform, the authorities should press ahead with the proposed measures, which include

broadening the tax base, enhancing VAT collection, and improving tax administration. Regarding the taxation of the forestry sector, we welcome the financial study of the sector and encourage the authorities to rationalize its taxation while promoting the development of processing industries. On the expenditure side, enhanced budgetary revenues should allow for the much-needed increase in spending on the priority areas of health, education, poverty alleviation, and infrastructure. We would like to emphasize the importance of enhancing the productivity of spending in the social sectors in order to achieve the desired improvement in social indicators. Furthermore, we welcome the authorities' initiatives to enhance public expenditure management through streamlining budgetary procedures, reducing bureaucratic work, and enhancing the control functions of the Ministry of Finance.

In the area of structural reform, we agree with the general policy framework contemplated in the new program. Significant progress has been made in the structural reform, so far, including progress in the privatization of some public utilities, telecommunications, and the appointment of an independent audit of the water company and the system for public procurement. The new reform measures which concentrate on agro-industry, the petroleum sector, transportation, and the remaining public utilities, if successfully implemented, will help enhance the efficiency of these industries and safeguard the external competitiveness of the economy.

Finally, we have a question regarding the frequency of monitoring. During the first annual ESAF-supported program, the Executive Board, on the basis of weak implementation during previous programs, requested enhanced monitoring. This practice continued during the second annual ESAF-supported program upon request from the authorities. We would appreciate staff's comments on the need to proceed with quarterly monitoring for the 1999/2000 program, especially following two years of good policy implementation performance and in light of the use of scarce staff resources which it entails.

With these remarks we wish the authorities every success in the period ahead.

Mr. Al-Turki made the following statement:

Economic developments in Cameroon over the past two years are most encouraging. The authorities' close adherence to the Fund ESAF-supported program has been paying off. The welcome mix of solid growth and virtually stable prices has been accompanied by commitment to macroeconomic and structural improvements broadly as anticipated under the ESAF-supported program. These trends, however, are still fragile and can only be sustained

through further interaction of domestic initiative and international support. The authorities' request therefore has my full support.

I broadly agree with the identified policy priorities and will only add two remarks.

First, I fully share the program's priority for further fiscal consolidation and agree that the proposed proactive revenue effort is essential. Strengthening customs and tax administration as well as VAT collection are welcome steps. At the same time, I would also underscore the importance of containment and qualitative improvement of spending. The plan to strengthen expenditure management and increase spending on health and education is appropriate.

Second, the program's emphasis on strengthening structural reforms is encouraging. Here I endorse the authorities' efforts to increase efficiency in the financial sector. Indeed, the progress made in privatizing BICEC is reassuring. I also endorse the efforts to strengthen bank supervision and prudential regulations. The ongoing reform of the agro-industrial sector, the planned privatization of the utilities sector, and the measures taken to enhance the efficiency of the transport sector also bode well for future growth. It is essential, however, to sequence the reforms so as not to overload the country's administrative capacity.

With these comments, I wish the authorities success.

Ms. Patel made the following statement:

The authorities' commitment to sound policies under the first two years of the ESAF-supported program is evidenced by the substantial progress that has been made in improving the economic performance and prospects in Cameroon. Despite the adverse impact of the sharp deterioration in the terms of trade, the economy has grown more than 4 percent, inflation has remained low, and important progress was made in structural reforms. The increase in oil prices experienced since March has greatly facilitated the task of fiscal adjustment, allowing the primary budget surplus to reach the target of 4.6 percent of GDP as envisaged in the 1998/99 program.

However, the country is still faced with important challenges posed by the widespread poverty reflected in the substantial decline in per capita income from US\$800 in the mid-1980s to US\$590 in 1998, and very discouraging social indicators. Hence, it is obvious that the recent encouraging results need to be consolidated through further efforts on both macroeconomic and structural fronts and aimed at restoring financial viability and enhancing the growth potential of the economy. The new annual ESAF arrangement

provides an appropriate basis on which to pursue this consolidation. In this regard, to protect the gains made thus far, it is essential that the authorities maintain their prudent financial stance. In the fiscal area, despite recent improvements in the overall deficit, a stronger fiscal stance is required to create a more stable environment for savings and investments. In this connection, the projected increase in government savings in 1999/2000 by 2 percentage points of GDP is a welcome development. The planned improvement in tax and customs administration and measures to combat tax fraud evasion are important steps to improve revenue performance and strengthen the fiscal position in a durable way. We note the authorities' intention, stated in Mr. Barro Chambrier's comprehensive preliminary statement, to review the taxation of the forestry sector, which remains an area of concern. On the expenditure side, given its large share in total expenditures, tight control on the wage bill is necessary. To this end, it is important that the authorities expedite the implementation of civil service reform. These, together with other actions envisaged under the program to improve expenditure management, will make room for the needed increase in outlays in the health and education sectors.

Mr. Barro Chambrier's indication that the authorities intend to address the issues of governance and transparency in a determined manner is most encouraging. In this respect, the authorities are to be commended for agreeing to the publication of the Memorandum on Economic and Financial Policies, the Policy Framework Paper, and the Experimental Report on Implementation of Standards and Codes.

Monetary policy should remain restrained while ensuring that there is adequate credit allocation to private sector activities. The move towards reinforcing the use of an indirect monetary policy instrument is welcome and will enhance the efficiency of the banking system.

These developments need to be complemented by broader structural reforms that could enhance the country's external competitiveness. In this regard, it is encouraging to note that the authorities have embarked on a far-reaching public enterprise reform with emphasis on agro-industry, public utilities, petroleum, transport, and the financial sectors. Although ambitious, these measures, if carried out expeditiously, will lend credibility to their policies.

The updated debt sustainability analysis shows that Cameroon's external debt remains burdensome, despite the debt relief provided under various mechanisms. The external debt and debt-service ratios have increased substantially, and the country is now eligible for assistance under the HIPC Initiative. The staff correctly stresses the need for continued strong program performance with well-defined spending plans in the social sectors as

prerequisites for this eligibility. Given the authorities' recently demonstrated commitment to reform, we hope that their efforts could soon be supported by the international community under the HIPC Initiative.

With these remarks we support the proposed decision and wish the authorities continued success.

Mr. Jacoby made the following statement:

Cameroon's performance under the current ESAF arrangement is commendable. In an environment marked by continuing political stability, progress with economic reforms has been consistently encouraging. Despite the terms-of-trade shock, all structural benchmarks were met, and the budgetary results have likewise satisfied the program targets. I join the staff in emphasizing that the economic reforms now in process will have to be deepened further if the economy is to reach a sustainable long-term growth path.

As I generally agree with the staff appraisal, I will limit myself to some remarks on the privatization process.

The dismantling of the public enterprise sector represents one among several essential steps toward creating an environment attractive to the kind of private sector investment needed to diversify Cameroon's economic base and improve the competitiveness of the economy. Progress with privatization has been satisfactory, especially with respect to the agro-industrial sector. But further efforts will be needed to dismantle public utilities such as telecommunications, electricity, and water.

To bolster the privatization process and encourage foreign investment, the authorities will have to take appropriate actions to eliminate corruption and enhance the legal and regulatory framework. In this connection, let me repeat the staff's call to the authorities to move vigorously to improve governance and transparency. The durability of growth and social progress will require full commitment to these key elements of the reform process.

To conclude, because of Cameroon's excellent performance under the first two annual ESAF arrangements and the economy's growth prospects, I have no problem supporting the proposed decisions.

Mr. Hajian made the following statement:

Cameroon's economic performance under the first two annual ESAF arrangements has been impressive. Despite adverse terms of trade developments, the growth rate in 1998/99 remained satisfactory, inflation was low, and the external

current and budget balances were within program objectives. Moreover, all performance criteria and benchmarks for 1998 were observed and the implementation of structural reforms was on track. The authorities are to be commended for their commitment to the program. In view of Cameroon's performance during the first two annual ESAF arrangements, we support the authorities' request for a third annual arrangement.

On fiscal policy, we welcome the government's plan to strengthen non-oil revenue. In this respect, the intention to extend the responsibility of the large taxpayer unit to all taxes is appropriate.

The policy directing government expenditure toward health and education is welcome. This could alleviate poverty, which affects one-half of the population, and could also help to enhance the productivity of the labor force. We commend the authorities' intention to reach an agreement with the London Club and nonbank creditors, in view of the heavy burden of the external debt on the balance of payments and the budget. In light of its good track record, Cameroon deserves more international support. We hope that with the continuation of the current performance, the country can reach the decision point under the HIPC Initiative at an early stage.

Despite Cameroon's limited administrative capacity, the achievements in the structural area, particularly on privatization, are encouraging. In light of the ambitious privatization program, the measures taken to enhance transparency and combat corruption are necessary and should be intensified. We do not understand the staff's recommendation to sell only a limited proportion of the shares of the privatized companies to Cameroonian investors. The staff may wish to comment on this issue.

We wish the authorities further success in their adjustment program.

Ms. Sharipova made the following statement:

We commend Cameroon for the good record of performance achieved during the second annual ESAF arrangement. We welcome the fact that all fiscal, monetary, and structural targets were met despite the adverse environment caused by the sharp deterioration of oil prices.

However, the achieved growth rates are still insufficient to fight poverty. Much remains to be done in this respect. Though we find fiscal benchmarks ambitious, we fully support the measures proposed in the memorandum and consider them of key importance to alleviate the dependency on oil. We believe they will provide the government with more regular and predictable revenues.

We still have some worries over tax revenues. We would like to urge the authorities to increase their efforts to broaden and modernize both the tax

base and the tax system. We welcome the shift from taxes in international trade to a VAT, the creation of a large taxpayers unit, and the customs reform as steps in the right direction. As far as VAT is concerned, we would be interested in getting more information about the experience so far, as well as about difficulties that have been encountered in introducing the new tax.

On the expenditure side, while we support the proposed target of 5 percent contained in Policy Framework Paper for health and education and welcome the strategies for these sectors to be prepared in the coming year and their linkage to a medium-term expenditure framework, we would encourage the government to discuss these policy issues with the civil society in order to get a broader consensus on development priorities. Although we support annual audits, cash plans, and credit delegation to line ministries, we believe that efficiency in public expenditure is more than proper accounting. What counts are tangible results in poverty reduction. Therefore we welcome the efforts of the government in improving the database of social indicators which are indispensable in targeting the poverty.

We associate ourselves with the staff and other speakers that say that privatization is not an aim in itself but should lead to a better allocation of resources through increased competition. In the absence of competition, there is a need for clear rules and a strong surveillance body. The PFP states that the government "will ensure full transparency in privatization operations." We wonder how the government is going to ensure that, and who will be conducting the audits—a government audit agency or independent auditors? We would appreciate staff's comment on this.

We welcome the efforts of the government in the restructuring of the banking sector and urge it to go ahead with privatization of the remaining public financial institutions. We wonder at which stage is restructuring of financial cooperatives that previously suffered from financial mismanagement?

Finally, the efforts of Cameroon to avoid any external payment arrears in order to reach debt and debt-service reduction agreements with creditors are highly commendable. This, as well as performance under the ESAF-supported program, will undoubtedly positively impress the country's donors.

Mr. Merz made the following statement:

I can be brief, as I broadly share staff's analysis and recommendations and support the proposed decision. Let me therefore only touch on structural issues:

After the past record of four failed Fund-supported programs, it is certainly welcome that during the first two annual arrangements macroeconomic targets have been met, coupled by progress in fiscal consolidation and privatization. Now is the time to preserve the macroeconomic achievements, to accelerate structural reforms, and to improve governance. With regard to privatization, I share the remarks made by Mr. Jacoby. The further modernization and opening of the economy is urgently needed to improve its still fragile external viability and to mitigate possible external shocks.

With regard to the structural part of the program, we endorse the main focus in the area of education, health, and infrastructure. In addition, we would also place considerable emphasis on saving natural resources, in particular the rational use of the country's large forestry resources. It is without any doubt that all structural measures place an additional toll on the population; therefore, the fight against poverty has to be further pursued. The strategy of the government in this regard should be implemented as soon as possible.

Action in those areas is also needed to pave the way for a possible decision that Cameroon will become eligible under the HIPC Initiative. We therefore strongly endorse staff's view that, I quote, "to reach the decision point, the authorities will not only continue to demonstrate a strong program performance, but will also create well-defined spending plans in the social sectors and improved efficiency in the delivery of the added resources in the priority areas of health and education and poverty alleviation."

Turning to governance issues, we would very much welcome if the government would finalize, adopt, and implement its national governance plan, with the support of the United Nations Development Program, as soon as possible. The additional information provided by Mr. Barro Chambrier at the beginning of this meeting is encouraging in this regard.

Finally, we welcome the decision of the authorities to publish the Letter of Intent and the Policy Framework Paper. We wish them much success in their future adjustment efforts.

Mr. Donovan made the following statement:

We are pleased to see that Cameroon has continued its noteworthy turnaround in performance that began with the first annual arrangement under the current ESAF-supported program. Although much remains to be done, substantial progress has been made under the second annual arrangement, including in the areas of fiscal sustainability and the launching of key structural reforms.

We endorse the staff recommendations for the agenda for future action, as described in the staff appraisal. To staff's list, we would add the need for continued liberalization of trade with the world beyond CEMAC to reduce import barriers and the degree of anti-export bias in the economy while promoting Cameroon's integration with the global economy.

The rate of GDP growth in the last two years, while better than that prevailing in the early to mid-1990s, is still insufficient to achieve Cameroon's development and poverty reduction goals. If we were to point to two areas that are paramount in efforts to improve this record, they would be, first, a stronger focus on enhancing transparency and accountability as well as combating corruption and, second, increased efforts to encourage private direct investment, both domestic and foreign.

On transparency, the extensive use of audits, both by independent agencies and on a routine basis within the government, should substantially enhance the credibility of Cameroon's efforts to control corruption and reassure investors. The specific focus on auditing 10 recent major procurement actions is welcome. We found the summary of government actions in Box 2 of the staff report to be very useful. It must be stressed that overcoming long-held perceptions about problems in governance and transparency does not come easily or quickly. Strong and continued evidence of government efforts to attack these problems is vital.

I would especially like to commend the authorities for their decision to participate as a pilot country in the FAD fiscal transparency project.

With respect to privatization, I would like to associate myself with the remarks of Mr. Jacoby.

The progress on structural reforms in the fiscal sector is noteworthy, and we urge continued efforts in broadening the tax system and in improving the operation of customs administration, which has been a major problem in the past. The specific measures planned by the government, as described in the annex to the government's Memorandum of Economic and Financial Policies, are encouraging. We were somewhat disappointed, however, to learn that there has not been more progress in reform of the civil service and decompression of wages, as these issues were identified as substantial problems in the aftermath of the 1994 devaluation. We would endorse the staff's identification of this as a major area for policy focus under the new program.

The strong environmental focus on forestry policies is overdue and most welcome. The discussion on forestry and environmental protection in the

PFP is encouraging. We regret, however, that it was not possible to say more in this program about environmental policies related to the Chad-Cameroon oil pipeline, as the project will have a substantial economic, environmental, and social effect on a large swath of the country. We would expect those considerations to be worked into the government's planning as soon as the remaining specifics of the project can be determined.

We strongly support the focus on increasing the quality and volume of spending on social programs including health and education. To this end, the authorities must be vigilant in reducing unproductive expenditures.

Finally, we are pleased to see, as another example of increased transparency, that the authorities have agreed to the publication of the Memorandum of Economic and Financial Policies and the Policy Framework Paper.

Mr. Wong made the following statement:

The authorities of Cameroon are commendable for successfully graduating from the economic programs under the first two annual ESAF-supported program arrangements, meeting all quantitative and structural performance criteria and benchmarks. They should also be commended for achieving admirable macroeconomic performance, with real GDP rising by 4.5 percent in 1998/99 and inflation contained below 3 percent. The widening of the current account deficit was mainly a result of a deterioration in the terms of trade, which is outside the control of the authorities. As pointed out by Mr. Chambrier's useful preliminary statement, prospects will probably improve over the medium term in light of the gradual recovery of oil and non-oil export prices in the second half of 1999.

With regards to the country's performance in the recent programs, I am particularly impressed by the progress made in tax and structural reforms, which should help substantially in bringing the economy to a sustainable growth path. I agree with the staff that it is time to consolidate these gains and focus future resources and efforts on improving the efficiency of government spending, broadening the tax base, fighting tax fraud, and enhancing transparency and accountability of fiscal operations in general. In this regard, it is important that a suitable program be put in place for 1999/2000 under the third annual ESAF-supported program arrangement for these purposes, and I would like to thank the staff for their efforts in designing such a program for the country.

Finally, as the staff said, Cameroon merits our support, given the country's sound performance during the two annual ESAF-supported program arrangements. Needless to say, this chair is on their side.

With these remarks, I wish the authorities continued success in their endeavors.

The staff representative from the African Department pointed out that it was not the government's intention to sell only a limited number of shares to Cameroonians, but rather to specifically set aside about 5 to 10 percent of the shares for Cameroonians in order to enhance the support of the public for the privatization program, particularly that of the large public utilities. In fact, the successful bidder for the privatization of one agricultural enterprise had been a Cameroonian enterprise, operating in collaboration with some foreign enterprises. In this way, the government hoped to prevent abuse and to ensure that the process was conducted in an open and transparent fashion.

Transparency in the privatization process would require that the call for bids be well publicized, the staff representative continued. That meant advertising not only in the Cameroonian newspapers, but also in lead international newspapers in Europe, the United States, and elsewhere. In addition, the bids had to be opened in the presence of all bidders and the selection of the successful bidder publicized. The World Bank staff in Cameroon generally participated closely in the bidding process, which to date had worked well.

The experience with the value-added tax (VAT) had been positive, the staff representative noted. There had been adequate preparation, with substantial technical assistance by the Fiscal Affairs Department (FAD) and missions to prepare the law, which was passed in July 1998. The VAT was then introduced in January 1999, thus giving the authorities and the private sector ample time to prepare. The VAT applied specifically to large enterprises, and a special unit dealing with those enterprises had been created. In addition, the authorities had been able to draw on the experiences of other countries.

The VAT was not significantly different from its predecessor, the turnover tax, and this had made its introduction easier for the authorities, the staff representative continued. Some difficulties had, nevertheless, been experienced. The authorities appeared to be somewhat reluctant to reimburse or repay tax credits that were due, but that problem appeared to have been resolved. Another problem had been the lack of coordination between the customs and tax departments, but that situation was now improving.

The Chad-Cameroon oil pipeline project was still at the preparatory stage and would be presented to the World Bank Board for a loan in the following few months, the staff representative reported. The staff did not have details on the reasons for the delays in the launching of the project, but the reasons were largely related to environmental considerations. More concrete information might become available by the time of the next mid-term review and the next Article IV consultation.

At the time of the approval of the first annual arrangement, the Board had called for enhanced program monitoring, the staff representative noted. In the second annual arrangement, the authorities had requested a continuation of the enhanced monitoring, in

light of the difficult international environment. Despite the scarcity of its resources, the staff would continue with quarterly visits and reports to the Board under the third annual arrangement, as that had proved useful.

The staff representative from the World Bank said that before approving the startup of the Chad-Cameroon oil pipeline, the Bank had required a fully satisfactory environmental assessment for both countries, particularly Cameroon, including adequate plans for mitigating any eventual environmental damage. The World Bank staff could, if needed, provide a short note with additional information in that regard.

Mr. Barro Chambrier made the following concluding statement:

Let me thank my colleagues for their support and constructive remarks, which I will convey to the authorities. I can assure you that they will take the Board's recommendations seriously. It is clear that the challenges in the period ahead include further fiscal consolidation on the revenue side, where the situation is still fragile, and there is still need to enhance revenue to GDP and to improve the quality of the public expenditure, especially in the social sectors. These concerns are shared by the authorities, as is the need to make progress on the governance issues.

Structural reform—particularly further privatization and trade liberalization—will be critical to achieving a higher growth rate and improving the living standards of the population. In spite of the country's limited administrative capacity, the Cameroonian authorities remain strongly committed to implementing the ambitious reform agenda described in the memorandum and are determined to achieve the targets set in the medium-term economic and financial program. They intend to focus, in a transparent manner, on accelerating the pace of structural reform, even in the face of internal resistance and an adverse external environment.

The salary policy followed in Cameroon has not been consistent in the past and has limited the incentives for civil servants to improve their productivity. The authorities have initiated changes to enhance public sector efficiency, but private sector development will be critical for the success of the civil service reforms.

The authorities are committed to increasing transparency in the privatization program, as well as in the fiscal area, as demonstrated by their agreement to participate in the pilot program on the implementation of standards and codes, fiscal transparency, and good governance. Another challenge ahead is poverty alleviation. In this regard, I would like to draw Directors' attention to the measures that the authorities intend to take, particularly in the fiscal area, including adequate targeting to improve primary health and education and to provide access to safe water.

These efforts alone, however, will not be sufficient. A continuous and adequate level of external concessional financing will also be required. In this context, I welcome the fact that, based on its updated DSA, Cameroon may soon be

eligible under the new HIPC Initiative. The authorities are willing to pursue the quarterly monitoring review, given the volatile external environment and the need to enhance capacity. I thank Directors again for their support of Cameroon's request for a third annual arrangement under the ESAF-supported program, and join the authorities in expressing our appreciation to the staff for its advice and efforts to ensure successful implementation of the program.

The Executive Board took the following decision:

1. The government of Cameroon has requested the third annual arrangement under the Enhanced Structural Adjustment Facility.
2. The Fund has appraised the progress of Cameroon in implementing the economic policies and achieving the objectives of the program supported under the second annual arrangement, and notes the updated policy framework paper for Cameroon set forth in EBD/99/98.
3. The Fund approves the arrangement set forth in EBS/99/153, Supplement 1. (EBS/99/153, 8/11/99)

Decision No. 12047-(99/99), adopted
September 7, 1999

3. UKRAINE—EXTENDED ARRANGEMENT—REVIEW, WAIVER, AND MODIFICATION OF PERFORMANCE CRITERIA

The Executive Directors considered a staff paper on the third review under the Extended Arrangement for Ukraine and its request for a waiver and modification of performance criteria (EBS/99/170, 8/27/99; Cor. 1, 9/2/99; and Sup. 1, 9/3/99).

Mr. Yakusha made the following statement:

The Executive Board is considering this report on Ukraine at an important time, when the political atmosphere in the country is charged with events related to the upcoming presidential elections. This atmosphere has not prevented the authorities from implementing the program, with many macroeconomic indicators being even better than programmed.

Inflation at 8.5 percent (January–August) and net international reserves have particularly performed better, if compared with the program projections, and the budget deficit has been contained within established limits. Additional purchases of foreign exchange by the National Bank and related increases in base money have not yet been translated into a visible acceleration of inflation, as the demand for money appears to have increased,

reflecting some economic recovery in the industrial sector and services as well as improved confidence with respect to the developments in the financial sector. On the other hand, the recent episode of exchange rate volatility in mid-July–August, caused by the regional fuel crisis, reflects the fragility of the market confidence. The National Bank behaved highly responsibly when pressures on the exchange rate emerged, tightening monetary policies (in the course of one week, interbank market interest rates increased tenfold) while refraining from interventions. This policy stance appeared to be helpful for restoring confidence in the domestic currency, and the exchange rate appreciated (with the National Bank actually buying foreign exchange) after losing more than 25 percent of its value. A new market equilibrium exchange rate seems to have been established at a level of about 10 percent below the level of the rate of end-June, which may eventually bring additional inflation or import compression, or both.

The volumes of foreign trade remain discouragingly depressed, and expectations of the increased FDI inflows have not yet materialized. Import volume losses exceeded export contraction, so the current account data shows some notable improvement and surpluses (for January–June). Exports to non-CIS markets are actually on the rise, but the regional propensity to import goods and services from Ukraine remains low due to the crisis environment and the significant degree of depreciation of exchange rates in some neighboring countries.

Authorities deserve credit for cutting in an election year both expenditure commitments and actual cash outlays, while increasing expenditures on clearing budget wage and pension arrears accumulated in previous years. They resisted at the same time pressures to use unsound sources of financing for clearing these arrears. The overall actual fiscal adjustment (in the order of more than 6 percent of GDP) in only one year has been larger than we expect from many other program countries in the course of their multiyear adjustment effort. On the other hand, the fragility of the overall external position and the upcoming bunching of the foreign debt service in 2000, in particular, provide additional incentives for an extra-cautious approach to fiscal policy and for a determined effort to reschedule some of the debt service payments.

Authorities appreciate the timely advice and help from the Fund staff who helped them to handle dramatic negotiations with a group of creditors in May–August of this year. The results of these negotiations are considered by the authorities to be a success, as they manage to reduce the debt burden, not only for this year, and to exchange \$250 million of bonds due in 2000 into debt instruments due in the year 2001. To this end, my Ukrainian authorities are fully cognizant of the fact that the most recent debt agreement came at a serious price, as now seems more and more clear. The attention of both

domestic and international markets has been drawn to the future debt service problems, which might have contributed to the recent volatility at domestic markets and might have delayed the return of Ukraine to international private capital markets.

Authorities are fully committed to the voluntary character of any future rescheduling agreements (contrary to numerous media misreporting, which just adds to so far grim prospects of renewed market access) and are now working hard to secure additional substantial privatization receipts to make next year's debt service problem more manageable.

The charged domestic political environment has not allowed the authorities to achieve all the structural benchmarks in accordance with the initial program schedule, but the implementation of structural reforms has recently improved in the course of implementing the impressive list of prior actions for Board consideration of Ukraine's request. The communal tariff increases for Kyiv have finally been implemented. Complete implementation of long overdue measures on communal tariffs on water, sewage, and rent in the regions and municipalities which still have uncleared budget, wage, and pension arrears can be enforced only after another ruling of the constitutional court (the President filed a corresponding complaint on July 8 this year; on a similar previous complaint the constitutional court produced a ruling in favor of the government). Energy and gas tariffs (which are established by the central authority across the country) have been now fully implemented. Regrettable problems with this particular measure underscored again the importance of a complete reshuffling of the intergovernmental fiscal relations in the country, as the division of responsibilities and authority among the central and local governments remains somewhat vague.

There are many other challenges in the structural area which need to be addressed in order to make both the fiscal adjustment and the economic growth recovery sustainable. Many in Ukraine are fully aware of the reality, that neither sufficient financial support from the international community nor the private sector contribution to the debt service solution for the year 2000 would be available unless these structural challenges are addressed. Therefore, my authorities are determined to use the window of opportunity after the elections to the full extent possible. The authorities have requested technical assistance for identifying the appropriate sequence of measures which should help them get rid of the still substantial nonmonetary economy; the deeply entrenched culture of nonpayments; the still-high role of the government in financing agriculture; inefficiencies and structural rigidities in the health, education, and social security systems; and enterprise management. In the meantime, even in the current tense stage of the political cycle, the authorities are doing their utmost to promote transparency, further deregulate the economy, and reconsider the role and structure of key ministries.

All the above-mentioned structural challenges are scheduled to be discussed at the special conference scheduled for the time immediately following the election season of October–November with the purpose of building up sufficient support for the necessary breakthroughs in the implementation of structural reforms.

Extending his remarks, Mr. Yakusha pointed out that they would put their Letter of Intent on their website and would authorize the Fund to publish it, too.

Mr. Pickford made the following statement:

Let me say at the outset I welcome Mr. Yakusha's statement about publishing the Letter of Intent.

On the substance of the program, I welcome the progress made in meeting performance criteria, but my authorities remain concerned about the continued slippage on fiscal and structural conditions and the weakening of some performance criteria. It is clear to us that an exchange policy adjustment would be required after the presidential elections if Ukraine is to move toward a sustainable economic path.

On fiscal policy, we are concerned about some weakening in conditionality, with an increase in the targeted budget deficit for this year. There is to my mind some slight inconsistency in the staff paper. Staff says, on the one hand, that the authorities are undertaking serious efforts to keep the fiscal situation under control, but then says that pressures on the budget have been increased by a number of recent decisions by the government and parliament. Perhaps some explanation of this would be in order. We are also concerned by the increase in arrears of the new netting operations. Could I ask the staff what fiscal numbers they think will be appropriate for the year 2000?

The fall in the inflation rate is obviously welcome. However, we remain somewhat more concerned than the staff is apparently about the sharp increase in base money, which is now well above its indicative target. There must be some concern that this would have an impact on inflation, albeit with a lag. In light of that increase in base money, the depreciation in the exchange rate, and the putative rise in communal tariffs, what are the staff's inflation projections for next year?

Finally, on the structural areas, clearly it is welcome news that the structural benchmark prior actions have been completed, but progress on structural reform continues to be rather poor, even after making allowances for the political situation. I welcome the renewed commitment of the authorities to speed up structural reform, but I have to say this commitment needs to be balanced against the track record over previous years. Also,

progress in agriculture and energy has been slower than expected, as has progress on public administration reform.

Specifically, on agriculture, part of the proposed fiscal measures will involve cuts in transfers to agriculture expenditures, which would require significant reform. I wonder whether the opportunity could have been taken to move agricultural reform further up the agenda. Does the staff sense any changing attitudes on the part of the authorities to engage in much-needed reforms in this area overall?

In the whole area of structural reform, my authorities are somewhat less sanguine than the staff that assurances from the Ukrainian authorities would send a strong signal to international investors about the seriousness of their commitment to reform. In our view, nothing short of a significant change in the pace of structural reform in the coming months after the election would be sufficient.

I turn now to financing issues. The U.K. has consistently advocated that the private sector should be adequately involved. My authorities do not regard the private sector refinancing of the ING bond as adequate. We don't think that the 60 or 61 percent refinancing was sufficient either in this case or in general. It was significantly lower than the 75 or 80 percent refinancing which Ukraine achieved last autumn. We are concerned that it could be seen as setting a benchmark for future situations.

On the more general question, this case raises issues about the adequacy of the reserves floor condition in the program, because in this case we do not regard it as having been sufficient to ensure an adequate level of private sector involvement. I think this comes back to a point I made earlier about the increase in base money, where it appears that Ukraine has been able to increase base money significantly and use it to buy foreign reserves without breaching the NDA criteria. As we said in Friday's discussion on involving the private sector, we don't think the combination of reserve floors and NDA targets are an adequate method of delivering sufficient private sector involvement, and we urge the staff to continue working on this aspect of program design.

We are concerned not only by the level of financing, but that the terms may not be consistent with Ukraine's ability to pay over the medium term. In that case, the refinancing agreements that have been reached risk merely postponing rather than resolving financial problems. In this situation, a restructuring rather than a refinancing of debt might have been more appropriate. This would have pushed more of the burden of adjustment onto the private sector and helped point Ukraine toward a sustainable financing position. Effectively, we regard Fund money as bailing out private investors. I

will not repeat the more general points we made, though, on private sector involvement.

The Acting Chairman asked whether Mr. Pickford wanted the Fund to tell the authorities to default.

Mr. Pickford explained that his authorities were of the view that the Fund had ended up with refinancing short of the target and on unfavorable terms, which could put the program at risk. A more general strategy for involving the private sector needed to be worked out, and the international community needed to face up to the prospect of a default.

The Acting Chairman remarked that the only conclusion was that the private sector had to be forced to refinance, and the only way it could be forced to refinance was by a default, but that seemed to be a blunt instrument.

Ms. Lissakers said that the Fund's ability to dictate the terms was very limited when restructuring was carried out on a voluntary basis. The range of choices was the default scenario, the deny Fund support scenario, and the muddle-through scenario which was what was currently employed. The real solution was for Ukraine to move ahead on structural reforms, including privatization, that had the potential to yield enough cash to provide a different standing with creditors.

Mr. Dañri believed that achieving balance of payments viability and nominal access to markets should be the overriding purpose of Fund involvement with members. Members should not be used as guinea pigs to achieve other purposes of the Fund with respect to private sector involvement, especially when that led to either higher credit terms or less prospect for a return to the market at an early stage. The main objective was to ensure that the country had made its best efforts.

Mr. Esdar noted that 61 percent was not optimal, but worse were the arm-twisting conditions. The Fund had to envisage a possibility of turning around the power of negotiation by financing into arrears in a particular case to clarify to the financial sector that, if the conditions are not acceptable for the country or for the balance of payments situation, then that had to be paid by the country, but that was not a sustainable situation. In that case, the Fund had to accept a default and finance in spite of that.

Ms. Lissakers noted that the Fund was not party to the negotiations between Ukraine and its private creditors. The goal of Fund support was to normalize market access for a country that has lost capital market access, but as a condition for Fund support you needed to default, which was seen as deepening the crisis. That was a timing issue.

Mr. Pickford pointed out that Ukraine was facing a continuing problem in terms of financing over the next year or two. The first best solution was to reduce the financing requirement by privatization, and secondly to put in place the options of more attractive

financing instruments such as privatization-backed bonds. These were enhancements which would help.

Mr. Burnashev made the following statement:

Ukraine has made good progress with its Fund-supported program. The authorities have met the performance criteria and implemented the prior actions for completion of this review, and we therefore support the completion of this review and the proposed decision, although we are especially concerned about Ukraine's external position next year.

In fact the staff predicts that Ukraine's external position next year will be rather delicate. Its net financing gap is expected to be rather large, but if projected capital inflows connected with FDI and debt restructuring do not materialize, the gap may well be much larger. With the Fund's net lending expected to fall almost eightfold to \$47 million, and Bank lending to drop from \$460 million to \$200 million, the authorities may find the gap difficult to close. I do not see how they can do it, and I wonder whether the staff at this stage could update the Board on the financing strategy for the next year.

In our discussions today we should not forget that this is an extended arrangement tailored to support structural transformations in the economy. Ukraine has made encouraging progress in this area since the time of the second review. But more definitive efforts are needed to correct the underlying structural imbalances that have caused massive disinvestment and decapitalization of the economy's main sectors. The most recent WEO estimates show fixed investments in Ukraine falling more than 18 percent a year for the last five years, compared with an annual growth of 9 percent in its central European and Baltic neighbors. In recent years, capital outflows have far exceeded FDI inflows, leaving the capital account weak and the country vulnerable to any external disruptions.

What Ukraine needs to strengthen its medium-term external position and resume economic growth is sufficiently large inflows of capital to the competitive sectors of the economy. This will require the authorities to accelerate structural reforms, create an investor-friendly environment, drastically reduce state interference at all levels of the economy, and improve the quality of public sector governance. The last point is especially important in light of the increased public scrutiny of Fund policies in the countries of the region. The financial assistance provided by multilateral institutions, including the World Bank and EBRD, should henceforth be directed toward the development of a sound private sector.

Ukraine is passing through challenging times and has to tackle many problems simultaneously. I fully agree with Mr. Yakusha's informative

preliminary statement that neither fiscal adjustment nor economic recovery will be sustainable unless they are backed by consistent structural reforms. Recent progress in that direction is encouraging. Let us hope that the reform momentum will not be lost in the turmoil of electoral politics.

Mr. Bernes made the following statement:

I certainly welcome the better-than-expected macroeconomic performance of the Ukraine economy, as well as the central bank's prudent reserve management in the face of downward pressure on the exchange rate.

As staff point out, the authorities deserve some credit for their efforts, in particular on the fiscal front.

Looking back, this chair has been supportive of the Ukraine authorities' determination in the face of strong parliamentary opposition to the reform process. Each time the Rada refused to pass or overturned an initiative of the executive branch, the authorities mobilized appropriate legal and constitutional means to overcome the blockage and, for the most part, reforms moved forward, albeit at a slower pace than the Fund, and the authorities themselves, would have preferred.

Unfortunately, movement forward has slowed from even its earlier incremental pace. Indeed, at this time, and as the Prime Minister and Central Bank Governor indicated in their letter to the Managing Director, "the parliamentary situation does not permit the introduction of new revenue measures prior to the Presidential elections in October." Staff seem to be only marginally more optimistic when they observe that "there is little scope for collecting more cash revenue and the possibility of further reductions in expenditure in the next few months... is limited." Also troubling is that the use of presidential decrees has led increasingly to prolonged battles in the courts, as is now the case with water, sewage, and rental communal tariffs.

Nevertheless, I am prepared—with some reluctance—to support completion of this review and approve the associated waivers and modification of performance criteria. I do this after having weighed the current legislative stalemate against the authorities' intentions and their responsible efforts to mobilize private sector financing against a backdrop of economic and political uncertainty. The balance is a tenuous one but—at least for this review, and given the degree of credibility the authorities have established with respect to their reform commitment—I am prepared to tilt it in the authorities' favor. At the same time, there remains considerable room for improvement with respect to the authorities' reform commitment, particularly with respect to reversing the granting of tax exemptions.

That being said, should domestic political support continue to be inadequate to implement key structural and fiscal reforms beyond next month's presidential elections, and should the authorities find no effective, reasonable, and legal means of achieving the necessary legislative actions, serious consideration will need to be given to the extent of Fund involvement. Good intentions will not be enough, a point recognized by Mr. Yakusha in his preliminary statement. Regrettably, I do not believe that, as is suggested in the staff report, it is a question of the authorities "working closely with Parliament." Indeed, we may need to question whether or not any intensified efforts to work with the legislature will achieve the required results.

It would be truly unfortunate if this were to happen, but if the implementation of much-needed reforms continues to seesaw between passage and repeal, we will have little option. I sincerely hope it does not come to this. I would therefore welcome any insights the staff or Mr. Yakusha can provide into the prospects for improvement in the legislative climate for implementing the IMF program.

Finally, with respect to the issue of private sector financing, I am quite sure the authorities understand the difficulty and importance of the challenges ahead of them, so I will not belabor the point. I hope that by next year, the international community will have made some further progress in tackling the problems associated with ensuring adequate private sector involvement in crisis resolution so that the framework in support of the authorities' efforts can be of greater assistance than it has been in the recent past.

With respect to the earlier interchange on the suboptimal nature of refinancing outcomes to date, I would only repeat the point this chair made at last week's discussion about involving the private sector in forestalling and resolving crises. Our basic problem remains that the costs of default to the borrower are prohibitively high for default to be a credible alternative. At the same time, the costs to creditors of noncooperation remain too low, resulting in weak incentives to come to an acceptable refinancing agreement at a reasonable price.

Mr. Yanase made the following statement:

I understand that the authorities face many difficulties, such as Parliament being opposed to their economic policy and economic growth remaining negative. However, it will be hard for the authorities to send a good signal to international markets if they continue their current unstable economic management, with which they have so far been unable to continuously achieve the performance criteria.

In addition, based on the upcoming presidential election this fall, the risk of expanding uncertainty may grow, and I am concerned that, in this situation, the credibility of economic management through observance of the Fund program would become minimal. As this chair has stressed before, I must again emphasize the importance of achieving the program target without slippage.

On monetary and structural policy, I basically agree with the staff appraisal. Therefore, I would like to limit my comments to fiscal policy and the problem of the financing gap in the year 2000/01.

The level of the fiscal deficit has been expanded from 1.3 percent of GDP to 1.5 percent of GDP for 1999. However, these targets still require significant adjustment compared with the fiscal deficit in 1998. The expansion of the deficit target should be permitted only when there are no other options. In this sense, I appreciate the authorities' making every effort to strengthen revenue performance by improving tax administration. In addition, I hope that they will continue to discuss in Parliament eliminating the remaining tax exemptions and increasing the rate of excise tax on petroleum products with a view to improving the midterm review performance.

On the expenditure side, as the staff has already recognized, it is paramount to strengthen expenditure controls so as not to cause an expenditure overrun because of the presidential election. The authorities should recognize that, if this should occur, recovery of confidence will be further delayed.

Second, considering that the authorities could receive only about \$100 million as a result of the bond restructuring negotiations between ING Barings and Merrill Lynch, imagine how difficult it will be to fill the gap of \$433 million by the same method. In this regard, it is prudent that the baseline scenario of the staff says that no new money will be forthcoming from international capital markets.

Regarding the positive method to fill the gap in 2000, the staff report indicates that a significant contribution from private sector creditors and a more ambitious privatization program will be needed. We should consider how this will be achieved effectively, as it is likely to fail if the authorities try to negotiate with private creditors just prior to the due date. It seems appropriate to consider the strategy well in advance of the due date. I hope that the authorities continue the necessary policy adjustments in cooperation with the staff in order to fill this gap.

With these remarks, I support the proposed decision and wish the authorities success in their continued endeavors.

Mr. Cabezas made the following statement:

At the outset, I would like to commend the authorities for the commitment shown to comply with the proposed target for the first part of the 1999 fiscal year. Especially commendable are the efforts made to attain the proposed consolidated general government deficit, although in this respect I would appreciate the staff's views on two issues: first, whether the increase seen in arrears of nonpriority expenditure items are significant; and second, whether the recently approved increases in pension benefits, that usually have a strong impact on fiscal accounts, coupled with the tax exemption granted by Parliament, put at risk the completion of the fiscal target for 1999 and future years.

We welcome the staff's pragmatic recognition that there is little scope for collecting more cash revenue and to implement further expenditure reductions in the near term until the new government settles in. We concur with the staff that the efforts shown by the authorities to keep the fiscal situation under control in the present situation deserve to be backed, and I would like to express this chair's support for the proposed decisions. Let me turn now to two aspects of the program that I would like to comment on.

On the structural front, the commitment shown by the government in the direction of strengthening its efforts toward deepening the reform process in Ukraine is, indeed, reassuring. In this respect, we call on the authorities to make every possible effort in order to advance the future privatization of public enterprises, including telephone and electricity providers, not only to help alleviate the financing needs of the government, but also to introduce new technologies and valuable know-how that will produce the much-needed productivity improvements in the country. This point becomes especially important if we consider that the country might resort to including privatization clauses in future government bond sales. This in turn will serve to establish a strict scale for the privatization process to be completed. Thus, we find it appropriate to have a clear definition of what constitutes an acceptable privatization along the lines expressed above so that the enhancements to be introduced in future bond issues will serve their intended purpose of facilitating both debt management and efficiency gains in the economy.

On monetary policy, I am somewhat concerned about the increase in base money that has been observed since June this year. In this respect, I would not be as optimistic as the staff in relying on a stable increase of money demand to absorb this excess liquidity. As a matter of fact, the increased experience in the domestic interest rate, which jumped from 10 percent to 100 percent last August, shows in part the need to keep the money supply bounded within the limits set by the original program. Keeping in mind developments

during recent months, I would urge the authorities to avoid further slippages such as the one that occurred during the second quarter when base money expansion almost doubled the proposed target.

With these remarks, I wish the authorities every success in their difficult endeavors.

Mr. Schlitzer made the following statement:

We think, like the staff, that the government has made a serious effort to keep the program on track, and that with the recent agreement with private creditors it has fulfilled the financing requirement. One must recognize that the government has continued to operate in a very difficult external environment, which, as recalled by Mr. Yakusha, has depressed both Ukraine's foreign trade and capital inflows, especially FDI. Moreover, the government has confronted a hostile Parliament, which has complicated its task considerably.

On the financing issue, we note that while the contribution of the private sector to the financing of Ukraine's program may be somewhat lower than envisaged, this is counterbalanced by a better than expected performance in foreign reserves. Against this background, we consider that the government deserves our support at this stage.

We are glad to see that, external and internal difficulties notwithstanding, the macroeconomic performance has turned out better than anticipated, as shown by both the lower GDP contraction and inflation rate and, as said at the onset, the higher level of reserves. The increase in base money related to the NBU's net purchases of foreign exchange does not seem to us to be of particular concern, given that the better performance in terms of growth and stabilization has induced an increase in money demand. The situation requires, in any case, a close monitoring of monetary conditions.

We certainly cannot be happy with the delays in implementing some of the structural reforms, and we encourage the government to stick to the program schedule in the future. But the fact that the slippages in the structural performance criteria have now been corrected, including the one regarding Kyiv's communal tariff, is to us a clear demonstration of the authorities' commitment to the program.

It goes without saying that the macroeconomic situation remains fragile and that any hesitation on the part of the government in fulfilling the program conditions will be very costly in terms of credibility.

The most difficult challenge lies in maintaining the fiscal consolidation effort, which has so far delivered good results. But the difficulties are mounting with the upcoming elections. Resisting the political pressures to ease the fiscal consolidation process is crucial to the success of the program and is made even more compelling by the need to cope with the debt service problem in the years 2000 and 2001. In this regard I feel somewhat concerned by some recent measures taken by the government and the Parliament to reduce taxes or extend tax exemptions.

The division of responsibilities between the central and local authorities in the fiscal domain is another problem that has to be addressed. I would appreciate comments by the staff or by Mr. Yakusha on what is being done in this regard.

In their Letter of Intent the authorities envisage an acceleration of the privatization effort. Beyond the formulation of a privatization plan, the government intends to submit to Parliament a law providing the legal basis for the dismissal of large strategic enterprises. Perhaps the staff can comment on the progress made so far on this front. Speeding up privatization, beyond being a desirable objective per se, could allow the issuance of privatization-backed bonds in order to catalyze additional private financing, which would help cope with the debt service problem.

The staff has maintained essentially unchanged its projections for GDP growth and inflation that underpin the program targets. Hence GDP is expected to grow at 2 percent and inflation to be about 21 percent at the end of the year. I wonder, however, whether these assumptions are consistent with the recent, better-than-expected data on output and inflation. In particular, inflation has been contained, on average, at 8.5 percent in the first eight months of the year. Even considering the pass-through from the exchange rate depreciation and the increase in communal tariffs during the remainder of the year, I find it hard to see how inflation could go back to 21 percent. Staff comments are welcome.

I would also ask the staff to comment on the draft law on banks and banking activity that was submitted to Parliament in June and that is instrumental for a strengthening of prudent regulation in this sector.

Finally, I fully support Mr. Pickford's remark on the crucial importance of agricultural reform and the need to upgrade it in the authorities' agenda.

With these remarks I support the proposed decision.

Ms. Lissakers made the following statement:

Let me start by commending the authorities for implementing a difficult list of prior actions necessary to complete this review and bring Ukraine's program back on track, and by recognizing their ongoing efforts to keep reforms on track in the face of external economic and internal political challenges. That being said, Ukraine still faces major challenges in the not very distant future which the authorities will have to address by further developing and implementing a strong, proactive reform agenda. While there is no shortage of elements that should appear on such an agenda, for the purposes of today's discussion I will focus on three areas: fiscal adjustment, debt service capacity, and structural adjustment.

First, on fiscal reform, we agree with staff's assessment that adjustment over the past year has been substantial. However, slippage observed over the summer is regrettable and, more importantly, unsustainable given that the resulting 1999 fiscal gap will now be closed through a combination of continued recourse to arrears, netting out operations, and the decision to accept a higher than anticipated budget deficit for the year. The effects of tax exemptions and free trade zones put in place to cater to political interests will have to be undone or limited promptly after the election season in the context of the 2000 budget, as this is the only way to put fiscal policy back on a sustainable path.

With regard to Ukraine's debt situation, the authorities are to be commended for negotiating intensively with their private sector creditors to achieve a voluntary restructuring of obligations coming due this summer, with the end result also providing some improvement in Ukraine's debt maturity structure. That being said, the deals reached with ING and Merrill Lynch noteholders, while somewhat forward-looking, ultimately amount to a discrete event that did nothing to meaningfully alleviate the debt hurdles Ukraine faces in 2000 or put the country on a path toward medium-term debt sustainability.

Regarding next year's external obligations, while it is true that Ukraine's external debt load is not that high in aggregate terms, the maturity structure is awful, and the continued decline in GDP does not help matters. This leaves the authorities and ourselves with the unappealing prospect of one or more subsequent negotiations along the lines observed this summer if no steps are taken in the meantime to avert this outcome. This is something that none of us relish, so it behooves us all to think through how best to break the recent pattern of stumbling from debt crisis to debt crisis and of voluntary reschedulings at very high interest rates.

The Letter of Intent and Mr. Yakusha's preliminary statement both highlight the authorities' intention to accelerate structural reform to achieve

the breakthrough necessary to put macrostabilization on more sustainable footing. They feature an ambitious plan to bring critical elements of Ukraine's privatization effort to the brink of completion ahead of and during this election season. This renewed emphasis on privatization is exactly what is needed over the medium term, and the authorities deserve our full support.

In the near term, however, we cannot ignore the fact that time is very short before a substantial portion of Ukraine's 2000 external debt comes due, and the identified financing gap of \$439 million looms large. The authorities argue that an all-out push on privatization could set the stage for the newly elected government to move quickly and credibly to selling these state assets and possibly issuing asset-backed securities. However, when we factor in that the authorities are now focused on upcoming elections, and afterwards it will take some time to form a new government, what is described as the October–November political season is more likely to extend some time into December. In this light, while we would not want to prejudge the outcome of these efforts, prudence dictates that Ukraine develop a fall-back position for restructuring or refinancing its external obligations on terms that are consistent with a viable medium-term payment path in case other financing options don't pan out.

The effectiveness of other avenues, in particular privatization bonds, is uncertain. While slated to enhance the effectiveness of GOU access to new private financing and to commit the government to a specified pace of structural reform, privatization bonds raise numerous questions. First, their effectiveness is substantially reduced if Ukraine does not keep pace with a preestablished privatization plan. In other words, Ukraine may provide the bond, but not the appropriate collateral. Indeed, it appears that, from the Fund's perspective, privatization revenues have never played an important part in Ukraine's ability to repay Fund obligations. The fact that several political challengers have articulated a desire to stop and even reverse privatization certainly makes this type of financing that much more questionable. And second, whether or not Ukraine keeps pace with a specified plan, privatization bonds may raise the inherent risk of preexisting, noncollateralized bonds held by the private sector. In the event, they may make potential future private sector restructurings that much more difficult to muster.

Touching briefly on other aspects of Ukraine's structural reform agenda, we note progress has been made in the financial sector, and hope that when the Constitutional Court rules once again on the issue of communal tariffs, we will have arrived at a durable solution to this chronic problem. Inadequate progress on reform of agriculture and the energy sector continue to act as drags on the economy, highlighting the need for acceleration. Finally, Ukraine's continued fiscal slippage draws attention to the importance of

accelerating public sector reform, to include clarification and rebalancing of fiscal federalism and improved expenditure effectiveness. Thus we welcome the authorities' determination to move ahead on public administration reform in cooperation with the World Bank.

Mr. Le Gal made the following statement:

Ukraine is still facing difficult times. While the Russian crisis has a lasting impact on the Ukrainian economy, the core of the problems remains the slow progress in vital reforms. Unfortunately, this will not change rapidly since, in the run-up to the forthcoming October elections, the authorities are unlikely to implement critical measures. Nevertheless, in light of the authorities' effort to bring the program back on track and of the fact that the indicators for the first half of 1999 show some improvement in macroeconomic conditions, I support the staff's recommendation and the completion of this review.

I will focus my comments on two sets of issues: financing of the program and private sector involvement. I welcome the fact that after months of negotiation the authorities have managed to find an agreement with ING Barings on terms for a partial refinancing and that Ukraine has constantly tried to achieve private sector involvement in the course of its IMF-supported economic programs. The agreement reached on the refinancing of the ING Barings loan should give some breathing space to the authorities for developing a strategy for dealing with difficult debt negotiations in the year 2000. I note, however, that the conditions of the refinancing by the private sector have worsened since the first agreement with Merrill Lynch in the fall of 1998. This raises concerns regarding the pertinence of a market-friendly approach at a time when private investors are willing to test their position regarding the Fund's involvement. Moreover, I would welcome the staff's comments regarding the appropriateness of the conditions offered for the less-than-one-year rollover to Merrill Lynch bondholders. In light of the expected financing gap that remains for 2000, I agree with the staff on the need for the authorities to continue to ensure a significant contribution from the private sector and on the need to establish a more ambitious privatization program.

On tax reform, the staff's report highlights that that is still posing serious challenges to Ukrainian policymakers. Despite broad agreement that the existing system has failed to solve the country's persistent budget crisis, strong disagreements continue domestically over whether to reform the current system, as underscored by the delays in the full implementation of energy and gas tariffs. Therefore, I support the staff's view that an appropriate budget for 2000 is critical, and that the authorities should clarify the division of fiscal responsibilities among the central and local governments as soon as possible. In this context, I believe that the authorities should also devote their

efforts to simplifying a complex fiscal system that has so far done little to reduce the significant shadow economy.

Mr. Esdar made the following statement:

The economic situation in Ukraine is rather mixed. On the positive side, inflation has come down faster and the contraction of growth has been slower than expected. The external situation, in particular reflected in the development of foreign exchange reserves, has improved. On the structural side, on the other hand, progress is far from satisfactory. There is still significant red tape in the economy, and there are uncertainties surrounding the institutional setup, both of which pose a major obstacle to private investment and direct investment inflows. Also, the upcoming elections generate uncertainties, and the government is still confronted with a situation where the Parliament opposes the reform process. The recent pressures on the revenue underscore the fragility of this situation.

Against this background, the deviation from program targets is somewhat disappointing; also, the fact that some of the performance criteria have been weakened is a step in the wrong direction. However, given the very difficult situation the government is confronted with, especially with regard to the Parliament, we are prepared to support the proposed decision. However, we strongly urge the authorities to remain committed to implementing the program as agreed and to make up for shortcomings arising from the opposition of the Parliament. This refers especially to the need to maintain fiscal discipline.

Given that the room for further tax collection, because of the insufficient support of the Parliament, seems to be limited, the main focus has to be on the expenditure side, with the objective to prioritize expenditure but also to streamline the public sector, which is still too large and which has significant efficiency gaps. Also, the need to widen the tax base and to remove tax exemptions has to remain high on the political agenda.

On monetary policy, the increase of base money gives some reasons for concern. We would encourage the central bank to monitor future developments carefully. We share the staff's assessment that the recent depreciation of the hryvnia will have a positive impact on competitiveness and will raise exports in the medium term. Nevertheless, the recent decision in the field of excise taxes and import duty policies is a severe roadblock for Ukraine's ability to better integrate into the world economy.

On structural policy, we are encouraged by some positive developments in reforming the financial sector, and there is also some progress on privatization. However, Ukraine is still very much at the

beginning of a road which may turn out to be longer than expected. Here I would especially mention, like other colleagues, the need to tackle problems in the agricultural sector and to tackle the problems of property rights. We welcome the fact that the prior actions, which overwhelmingly refer to the structural part of the program, have been met.

We appreciate the efforts of the government to come to an agreement with the private sector. However, as mentioned by Mr. Pickford and Ms. Lissakers, this is only a holding operation, and the problem will be to find a reasonable solution for the year 2000. In this regard, the best way the Ukrainian authorities can contribute to a reasonable solution is to implement the program as agreed, and especially to improve the climate for private investment and private capital inflows.

The staff representative from the European II Department made the following remarks in response to questions:

Fiscal policy is at the core of many of the problems. We are concerned about the number of tax exemptions that have been granted in the last few months, and this is something that the authorities will need to address in the context of the year 2000 budget. It is absolutely critical to expand the tax base. Some tax rates in Ukraine are high, but these cannot be reduced unless the tax base is expanded.

Reliable information on budgetary arrears are not available, and, as a result, we cannot monitor all arrears under the program. This is because most of the arrears incur at local government levels, and it is very difficult to monitor them. What we know is that energy arrears have increased by about Hrv 1.3 billion for the first six months of the year, but this is not any worse than what has happened in the past. Indeed, the extent of fiscal adjustment so far in 1999 will not change significantly if current and historical data are corrected to include the limited information on all government expenditure arrears.

Expenditure control problems reflect the need for the streamlining of the government. The Ukrainians have cut cash expenditures to a notable extent; however, the authorities have not adopted the necessary measures to reduce the size of the government and to streamline the programs that the government supports. As a result, these expenditure cuts are not sustainable, and expenditure arrears are likely to increase. This is something that they are working on with us and with the World Bank. However, substantial progress is needed in this area.

It is too early to discuss the year 2000 budget, given that presidential elections are coming up. But the authorities are required by the constitution to present a draft budget to Parliament in September and are looking at the possibility of a small surplus in the budget. However, in our view, achieving a fiscal surplus will not be possible, unless measures are taken to expand the tax base and to cut expenditures.

Additionally, the authorities will need to find ways to restructure Ukraine's official external debt unless they can move ahead with privatization forcefully.

There has been a substantial amount of technical work carried out in the area of local and federal government relations. The World Bank has undertaken a project, and we hope that, beginning with the year 2000 budget, the authorities would move ahead with some modest steps initially. An important step in this area is to establish a formal base for revenue sharing between the federal and local governments so that ad hoc changes are not introduced by the Parliament or by government.

On the monetary side, some directors have noted the increase in base money and asked if this was not a slippage under the program. Directors may recall that when the EFF was approved, Ukraine's liquid reserve position was \$325 million. For Ukraine to take the opportunity to increase its reserves, in the staff's view, has been very prudent, even though it resulted in a sharper rise in base money. This is very closely linked to the inflation target question. For the first eight months of the year, inflation has been substantially lower than the program had envisaged, but adjusting for the expected increases in communal tariffs which did not take place, the underlying inflation was not very different from what we had assumed. Communal tariffs have been raised in the city of Kyiv, and the rest should be increased in September. That will increase prices. The increase in base money is likely to put pressures on prices toward the end of the year, and that is why we have not revised our inflation target down, even though I would not be surprised if we ended up with lower inflation than the 21 percent that the program has assumed.

The commercial banking law has been submitted to Parliament, which has not discussed the issue, but is expected to pick it up in the near future. It is a very important law, and we hope that progress can be made.

A number of issues have been raised regarding the ING package and the debt strategy in Ukraine. We would have liked to see a better deal and agree that the package is expensive and does not provide a solution. But it will buy some time, and given the condition that the Ukrainians were in, this is as good a package as they could get. The issue of privatization-backed bonds is very interesting, and there is a lot of interest by foreign investors in Ukraine; however, authorities need to make substantial progress in resolving privatization issues with Parliament and in establishing the appropriate legal environment. As for whether they can get the privatization going by March 2000, when large debt payments fall due, that will be very difficult. The political season only ends by the beginning of December, and with a change in government, it would be difficult to put a privatization package together and get it approved by the Parliament. Substantial progress in these areas is necessary for successful placement of privatization bonds. The authorities may not be able to do much on the political side between now and November, but they can do a lot of preparatory work. They have formed a committee chaired by one of the deputy prime ministers in which a number of senior officials and outside consultants are involved.

The World Bank is also providing advice, and the authorities have agreed on a small list of enterprises for case-by-case privatization with the World Bank, which would have to be expanded. An independent appraisal of some of these enterprises is likely to be necessary before they are offered for sale.

On the structural side, we agree entirely with the Directors on the need for a marked step-up after the elections. Agriculture and energy are at the core of the problem. The energy sector is a major drain right now, both domestically and in terms of international relations for Ukraine, and the authorities have to address these problems. But there is also a need for public administration reforms. Directors may recall that Ukraine is participating in the project for fiscal transparency. Even though substantial progress has been made in this area, a lot remains to be done. Many of the arrears and noncash operations indicate the need to improve governance and transparency; however, addressing these issues will require fundamental changes, and not much can be done without parliamentary support.

There was a question on the fiscal impact of the recent increases in pensions. This did not have a negative impact. The authorities were extremely cautious. The law increased the minimum pension, which has been increased. But for many pensioners who were already receiving more than the minimum pension, there was not much change. Moreover, Parliament has also adopted measures that enabled the authorities to raise more revenues for the pension. The authorities have been more successful in reducing pension arrears than the expenditure arrears of the central government.

Mr. Burnashev noted that in transition countries, privatization was not greeted with enthusiasm, and therefore it would be difficult to receive parliamentary support. As this required the redistribution of former public property, realistically that would mean a long wait for building up a consensus in the country. It was not possible to build this consensus if reforms were not delivered. It was a difficult situation.

Mr. Chelsky wanted to have more information regarding the upcoming presidential elections.

Mr. Yakusha explained that he would not exclude the possibility of some improvements in the legislative process. Currently, the division of forces in the Parliament is about 50/50, and that is why it is difficult to predict what is going to be approved. However, that situation could change.

The staff representative from the European II Department noted that the small-scale privatization was finished; however, the President could not direct the government to privatize some of the large enterprises without a legal basis and political support. For example, although privatization of the electricity and telephone companies has been envisaged under the program, this has been repeatedly rejected by Parliament. The

consequences of not going forward with privatization would be very damaging for the period 2000–2001.

Regarding Ukraine's financial position for the year 2000, he said that the resources being provided by the international community were not very large. The Fund was the largest creditor, but there were very large obligations to the Fund falling due next year. Also, without a major step-up of structural reform, the World Bank would not be able to disburse more money, although the potential for disbursing significantly larger amounts was there. It was critical for Ukraine to start with fiscal adjustment, the staff representative concluded.

Mr. Estrella made the following statement:

Macroeconomic performance is broadly in line with program objectives, with inflation and international reserves in 1999 performing better than expected under the program. Most quantitative performance criteria were met, although end-June performance criteria on the state cash revenues and communal tariffs were not observed. As the staff have said, despite these slippages, the authorities have made a serious effort to keep the program on track and all end-July performance criteria were met. Therefore, we support the completion of the third review, the authorities' request for modification of the program, and the waivers requested.

Macroeconomic targets and policies for 1999 and beyond are appropriate. For 1999, although the fiscal outlook remains very difficult, the fiscal target has been set at 1.5 percent of GDP, an improvement of 1.2 percent of GDP relative to the 1998 outcome. Moreover, real GDP will decline 1 percentage point less than previously expected, and an annual average increase in prices of about 25 percent will be lower than expected. Also important is the buildup of gross official reserves, which are now projected to be stronger than envisaged earlier. As a result, broad money growth has been targeted at about 27 percent—higher than projected before. Some structural reforms were not implemented in line with commitments under the program; however, these slippages were to be addressed with the prior actions for today's review.

Moreover, the government made progress in normalizing relations with creditors. The successful restructuring of the ING bonds has allowed the authorities to generate a more comprehensive debt negotiation strategy for 2000. No doubt a set target for restructuring, such as 80 percent, has proved to be difficult to implement; therefore, we want to support the authorities' commitment to negotiate any additional rescheduling agreement with the private sector in a voluntary way. This is for us a very important point. We hope to see a voluntary, market-friendly solution which involves new money for Ukraine and does not increase the future cost of borrowing for the country.

All in all, although progress in fiscal consolidation has been commendable, every effort must be made to maintain fiscal discipline in the coming months. Despite significant progress in a number of areas of structural reform, the overall pace of structural reform needs to be accelerated. No doubt, the financing outlook for the year 2000 is very difficult due to a peak in debt service obligations. Therefore, we welcome the authorities' efforts to explore options for reentering international capital markets, including through the issuance of privatization-backed bonds.

We wish the authorities all success in their very difficult endeavors.

Mr. Szczuka made the following statement:

Ukraine's record of achievements under the EFF program is once again mixed. The nonobservance of the two end-June performance criteria is very disappointing, as is the failure to reach any of the indicative targets and quantitative structural benchmarks set for June and July. Although the budget deficit criterion was only met thanks to the prolonged negotiations on bond restructuring, the government and the Parliament took several decisions that added to the pressure on the budget. The very limited flexibility on both the expenditure and revenue side forced the government to adopt and the staff to accept some poor quality adjustment measures like the increase in netting-out operations and a slowdown in reduction of arrears. However, even with these measures, the financing gap in the second half of 1999 will not be closed, and the authorities had to request some relaxation of the fiscal criteria.

This situation leads to asking at least two sets of questions: first, about the sustainability of the fiscal adjustment in Ukraine that relies almost exclusively on expenditure cuts, and second, about the feasibility of the consistently missed cash revenue targets. One may also add to this a broader question: How much flexibility, if any, should the program allow for a country that is approaching elections where the government is in an enormous permanent struggle with the Parliament? Staff comments would be welcome.

Looking at the more positive aspects of the recent developments in Ukraine, I have to acknowledge the slightly better than expected macroeconomic performance, the very sizable adjustment of fiscal position, the continuation of prudent monetary policy, and the overperformance with respect to the NIR targets. One has to admit that the authorities have undertaken a serious effort to bring the program back on track. This is confirmed by the indication that all end-July performance criteria were observed, and by the implementation of the numerous prior actions, including the crucial one on communal tariffs in Kiev that compensates in part for the missed structural performance criteria. Taking all this into account, this chair is ready to grant the requested waivers, to accept the proposed modification of

several performance criteria, and to support the completion of the third review, even though, as admitted by the staff, such a decision is relatively fraught with risk.

I would like to add two additional comments. First, on the financing needs in the year 2000, even with quite optimistic assumptions providing for the doubling of the foreign direct investment inflows, the staff identified a very sizable gap of \$439 million. Closing this gap will require contributions from three major sources: the government and the Parliament working together to present a realistic budget for next year and agreeing on the significant acceleration of structural reforms; the Fund and other international financial institutions; and the private sector through so-called voluntary debt restructuring. It is quite obvious that the second and the third sources will soon dry up if the authorities are not able to do their part and implement serious structural reforms, including starting privatization in some key sectors like telecommunications and energy.

I broadly endorse the structural reform agenda proposed by the Fund and Bank staff, and I urge the authorities to proceed along these lines.

Unfortunately, even though the staff has welcomed Ukraine's renewed commitment to move on the structural reform front, this commitment cannot be considered binding for the short period until the presidential election. One can hope that the result will only help to reiterate and strengthen the commitment. In view of the performance of the structural reforms, it is regrettable that progress in this area during the period under review has once again lagged behind expectations—even more so since the expectations were certainly not overly ambitious.

Before concluding, I would like to raise an issue linking this discussion to our recent debate on private sector involvement. I noted that the revised staff scenario does not foresee any spontaneous (as opposed to voluntary private) capital inflows during the next two years. I wonder whether the staff is able to prove that Ukraine is actually better off when permanently struggling to avoid default and being forced to pay interest rates in excess of 20 percent without prospects for a quick resumption of private financing than it would be after choosing the option of an outright default. To be more precise, I'm not yet advocating a default, but I wonder whether in staff's view Ukraine would be banned from international capital markets for a longer period after default, but with better reserve position, than under the current strategy. I could refer to the Polish example, which is not completely conclusive because there was an extended period of political problems, but as soon as the agreement had been reached, the access to the market was immediate. And Brazil was able to put new bonds on the market even before signing a deal for the very deep reduction of its debt.. In the Polish case, the

deal was in 1994, and in 1995 the first bond was on the market. The offers were coming before the actual signing of the bill. The period between the signing of the new deal on restructuring or reduction of the debt and a return to the market was very brief. I wonder whether the staff has produced any such scenario.

One final point: please note that the NIR target (the reserve target for the end of 1999) has been revised from very low level of 3.3 to the still low level of 4.1 weeks of imports, and that the reserves are expected to cover two months of imports only in the year 2004. This answers the question of whether we should insist on more private sector involvement even if the reserves are growing slightly faster than expected. With these comments, I wish the Ukrainian authorities continued success in implementing the reforms.

Mr. Lehmussaari made the following statement:

Let me first say that I support the completion of the review. While I consider the request for waivers unfortunate, I base my support on, among other things, the observance of the end-July performance criteria and the implementation of the prior actions for the review.

Having said that, I only want to make a few brief remarks. First, it is reassuring to note that macroeconomic stabilization has been reasonably maintained despite difficult conditions, both globally and domestically. Although the exchange rate came under renewed pressure late this summer, the authorities demonstrated strong resolve in the way they conducted monetary policies through this period. I consider it critically important that the authorities remain firmly committed to macroeconomic stability in the period ahead, not least because political factors might generate uncertainties that could quickly undermine the still-fragile situation in the financial markets.

Second, I recognize that the authorities have made considerable efforts to improve the fiscal situation thus far in 1999. I regret, however, that the reductions in arrears on wages, pensions, etc., have been slower than expected. Anyway, I agree with staff that the authorities deserve support in their efforts to keep the budget under control in the run-up to the presidential election. Looking forward, the key challenge is, of course, the budget for 2000. Every effort must be made to maintain fiscal discipline. Tax collection must be improved, and ad hoc tax exemptions for specific sectors of the economy must be avoided, as stressed by several speakers.

Third, the progress in the structural area is less than satisfactory. The authorities need to press ahead more forcefully with structural reforms, without which a lasting return of foreign capital would most likely fail to materialize. Needless to say, additional progress in privatization is crucial in

this context, as pointed out by other speakers as well. Further progress in reforming the energy and agricultural sectors is also of vital importance. In order to carry out this challenging reform agenda, it is very important to promote true ownership of the program—a task that requires the authorities' full attention.

Finally, Mr. Chairman, I welcome the fact that the program is fully financed for the remainder of 1999. Nonetheless, I am seriously concerned by the financing outlook for 2000 and 2001. While the private sector has been involved through extraordinary measures, the financing gap in the future would be extremely difficult to close in a sustainable way unless foreign investors are sufficiently convinced that Ukraine is going in the right direction. This underscores the need for continued prudent macroeconomic policies and further substantial progress on the structural front.

Mr. Mozhin made the following statement:

Two months have passed since our previous formal discussion on Ukraine, and it is my impression that the overall picture has remained broadly unchanged. Given the political pressures related to the forthcoming presidential elections, the choice of policy options to address various imbalances has been very limited. Nevertheless, the Ukrainian authorities have undertaken noticeable efforts to keep the program on track and to stabilize macroeconomic conditions. As a result, Ukraine's performance has been somewhat better than was expected. The GDP decline has slowed down, inflation has fallen more quickly than was projected, and the international reserves position has further strengthened. However, important slippages occurred on the fiscal front and the area of structural reforms. Substantial progress has been achieved in reducing the overall cash deficit of the consolidated general government. This was possible mainly due to a significant reduction in government expenditures amounting to almost 7 percent of GDP. However, cash revenues have been lower than envisaged under the program. It is clear that any revenue measures which would be desirable at this stage are not going to be approved by the Parliament in the run-up to the presidential elections. This call for expenditure reductions is also limited. Under these circumstances, it is essential to focus even more strongly on strengthening tax administration. The steps undertaken recently by the government and Parliament, such as reductions in excise tax rates and import duties on petroleum products and extension of the period of payment of VAT and excise taxes on these products, will only add to the fiscal pressures. Given the already weak fiscal position, the establishment of free trade zones is also absolutely undesirable. I agree with the staff on the urgent need to broaden the tax base through elimination of tax exemptions and abolition of free trade zones. On the expenditure side, the problem of accumulated arrears remains unresolved and will have to be addressed. This will require further

expenditure restraint, including rationalizing subsidies and transfers to the coal and agricultural sectors.

Given the very heavy debt servicing requirements in the year 2000, private sector involvement will be essential in helping to reduce the financing gap. Both privatization programs will also be needed to finance this gap.

As for monetary and exchange rate policies, I would like to commend the authorities for prudent steps which have led to further strengthening of the international reserves position. However, as a result of net purchases of foreign exchange by the NBU, base money has risen substantially and exceeded the program projections. The staff has indicated that, so far, no pressures on the price level have been observed. Does that mean that the measures undertaken by the authorities to absorb excess liquidity have been fully adequate, or is there the possibility that these pressures will become evident at a later stage? The authorities should monitor the situation very closely.

As the political situation in Ukraine will remain difficult for some time, pressures on the national currency are quite possible. The authorities should refrain from intervening in support of the exchange rate, even if this would lead to somewhat higher inflation. With these remarks, I support the proposed decision and wish the authorities every success.

Mr. Kpetigo made the following statement:

Substantial progress has been made in macroeconomic performance since the second review, although the economic and social environment in Ukraine remains fragile due to the upcoming presidential elections at end-October. Most performance criteria were met, including the reduction of budgetary arrears on wages, pensions, and benefits. As a result, output decline continues to slow down, and inflation has fallen below the projected target. However, much has to be done on the structural reforms front.

The authorities are committed to filling the fiscal gap before the end of the year, but are encountering some difficulties to get new measures approved in a timely manner. As an alternative, the government resorted to strengthening tax administration along with the establishment of a taxpayer unit. The authorities also envisage making deep cuts in social expenditures on the eve of this presidential election. I wonder how productive these measures will be and would welcome staff comments. I also have concerns regarding the authorities' confidence about removing in the near future most tax exemptions and reversing the impact of the free trade zones in the next budget since some major policy changes may emerge from the October elections.

The prudent monetary policy has been enhanced by the tight liquidity policy implemented by the commercial banks. The NBU should be commended for having continued net purchases of foreign exchange in order to strengthen its reserve position without fueling inflation, and also for having resisted selling foreign exchange at the time the hryvnia started depreciating. The subsequent rise in the interest rate helped the currency to halt its depreciation and to stabilize rapidly. Ukrainian trade has, however, substantially benefited from the depreciation that occurred as competitiveness has improved.

The authorities' commitment to closely monitor domestic liquidity conditions and to absorb excess liquidity through the use of monetary instruments is encouraging, as these measures could ease inflationary pressures through the election period.

On the structural front, much has been done and performance has been on track for most sectors (including reforms) as regards deregulation and privatization in the banking sector, except for one bank whose recapitalization plan was not appropriate. The authorities' swift reaction to correct the slippages in the agriculture and energy sectors was appropriate, as was the reform of the public administration, although the performance criterion on increasing communal tariffs in Kyiv has not been met.

I share the authorities' determination to correct the slippages and to reverse the reduction in communal tariffs in the city of Kyiv to pave the way for, and swiftly resume, more comprehensive structural reforms during the post-election era.

Finally, Ukraine's financial outlook during the two coming years appears to be difficult, although its capacity to repay the Fund continues to improve. This chair has no difficulty supporting the staff recommendations and encourages the authorities to pursue their efforts to maintain the program on track.

Mr. Daïri made the following statement:

The Ukrainian authorities are to be commended for their commitment to the program under difficult conditions. Since the last review, macroeconomic performance under the extended arrangement has been improved, as illustrated by the slowing rate of output decline, the reduction in the inflation rate, and the strengthening of international reserves. The authorities should continue full implementation of the program and compensate for the past slippages in order to achieve sustainable growth.

We broadly agree with the thrust of the staff appraisal and wish to make a few comments:

While the slippages which occurred on the structural reform front have been reversed (as prior actions) for the completion of the third review, introducing a policy and then reversing it impose some cost to the economy, send conflicting signals to the domestic economic agents and foreign investors, and impair the credibility of the policymakers.

The difficulty faced by the authorities in the run-up to the election with regard to achieving a sound budget position and keeping the expenditure down is understandable. However, in order not to lose the gains achieved so far, it is necessary to improve cooperation between the government and the Parliament. In light of the existing problems before the election, the measures envisaged to cut some expenditure, improve tax administration, and establish a large taxpayer unit are welcome. It is encouraging that the government intends to remove most tax exemptions and reverse or limit the impact of the free trade zone in the 2000 budget. The staff indicate that "rigidities in revenue sharing arrangements prevent the transfer of revenues from local governments to the state budget." We encourage the authorities to correct this deficiency to enhance budget flexibility.

On monetary policy, in order to preserve the stability of the hryvnia, tight monetary policy should be continued and the authorities should be ready to cope with the pressures on the currency. But, in view of the low international reserve position, the central bank should avoid intervention in the exchange market.

The staff has revised their projection of private lending in the balance of payments table from \$300 and \$325 million in 2000 and 2001, respectively, to zero. In light of the performance of this variable in the past and the projected figure for 1999 (the election year) and in view of the authorities' determination to maintain nonconflictual relations with their private creditors, the projection for the next two years may seem pessimistic. Staff may wish to comment on this issue.

With these remarks, we support the proposed decision and wish the Ukrainian authorities further success in implementing the program:

The staff representative from the European II Department said that it was true that the authorities had relied to a large extent on expenditure cuts, but that cash revenue had increased by about 40 percent in nominal terms and 20 percent in real terms. There was an effort to increase cash revenue, even though the authorities had missed the targets. This was due partly to improved tax administration, despite all the exemptions.

A senior delegation from the Ukraine government and the National Bank had assured management of their intention to keep the program on track before the election. The record on expenditure control has been very good since the second quarter of 1998.

On foreign direct investment, he noted that staff was assuming that the year 2000 would be the same as 1998 since there had not been much investment this year. Staff was also pessimistic about projecting the access to the market at this time, but at this stage they did not have any indication that there was going to be an easy reentry. He said that he could not answer whether or not a country would find access quicker by following the path that Ukraine had vis-à-vis a default, but the latter was not an option the authorities' were considering.

Mr. Yakusha made the following concluding remarks:

I would like to thank the Board for extending yet again the benefit of the doubt to my Ukrainian authorities, and it goes without saying that all concerns and suggestions expressed today will be reported to the authorities.

In my view, despite mentioning today's shortcomings in implementing structural reforms, the authorities deserve perhaps more credit for their efforts. Today is a kind of an anniversary: at the beginning of September last year the current program was approved by this Board, and I must admit that despite some difficulties, many feared doomsday scenarios have not emerged. Macroeconomic stability has been preserved despite adverse circumstances, both domestic and external. Reserves are \$1 billion higher than they were a year ago, and the economic decline appears to have bottomed out. The last data on industry suggests that industrial production this August was up more than 7 percent since last August.

Moves in monetary and fiscal areas have been implemented by the authorities. Given the authorities' track record with respect to structural measures, they have improved during the course of the first year of the program implementation.

I would not exclude the likelihood of Parliament canceling some of the existing tax exemptions, as it has already been reported by the government that a lot of exemptions granted by the Parliament did not produce the desired results and even had added reverse incentives in the corresponding industries. Therefore Parliament has not objected to the government taking initiative and canceling certain exemptions which were within their area of responsibilities.

I am much less optimistic about the likelihood for reversing petroleum excises, which have been decreased by the Parliament, as there is no room for that.

On intergovernmental fiscal relations, the authorities were very much in favor of the fiscal transparency report, despite the fact that it is one of the most critical reports. It was their view that the unclear division of responsibility should not be tolerated for long, and policy advice provided in the report as well as in the staff assessment is going to be used for making policy changes.

On inflation projections, staff usually overestimate inflation in the case of Ukraine, and the authorities are of the view that it would go below 19 percent and not stay at 21 percent for the year as a whole. The trend is what matters, and the authorities are concerned that the monetary expansion may at some point in time be translated into higher inflation. They stand ready to implement appropriate measures if this is the case. Thank you.

The Executive Board took the following decision:

1. Ukraine has consulted with the Fund in accordance with paragraph 3 of the Extended Arrangement for Ukraine (EBS/98/144, Sup. 3), the final paragraph of the letter of the Prime Minister of Ukraine and the Chairman of the National Bank of Ukraine dated August 14, 1998, and the letter of the Prime Minister of Ukraine and the Chairman of the National Bank of Ukraine dated June 28, 1999.

2. The letter of the Prime Minister of Ukraine and the Chairman of the National Bank of Ukraine dated August 26, 1999, shall be attached to the Extended Arrangement for Ukraine and the letter of the Prime Minister of Ukraine and the Chairman of the National Bank of Ukraine dated August 14, 1998, with the attached memorandum of economic policies for July 1, 1998, to June 30, 2001, as modified, shall be read as supplemented and modified by the letter dated August 26, 1999.

3. Accordingly, the Extended Arrangement for Ukraine shall be modified in the following manner.

- a. The performance criteria for end-August and end-September 1999 set out in paragraphs 3(a)(i) through 3(a)(iii), and the performance criterion for end-September 1999 set out in paragraph 3(b)(v) of the Extended Arrangement shall be as specified in Table 3 attached to the letter dated August 26, 1999.

- b. The performance criteria for end-December 1999 set out in paragraphs 3(a) and 3(b) of the Extended Arrangement shall be as specified in Table 3 attached to the letter dated August 26, 1999.

c. The following shall be added as a new paragraph 3(c)(iii): After September 19, 1999, if Ukraine has not implemented the increases in communal tariffs as described in paragraph 9 of the letter dated August 26, 1999; or

4. The Fund decides that the third reviews contemplated in paragraphs 3(g) and 3(h) respectively are completed, and that Ukraine: (i) may continue to make purchases through September 19, 1999, in accordance with the provisions of the arrangement, notwithstanding that the data for end-August 1999 for the performance criteria set out in paragraph 3(a) of the arrangement is not available; and (ii) may continue to make purchases in accordance with the provisions of the arrangement, notwithstanding the nonobservance of the performance criterion for end-June 1999 set out in paragraph 3(b)(v) of the arrangement, and the performance criterion set out in paragraph 3(c)(ii) of the arrangement. (EBS/99/170, Cor. 1, 9/2/99)

Decision No. 12048-(99/99), adopted
September 7, 1999

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/99/98 (9/3/99) and EBM/99/99 (9/7/99).

4. PAKISTAN—REPORT ON NONCOMPLYING PURCHASE AND WAIVER OF PERFORMANCE CRITERION

The Fund notes the report of the Managing Director set forth in EBS/99/151 on the noncomplying purchase made by Pakistan on May 24, 1999, under the Extended Arrangement for Pakistan and decides to waive the nonobservance. (EBS/99/151, Sup. 1, 8/13/99)

Decision No. 12049-(99/99), adopted
September 3, 1999

5. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAM/99/122 (9/2/99) is approved.

APPROVAL: January 24, 2001

SHAIENDRA J. ANJARIA
Secretary