June 6, 2003
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 03/26

10:00 a.m., March 19, 2003

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

H. Köhler, Chairman
E. Aninat, Acting Chair

Executive Directors	**Alternate Executive Directors**
	A.S. Al Azzaz
D. Ondo Mañe	L. Rutayisire
I.E. Bennett	M. Kruger, Temporary
M.J. Callaghan	
F. Zurbrugg	O. Steudler, Temporary
K. Bischofberger	R. von Kleist
P.C. Padoan	H. Vittas
	D. Lombardi, Temporary
S.M. Indrawati	
Y.V. Reddy	K. Kanagasabapathy, Temporary
	J. Prader
	I. Ábel, Temporary
	B. Andersen
	S. Kropas, Temporary
N. Jacklin	M. Lundsager
	N. Epstein, Temporary
	S. Boitreaud
	M. Daïri
A.V. Mozhin	A. Lushin
	I. Zakharchenkov, Temporary
	M. Beauregard
T. Scholar	N. Joicey, Temporary
M. Portugal	
	J. Mafararikwa, Temporary
	J. Milton, Temporary
	O. Kanaan
Wei Benhua	Y. Wu, Temporary
J. Kremers	M. Abbing, Temporary
K. Yagi	T. Miyoshi, Temporary
G.R. Le Fort	A.G. Zoccali
	C.E. Pereyra, Temporary

S.J. Anjaria, Secretary
A. Linde, Acting Secretary
B. Esdar, Acting Secretary
T. Davidson, Assistant
J. Morco, Assistant
J. Puig, Assistant
M. Schulte, Assistant

Also Present

IBRD:P. Levy, Lead Economist & Sector Leader; A. Bhattacharya, Senior Advisor. ECB: B. Kisselevsky. African Department: N. Kirmani, D. Rwegasira. Asia and Pacific Department: D. Burton, Director; D. Citrin, R. Kronenberg, J.S. Lizondo, M. Takeda, A. Wolfson. European I Department: A. Leipold, Deputy Director; J.J. Fernandez-Ansola. External Relations Department: T.C. Dawson, Director; M. Chatah, A. Gaviria. Fiscal Affairs Department: W. Allen, A. Baldini, M. Petri. Independent Evaluation Office: I. Mateos y Lago. International Capital Markets Department: D. Grigorian, J. Roaf. Legal Department: W.E. Holder, Deputy General Counsel; H. Elizalde, D. Siegel, R. Weeks-Brown. Monetary and Exchange Affairs Department: L. Cortavarria, D. Hoelscher, M. Moretti. Policy Development and Review Department: T. Geithner, Director; M. Ahmed, Deputy Director; M. Allen, Deputy Director; H. Al-Atrash, L. Aylward, C. Aturupane, N. Blancher, C. Christofides, E. Chi, D. Desruelle, P. Gajdeczka, R. Glennerster, K-W. Hur, R. Kincaid, K. Langdon, I. Lukonga, Y. Metzgen, A. Tiffin. Research Department: K. Rogoff, Economic Counsellor and Director; L. Catao, H. Edison, T. Helbling, M. Kumar, J. Ostry, D. Robinson. Secretary's Department: M. Miller, P. Ramlogan. Statistics Department: C.S. Carson, Director; C. Enoch, Deputy Director, M. Hassine, J. Reitmaier, R. Rosales. Treasurer's Department: H. Hatanpaa. Western Hemisphere Department: A. Singh, Director; J. Dodsworth, Deputy Director; A. Cebotari, L. Giorgianni, E. Ramirez, J. Thornton. Office of the Managing Director: V. Read, Personal Assistant; R. Moghadam, A. Tweedie. Office of Budget and Planning: B. Potter, Director; H. Young. Office of Technical Assistance Management: M. de Zamaroczy. Advisors to Executive Directors: J.A. Costa, C. Duriyaprapan, D. Farelius, J. Gallardo, P. Gitton, F. Haupt, A.R. Ismael, J. Jonáš, F. Manno, M.F. Melhem, T. Moser, K. Nauphal, P.A. Nijsse, E. Nyambal, S. Rouai, K. Sakr, K. Shbikat, C. Sia, A.A. Tombini, F. Varela. Assistants to Executive Directors: C. Gust, O. Basdevant, J.G. Borpujari, R. Calderón-Colin, N.J. Davidson, V. de los Santos, N.H. Farhan, M. Faulend, M. Franken, C. Harzer, M. Jamaluddin, Jin Z., J.T. Kanu, T. Komatsuzaki, A. Lanza, M. Marques, P. Moreno, K.S. Oo, J. Salleh, T. Segara, S. Vtyurina.

1. ARGENTINA—STAND-BY ARRANGEMENT—REVIEW, MODIFICATION, AND WAIVER OF PERFORMANCE CRITERIA; AND EXCHANGE SYSTEM

Documents: First Review Under the Stand-By Arrangement and Exchange System, and Request for Waiver of Nonobservance of Performance Criteria (EBS/03/32, 3/10/03; and Sup. 1, 3/17/03)

Staff: Dodsworth, Thornton, WHD; Kincaid, PDR

Length: 2 hours, 45 minutes

Mr. Zoccali submitted the following statement:

Overview

The first review under Argentina's Stand-By Arrangement approved last January 2003, has provided a good vantage point from which to assess not only recent economic developments, but also the prospects in the social and political spheres. My authorities have appreciated the constructive policy dialogue with Fund management and the staff. They are encouraged by the finding that, despite fragilities and the pre-electoral period, the economic recovery continues and all macro-economic performance criteria under the program for end-January were observed with considerable margins. In keeping with their policy of full transparency, they consent to the publication of the staff report although not always agreeing with the observations made, subject to any correction or deletion that may be appropriate in accordance with the Fund's guidelines for release.

Equally heartening is that the Argentine society has reaffirmed its vocation to abide by the democratic process. To this end, the major presidential candidates are presenting the electorate with mature scenarios of the circumstances confronting Argentina and the efforts that will be required to strengthen its institutions, secure long-term growth and social stability and maintain a welfare-enhancing link with the international financial community.

Macroeconomic Developments

Staff have noted the faster than expected consumption-based recovery that began in the second half of 2002. The generalized sentiment is that this process is at last beginning to revert the deep and persistent contraction in economic activity since the end of 1998 that resulted in unprecedented levels of unemployment, poverty and indigence, and the steep fall in the value of the currency early last year. In fact, seasonally adjusted industrial production between April 2002 and January 2003 grew by 17.2 percent and labor intensive sectors such as textiles and heavy machinery recovered strongly.

This factor together with the implementation of the Heads of Households program contributed to the creation of over 800 thousand new jobs since May.

The doubling of the GDP growth forecast for 2003, to around 4 percent, may be explained by the improved demand-side sentiment, in particular consumer confidence. The pent-up demand and the success in keeping inflationary pressures at bay helped spur household spending, auto sales and residential construction. Import substitution following the plummeting value of the peso early last year and the change in relative prices leading to a projected record grain crop also contributed prominently to the improvement in economic indicators.

While vigorous export growth has yet to materialize, it is worth keeping in mind that export prices actually declined in 2002 by some 4.5 percent, that comparative advantages in agriculture remains impaired by distortions affecting international supply and market access, that accommodation to the new relative prices normally occurs with lag, and that the unwinding of the acute credit crunch has been slow. Nevertheless, Argentina more than doubled its trade surplus last year, to over US$17.5 billion and rebuilt its international reserves position while making net payments to the IFIs in excess of US$4.1 billion.

Inflation on an annualized basis has also continued to decline. In February 2003 the CPI and WPI increased by 0.6 and 0.4 percent, respectively. In addition, the nominal exchange rate has been appreciating gradually since last November despite the steady liberalization of foreign exchange and payments restrictions, including virtually all under the broadest definition of Article VIII. In the current context, the central bank’s inflation assumption for the year of 22 percent appears attainable.

The Stand-By Arrangement with the IMF has contributed to strengthening confidence and macro-economic stability that are essential for an orderly political transition and to lay the basis for the structural reforms needed to address sustainability concerns in a medium-term context with the continued support of the international community. Against this backdrop, some additional observations regarding the fiscal, monetary and structural developments bearing on program implementation are deemed warranted.

The Stance of Policies

Prudent management of the public finances has and continues to be a cornerstone of my authorities’ strategy for stabilization and recovery. On the revenue side, export taxes, inflation, strengthened tax administration and the improved economic activity, in particular since Q4 of last year, raised nominal tax collection through February by some 55 percent y-o-y and by over 9 percent in real terms. On the expenditure side, it is worth stressing that strict control over public outlays in nominal terms significantly contributed to the improvement that took place in the primary balance. As a result, real primary expenditure in January 2003 was some 10 percent lower than in the same month last year. The combination already produced a cumulative primary surplus of the federal government during the first two months of this year that is approximately 85 percent of the end-March target level under the program. Regarding the first fiscal performance criteria for March 14 identified as pending in Box 1, the congress approved on March 12 the suspension of the income tax exemption on export rebates. The conversion of the fuel tax to an ad-valorem tax which already was passed in the lower house, was sent back to senate committee to clarify technical estimates of yield and is scheduled for reconsideration by the full senate this week. In addition, the congress passed the law delegating to the executive branch the elimination of the remaining competitiveness plans, which is a performance criterion for the second review. The pertinent legal instrument to implement this undertaking is being readied.

In addition, the provincial finances in aggregate have moved into balance faster than envisaged, and the second pending fiscal performance criteria relating to bilateral fiscal consolidation agreements for 2003, signed with eight provinces accounting for 81 percent of the aggregate deficit, has also been met. More specifically on the general issue of the provincial finances, the aggregate primary balance reached in 2002 should be seen against an expected deficit of one-half percent of GDP for the year. This represents an adjustment of more than 70 percent with respect to the aggregate 2001 provincial fiscal deficit. In turn, the fiscal consolidation agreements signed by provincial governors for 2003 would represent an additional fiscal adjustment at the provincial level of almost 40 percent with respect to 2002. The commitment of provincial governments that signed the bilateral agreements last year (all except two surplus jurisdictions) to refrain from issuing new quasi-monies has also been met. In fact, no provincial government issued new quasi-monies since the middle of last year, in accordance with the continuous performance criteria under the arrangement. Recognizing the progress made and the importance of fostering further consolidation, my authorities recently announced a staged plan to start a process of orderly withdrawal of outstanding quasi-monies. Initially bills amounting to about US$1 billion, issued by eight provinces compliant with fiscal consolidation undertakings, would be withdrawn. This would leave those issued by the federal government (Lecops), and the provinces of Buenos Aires (Patacones) and Cordoba (Lecor), which represent the bulk of the quasi-monies stock issued at the height of the crisis, for a second stage. Funding for this purpose would be from the federal government, including possible support from the World Bank, in the form of conditional loans to the eight initially eligible provinces. Work is also underway, with a FAD technical team on the assessment of possible reforms in intergovernmental fiscal relations.

Enhancing the credibility of monetary policy and the stability of the financial system remains an overriding objective for my authorities. In this regard, as the fears of hyperinflation receded and economic activity began to recover, deposit reflows into the banking system, despite the "amparos" and the lifting of restrictions on reprogrammed time-deposits, maintained the trend that began last July. It should also be kept in mind that over 80 percent of total deposits in the banking system are now free of any restrictions and that the stock of peso deposits has clawed back to the level prevailing last April at the peak of the deposit freeze. In sum, the improved functioning of the payments system, the pick-up in activity and the marked deceleration of inflation all contributed to a noticeable increase in the demand for money, that began last September.

My authorities are encouraged by the fact that the conservative monetary targets set for end-January under the program have been comfortably met and that no adjustments have been deemed necessary in this review. The continued favorable evolution of transactions-linked deposit in pesos was encouraged by the policy of attractive interest rates that has enabled the banks to reconstitute their liquidity positions and reduce outstanding liquidity assistance with the central bank. The combination of monetary absorption through a deepened market for Lebacs, reduction in the stock of rediscounts, liberalization of exchange controls and exchange rate flexibility have afforded the central bank significant control over NDA. However, the relatively tight stance has contributed to the gradual appreciation of the nominal exchange rate, only in part compensated by the liberalization of exchange controls, and to the increase in interest rates on Lebacs this year. Neither of these effects have been significant so far. Nonetheless, the present tightening of financial conditions may warrant a second look during the second review, particularly in a context of evidence of a further strengthening in the demand for money and subdued inflation pressures. In this regard, it is worth noting that starting in Q4 of last year the composition of the monetary base changed in favor of a persistently higher participation of money in circulation, pointing to the improvement in real activity and the lower price volatility prevailing since the second half last year. This development provides greater assurances to my authorities that a progressive liberalization of the much-reduced proportion of reprogrammed time-deposits remaining in the banking system would not trigger significant monetization as the present trend is being underpinned by a strong fiscal effort and a conservative monetary program. In any event, the monetary authorities remain vigilant to maintain the consistency of the monetary stance with the both the requirements of the program and of the recovery during this pre-electoral period.

On March 5, 2003, the Argentine Supreme Court issued a long-awaited and case-specific ruling declaring unconstitutional the pesoification of the dollar deposits held by the province of San Luis in Banco de la Nación.

Understandably this has triggered renewed discussion within and outside the country. My authorities consider the situation manageable even in the case that this judgment is extended to other depositors. They consider that the ruling, in essence, recognizes the competence of the government to deal with the emergency situation stemming from the crises to return the deposits, within a reasonable time-frame while respecting the original currency of denomination. In any event, the supreme court has granted the parties involved 60 days to agree on the modality and the terms for returning the deposits initially made in dollars. Lack of agreement would require returning the case to the supreme court. In this regard, the administration eschewed a compulsory solution. It is also relevant to note that markets have assimilated the news from the supreme court without altering the more encouraging climate of expectations, as reflected in the continued firmness of the peso and net purchases of foreign exchange by the central bank, and the generally stabilized interest rates.

The concern expressed in the staff paper in relation to “the announced desire of President Duhalde of lifting the remaining restrictions on deposits in the “corralón” (subject to reprogramming) should, thus, be seen in the context of the authorities’ recent track-record privileging price stability and the maintenance of orderly financial market conditions. Prudent liberalization has been part and parcel of their reform strategy. In fact, the recent announcements by the central bank establishing: i) a new prudential limit, effective May 1, 2003 on the foreign currency mismatch of banks, of 30 percent of their net worth, and ii) increasing the allowance for portfolio purchases of foreign exchange up to US$200,000, together with the authorization for prepayment of import credits, were well received. Similarly, the issuance of transparent, new guidelines for liquidity assistance, provide clear indications of the commitment of the authorities to advance the liberalization in a sequenced fashion and in consonance with the evolving conditions of the financial markets. They view the eventual removal of restrictions on remaining reprogrammed time deposits as part of this same process, and as a factor that could further contribute to strengthening confidence while simultaneously enhancing market discipline conducive to maintaining the consistency of the macro policy mix.

Regarding conditionality in the structural area, it is important to distinguish between actual undertakings contemplated in the authorities’ program and measures which they recognize as desirable but which either do not form part of the program conditionality or may apply in a subsequent test date. This helps to put in proper perspective staff doubts regarding degree of observance in paragraphs 11, 19 and 20 of their report referring to identified measures such as the mechanism to compensate banks for the impact of asymmetric indexation and "amparos", further refinements to the framework for private debt restructuring and the strengthening of the central bank autonomy, respectively, all of which are substantially advanced.

A brief additional extension motivating my authorities' request for partial waiver for nonobservance of the structural performance criterion on new prudential regulations, relates to the valuation of government loan and bonds and commercial loan classification requirements. This should be seen in the context of increased ambitiousness of the new authorities of the central bank to use the opportunity to expand the scope of the prudential guidelines and include a forward-looking perspective. As noted earlier, the revision to the norms for foreign exchange exposure have already been issued and my authorities are intensively working on the valuation of government debt instruments and loan classification requirements under the broader focus, for completion by end-March, 2003, and on the new capital-adequacy requirements for issuance as envisaged as part of the performance criteria for the second review by May 15. Similarly on the implications of draft legislation on voluntary out of court procedures noted in paragraph 12 of the staff report, my authorities are being guided by the spirit of the continuous performance criterion on the avoidance of any involuntary suspension of creditor rights. They expect to submit consistent legislation to congress by the time of the third review. In fact, bankers also expressed the sentiment that rushing this issue in the present circumstances could be counterproductive.

On the privatized utilities, the government is engaged in a process of renegotiation of contracts dictated by the Emergency Law of 2002. My authorities consider that the recent joint World Bank/Fund technical assistance mission produced a very useful assessment of the legal, regulatory and financial aspects of the ongoing process, rightly emphasizing the importance of defining a new, long-term framework. In addition, they welcome the legitimacy the mission afforded to the concept of "social tariff", an important element to address social equity considerations, which was missing from the regulatory frameworks put in place in the 1990's. In the meantime, the government has been trying to advance partial utility rate increases by way of three presidential decrees since last September and has appealed the court ruling issued at end-February rolling-back the increases that had been authorized for electricity and gas.

My authorities fully share the need to affirm a process to restructure Argentina's debt and normalize the relationship with its private external creditors in a manner that addresses inter-creditor equity concerns, and the need to reconcile debt sustainability with long-term growth and stability. The initial progress made in stabilizing the domestic financial system, in fostering the recovery and in putting in place a transitional Stand-By Arrangement with the Fund provide conditions for improved frequency and quality in the dialogue as the first steps in this process that constitutes a national priority. Following preliminary contacts with investors in meetings held in Buenos Aires, the United States, Europe and Japan, my authorities appointed an external advisor on debt restructuring last February 27, 2003. This has been followed by further direct contacts with a wide cross-section of bondholders in New York and Tokyo. Additional meetings are scheduled in Rome, Frankfurt, and other European financial centers in the coming weeks. The aim is to identify the creditor base and its concerns and foster the formation of working groups among different classes of asset holders as a basis for future negotiations. Work is moving ahead on these fronts, including the compilation of the needed investor/instrument database, to lay the groundwork for expeditious negotiations by the incoming administration.

My authorities are appreciative for the support received from the international community to help Argentina address its imbalances. In particular, the Stand-By Arrangement with the IMF and the resumed lending of the IADB have served to stabilize net financing flows and reduce the debt servicing burden to these institutions. My authorities have been working intensively to ensure a similar outcome in the coming months in respect of identified lending agreed with the World Bank and look forward to close collaboration consistent with the envisaged financing assurance reviews under the program.

Mindful of its international responsibilities, the government of Argentina has also been active in the area of anti-money laundering and combating the financing of terrorism. In this connection, it has communicated its request to participate in the ROSC program on these issues in the fourth quarter of 2003.

Conclusions

My authorities see the attainment of the objectives in the current Stand-By Arrangement with the Fund as essential for the orderly restoration in Argentina of equitable, long-term growth with external sustainability. The challenges that remain in the economic, political and social spheres are daunting and the leeway in this pre-electoral period is limited. However, my authorities are encouraged by the progress made in reverting the painful consequences of this unprecedented crises and are determined to advance implementation of the agreed undertakings to facilitate the transition towards the medium-term structural reforms that need to follow. The continued support of the IMF and the international community for this program and for helping to maintain its financing assurances in the coming months will be critical for the success of the effort.

Extending his remarks, Mr. Zoccali made the following statement:

Mr. Chairman, I would like to request that my preliminary statement be included in the minutes and briefly to refer to a few recent developments that could reflect on the prospects for near-term macro performance of the Argentine economy.

First, the statistical office released yesterday the February preliminary industrial production figures, indicating a rise of 17.4 percent year on year, representing also a seasonally adjusted rise of 1.5 percent month on month. So that for the first two months of the year industrial production is up on a seasonally adjusted basis by 4.1 percent. This is the fifth consecutive month with a seasonally adjusted rise, and the second quarter of 4 percent growth, indicating that the economy is off its lows. This might help to dispel the concern expressed that strong fiscal performance may have been due to temporary factors. Despite the declining inflation and the firming value of the peso, tax collection has also remained strong, and the primary balance has been in surplus for the last 11 months. In fact, tax revenue performance during the last six months has been in line with projections. The lower inflation and the more appreciated nominal exchange rate may actually have exerted a favorable impact on real incomes and consumption, reducing the real opportunity cost of tax compliance.

In addition, as also referred to by Mr. Bennett in his statement, lower inflation could be expected to result in a lower financing requirement of the government via lower debt servicing costs on Phase 1 debt. In addition, the strengthening of the exchange rate is helping to reduce the fiscal burden of external obligations being serviced, including to the IFIs.

My authorities remain confident that the primary surplus of the federal government of around Arg$450 million reached in February with no increase in the floating debt and lower than expected distribution of central bank profits can be sustained in March, and that they will be able to comfortably meet the corresponding end-March target.

The concern was also expressed regarding potential salary increases, in particular via the teachers fund. This should also be seen in the context of the conditionality governing that potential action; namely, that if there is an excess in the collection of revenue from the financial transactions tax, part of it could be devoted for this purpose. At the present time, tax collection stemming from the financial transactions tax is in line with projections. Therefore, no increase in the teachers fund is envisaged according to the present trend in 2003.

In addition, Mr. Chairman, yesterday's Lebac or bill auction by the central bank demonstrated that the central bank was able to place bills amounting to Arg$126 million, including Arg$33 million at a 364 day term. This represents a further deepening of the bills market at declining interest rates. The combination of the continuing firming of the nominal exchange rate, with the central bank the only net buyer in the foreign exchange market, and the forward rate for the peso exchange rate for end-May and end-June 2003 stable at pesos 3.20 and 3.27 per U.S. dollar, respectively, serve to put in better perspective the concern of potential market disturbances raised in relation with the March 5, 2003 supreme court ruling on the unconstitutionality of the pesoization of deposits of the province of San Luis in Banco de la Nación. In this regard, the staff is right to note its case-specific nature and the time-frame of 60 days for the parties to agree on the modalities for repayment of the dollarized deposits or return to the court in case of no agreement on this issue.

The prospect of further court decisions involving private depositors should be seen in this light, keeping also in mind the postponement by the court yesterday of the hearing of the "Beratz" case, considered a test for private depositors. The proximity to elections, the continued trend increase of deposits in the banking system, and the sensitivity of the court to the widespread consequences of the economic emergency, including on bank balance sheets, do not rule out deposit payment modalities which would reduce the likelihood of new liquidity pressures emerging in the near term.

Similarly, Mr. Chairman, the incentive for seeking new "amparos" has diminished as cash payments have not exceeded 50 percent of the blocked deposit amounts, the incidence of legal costs has risen in relation to the narrowing differential between the market exchange rate and that for adjusting deposit amounts. As importantly, there is the prospect of a general ruling by the supreme court, most probably after the elections. Thus, my authorities consider unlikely the acceleration of court cases dealing with the pesoization of deposits or loans in the near term.

Without knowing the precise modality for the repayment of dollarized deposits that could be sanctioned by the supreme court, my authorities therefore deem premature at this stage to speculate on the fiscal costs from the ruling. In the interim, they are working intensively with a view to agreeing shortly on the mechanism to compensate banks for the cost of the "amparos" and of the asymmetric indexation.

Finally, as I indicated in my preliminary statement, Mr. Chairman, as a signal of full ownership of the program and in keeping with their policy of transparency, my authorities have consented to the publication of the staff reports, with the corrections or deletions that might be appropriate.

Mr. Daïri and Mr. Ahmed submitted the following statement:

We commend the staff for the concise and well-written report, and thank Mr. Zoccali for his comprehensive statement. We welcome recent indications of a continuing recovery in Argentina under difficult circumstances and the expectation that economic growth would exceed the target in the program. Fiscal performance has been encouraging, especially at the provincial level, and the deceleration in money growth, combined with an appreciation of the exchange rate, augurs well for overperformance on the authorities' inflation forecast. However, the positive developments on the macroeconomic front have been clouded by difficulties in meeting the structural conditionality. We, therefore, welcome Mr. Zoccali's reassuring statement in this regard. Given the approaching presidential elections and the impact this is likely to have on the policy-making environment, the authorities' task may become even more challenging in the period ahead.

Although the fiscal program remains commendably on track, there are looming risks, especially on the spending side in light of the political calendar. It will be important to enforce expenditure control at all levels of the government and reactivate cooperation with the IFIs so as to address financing shortfalls and reduce dependence on central bank credit. We look forward to a reassessment of fiscal risks in the context of the second review.

Monetary policy has been handled with prudence and has played an important role in anchoring inflation expectations. We support a continuation of this cautious approach in the period ahead and agree with the staff that the authorities should guard against premature deposit liberalization in weak banks. It is unfortunate that the supreme court deemed pesoization as unconstitutional since this adds to uncertainty, but we hope that the authorities would be able to formulate an effective response with a view to settling this matter.

Stepping up the pace of implementation of structural reforms—so as to build policy credibility and underpin achievements on the macroeconomic front—is an urgent task. We attach particular importance to the preparation of fiscal structural measures in light of FAD recommendations, ensuring legal certainty, protecting creditor rights, and an expeditious passage of amendment to laws affecting the financial sector, as well as strengthening central bank autonomy. The appointment of an advisor on public debt restructuring and plans to move the process forward are welcome.

In sum, despite disappointment in the structural area, the Argentine authorities have done well with implementing the Stand-By Arrangement under extremely trying conditions. Nevertheless, the task ahead is daunting, requiring continued prudence in macroeconomic policies and a visible reinvigoration of pace of the structural reforms. We support the proposed decision.

Mr. Usman submitted the following statement:

We thank the staff for the very concise paper on the First Review Under the Stand-By Arrangement and Exchange System and Mr. Zoccali for his informative statement. Developments in Argentina have been encouraging since the Fund approved the interim program. The authorities have proved their ownership of and commitment to implement the program by meeting all the quantitative targets, while missing only one structural performance criterion. Hence we support the request for a waiver, and the completion of the first review.

Growth performance, driven by strong consumption expenditure and increased industrial consumption, has been better than envisaged, during the period under review. This performance is commendable, particularly, after the country had experienced a few years of weak growth output. This performance could be attributed to increased optimism in the country, particularly improved demand-side sentiment and consumer confidence, as noted by Mr. Zoccali in his statement. Construction activity and industrial production have also increased and we are pleased to note that employment has improved since May. We agree with the staff, however, that it would be difficult to estimate the sustainability of this performance, particularly in an environment of global uncertainty.

The implementation of fiscal policy remained largely on track, particularly given the strong revenue collection since the beginning of the year. The improved tax collections could be attributed to improved economic activity, which also helped the country in achieving its primary surplus target for end-January. We are also pleased to note that given the prevailing difficult social situation, the authorities have managed to sustain social safety net spending.

Given earlier concerns about possible hyper-inflation, which did not materialize, we are pleased to note that inflationary pressures have subsided. However, monetary authorities still have to deal with the difficult process of lifting demand deposits that have been frozen. The efforts so far in liberalizing deposits have been successful since the funds were re-deposited into the banking system, with the result that the liquidity in the system was not affected. The outgoing government has expressed a desire to lift the remaining demand deposits during their term, albeit against the staff's advice. We wonder how real this risk of a liquidity shortage in the banking system would be. Staff comments would be welcome.

The implementation of financial policy by the Argentine authorities has been frequently challenged in the Argentine courts throughout this difficult period. This was again the case when the supreme court recently ruled that the pesoization of the deposits of a provincial governments in one of the state banks was unconstitutional. With the possibility of further court cases to enforce redollarization, the implications of such actions on financial stability in Argentina could prove damaging.

We wish the authorities every success in their future endeavors.

Mr. Kanaan submitted the following statement:

After a rather turbulent period, Argentina's macroeconomic performance improved in several respects over the past year. Driven primarily by a recovery in private consumption, real output in key sectors picked up, including in retail, industry and construction, while price pressures have remained low. Increased consumer confidence was also reflected in a recovery in money demand, as well as the re-deposit in the domestic banking system of most private funds recently released from the corralón. This confidence was strengthened by the authorities' determination to tighten the fiscal stance and pursue a cautious monetary policy, as reflected by the fulfillment of all quantitative targets for January under the Stand-By Arrangement.

Notwithstanding the incipient pick up in economic activity, major uncertainties remain with regard to the stability of the policy environment, which are likely to persist as long as a broad-based consensus has not fully emerged among various state branches on the scope, content, and pace of reforms. Partly reflecting a still developing consensus, several key court decisions have been taken which, if carried out, would require bold compensating measures to keep the program on track. These uncertainties are likely to increase as we approach the period of federal and gubernatorial elections, which poses additional risks to the program. In addition, there has been some delay—albeit, we understand, for largely technical reasons—in the implementation of structural measures, notably in the areas of tax reform and bank prudential regulation, some of which are performance criteria under the SBA. Nevertheless, in view of the authorities' good faith efforts thus far, especially on the fiscal front, and their commitment to persevere with reforms in the difficult period ahead, we support the completion of the first review.

Fiscal Policy

The fulfillment of the quantitative targets for January is to some extent reassuring. However, there are several significant risks in the period ahead that could undermine both revenue and expenditure performance. First, the revenue over-performance in January was largely due to exceptional factors, and is thus unlikely to be sustained for long. We understand from staff that, while income tax results were strong, there were shortfalls in other revenue categories (including the VAT and trade taxes) compared to program targets. Such shortfalls could widen in the period ahead due to lower than anticipated inflation and greater exchange rate appreciation, and income tax revenue could suffer due to a possible court ruling allowing firms to adjust their income tax returns for inflation. Second, there is a risk of expenditure pressures arising from likely or pending court orders and legislation, including: (i) new supreme court orders to re-dollarize deposits, which would require budgetary cash injections or government bonds to compensate banks; (ii) the recent court order to restore in cash last year's cut in pensions; and

(iii) the legislation to supplement teachers' salaries through revenue earmarking, which could burden the budget down the road.

These risks underscore the importance of promptly implementing the revenue measures in the program, notably the conversion of the fuel tax to an ad-valorem basis and the elimination of the competitiveness plans. Furthermore, with gubernatorial elections approaching, there is a risk of a slippage in provincial finances. In this connection, while the recent signature of the bilateral agreements is a promising step, it is essential that provincial governments take prompt action to prevent any issuance of quasi-money and minimize the accumulation of domestic payment arrears, and not wait until these agreements become legally binding following their ratification in May.

With regard to budget financing, we are concerned about the substantial shortfall in World Bank disbursements in January and February, which led to a drawdown in international reserves and higher than expected central bank credit. The staff report notes that the delay is due to the non-implementation by the authorities of agreed actions. We would welcome some elaboration on precisely what those actions are, the current status of their implementation, and whether disbursements from other World Bank projects would also be at risk if these actions are further delayed.

Monetary Policy

We are encouraged by the modest increase in private sector deposits, and the fact that most deposits recently released from the corralón have been re-deposited in the banking system. At the same time, we agree with staff that deposit liberalization should proceed very cautiously and on a case-by-case basis, following supervisors' assessments of the adequacy of each bank's liquidity position. We view the authorities' announcement to lift the corralón on all deposits by May as premature and entailing significant risks, especially given the still uncertain environment. The uncertainty is certainly not diminished by the recent supreme court ruling on the unconstitutionality of the pesoization of the deposits of a provincial government in one state bank. In this connection, we would welcome further elaboration from staff on the extent to which this ruling sets the stage for, or establishes a legal precedent to, subsequent rulings encompassing a wider range of deposits. In case of a "blanket" ruling by the supreme court against the pesoization of bank deposits in Argentina, what compensating measures could be incorporated into the program to address the consequent impact on the budget and banking sector?

Structural Reforms

Adequate information on the soundness of the banking system and its vulnerability to shocks is still not available, notwithstanding the preliminary estimates which indicate that banks have suffered high operational losses and a significant increase in their non-performing loans in the aftermath of the crisis. We urge the authorities to give high priority to completing the revision of prudential regulations, which are essential to expedite the provision of meaningful bank statements, and thus allow a timely evaluation of banks' financial condition. A prompt announcement of a new regulatory framework would also reduce the uncertainty facing banks in their capitalization and lending decisions, and help them firm up their medium-term plans. In this connection, we are encouraged by the recent issuance of some important regulations, including on limits to banks' foreign currency mismatch, as noted in Mr. Zoccali's very helpful statement.

Restoring investor confidence and enhancing bank credit flows requires the building of a solid track record to demonstrate the stability and consistency of the legal process affecting creditors' rights in Argentina. We are reassured by the authorities' determination to ensure a uniform enforcement of the insolvency law, and prevent involuntary restraints which affect creditors' ability or incentive to exercise their rights. In this connection, it is particularly important that the proposed legislation on the out-of-court workouts, as well as the executive decree to facilitate mediation for individuals and small and medium-sized companies, uphold the principle of voluntary participation and do not infringe on the enforcement of creditors' rights granted by the insolvency law.

A potential source of economic inefficiency and perhaps even budgetary difficulties in the period ahead emanates from the long-standing suppression of utility price increases. The last Article IV consultation report noted that the situation regarding utility pricing was unsustainable, given profitability considerations for electricity and gas companies, and pointed out that the 7–9 percent price increases planned for 2003 were too low. The recent court decision to reverse even the latter price increases, if upheld, is bound to make the companies' financial position all the more precarious. We urge the authorities to give high priority to the adoption of the recommendations of the recent joint Bank-Fund mission in this area, in particular the application of a stable and predictable long-term framework for the determination of tariffs, while ensuring efficient targeting of lower rates for vulnerable groups. We would welcome comments from staff on the likely budgetary impact of continued tight price controls, in particular from any subsidies that would be required down the road to prevent significant disruptions in utility companies' operations.

In closing, we wish the Argentine authorities every success in overcoming the challenges ahead.

Extending his remarks, Mr. Kanaan made the following statement:

I would like, once again, to thank the staff for a candid staff report, and for their forthright approach in answering the many questions from Directors, both during and in-between Board discussions. In addition to the questions I raised in my preliminary statement, I would like to take up here some of the issues discussed in the supplement to the staff report.

The fiscal updates in the supplement confirm that the strong revenue performance in January is unlikely to be sustained for long, given that the strong income tax results are temporary, and given that there are shortfalls in other important receipts already in February, including from the VAT and trade taxes. However, I am reassured by Mr. Zoccali's comments, perhaps using more recently updated figures for February, that there does not appear to be shortfalls in the tax revenue performance. I would be grateful for further clarification from staff on the position taken in the supplement, which suggests that VAT and trade taxes appear to have been below target for February.

The staff notes that for the second review, it will undertake a revision of the fiscal program on the basis of an update in the macroeconomic framework, including the implications of the lower inflation and exchange rate appreciation, which are bound to further widen the revenue shortfalls.

However, I think it is also important to realistically take into account in such a revision the likely budgetary impact of the various pending court orders which are hanging over the program, and which, if they end up being upheld and carried out, would require tough compensating fiscal measures.

I have in mind the following pending court decisions and legislation:

- Supreme Court orders to re-dollarize deposits, which would require budgetary cash injections or government bonds to compensate banks. This would entail expenditures in the order of 3 percent of GDP if the compensation is paid fully in cash, but even if the compensation is made through government bonds, it would involve significant interest payments.
- Court order to restore in cash last year's cut in pensions.
- Court ruling allowing firms to adjust their income tax returns for inflation.
- Legislation to supplement teachers' salaries through revenue earmarking, which could burden the budget depending on the receipts of the financial transactions tax.

So far, the fiscal program has been based on a rather optimistic outlook with regard to the likelihood or timing of the implementation of such orders. I feel it is important that, during the second review, the staff discuss and identify with the authorities a set of contingency measures, in the form of additional revenue generating or offsetting expenditure cuts, that could be implemented in a timely manner to compensate for the impact of court orders if these end up being upheld and carried out, so as to keep the fiscal program on track and maintain the primary surplus target of 2 percent of GDP for 2003. Staff's views on this would be welcome.

Mr. Yagi and Mr. Toyama submitted the following statement:

It is a relief that the Argentine economy has maintained its momentum for spontaneous recovery following a reversal of its sharp fall last year, as evidenced by better- than-projected growth and inflation rates amid deepening of uncertainties in the world economy stemming from the risk of a war in Iraq. Behind the improvements in macroeconomic indicators in the midst of significant hair-trigger risks that the credibility in the banking system is lost or hyperinflation is generated lies the Argentine people's sense of calm and patience in response to their difficult situation and to the timely support extended by the international community. This transitional program is the core of this support, and we welcome that completion of the first review has been proposed without delay.

In macroeconomic performance, however, it is disappointing not to see an increase in exports despite the sharp depreciation of the currency. We are also concerned to see no end to the decline in credit to the private sector. Social programs to support the poor who have been most severely hit in the current crisis have barely begun. On top of these issues, we are uneasy viewing the remaining large gap between a generally cautious staff and the apparently optimistic authorities on concrete measures to carefully untie the entangled problems that cross realms of fiscal policy, monetary policy, the banking sector, and the debt issue, while avoiding an abrupt move that might collapse the total system. That said, improvements in general macroeconomic conditions should somewhat alleviate the difficulties in dealing with these problems. We urge the authorities to advance steps for restructuring as much as possible to lessen the next administration's burden.

The fiscal structure should be strengthened so that fiscal debt sustainability should not become critical once again after debt is restructured. In this regard, tax exemptions could be a serious impediment to improving a taxpayer's morale. We therefore welcome the steps taken by the congress last week to eliminate the income tax exemption on export rebates and the remaining competitiveness plan.

Improvements in inflation rates rose at a faster pace than originally anticipated largely owing to the fact that a sizable portion of time deposits that have been voluntarily liberalized have been redeposited in the banking system, in addition to a reduction in purchasing foreign exchanges and an increase in debts issued by the central bank. The general public's credibility in the banking system has apparently recovered its composure. However, the vulnerable situation in which a dent in a small weak bank can quickly spread into a fissure in the whole system has not changed, and we agree with staff that lifting corralón before the changeover of the administration is premature. A cautious approach is warranted for liberalizing time deposits given uncertainties as to how the recent supreme court ruling about pesoization will affect possible courses of action for the banking sector and whether the central bank debts whose dues are concentrated in a period ahead of the election can be rolled over smoothly.

The appointment of an advisor on debt restructuring is a major step forward toward a comprehensive solution to the debt problem. We hope the authorities will perform their obligations toward formulation of a concrete restructuring plan, such as in promptly providing creditors with information and showing sincerity in negotiations with them in a fair and efficient manner.

With these remarks, we support the proposed decisions on completion of the first review and exchange system.

Mr. Portugal submitted the following statement:

The first review of Argentina's transitional Stand-By Arrangement is a good opportunity to confirm the useful role the Fund is playing in consolidating progress made and in helping to stabilize Argentina's economy, while preparing the ground for the resumption of stronger and sustainable economic growth. I congratulate the Argentine authorities for their commitment to make the program work. I wish also to express again my appreciation to management for their support of the program; to thank staff for a well-focused report; and to thank Mr. Zoccali for his comprehensive and insightful statement.

I support the completion of the review, including the waivers requested by the authorities. It is encouraging to learn about the results achieved thus far, as well as the improvements that are being made in strengthening the macroeconomic policy framework within this transitional program. Particularly important are the recent developments indicating that the economic recovery is firming, and that the authorities are now expecting growth in 2003 to surpass the originally envisaged 2–3 percent range. It is also very positive that inflation could moderate more than originally expected, leading the authorities to aim at a level below 22 percent for calendar year 2003.

The initial fiscal outturn augurs well for the feasibility of program targets. In addition to a robust revenue performance, the Argentine authorities have managed to limit public expenditure growth. Likewise, it is quite encouraging that sub-national governments have managed, in the aggregate, to generate a balanced primary result as well. I commend the authorities for the progress achieved in further securing debt agreements with the provinces, which among other results, have curbed the issuance of new quasi-monies. A very positive development in this regard is the recently announced plan to withdraw the stock of quasi-monies, which according to Mr. Zoccali's statement, will proceed in two stages, the first one including the retirement of quasi-monies from eight provinces in line with the broader fiscal consolidation effort.

In tandem with a strengthened fiscal position, the monetary results have surprised favorably. Further liberalization of time deposits have essentially returned to the banking system, the peso exchange rate has remained quite stable, and money growth has slowed in 2003. Inflation and inflation expectations have improved, and, as the staff acknowledges, inflation could outperform the program forecast.

As I mentioned in the previous discussion on Argentina, I believe that the money-based anchor, under the form of a broadly constant monetary base, to be followed by an inflation-targeting mechanism, should provide a base for the conduct of monetary policy. The well-known difficulties to predict the demand for money recommend some flexibility in establishing monetary targets. Moreover, the current indications that the demand for money is strengthening, following the resumption of economic growth and lower price volatility, may warrant revisiting the indicative monetary target during the second review of the program, as suggested by Mr. Zoccali, to prevent what could perhaps be an unduly restrictive policy stance.

Structural reforms have advanced, albeit at a somewhat slower pace than originally envisaged. I am encouraged, however, by Mr. Zoccali's statement taking stock of the very recent progress made in congress, on March 12, approving the suspension of the income tax exemption on export rebates, as well as the progress made towards converting the fuel tax on an ad-valorem type tax.

On the relations of Argentina and its private external creditors, the authorities have appointed the advisor on debt restructuring, and initial steps are being taken to advance negotiations. I accept the staff's assessment that Argentina is complying with the good-faith criterion of the lending into arrears policy, but I also share the staff's recommendation that expeditious progress can be made on technical preparations to facilitate negotiations with creditors in the near future.

While I recognize that there are risks to the program, it seems from this first review that downside risks may be balanced by upside risks. The consolidation of macroeconomic improvements, together with clear improvements on the Argentine outlook in 2003, are indications of the importance of the current transitional program. The Fund is playing a useful role in very critical times for the future of Argentina. We hope that the authorities will continue to maintain their commitment, despite the still-difficult circumstances, and that the transitional program can contribute to lay the basis for a sequel program to be proposed by the new administration.

Mr. Reddy submitted the following statement:

We thank the staff for a precise and candid report and Mr. Zoccali for his useful statement. In particular, we are encouraged by Mr. Zoccali's statement that the Stand-By Arrangement has contributed to strengthening confidence and macroeconomic stability that are essential for an orderly political transition. We agree with the staff appraisal that the transitional program is broadly on track with quantitative program targets for January met with comfortable margins. It is in particular very encouraging that fiscal outlook has shown improvement, real growth is expected to significantly improve for 2003 and inflation will be contained within much lower level than originally anticipated.

We agree that policy preparation can facilitate the transition to the new government, in particular the debt restructuring program, with the appointment of a new public debt advisor. It is understandable that, given the fluid political situation and opinion polls showing none of the candidates showing any decisive lead, the policy making environment has become more difficult, and there were delays in one or two structural components of the program, in sensitive areas like public banks and private debt restructuring. We encourage the authorities to take efforts towards revisions of prudential regulations and draft legislation on tax reforms and inter-governmental relations. In view of the given challenges, it is necessary to emphasize the importance of strong commitment by the authorities and close monitoring by the Fund. We welcome staff comments on the state of any parallel progress towards a more comprehensive program for Argentina.

While there are some signs of recovery in demand for money, with modest increase in private sector deposits, we agree with the current cautious monetary program in order to anchor inflationary expectations, given the uncertainties surrounding the elections.

We endorse the staff recommendations for approval of restrictions under Article VIII arising from corralón. Also, we join the staff in supporting the waiver for non-observance of structural performance criteria. Subject to these, we find that the performance of the authorities has been extremely satisfying particularly relating to quantitative targets in fiscal and monetary areas. The authorities have also met the 'good faith' criterion for lending into arrears policy of the Fund. On all these considerations, we fully support the staff recommendation for completion of the First Review under the Stand-By Arrangement.

We wish the authorities success in the reform measures and their policy endeavors.

Mr. Mozhin and Ms. Vtyurina submitted the following statement:

In less than two months from the initiation of the arrangement, Argentina performed according to, and in some areas better than, the expectations in the macroeconomic domain. In the structural reform area, the progress has been less satisfactory as two performance criteria and one benchmark were not completed. Nonetheless, we support the requested waivers as we give the authorities the benefit of the doubt that one PC was delayed due to technical reasons (i.e., more time to expand the scope of banking sector regulations was needed) and the other PC is now expected to be completed before the next review. We also welcome the elimination of the remaining competitiveness plans ahead of the schedule.

However encouraging was better than expected fiscal performance in January, its continuation is surrounded by major uncertainties. February tax collections outcome has proven that serious difficulties remain. Some of the previous gains were due to one-off factors and pressure persists for increased pre-election spending. Nonetheless, we are encouraged by the authorities' efforts in the fiscal area, especially the signing of bilateral agreements with many provincial governments for 2003. We agree with the staff that, given risks to the fiscal program stemming from possible judicial decisions, there may soon be a need to adjust the macroeconomic framework to potential changes. However, maintaining the federal government primary surplus of around 2 percent of GDP in 2003 will be essential. This, among other things, will provide the basis for negotiations with external creditors. We are concerned, however, that earmarking of revenues (from the financial transactions tax) has taken place recently, which further reduces the room for maneuver in the budgetary area.

Monetary policy is kept together by threads, which can burst apart at any time triggered by a hasty move by the administration, the legislature or the judiciary. Premature lifting of the corralón and the continuation of court decisions against pesoization, while understandable from a point of view of reinstitution of contractual obligations, could nonetheless result in detrimental consequences for the nascent and fragile economic recovery, including damping the prospects for the renewal of domestic credit. The landmark decision against pesoization was watched apprehensively by the markets, and while the decision has been taken, some breathing space has been left for the current government to counteract. While the staff cited the authorities' hope that the final decision would be left to the new government, the sixty day period still expires during their present term. Thus, we would be interested in the staff's comments on their possible actions, including the one mentioned in Mr. Zoccali's statement, i.e. avoiding compulsory solution in case there is no agreement and sending the case back to the supreme court.

The authorities' success in restructuring the financial system will be a crucial determinant of monetary policy in the period ahead. Being aware of the constraints put on this government, it would be, nonetheless, extremely important to devise expeditiously new regulations for the banks and start the bidding process for due diligence of public banks. The heavy pressure on the banks stemming from potential dollar payouts to depositors and continued uncertainty regarding the corralón still remains. A lack of action to specify a mechanism by which the banks would be compensated for losses from asymmetric compensation and amparos adds to the uncertainty and we urge the authorities to press ahead with the identification of such a mechanism so that to dissipate at least some of the apprehensions.

Utility price increases have been recently overruled by the courts further complicating government's fiscal efforts and the attempt to restitute contracts with private utility operators. In addition, the government's intention to launch a public debate on the re-nationalization of utility services, while politically motivated and probably a hoax, nonetheless raises risks that the previous investor-friendly stance of successive administrations will be reversed deflecting the badly needed foreign investment. While it is quite unrealistic to expect a reasonable compromise on utility tariffs before the elections, some balance needs to be found in preserving social stability yet not starving utility operators of the needed revenue. While we do not know much about the specific proposals of the World Bank mission in this context, we trust they are targeted to achieve this very result in both short and longer terms.

While the recovery is still fragile, there are some welcome signs, such as an increase in consumption and an impressive growth of import substitution manufacturing. According to a report by Argentina's industry secretariat, local manufactures are now able to produce as much as 40 percent of previously imported goods. This production is particularly strong in the consumer goods industry. Yet since the 1990s, Argentina became quite dependent on imported inputs (machinery especially). In this regard, the relaxation of exchange controls was a very important step in reviving such necessary imports. Apparently, foreign banks are also reopening trade financing lines. Many companies seem to be venturing to invest again with 54 percent of 150 companies surveyed by the secretariat planning to invest in machinery and equipment, and half of those planning such investment aim at developing their export sales. This is all encouraging news. We invite the authorities to liberalize the remaining exchange controls as soon as the situation permits.

Finally, we commend the authorities for having nominated an adviser for debt restructuring negotiations. Further close communication with creditors and investors is essential for laying “the groundwork for expeditious negotiations by the incoming administration”, as stated in Mr. Zoccali’s preliminary statement. We support the review and wish the authorities well.

Mr. Rutayisire submitted the following statement:

Introduction

We thank the staff for this excellent report. As Mr. Zoccali indicates in his helpful and reassuring preliminary statement, the Argentine economy is showing signs of gradual improvements under the Stand-By Arrangement. Performance has exceeded expectations. All quantitative performance criteria for end-January 2003 were met comfortably, although some structural measures have been delayed. Macroeconomic indicators were encouraging, as the economy experienced a modest recovery, inflation was kept under control, fiscal performance at the national and provincial level was better than expected and the peso appreciated against the U.S. dollar. These positive developments were made possible by the continued implementation of prudent economic policies.

However, the situation remains fragile, as the banking system is still weak, export performance is below expectations and almost half of the population still lives below the poverty line. In this context, the authorities should strengthen the implementation of prudent policies in the fiscal, monetary and structural areas, so as to help stabilize the progress achieved thus far and facilitate the transition to medium term reforms under the new government.

Fiscal Policy

Fiscal performance was encouraging at all levels of government. The targets were met with considerable margin, as the primary surplus was almost the double of the programmed level, thanks to higher income tax collections, partly made possible by the early payment of the 13th month salary. We encourage the authorities to strengthen their revenue mobilization efforts, notably through the conversion of the fuel tax to an ad-valorem basis, the elimination of the income tax exemptions on export rebates and the elimination of the remaining competitiveness plan. On the expenditure side, social safety net spending was in line with the program targets. Moreover, it is highly commendable that now the authorities have reached agreement with a number of provincial governors regarding the maintenance of fiscal discipline at a provincial level. As a result, fiscal performance of the provincial governments was better than expected.

Nonetheless, there are still risks to revenues and expenditures from possible judicial decisions, the upcoming congressional decisions on the approval of structural fiscal measures and the budgetary impact of the upcoming presidential and congressional elections. In this context, we encourage the authorities to take the necessary actions to accelerate World Bank disbursement and lay the ground for the adoption of a comprehensive tax reform system that will help achieve fiscal sustainability.

Monetary and Foreign Exchange Policies

We commend the authorities' continued cautious conduct of monetary policy to achieve inflation and exchange rate objectives. Monetary targets were met, thanks to better-than-expected fiscal performance; the further liberalization of exchange rate policy, which permitted reduced purchases of foreign exchange; substantial increase in sales of central bank bonds; and banks' voluntarily liberalization of the reprogrammed time deposits ahead of schedule. As a result, there was a recovery in the demand for money. However, the situation remains fragile, as evidenced by the recent supreme court decision on the constitutionality of pesoization. In the context of judiciary uncertainties and increased market sensitivity ahead of elections, we encourage the authorities to guard against premature deposit liberalization because such a decision could place significant pressure on weaker and less liquid banks and the central bank. Moreover, the authorities should press ahead vigorously for reforms in the banking law, in order to have more power over court rulings in matters pertaining to banking supervision and dealing with financial sector crises.

As regards foreign exchange, we are encouraged by the authorities' continued efforts to dismantle the exchange restrictions and controls introduced in 2002. We also invite them to liberalize the remaining exchange controls and the export surrender requirement as soon as possible.

Structural Reforms

In the structural area, while there was progress in the implementation of fiscal structural measures and public debt management, implementation difficulties were encountered in areas such as public bank reforms and private debt restructuring. In the banking sector, we encourage the authorities to accelerate public bank reforms and define a mechanism to compensate banks for the adverse impact of asymmetric indexation and amparos. These efforts should be complemented by the establishment of a more predictable regulatory framework. To this end, it will be important not only to strengthen central bank autonomy, but also to expedite the revision of prudential regulations and the adoption of the amendment to the financial institutions law that facilitate bank resolution. As regards private debt restructuring, we encourage the authorities to insure legal certainty and protect creditor rights.

In this regard, it is important to accelerate the adoption of legislation on voluntary out-of-court workouts to facilitate debt restructuring for individuals and small-and-medium sized companies. On public debt restructuring, we welcome progress made in a number of areas, including the appointment of a public debt advisor, advance in technical work and the strengthening of relations with creditors. These efforts are laying the ground for the determination of compliance with the good faith criterion under the Fund policy for lending into arrears. On utility prices, we commend the authorities for progress made recently. We also see merit in further discussing the main conclusions of the joint World Bank-Fund mission regarding the need for more predictability of tariff increases, the importance of social tariffs and the need to restore investor confidence.

Conclusion

Despite the transitional nature of their administration, the Argentine authorities have performed well in the fiscal and monetary area, while making inroads in debt restructuring. Based on their performance and commitment to reforms, we support the completion of this review and we wish every success to the authorities.

Mr. Bennett submitted the following statement:

Key Points

Macroeconomic performance in January and February has been better than expected. While there has been some slippage on the structural front, we assume that these will be shored up in the near future.

There are a number of risks on the horizon. Foremost of these is the recent ruling on the pesoization of deposits. However, the effect of the rapid fall in inflation on government revenue, the failure to increase utility prices, and the special treatment for teachers are also causes for concern.

We Welcome the Positive Outturn to Date

We welcome the favorable economic and financial data released for January and February. Since fiscal consolidation is the centerpiece of the program, we are heartened by Mr. Zoccali's statement that the federal government's surplus for the first two months is already 85 percent of the end-March target level under the program. Moreover, it is encouraging that the federal government and eight provinces, accounting for 81 percent of the 2002 deficit, have signed bilateral agreements. The data showing that deposits are increasing, that the exchange rate is stable, and that the market for Lebacs is deepening is evidence of sound monetary management. We note that some progress is also being made on the debt restructuring front, with the government's appointment of an external debt advisor and preliminary contacts with creditors.

While we support completion of the review and granting of the waivers, we would stress that the authorities should be vigilant of the risks going forward.

Major Risks Going Forward

The major risk to the program is that the ruling with respect to the dollar deposits of San Luis province becomes precedent-setting. This would result in additional fiscal costs for the government. The question is how these would be borne. One option is to run a larger primary surplus. However, it is not clear how much scope there is for this. A second option is to give the claims of depositors seniority and impose a bigger haircut on the government's other creditors. Presumably, this would mean a reduction in the value of the Phase I debt. A third option is to turn to the central bank for finance. We would urge the authorities to articulate a clear plan to deal with this new liability.

We welcome low inflation as a sign of sound monetary management. However, we worry that it may complicate fiscal policy. Over the last six months, consumer prices have increased at an annual rate of 9 percent, well below the central bank's assumption of 22 percent for 2003. Thus, is it possible that government revenues will be less than budgeted? We understand that the majority of the government's interest expenses are indexed to inflation as a result of the treatment of Phase I debt. However, there is a possibility that low inflation will result in revenues increasing more slowly than non-interest expenditures, putting the primary surplus at risk. Could the staff estimate the extent to which non-interest expenditures are linked to inflation? If inflation was to continue at its 8 percent trend, what would be the effect on the primary surplus?

A further risk results from the inability of the government to increase utility prices. We worry that, as the financial position of the utilities deteriorates, their ability to provide service will be impaired.

The final risk that we will raise here is to governance. We remain concerned that the government has decided to allocate bonuses to teachers. Our understanding is that Arg$1.4 billion will be paid to teachers in 2003 or 2004 depending on the yield of the financial service tax. This represents 0.3 percent of GDP, a large amount for a government that is projected to face a cash deficit of 0.4 percent of GDP in 2003. We are concerned about the government's ability to finance this expense. Moreover, these payments appear to be allocated to a group with political leverage rather than those that are poor and vulnerable. In our view, one of the key objectives of the interim program was to build a consensus for reform. This is complicated by policies which appear to favor special interests.

Mr. Alatza submitted the following statement:

I welcome the progress made by Argentina in implementing the Fund supported economic program in a difficult and uncertain environment. All quantitative performance criteria were met with wide margins and further advances in structural reform were made. Here, I am encouraged by the recent approval of the suspension of income tax exemptions on export rebates, as noted in Mr. Zoccali's helpful statement. These efforts have contributed to the improved economic climate in Argentina. Indeed, the recovery is gathering strength at a faster than expected pace and the inflation outlook has improved. Confidence has also strengthened as evidenced by the recent appreciation of the peso and the deposit reflows into the banking system.

These positives results notwithstanding, the economy is still facing substantial risks and vulnerabilities including the uncertainties and pressures related to the upcoming elections, legal challenges, and adverse court rulings. This underscores the need for continued vigilance and determined implementation of the agreed policies.

The authorities are to be complimented for the overperformance in the fiscal area. I am also reassured by the authorities' confidence that they could meet the fiscal targets through June. The elimination of the income tax exemptions on export rebates should help in that regard. However, in view of the risks to the fiscal outlook, as detailed in paragraph 4 of the staff report, the authorities need to remain cautious.

News on the monetary front are also encouraging. The program targets were met and inflation is on a declining trend. Moreover, there are signs that the demand for money is recovering and 80 percent of deposits are now free of restrictions. While the response of depositors so far has been encouraging, it is important to take into account the staff's concerns regarding lifting the remaining restrictions on deposits at this stage.

Turning to the external sector, the improvement in the trade surplus and in the international reserve position is welcome. However, export performance remained weak despite improved competitiveness. Here, I take note of Mr. Zoccali's comments regarding distortions affecting market access to Argentine agricultural exports. The weak global economy, increased import substitution, and dislocations in Argentina also likely contributed to this outcome.

In addition to macroeconomic prudence, it is essential to continue moving ahead with structural reform. In this regard, I welcome the progress being made on a number of issues. However, the rulings by the court on utility prices and on the pesoization of the deposits of a provincial government underscore the challenges as well as the need for advancing banking sector reforms. Here, I welcome the assurances in Mr. Zoccali's statement on the authorities' efforts in those areas. Sustaining the recovery is also dependent on a meaningful dialogue with creditors. In this connection, the designation of an external financial advisor is a welcome step.

Finally, I support the completion of the review and wish the authorities success.

Ms. Indrawati and Ms. Duriyaprapan submitted the following statement:

We thank the staff for their concise yet insightful report, and Mr. Zoccali for his very helpful preliminary statement. Despite the uncertain political situation and the relatively short period since the first approval of the program, Argentina has continued to demonstrate gradual economic recovery under the transitional program. We are pleased to learn that all quantitative performance criteria for end of January 2003 were met with considerable margins. Fiscal targets have been achieved, provincial finances have been encouraging, inflation has been declining steadily, and base money growth has slowed further. In addition, the authorities' reaffirmation to implement the program consistently as reflected in the letter of intent and Mr. Zoccali's statement, provide the assurance necessary to support the completion of this review. Hence, we support the proposed decision and grant the requested waiver of a structural performance criterion.

Notwithstanding the progress, the fundamental economic situation in Argentina remains fragile and broader structural reforms are warranted. The staff report highlighted that policy implementation in several structural areas, which are crucial to the establishment a stronger foundation for more sustainable economic growth, have been delayed. The road ahead will no doubt continue to remain challenging, in particular, due to uncertainties in relation to the upcoming elections and the result of court rulings. As we broadly concur with the staff assessment, we will highlight only some issues of particular concern.

Uncertainties Under the Program in this Review

Despite the achievements thus far, there are major uncertainties faced by Argentina, mainly in connection with the upcoming presidential elections, that might disrupt the reform momentum. The required reform measures that need to be implemented by the newly elected government (i.e., reduce spending and subsidies, increase taxes, renegotiation of public service contracts, etc.) might not gain public support as these will be considered as unpopular measures. As has been the case recently, several measures taken by the government were overruled by the court or subject to further legal action which may hinder the continuity of the program implementation. Hence, such risks should be taken into consideration in the program, and the authorities together with the staff need to be prepared to find alternative ways of achieving consistent progress.

The supreme court ruling on March 5, that the government decree forcibly converting dollar deposits into pesos was unconstitutional, would create vulnerability in the financial sector. The ruling, though it applies only to deposits of one provincial government, could set a precedent for a series of similar lawsuits from other depositors, which may generate further heavy losses for the banking sector. It is evident that depositors prefer to wait for the final result of the supreme court ruling on the pesoization deposits, as they are reluctant to accept the offer from a group of commercial banks to return their frozen deposits ahead of schedule. In this connection, we encourage the central bank to remain vigilant to the risk of redollarization. Against this background, we would like to reiterate that the Central Bank of Argentina needs to work closely with the judiciary bodies to come to a common understanding on the objectives and rationale underlying the central bank's policy decisions and implementation.

Monetary Policy

As this Stand-By Arrangement arrangement has been ongoing for less than two months, we are of the view that the review of the monetary targets should be done as a continuous assessment rather than strict judgment of the level of performance per se. In this connection, we commend the Central Bank of Argentina for the implementation of prudent monetary policy, in particular, their effort to contain inflation below 22 percent for 2003. This is obviously a challenging task for the central bank, particularly in connection with the upcoming presidential election, when expenditure is likely to be more difficult to control, and given a still fragile banking situation. Therefore, there should be close monitoring of monetary developments to ensure the achievement of the performance criteria. The authorities should also be prepared to take necessary action in the event of an unexpected development.

With regard the "corralón", we broadly concur with the staff that the authorities should continue with the voluntary process of deposit liberalization. Under current circumstances, where the market is sensitive, in particular before the elections, the introduction of mandatory process might increase the risk of instability, and put pressure on weaker and less liquid banks.

Bank Restructuring

We note that the implementation of the banking strategy has been further delayed. We strongly urge the authorities to start working vigorously with staff in preparing and implementing a comprehensive bank restructuring program, in order to lay a solid basis for economic recovery and rebuild a well functioning, healthy banking system. Consistent with these efforts, we also encourage the authorities to improve prudential regulations, especially in the valuation of government bonds and CAR. In addition, the authorities should maintain an even-handed and transparent approach to bank restructuring which is critical to the full-fledged program.

Fiscal Policy

The Argentine authorities' efforts to achieve the primary surplus target with a considerable margin are commendable. However, we note that this strong fiscal performance was mainly due to temporary factors rather than spending reductions or tax administration reforms. Hence, we share the view that in the event of lower inflation and greater exchange rate appreciation relative to the program, there may be nominal revenue shortfalls. With higher inflation in recent months, the higher-than-expected income tax receipts in January do not imply that the past fiscal problem has been resolved. Instead, the government will face pressures to increase public spending accordingly, while the level of tax compliance remains low. In this regard, we would like to underscore that the attainment of the primary surplus target should remain the focus of fiscal policy under this transitional program.

We are encouraged by the authorities' optimism to achieve the fiscal targets set in the program, underpinned by the conversion of the fuel tax to an ad-valorem basis, and the elimination of the income tax exemption on export rebates. Given the lower inflation expectation for 2003 and exchange rate appreciation, however, the authorities need to be more vigilant and redouble their efforts. In this context, the court challenges to restore last year's pension cut is worrisome, as it could potentially disrupt the budget. In addition, the possible ruling by the courts allowing firms to adjust their corporate income tax returns for inflation (footnote 3 of the staff report), would also be a constraint to the achievement of revenue targets.

We welcome the authorities' recent announcement of a staged plan to start the process of orderly withdrawal of outstanding quasi-monies amounting to about US$1 billion. We hope this measure will establish financial discipline among provincial governments and be followed by the withdrawal of quasi-monies issued by the federal government (Lecops), and the remaining provinces of Buenos Aires (Patacones) and Cordoba (Lecor).

Structural Reforms

The staff's recommendation to adjust utility tariffs is apparently dilemmatic and difficult to implement. We noted that while the tariffs have fallen sharply in dollar terms owing to the devaluation since January 2002, household income has also declined in real terms. Therefore, we share the authorities' view that only gradual increases in the tariffs of utilities are feasible. However, it was unfortunate that government's efforts to adjust gradually the utility tariffs were overturned by the court ruling, which may reduce the credibility of the government to take further reform measures. In this regard, priority should be given to increase the operational efficiency of the utility companies and address the issue of leakage. In addition, the authorities should prioritize and implement structural reforms gradually on a timely basis.

Conclusion

In summary, despite some progress achieved, broader and deeper reforms are warranted for Argentina to restore economic growth to a more sustainable path. In this regard, strong ownership of the program and broad political support to maintain the reform momentum will be critically important to the successful implementation of this transitional program. We certainly hope that the newly elected government will continue to implement this transitional program consistently to lay a foundation for a full-fledge program.

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

Ms. Jacklin and Mr. Epstein submitted the following statement:

Summary

At the outset, we want to thank the staff for a well-written and concise paper and Mr. Zoccali for his helpful statement. The staff does a good job in highlighting the continued difficult situation facing the Argentine economy notwithstanding the nascent recovery in activity and confidence. The authorities have made some important progress, but difficult policy challenges remain. The authorities' performance relative to the end-January quantitative performance criteria is welcome, and we support the completion of this review. However, it is with reluctance that we grant waivers on key structural performance criteria. We urge the authorities to fulfill their commitment to the revised schedule for those criteria per Box 2 of Supplement 1. Strong performance in all program areas is critical, as rigorous and consistent implementation will be needed to maximize the likelihood of a positive outcome.

Fiscal

In the fiscal area, we welcome the strong performance through end-January. Indeed, program targets were met with comfortable margin. But in order to sustain such performance and strengthen credibility, the authorities must remain vigilant, particularly as elections approach. Recent congressional approval of an Arg$1.4 billion incentives fund for teachers highlights the challenges to fiscal discipline and policy credibility going forward.

We welcome progress on provincial fiscal performance, including the better-than-expected results for 2002 and that governors of eight provinces representing a total of 81 percent of the combined provincial deficits in 2002 had signed the 2003 bilateral agreements (performance criterion). We look forward to conclusion of remaining bilateral pacts and rapid ratification of all of the bilateral agreements.

Monetary/Banking

As we noted previously, sound fiscal policy ought to reduce the need for central bank financing and enhance the ability of the central bank to respond to other potential shocks. In that context, we welcome the slower growth of base money in early 2003 and the moderate inflation so far this year.

In the banking area, delays on the issuance of revised banking regulations and the launch of a strategic review of public banks, while understandable, raise concerns about the pace of reform in a sector critical to Argentina's economic recovery. We note that while the revised date for these measures is May 15 (two months' extension), the authorities would be well-served to comply with this requirement at an earlier stage given the importance in providing a predictable regulatory framework for the banking system. We join the staff in urging that these regulations be issued by end-March. The recent ruling against pesoization only reinforces the need for steps to increase certainty in the banking sector including through timely measures to address the issue of asymmetric indexation of assets and liabilities.

Debt

We welcome the appointment of an external debt advisor and recent engagement with private creditors, and encourage the authorities to work closely with their creditors through constructive dialogue and exchange of information on resolution of the country's debt. In that regard, we urge further action to identify creditors, create committees to facilitate debt restructuring talks, and otherwise make as much progress as possible before a new government takes office.

Additional Issues

We continue to stress the need for broad commitment to restoring a conducive investment climate, including through enhancing confidence in the rule of law. We share the staff's concern about bankruptcy legislation that could infringe on the rights of creditors and thus violate a continuous performance criterion under the Stand-By Arrangement.

We are disappointed with lack of progress on utility prices and look forward to the joint IMF-World Bank report on the sector.

We are also concerned by threats to tax exports or tighten foreign exchange surrender requirements for oil companies, both of which would only continue to undermine the investment climate.

We welcome the poverty assessment, including the benefits of the Heads of Households program, and would appreciate if the staff can comment on whether progress has been made to better target the benefits of this program.

We encourage authorities to take the steps needed to ensure timely MDB disbursements.

Finally, as per Mr. Zoccali's statement, we welcome the authorities' consent to publication of the staff report, subject to appropriate corrections/deletions, and wish the authorities success in fully implementing the program requirements.

The staff representative from the Western Hemisphere Department (Mr. Dodsworth), in answer to questions and comments from Executive Directors, made the following statement:

First, I will give information on policy implementation. In the Memorandum of Economic Policies, the financial institution law amendments and the central bank autonomy amendments were to have been presented to congress by March 14, 2003. The authorities are still working on this. As of this morning, the amendments have not been presented to congress.

In terms of the questions in the written statements, most concerned two areas: (i) the supreme court decision with regard to the corralon and monetary policy, and (ii) the fiscal area. On the supreme court decision, the staff have given in the staff report and in Supplement 1 all the information that is available to us. Anything beyond what has already been given would amount to nothing more than speculation. Mr. Zoccali has pointed out the limitations of the court ruling; it is specific to the case of San Luis province, and although courts will be guided in the future by this decision, it is difficult to know what future court decisions will be.

For instance, court decisions could affect a broader range of deposits. The staff does not know which deposits will be redollarized, and court decisions could affect the payment instruments that can be used in order to affect the liabilities of the banks. The ruling of unconstitutionality can go beyond deposits to assets, leases, and/or public bonds. The whole situation is highly uncertain, and therefore it is prudent not to engage in speculation.

The question was asked whether there could be a blanket ruling on deposits by the supreme court, meaning, could a whole class of depositors be repaid in dollars. It seems under the Argentine constitution that there is a possibility in some limited circumstances, but there is no case so far that would point out that this could be done for deposits. Again, the situation is uncertain. The government needs to continue to play a role in terms of trying to develop a burden sharing solution which would keep fiscal costs manageable while at the same time maintaining the credibility of the banking system. At present, it was too early for the staff and the government to specify what that burden sharing agreement might be. What can be said is that before the election and perhaps even after the election there will be a period of heightened uncertainty, and that the authorities have intimated to the staff that major decisions in this area will be made by the next government.

This raises the question of the corralon and the authorities' suggestion that they may lift the corralon or force the corralon to be lifted before they leave office. The staff's view is that the level of uncertainty is so high at this stage that lifting the corralon would be a highly risky strategy and would not have many benefits. Since the supreme court decision, the staff have become even more convinced that voluntary liberalization of the corralon should continue to be allowed, but that weak banks must not be permitted to liberalize their deposits. It is critical to be cautious in going ahead.

What the government could do is to implement the remaining parts of the program, and by that I mean that they could compensate banks for the symmetric indexation and for the amparos. They could also move ahead with banking regulations and with a strategy for the public banks. These measures taken by the government, which are all in the program, would help reassure the banking system and the public that constructive moves are being made.

Mr. Zoccali and Mr. Portugal noted the need to review the appropriateness of the monetary program, and to do so not only for the next review but also for all reviews. Given the level of uncertainty that prevails and is likely to prevail through the election, adherence to the cautious program that is mapped out at the beginning of the arrangement is the best choice for the authorities going forward.

Mr. Portugal asked a follow-up question on the supreme court decision and the corralon. He agreed with Mr. Dodsworth that it was too early to speculate on the ramifications of the supreme court's decision with regard to the province of San Luis. It would also not be appropriate to devise contingency measures because it might give the courts an incentive to take other decisions. Having said that, suppose that Banco de la Nación of San Luis returned to the supreme court and asked that the same principle of reversing the pesoization on deposits be applied to that of loans. Would it not be appropriate to say that if dollar deposits could not be forcibly converted into pesos, then loans denominated in dollars could also not be forcibly converted into pesos? A second question would be whether there could be a linkage between the solution for the supreme court ruling and the question of the corralon. The court had given a 60-day period for the banks to come to a solution, and perhaps if there were to be an earlier than envisaged liberation of the corralon, that could be one solution that the court could accept. Although the staff still pointed to high levels of uncertainty with regard to the banking sector, it was also the case that those deposits that had been released had on the whole remained within the banking system. Thus, perhaps an earlier than envisaged liberation of the corralon could be a solution.

Mr. Zurbrugg asked if the staff could comment on the recent lower court decision to redollarize bonds that would mature in 2005.

The staff representative from the Western Hemisphere Department (Mr. Dodsworth), in response to questions and comments of Executive Directors, made the following statement:

> The redollarization of both sides of the balance sheets of the banks is an interesting proposition. The difficulty is that the banks do not wish to redollarize their asset side for the most part. In such instance, they do not think that they would be repaid on those assets. Indeed, banks have received some compensation already which presumably would need to be returned in such a scenario. In any case, it would seem that such an option is entirely theoretical because many things have happened over the period since the pesoization. People have paid off part of their loans, and people have taken out part of their deposits. Could all those steps be retraced to return to the original state of affairs before pesoization? It would seem unlikely. There has to be a more practical solution than going back to stage one and pretending that the pesoization never happened. To do so would probably amount to a formula for chaos. A practical solution is needed at this stage, and one thing should be taken at a time.
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> On Mr. Zurbrugg's question, a lower court has found that a public bond that was pesoized may have been pesoized unconstitutionally. If that decision is upheld by higher courts and by the supreme court, then it would cause a major problem. Most of the Phase 1 debt which is being held by banks and being held by pension funds is originally in dollars. To go back to the original terms of those bonds as denominated in dollars would be very

difficult. Again I do not want to speculate too much, and the lesson here is that there is a high level of uncertainty which will remain over the coming months.

On Mr. Portugal's question concerning the corralon, of the banks that released deposits, only one-third of the depositors turned up to claim those deposits. The reason why is because people think a court ruling will come which will allow them to receive their deposits in dollars. Most people know that in aggregate that is not possible, but individually people feel that maybe they will still get their dollars back. Thus, Mr. Portugal is right that these two questions are interlinked in that a court ruling by the supreme court or by other courts will have an impact on the way in which the depositors come to receive their deposits. They could come in a hurry if, indeed, the supreme court rules in one direction. If it becomes clear that what will be received is a piece of paper from the government rather than dollars, there may well be people that subsequently think that perhaps it would be better to move out of the system now. It is a difficult situation.

Extending his remarks, Mr. Zoccali made the following statement:

I thank Mr. Dodsworth for the clarifications. I would just add two things. First, the narrowing differential between the adjusted deposit amounts and those that would result from applying the present market exchange rate is reducing the incentive for pressing forward with premature withdrawals of deposits from the banking system through "amparos". The present adjusted exchange rate for reprogrammed deposits, calculated on the basis of Arg$1.4 per dollar, plus the compensation adjustment (CER) results in an equivalent exchange rate of about two pesos per dollar. This has to be compared with an exchange rate level of about Arg$3.10 per dollar at the present time. When account is taken of the legal costs involved in of going the amparo route, this becomes a less attractive proposition. Additionally, if a ruling by the supreme court should emerge which produces a class action type definition for private depositors, it remains to be seen in which context. If it is after the elections whereby expectations and the uncertainty may be expected to subside, perhaps the differential will be even lower. I think it would be most prudent not to speculate. What is quite clear is that the court is being very conscious of the emergency crisis conditions that Argentina has had to internalize, that a burden-sharing process is involved, and that a sound banking system is necessary if the economy is to function well going forward. Consequently, I would suggest that we give the supreme court process a bit of time before drawing firm conclusions.

On the issue of the lifting of the corralon, it should be kept in mind that only 20 percent of total deposits are now subject to some type of restrictions, that the voluntary lifting has been, in fact, widespread, but among strong banks, and that it responds to an authorization that was issued mid-year last year, enabling banks that were in a position to lift the restrictions on deposits to do so voluntarily.

I think the important part of this is that the further lifting of the corralon today has taken place without generating pressures in financial markets, either an interest rates or the foreign exchange rate and without any central bank rediscounts. In fact, as banks exercise the option to voluntarily lift the restrictions, there is a prior process of bank supervision whereby the central bank determines whether these banks are in a position to withstand the potential pressure that may result from the lifting of restrictions without recourse to central bank rediscounts.

Mr. Portugal commented that Mr. Dodsworth had said that the banks probably did not want their assets to be reconverted because they did not think those loans could be collected. That indicated that losses would have been higher had the government not forced an asymmetric pesoization and subsequently compensated the banks. Mr. Portugal had made the same point numerous times in the past concerning the forced pesoization of loans.

The staff representative from the Western Hemisphere Department (Mr. Thornton), in response to questions and comments from Executive Directors, made the following statement:

There were questions on the risks to the fiscal program arising from lower inflation than projected, and from the delays in financing. On the impact of inflation on the fiscal program, the staff expect the program targets for the primary surplus in March 2003 to be met. As pointed out in the staff report, they were met in January with considerable margins. In Supplement 1, the staff note that revenues for February are still above the program target, but not as much above as they were in January. The reason revenues are above program projections is because of good performance from income tax revenues. Revenues from the other tax income streams are actually falling below the staff's expectations.

Part of the problem is that about half of the tax revenues have a close positive relationship with inflation, specifically the value added tax and the financial transactions tax. Another quarter of revenues have a close relationship to whether the peso appreciates or depreciates, as these are trade taxes. The situation is such that there is much lower inflation than envisaged, and a much stronger peso than what was programmed. Thus, revenue streams are starting to slow down. While the staff expect the revenue target to be met in March, it is doubtful it will be met with such a comfortable margin as occurred in January. Further, there are significant risks for the program after March.

On the impact of lower inflation and the more appreciated peso, it is worth emphasizing a couple of the points Mr. Zoccali made. Certainly with lower inflation the incentive to pay taxes is greater because the tax penalties in real terms are much more significant. Penalties are very high—about 3 percent a month—on tax arrears. So as inflation comes down, those penalties begin to bite. To the extent that real GDP is higher than projected, additional revenues would be obtained from that stream. Thus, there are risks that are partly balanced by some prospects of better tax compliance and better growth. Nonetheless, the balance of risks is still weighted toward underperformance on the revenue side later in the program.

There was a request in one of the statements to project a particular revenue stream if inflation reaches a particular level. The staff have not made such a projection at present. We are reworking the fiscal program in consultation with the authorities, and perhaps could discuss on a bilateral basis somewhat later what some of those projections are showing.

The risks on the revenue side underpin the need for the authorities to remain vigilant with respect to spending. In this context, pressures can already be seen in the scheme for bonus payments to teachers, which, as Mr. Zoccali has said, may not actually be paid this year if financial transactions tax revenue does not come in above the program target. In any case, there certainly will be an obligation for the budget in future years in that regard. Even if the revenues are not forthcoming this year, arrears are being accumulated that will have to be met in 2004.

In terms of the Heads of Households program, and whether spending is being targeted appropriately, according to recent World Bank reports there have been two external audits of this program, and both with generally satisfactory results—sufficiently satisfactory for the World Bank to continue financial support of the program. From the Fund's side, the staff have encouraged the authorities to publish these reports given that there is still considerable controversy in Argentina over the merits of the Heads of Households program. More transparency on the part of the authorities would result in a better chance that this controversy might dissipate.

On the financing of the program, as the staff make clear in the report, there was a significant shortfall in the first two months of the program with respect to projected disbursements from the World Bank. We know that there are intensive talks underway at the moment between the Bank and the authorities in attempts to work together to reprogram the planned disbursements for late March and early April 2003.

Mr. Daïri suggested that it was inaccurate to say that revenues had underperformed if revenues were lower than expected because of lower inflation. Lowering inflation was the overriding objective of the program, along with growth and the stability of the exchange rate, and if that overriding objective meant that revenues had to be lower than what was expected, the performance criterion on revenue should be adjusted.

The staff representative from the Western Hemisphere Department (Mr. Thornton) replied that that it was true that the staff would like inflation to come in a lot lower than programmed, but a lower inflation outcome was likely to be consistent with a lower revenue outcome. Spending was fixed in nominal terms, and therefore a rise in real terms with lower inflation. Thus, to the extent that revenues underperformed significantly, a financing issue would arise later in the program. The terminology could be changed, but the bottom line would not change significantly.

Extending his remarks, Mr. Zoccali made the following statement:

On the question of the revenue performance, it is important not to lose sight of the fact that growth and the recovery of economic activity have also had a bearing on the level of tax collection generally, and while there are different simulations or sensitivity analysis as to the impact of inflation or the exchange rate on the level of tax collection, the bottom line is that tax revenue has been performing quite robustly. As Mr. Thornton noted, there are risks down the road, and a test on the permanence of the revenue collection increase could come in April and May. Nevertheless, as I mentioned earlier, the primary surplus of the past eleven months, and the revenue performance of the past six months, linked to the recovery level of economic activity, are perhaps more telling than “ex ante” risk assessments based exclusively on sensitivity analyses.

Mr. Wei made the following statement:

At the outset, let me thank the staff for the concise but well-written paper and Mr. Zoccali for his helpful preliminary statement. Thanks to the authorities’ efforts and the support of the international community, the Argentine economy continues to recover at a pace more rapid than projected by the program. As indicated by the staff, the economy in many areas will probably outperform the program. Hence, we are very pleased to support the conclusion of the first review. Since we are in broad agreement with the staff appraisal, we have the following brief observations for emphasis.

The fiscal performance has been encouraging so far. The improvements in tax collection and taxation reform have begun to take hold. Meanwhile, the authorities have been successful in controlling the growth of expenditure. Moreover, fiscal balance at the provincial level has turned out to be better than expected. We also note the ongoing efforts of the authorities to further strengthen taxation. All these factors, together with economic recovery, will contribute to a further strengthening of public finance, which is of significant importance to a sustainable recovery of economic activities.

Another concrete progress is the appointment of the public debt advisor in February. We hope that the process of debt restructuring will proceed smoothly and concur with the staff that the authorities should strengthen its relations with creditors and deal with such technical work as developing databases to facilitate the work of debt restructuring.

It is very encouraging to learn from Mr. Zoccali's very insightful statement that inflation has been declining and the Argentine peso in nominal terms has been appreciating. The signs of recovery in the demand for money has reflected to some extent improved confidence in the currency and the lower than expected inflation. To further improve the credibility of the monetary authorities, we support the continuation of the current cautious monetary program.

To put the economy back on track, important structural reforms will play an important role in the process. The implementation of a banking strategy is yet to be fully unfolded. We note that more efforts on the authorities' side are needed in order to reach a broad consensus on proceeding with the required reforms in this area. A sound banking system is essential to recovering confidence in the economy and restoring sustainable economic growth over the medium term. Hence, we encourage the authorities to take ambitious steps to move ahead with banking reform. We take note of some delays in meeting some objectives of structural reforms. We would encourage the authorities to redouble their efforts in taking effective and prompt steps to meet all criteria.

The depreciation of the peso over the recent years has significantly improved the international competitiveness of Argentina. While the rebound of exports has not fully reflected this improvement, partially due to the lower price of exports, we believe that it partly reflects the J-curve effect and its effect on trade will take hold gradually.

With continued efforts by the authorities, we expect the economy to rebound more strongly than projected by the program. However, there is no room for the authorities to be complacent and much remains to be done to eliminate or reduce risks indicated by staff in the paper. At this juncture, as mentioned in Mr. Zoccali's statement "the continued support of the IMF and the international community for this program and for helping to maintain its financing assurances in the coming months will be critical for the success of the effort". We encourage the authorities to continue to take bolder steps in adjusting the economy and pursuing reforms and wish them every success in bringing the economy fully back on track.

Mr. Boitreaud made the following statement:

We would like first to thank the staff for the well written and comprehensive set of papers and Mr. Zoccali for his insightful and candid preliminary statement. We also welcome the efforts initiated by the Argentine authorities since the beginning of the program. Although we have concerns stemming from the delays in implementing some reforms, we acknowledge the substantial progress made so far, support the completion of this review and agree on the request for waiver of performance criteria.

I would like to stress a few issues regarding monetary policy and the banking system, fiscal policy, debt sustainability, and longer term perspectives.

First, on monetary policy and the banking system, the economic situation of Argentina has clearly improved since January 2003. The exchange rate has stabilized at around 3.1—3.2 pesos per dollar. The economic activity is recovering, while monthly inflation has decreased compared with its level one year ago. So far there is no danger of hyperinflation. All in all, the authorities should be commended for having met the targets on monetary aggregates, which is a result of a tight monetary policy. Moreover, the relaxation of exchange controls has helped to limit the monetization of the trade surplus. A note of caution, however, is in order, as the recent increase in broad money could considerably harm the realization of future objectives. Like the staff, we strongly recommend that the authorities maintain their strict monetary policy in order to prevent any slippage on the targets of the next review.

Although the reform of the banking system has started, it has suffered some delays, as compared to the original program. Various measures mentioned in the program aimed at improving the supervision of the banking system by the central bank have not been adopted yet. Moreover, because of the lack of political consensus, the implementation of the reform of the three public banks has not started either. We would also like to express our concern regarding the decision of the Argentine Supreme Court against pesoization, which could harm considerably the sustainability of the program. We thank Mr. Dodsworth for the clarification he has provided at the beginning of the meeting.

Second, regarding fiscal policy, as recalled by Mr. Zoccali, the primary surplus in January is well above the objective. This improvement in tax revenues comes from the activity recovery as well as improvements in tax collection, and we welcome the important measures taken by the authorities in this field. Bilateral agreements have been signed between the central and several regional governments on the reduction of deficits of provinces. It is a very positive step. Another positive development is the selection by the government of an advisor on debt restructuring. Both of those important measures will definitely help to ensure debt sustainability, although this objective will require many more reforms. We have some worries regarding the fact that the conversion of the fuel tax to an ad valorem tax has not been approved yet, so we welcome the reassuring information given by Mr. Zoccali and look forward to the adoption of this reform very soon. We also strongly encourage the authorities to continue to implement the agreed measures without delay.

Finally, having discussed issues on the monetary and fiscal sectors, we would like to turn to a longer term perspective. We welcome that a joint mission by IMF and World Bank staff visited Argentina in February 2003 to review progress in the negotiation of public services concessions and assess the current legal and regulatory framework. We would like to ask the staff to elaborate on the results of this mission as improvements in this respect are crucial for medium-term growth. In fact, like Ms. Jacklin and Mr. Epstein, we are a bit disappointed with the lack of progress on utility prices thus far. The staff mentioned that delays in reaching some objectives were expected given the tight political schedule of the authorities. Nevertheless, this program is a transitory one and focuses on a few important structural objectives, while other necessary structural reforms will have to be negotiated with the next government. We are concerned with the delays that have been observed right from the first review.

Like other Directors, we would like to stress that the coming election period will not be favorable to the adoption of important and difficult measures, so we would like to ask the staff to brief us, if possible, on the programs of the current candidates. More precisely, we would welcome some information on how these candidates consider future cooperation with the IMF and the World Bank and the implementation of structural reforms. Have the main candidates expressed their road map for medium-term policy with the staff or management so far?

Mr. von Kleist made the following statement:

We welcome the improved macroeconomic situation in Argentina and share the staff's appraisal, in particular the notion that the transitional arrangement is currently broadly on track. I also welcome Mr. Zoccali's additional positive remarks this morning. However, it remains to be seen whether the improvement of key macroeconomic indicators can be sustained over time. Apart from the stabilizing influence of one-off factors, whose positive contribution will wane, the ever growing, but eventually unpredictable economic consequences of looming court rulings cast shadows on the prospects for the further successful implementation of the program. Therefore, the overall situation remains quite fragile and requires consistent and credible implementation of all elements of the transitional program.

Even more worrisome is the fact that there have been major delays in the implementation of the crucial banking strategy. This is evidenced by one of the requested waivers and the delay in launching the bidding process for due diligence and a strategic review of the public banks. As rightly pointed out in the well-focused staff document, this can only be interpreted as reflecting a continued lack of political consensus. As made clear by most Directors at the time of the transitional programs' approval, the program implies a considerable leap of faith and trust by the Fund and its shareholders that the authorities seize the opportunities provided by the program. There was also broad agreement in the board that ultimate program success would first and foremost require a strong commitment on the part of all decision-making bodies in Argentina and the general public to build a broad political consensus towards a more comprehensive reform program, which, without doubt, will be necessary to address the still daunting challenge of helping Argentina reach a sustainable growth path. Against the background of reportedly continuing conflicts of interest between the government, parliament and the judicial system, we wonder whether in the staff's view there are already signs of such more fundamental reforms being undertaken?

Additional Specific Points

On fiscal developments, the recent approval of two tax bills agreed upon under the transitional program is welcome. Furthermore, we acknowledge the impressive boost in revenues since January 2003, although it is clearly biased by temporary factors, as the lower than projected tax revenues for February demonstrate. The signing of bilateral financial agreements with most of the large provinces for 2003 is encouraging. While we understand from the staff's supplement that the associated structural performance criterion has been met, the overall further fiscal outlook is clouded by the possibility of new court rulings, which could put further strain on the budget. Also, of course, a strategy to achieve a substantially higher primary surplus in the medium-term needs to be developed.

As regards monetary policy and the financial sector, the slight increase in the volume of bank deposits is a positive sign, since it may indicate improved confidence levels. However, the enhanced liquidity of banks is contrasted by a sharp drop in private sector credit which, once more, reflects the insufficient progress in implementing the banking strategy. On the controversial question of lifting the corralon, we fully concur with staff's cautious and selective approach.

On the ramifications of the recent pesoization ruling I took note that staff can not provide us with substantive additional clarification about the authorities' reaction and its possible effects on the program at this moment. We are particularly concerned about severe consequences for the stability of already weak banks and for the banking system as a whole. Moreover, what possibilities does staff see for financing the fiscal cost of the ruling to the budget which may arise in case the government was to compensate banks? Still on the financial sector, there have been conflicting press reports regarding the timeframe of defining the mechanism to compensate banks for the losses which they realized through the asymmetric pesoization and the amparos. Regardless of the outcome of the negotiations between the government and the banks, we deem it crucial that there is no discrimination between public and private banks.

While there has been some technical progress in laying the procedural foundations for a debt restructuring, we are concerned by recent press reports which indicate that a reorganization of the restructuring process is being deemed necessary, which could delay the beginning of substantial talks by as long as seven to eight months. Does this alter staff's assessment regarding the fulfillment of the "good faith" criterion and does staff share the assessment that "further refinements to the framework of private debt restructuring are substantially advanced"?

While there has been some technical progress in laying the procedural foundations for a debt restructuring, we are concerned by recent press reports which indicate that a reorganization of the restructuring process is being deemed necessary, which could delay the beginning of substantial talks by as long as seven to eight months. Does this alter the staff's assessment regarding the fulfillment of the "good faith" criterion and does the staff share the assessment that "further refinements to the framework of private debt restructuring are substantially advanced"?

Like the staff, we find the so far weak response of Argentina's export sector to the sharp depreciation of the peso striking. In our view, there is evidence that the favorable effects of the devaluation on export performance may have been, at least partially, neutralized by the introduction of exchange restrictions. Against this background, we welcome the authorities' intention to present proposals to liberalize the remaining restrictions at the time of the second program review.

Finally, we share the concerns expressed by the staff concerning the out-of-court workout legislation.

With these remarks we support the proposed decisions but, like others, we do so with some reluctance concerning the necessary waiver. Our continued support is based on our belief that the transitional program, if strictly and fully implemented, can provide an important stepping stone towards the much more comprehensive reform effort that still lies ahead.

Mr. Padoan made the following statement:

I thank the staff for their helpful report and Mr. Zoccali for his comprehensive and detailed preliminary statement.

The macroeconomic situation in Argentina is improving beyond initial expectations. Growth is positive for the first time in several years, inflation is decelerating and deposits are rising in the framework of the gradual lifting of restrictions. There are signs that the demand for money is stabilizing; fiscal targets are met with large margins.

Such results would have not been possible without a significant strengthening of confidence of the Argentinean people in their own economy and society. Signs of return to confidence after the crisis were already emerging at the end of last year but the Fund-supported transition program has proved to be a fundamental element in stabilizing expectations.

Renewed confidence is also the result of policies that are beginning to be on track. Authorities are doing their part in implementing the fiscal program and we welcome recent legislation approved by congress on the elimination of the competitiveness plans and on tax exemptions. We also welcome the decision of the authorities to define a road map for the withdrawal of quasi-monies.

We welcome the fiscal agreement with provinces and we encourage the remaining ones to follow suit. We hope that such an agreement will not represent an isolated event but the first step towards the consolidation of stable fiscal relations between central and local governments. We know from several country experiences that such a relationship is vital for a sound medium-term fiscal policy.

However, as many other directors have mentioned, sources of concern and risk remain. One source of concern is the possible adverse consequences of the supreme court ruling of the pesoization of deposits. Mr. Zoccali has clarified that the consequences to overall monetary stability should be manageable and that markets have not reacted negatively to the decision. However, while it the situation might remain stable in the short term, the risk is pending of more worrying consequences after the elections.

Another area of concern relates to the modest progress in the structural components of the program. These components have a limited conditionality role in the transition program. However their role is much more relevant in signaling the link between short-term stabilization and the medium-term adjustment strategy which should be the base of a successor program.

The pre-election period obviously represents a constraint on commitments in the structural area. It may also generate incentives to accommodate specific requests that could undermine overall targets However authorities would not be wise to deliver the message that nothing in the structural front can be done until a new administration is in place. Indeed, it would be the interest of the country if leading presidential candidates were to commit themselves to addressing these structural problems in their future programs. Argentina is now excluded from market access but a strategy that will minimize the time needed to regain such access as well as its cost should be started now.

In such a perspective we encourage authorities to continue their dialogue with creditors and to carefully address inter creditor rights. Diverging creditor interests that might be emerging show that creditor aggregation is indeed a major problem in debt restructuring.

Finally, let me comment briefly on two other issues.

The first one is related to the limited response of exports to the large depreciation. A pattern that, as the staff report shows, is off line with respect to other experiences of major devaluations after a crisis. The staff mention several reasons that could explain such a behavior. I am inclined to think that the decline of activity in the region could account for a large part of it. The chart in Annex 1, however, suggests that there has been an export reorientation towards faster growing regions such as Asia. I wonder, however to what extent the limited export response also reflects a reorientation toward domestic demand, given also the turnaround in the growth rate after several years of recession. Staff comments would be welcome.

The second point is related to the social implications of the crisis. I welcome the very instructive Annex II of the report on the poverty developments and the impact of the crisis. The main message is that the gravity of the crisis can be indirectly measured by the increase of income inequality since the second half of 2002. The annex also reports the results of a recent study on the characteristics of the households that were most severely hit by the crisis and suggests that the government policy of relieving poverty is well targeted. I encourage the staff to further monitor the issue and, looking forward, to consider the appropriate role that the fight against poverty will have to have in a successor program.

With these remarks I support the proposed decisions and wish authorities success in their difficult endeavor.

Mr. Prader made the following statement:

The paper on the first review under the Stand-By Arrangement confirms the existence of considerable obstacles to completing Argentina's very challenging agenda. It also clearly displays Argentina's remaining vulnerabilities already described in the interim program: precarious fiscal sustainability, numerous legal uncertainties, the slow pace of the banking sector's restructuring, and slow progress in Argentina's dialogue with its private sector creditors.

But there is very good economic news too. The best news is of course the continuation of the economic recovery and the decline in inflation. We also appreciate that all quantitative performance criteria—however modest they may have been—have been met. And the fiscal performance was better than expected, producing a surplus for the first time since 1998.

After the January Board meeting, marked by the absence of a staff recommendation on the SBA, we feel especially relieved by the return of the relative safety provided by the staff's recommendation to complete this review. I can also go along with the completion of the review.

Our main worry is that so little has been accomplished on the structural side, apparently because the authorities were either politically unable or politically reluctant to act. One consequence is the request for a waiver for the non-observance of a single performance criterion, related to the crucial issue of banking regulation and bank strategy. I am not sure whether the delay in the implementation can be justified.

Paragraph 20 of the staff paper stresses the importance of "expediting passage of the amendments to the financial institutions law that facilitate bank resolution, and measures to strengthen central bank autonomy." In all these cases, the necessary legislation has been ready since last fall, but has not been given to Congress. If this passivity on the part of the authorities was motivated by a desire to preserve stability, it could easily backfire if the Argentine volcano again erupts.

The recent supreme court decision reversing the pesoization of the dollar deposits in one province is a case in point. Despite the dismissal of this issue by Argentine officials, who insist that only one province is involved and the decision does not apply to other depositors, no one can be sure that the issue will not expand in size and severity, and indeed the supplement to the staff paper outlines a number of possible new developments increasing the pressure and uncertainty for the banks. Some prudent forward thinking and contingency planning would therefore be in order. I therefore support Mr. Kanaan's suggestion to discuss contingency measures at the time of the second review. I would be interested to know who, in the end, does the staff think will get stuck with the bill. Can the government compensate the banks? Some colleagues have pointed out the strain this would put on the budget. By the same token, if the banks are obliged to pay out all withdrawals of deposits in dollars, then they must be technically bankrupt, and a restructuring of the banking sector would be called for. The question then is whether a country with a bankrupt banking system can continue with a Fund program without a coherent plan for dealing with the problems of its banking system. Since so little seems to have been done to restructure the banking system, I would be interested if the authorities or the Fund, or anyone else, has developed a worst case scenario or considered bank restructuring.

Like Mr. von Kleist, I was not impressed by events on the debt restructuring front. Except for travel, and some attempts to build a data base, little has been achieved so far.

Finally, I am aware that little is to be expected from the current Fund program, which is openly presented as only a holding operation to get us through the elections. However, like Mr. Padoan, I think that crucial structural measures should not be postponed until after the elections. In addition, we hope and expect that both the staff and the authorities are preparing the elements of a strong successor program, and that after the elections the authorities will come up with a credible program which we can support without the usual reservations.

Mr. Kremers made the following statement:

Given that the Board has approved this program, I should judge the current review against the content of the program, and considering that it involves exceptional access and considering that the bar was set low under this program, a strong policy commitment should be expected.

Now, having said that, it is positive that some of the first outcomes in the monetary, fiscal, and macroeconomic areas are better than expected. However, the staff and other Directors around the table rightly point to the very significant risks that still lie ahead, not least of which remain in these specific areas.

I can go along with this first review, but I have one remaining question for the staff concerning structural policy. It is disappointing that waivers are requested for two out of three structural performance criteria and that a structural benchmark was not met. Apparently either these three missed commitments have turned out to be less relevant for the program or a delay in their implementation has been judged acceptable. I would like to therefore ask the staff which of the two is the case and how much delay can be accepted without affecting the integrity of the program.

Having said that, as on the previous occasion, I wish Argentina success in the present difficult circumstances.

Mr. Varela made the following statement:

At the outset, I would like to thank the staff for the concise and informative reports on the Argentine economy prepared for today's discussion. I also thank Mr. Zoccali for his comprehensive and candid preliminary statement and his earlier remarks.

I would like to join other colleagues in commending the Argentine authorities for their commitment on the transitional Stand-By Arrangement approved last January 24. There have been delays on the structural front, but the overall implementation of the program, particularly on the fiscal and monetary areas, has been quite remarkable. This chair supports the proposed waiver for nonobservance of the structural performance criteria on the issuance of new banking regulations, and supports the completion of the first review under the Stand-By Arrangement.

After many months of a depressing economic situation in Argentina, we are starting to see some positive signs that confirm earlier news of an incipient recovery. I think we should recognize that one important factor behind this recovery, besides the government's efforts and a positive response by the Argentine people, is the support of the international community, particularly through the transitional program approved by the Fund. The institutional and political, as well as financial and economic conditions in Argentina are much calmer now. The current Stand-By Arrangement, although limited in time, is providing an excellent basis for a renewed dialogue around a sustainable growth path, not only by reducing pressures on the political arena and facilitating a more focused policy debate, but also by creating the foundations of a future strong program through significant progress in key economic areas.

To fulfill the whole potential of the transitional program, the government should continue implementing the measures included in it as strictly as possible. Although the election date is approaching, the government should take every opportunity to continue implementing all the measures contemplated in the program, particularly in the structural front where the social and political pressures are stronger. It is worth recalling once again that the only way forward to carry out these decisions and to find a viable and lasting solution to the country's plight is having the complete support of the whole political class in Argentina back by a general political consensus. I think it could useful to stress this message in our communications with the authorities.

Regarding monetary policy, we support the staff's recommendation to continue with the cautious approach applied so far in order to provide a firm reference to monetary expectations. Nevertheless, we tend to agree with Mr. Zoccali and Mr. Portugal that perhaps a reassessment of the monetary targets could be justified during the second program review if the rather low inflation pressures and the recovery in money demand persist.

The gradual liberalization of the corralón has had positive effects as most of the deposits have remained in the banking system. This point to the idea, supported by this chair in the past, that both liberalization of deposits and the underlying problem of amparos could and should be solved in the context of a sufficiently coherent program with the Fund. As the amparos problem is rooted in a question of credibility, credibility of the banking system, but ultimately, credibility of the rule of law and the government decisions on key policy issues, the strengthening provided by the Fund through a sufficiently credible program is the basis for a reasonable solution to potential monetary leakages from the banking system.

Having said so, we agree with the staff that the authorities should not force now the process of deposit liberalization, especially taking into account that elections will take place very soon.

Regarding the banking strategy, the authorities should comply strictly with the public bank reform by launching the bidding process for due diligence and strategic review of public banks as contemplated on the structural benchmark that will be postponed for May 15, if the first review is approved today. I agree with Mr. von Kleist that the strategy for banking reform should not discriminate between private and public banks. The government should also define as soon as possible the mechanism to compensate banks for the adverse impact of asymmetric indexation and amparos. The recent ruling by the supreme court about the pesoization of the deposits of San Luis province has increased the uncertainties in the financial system. The government will have to contemplate as well compensation to banks if the supreme court decision is also applied to other deposits and institutions. I agree with the staff opinion stated at the beginning of this meeting about the role of the government regarding an appropriate burden sharing and maintain the credibility of the banking system.

We are very much encouraged by the steps taken in recent weeks by the approval by congress of legislation to eliminate the remaining competitiveness plans and suspending the income tax exemption of export rebates until end-2003. We are also encouraged by the central bank’s issuance of revised prudential regulations with respect to foreign exchange exposure. However, it will be important to press ahead to approve in the coming weeks the remaining steps to set a predictable regulatory framework for the banking system. We attach particular importance to the revision of prudential regulations, the amendment of the Financial Institutions Law and additional measures to reinforce the independence of the central bank.

Regarding the out-of-court workout legislation, we have to recall once again, that preserving the rule of law and the sanctity of contracts is of utmost importance and that the government should spare no opportunity to improve the prevailing legal framework when modifying relevant regulations. We therefore fully support staff recommendation that the proposed legislation should be amended before submission to congress.

The government has tried to take commendable steps to improve the situation of the utility companies, although the practical outcome continues to be disappointing. We urge the authorities to implement swiftly the well-focused recommendations made by the World Bank/Fund mission and to continue making efforts to facilitate a more realistic price structure that could help provide a sustainable basis for the provision of these key services.

We welcome the appointment of an advisor on public debt restructure and the continued dialogue with creditors. In our view, this satisfies the good faith criteria of the lending into arrears policy.

Mr. Andersen made the following statement:

I thank the staff for another well-written set of papers on Argentina and Mr. Zoccali for his helpful preliminary statement.

As Directors recall, the current program was approved without the support of our chair, as we were concerned that the program was falling short of what we considered to be the minimum acceptable requirements for a Fund program, including insufficient ownership and safeguards, and due to concerns about the Fund's credibility and the important principle of evenhandedness.

Now, with the program in place, I can go along with the completion of this review. I am pleased to note improvements in the macroeconomic performance in recent months. I also welcome the appointment of an external debt advisor and the authorities' consent to publication of the staff report. While there are limits to what could be expected of policies over a six-week period in a pre-election period, I am concerned about developments in a number of areas. Even with the bar set at a rather low level as noted by Mr. Kremers, performance has been mixed, not least with delays and insufficient progress concerning the structural area, and I share the concerns of others about the slow pace of reform in the banking sector. It also remains to be seen if the macroeconomic improvements are sustainable, as the situation remains fragile.

The incoming authorities will undoubtedly face very significant challenges going forward from the present, on a somewhat slippery stepping stone. I sincerely hope that they will use the window of opportunity to come to a new start in Argentina's relations with the Fund by agreeing to the necessary sound, coherent, and credible program centered on the well-known pillars. Swift agreement on such a program could lay the basis for sustainable growth in Argentina, and such a program, fully implemented, continues to be in the best interest of Argentina, the region, and the Fund.

Mr. Zurbrügg made the following statement:

The consumer-led recovery that was expected in the staff report for the Article IV consultation seems to be well under way. As indicated by Mr. Zoccali, this recovery might be even somewhat stronger than expected and I welcome the further positive news presented this morning. But data for the first quarter has to be interpreted with caution, given that year-on-year comparisons relate to a time period when economic activity was at its lowest level. Furthermore, we should be cautious not to over-interpret the observed exchange-rate stability. To a significant degree this reflects a low demand for dollars stemming from the collapse of import demand and the suspension of payments on external debt. Overall, the underlying situation remains fragile. The current revival of consumption alone will not suffice to bring about sustained growth. It will require a recovery in investment and exports, for which the prospects will hinge on the structural reforms that have been postponed to a successor program.

I welcome that monetary and fiscal targets were met. However, this is partly due to special and temporary factors that will not easily reproduce themselves. At the same time, considerable new threats to these targets have emerged, particularly from the supreme court decision on the unconstitutionality of the pesoization.

It is disappointing that even the limited structural component of the current program encountered implementation difficulties. But—as also noted by staff—it does not really come as a surprise. We have not changed our assessment regarding the transitional program, which is not adequate to bring the economy back to a sustainable growth path but mainly aims at postponing Argentina's obligations falling due to the Fund in the first eight months of 2003. A more substantive successor arrangement immediately following this transitional program will be a prerequisite for sustaining the recovery and enabling Argentina to meet is obligations to the Fund.

Regarding the dialogue with creditors, I welcome the appointment of an external advisor on public debt restructuring and the holding of the first creditor meetings. However, regarding Nielsen's remarks at the creditors meeting in New York, I do not think that the protracted negotiations with the IMF should be used as an excuse for Argentina not maintaining an adequate dialog with its creditors. As the recent decision by a regional court in Germany, which sentenced Argentina to compensate two bondholders for incurred losses, underscores, such a dialog is long overdue. I also reiterate my concerns regarding the fulfillment of the "good faith" criterion of our lending into arrears policy. Since this is the first case under the enhanced framework, we are setting important precedents. In my view, we have set the bar very low.

Finally on transparency, I welcome the authorities' commitment to full transparency by consenting to the publication of the staff report. However, the fact that the Article IV staff report and the staff report on the request for and Stand-By Arrangement have not been published sheds an unfortunate light on this commitment.

With these comments, I wish the authorities all the best in the difficult challenges ahead and look forward to the next review.

Mr. Scholar made the following statement:

We agree with the staff assessment that the transitional program is broadly on track, and we welcome many of the measures taken by the authorities in the last couple of months on fiscal performance, more recently on competitiveness plans and other tax measures, the degree of liberalization of exchange controls that we have seen, and the return of a degree of stability. That is all very much to be welcomed. At the same time, the position clearly remains very fragile. Like the staff and many Directors, we see major risks ahead. There is the supreme court ruling on the province of San Luis and the possible knock-on effects; there is the possibility of a premature lifting of the corralon; there are the risks to revenues and expenditures from further possible decisions of the courts and also of the congress; the inevitable pressures which are always seen in the run-up to an election in any country; the general effect on confidence of uncertainty over the outcome of the election and the likely direction of future policy; and, underlying all of the above, the continued lack of consensus around the program.

As many other Directors, we are also worried about the pace of structural reform. As a transitional program, the structural conditionality was restricted to the bare minimum that was essential to restore stability and allow growth. The delays are a matter of concern, particularly as many have noted in the banking sector, where the position is very fragile. It is a major risk to stability, but it is also a major obstacle to growth. As the staff report says, the financial sector remains dormant. As long as the financial sector remains dormant, we are not going to see a serious resumption of economic activity and growth, and there is a real need for urgency and a strategy to deal with this. I agree with Ms. Jacklin's comment here that the authorities should not wait until the deadline to press ahead.

I have one question to the staff which goes back to the original thinking behind the design of the program. The intention was to give the authorities a breathing space, both to support stability and to give them time to prepare for the broader program of reform which is to come after the election. I think on the first, the question of stability, the signs are encouraging, and to that extent it can be said that the program is working so far, which must be welcomed. My question concerns the second area. The hope was that

> preparations would be made both at a technical level and internally within the government, drawing on the advice of Fund and Bank staff, so that after the election not only would the preparatory and technical work will have been done, but also the country as a would have time to prepare in the run-up to the election and beyond at the public and political level the necessary consensus building for a comprehensive program. I would like to ask the staff under those two headings what progress has been seen in the last two months?
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> On publication, we, too, welcome the commitment to publish the staff report, as we welcomed the commitment in January. I would like to ask the staff if they have any information as to when these papers are likely to be published.
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> Finally, we approve this review, but in company with a number of others, we do have serious concerns about the risks ahead, and we do see an overriding need for caution on the part of the authorities and a measured approach. This does not seem to be the time for new risks.

Mr. Bennett welcomed the intention of the authorities to publish the staff papers. He mentioned that the transitional program was designed to provide an environment that would be conducive to an election, one that would be open to a debate on what kind of future the Argentine society as a whole would want. To the extent appropriate, the Fund should monitor the level of debate and the extent of commitment that might emerge during the electoral campaign.

Ms. Jacklin shared the concern expressed by a number of Directors and the staff about the need for caution with regard to when and how the corralon might be lifted. Concern was expressed about the fragility of the banking system and the delay in implementing some of the performance criteria related to that important sector. The reason for granting waivers on some of those criteria was the level of ownership shown thus far, and it was hoped that the level of ownership and commitment to the program would continue in the pre-election period ahead.

The staff representative from the Western Hemisphere Department (Mr. Dodsworth), in response to questions and comments from Executive Directors, made the following statement:

> On Mr. Boitreaud's question about the candidates, at the end of the first review mission, the authorities and Mr. Zoccali facilitated a meeting between the staff and several of the candidates and their key advisors. In fact, the staff met with four of those teams—Mr. Menem's, Mr. Kirschner's, Mr. Rodriguez Saa's, and Mr. Lopez Murphy's. We also extended an invitation to Ms. Carrio, who is also prominent in the polls, but the staff did not meet with Ms. Carrio or her advisors.

These were very preliminary discussions, and it was a way in which the staff could inform the candidates of the transitional program, plans for the successor program, and goodwill towards helping them if they are elected. The staff did not discuss matters at the level of specific programs. What was striking in these discussions was the similarity amongst the various teams with regard to what needs to be done. All of the issues discussed at the Board to some extent during the last Article IV consultation which would need to be addressed in a successor program—fiscal reforms, banking sector reforms, corporate debt restructuring, sovereign debt restructuring, social programs, rebuilding a good investment climate, etc.—all of those issues were matters which the teams could relate to and had ideas about. I did not hear many populist suggestions, and, to be frank, I thought that we would. But no one said that, for instance, wages should be increased immediately on the basis of financing from the central bank. There seemed to be a good degree of responsibility amongst these teams.

The staff has been trying to help the interim government lay the foundations for some of the more difficult and comprehensive decisions that lie ahead. There have been missions on tax reform, and a mission will leave soon on intergovernmental relations, which will be a major element of the successor program. A joint mission with the World Bank on utilities has taken place. The attitude of the current administration is that they are not in a position to make decisions in these areas, which has to be accepted, although the staff have encouraged the authorities to do as much in the way of preparation as possible. What I personally regret is that the elements within the transitional program have not been implemented; many of these elements are steps toward a successor program.

Mr. Kremers asked whether the waivers were requested because the staff no longer thought these were key elements of the program or whether the staff now find it acceptable that these structural performance criteria have been missed. It can only be said that the staff accept these waivers with great reluctance, and that the staff do think that, particularly on the banking sector reform, these are key elements to the program which cannot wait for a new administration to be installed before they are implemented. They must be carried out by this administration. In terms of the preparations for a successor program, the staff are prepared to help in what needs to be done. Having said that, the current government has to do its part as well.

With regard to pesoization, banks, and possible court decisions, Mr. Prader asked rather succinctly who would get stuck with the bill. The answer is not readily at hand. The size of the bill carries implications for who gets stuck with it. Clearly bank restructuring has to be part of this solution. It is unlike the Asian crisis. It is not a situation where governments and taxpayers can pay this bill. There has to be burden sharing, as well as elements other than the government issuing paper. Thus, bank restructuring is key, but again, this issue is something that will have to be addressed at a later stage.

On the question of publication and transparency, the staff had a rather lengthy dialogue with Mr. Zoccali and the authorities on the deletions that could be made within the policy guidelines with respect to the Article IV consultation and with respect to the staff report for the Stand-By Arrangement. The staff presented some choices to management; management responded; and suggestions on how to move forward are now with Mr. Zoccali.

The staff representative from the Western Hemisphere Department (Mr. Thornton), in response to questions and comments from Executive Directors, made the following statement:

On the results of the joint Bank/Fund mission on utilities, it is a good example of excellent cooperation between the Bank and the Fund, and demonstrates good cooperation with the authorities on what is a contentious subject. The mission reported on a number of areas, and found that the financial position of the utility companies has deteriorated significantly over the last year. Most of the companies have been forced to unilaterally defer payments on debt. Their combined debt at the moment is about US$8 billion. Almost all companies have been forced to curtail their investment program sharply. The mission also found that the commission in charge of the renegotiating process lacks the needed authority to give impetus to the adjustment process. Further, the emergency legal framework that governs the renegotiations and governs the increases in utility prices is a weak framework subject to legal challenges. Three attempts to push through utility price increases for gas and electricity have been overturned by the courts, reflecting the weakness of the emergency legislation. The mission also found that there were substantial short-term risks that services would deteriorate significantly, and that there would be serious overall defaults rather than deferment of payments from the companies involved. This would result in an increase in litigation, which has already gotten underway.

Finally, the mission generally supported the authorities' position on the need for a social tariff, but made recommendations for better targeting of the tariff. In all areas where the mission found difficulties, recommendations were made for strengthening or for next steps. Having said that, the mission was but a first step, and the staff anticipate another mission in the not too distant future.

On trade developments, it is true that the response of exports to the currency depreciation has been disappointing, both in absolute terms and relative to what has been seen in other countries emerging from crisis. Exports in volume and value fell quite sharply in 2002 on average. Exports by volume showed no signs of picking up until later in the year, and that pick up was concentrated in the agricultural sector, processed foods, and other agricultural manufacturers. The depth of the banking crisis and the public debt default probably restricted access of the corporate sector to bank financing and to external credit lines for most of 2002. Key markets also have not been doing particularly well. Argentina exports about 25 percent of total exports to Brazil, which has not been a growing market for the period discussed.

On the import side including import substitution, it is difficult to discern that imports essentially collapsed across the board, meaning the figures are not entirely clear. Areas of industrial production that are growing strongly are areas that typically have had high imports, and these areas have shown robust growth in recent months. The response to the depreciation has been delayed, but exports are showing signs of recovery in volume terms, and there does seem to be growing import substitution. These are all the things to be expected, given the exchange rate depreciation, but they seem to have arrived a little later than the staff had been anticipating, and a little later than what seems to have transpired in some other crisis countries.

The staff representative from the Policy Development and Review Department (Mr. Kincaid), in response to question and comments from Executive Directors, made the following statement:

Mr. von Kleist raised a question about the lending into arrears policy and whether the staff still thinks this policy is being adhered to in light of recent statements by the authorities. The actions by the authorities by which the staff gauges progress in debt restructuring—and therefore adherence to the lending into arrears policy—are articulated in the staff report and based upon steps that were agreed in the context of the original Memorandum of Economic Policies. Specifically for this financing assurances review, there is a structural benchmark for the appointment of an external advisor, and there are commitments to have additional meetings with external creditors.

As noted in the reports before the Board, the external advisor has been appointed and additional meetings with creditors have taken place. In terms of the actions that were laid down in January 2003, the authorities have met the specific measures that were set out. Therefore, for the completion of this review, the staff would consider the Fund's lending into arrears policy has been satisfied.

At the same time, the Supplementary Memorandum of Economic Policies lays out further actions that the authorities are to undertake between now and the next review related to contacts with the investors to solicit views from creditors on the appropriate negotiating structures, a database that is to be prepared on the creditors, and an action plan that is to be agreed with the newly appointed external advisor. These are the areas where the staff and the

> Board will have to focus in order to assess further progress so as to determine whether the lending into arrears policy is satisfied in the context of the next review.

Mr. von Kleist agreed with the staff representative that the good faith criterion had been adhered to. What was in question was the pace at which negotiations were proceeding with external creditors; it seemed that court cases were already being decided whereby judges were coming to the conclusion that the pace of negotiations was neither fast enough nor wide enough in scope. It might be the case that the Fund could inject a greater sense of urgency to the whole process to keep pace with the courts.

Extending his remarks, the staff representative from the Policy Development and Review Department (Mr. Kincaid), made the following statement:

> I agree with what Mr. von Kleist has stated, and the staff has made the same position known to the authorities, but as Mr. Dodsworth has indicated in his response to a different question, this administration sees limits to the progress with external creditors it can make, given its limited electoral mandate—the first round for the presidential elections take place on April 27, 2003. Further, the larger creditor groupings that have been contacted also are not expecting much progress to be made with regard to the substance of any negotiations during the lifetime of the current administration, and look toward the next government for more decisive progress. This does not mean that individual bondholders might not proceed to pursue legal remedies in various court systems. This is one reason why the staff have strongly pressed the authorities to appoint an external advisor as well as legal counsel to prepare a strategy and make headway as expeditiously as possible.

Mr. Kanaan asked how serious the shortfalls in World Bank disbursements were, and particularly to what extent they were caused by technical or procedural issues as opposed to non-implementation of agreed actions.

The staff representative from the Western Hemisphere Department (Mr. Dodsworth) replied that the amount of the shortfall of World Bank disbursements had been approximately US$500 million. There had been two loans, a SAL loan and an education loan, and the SAL loan was conditional on procurement legislation involving equal treatment in the procurement process between foreign and domestic bidders, which had not been signed into law by the government. On the education loan, which was rather more substantial, the World Bank was keen for provinces to disclose the payroll and number of teachers, and the amounts they were paid from each province. There was resistance from the provinces to provide such detailed information. The World Bank was rebalancing its portfolio, and was taking on a new project related to the redemption of quasi monies. Hopefully, there would be future flows which would compensate for the shortfall.

The staff representative from the World Bank (Mr. Levy), in response to questions and comments from Executive Directors, made the following statement:

> The Bank's efforts are focused on the longer-term development agenda of restoring sustainable growth and reducing poverty while attending to the immediate social protection needs of the population. Our response to the social emergency situation has included two major steps thus far. In 2002, the Bank reallocated US$270 million from existing projects to emergency social programs, including in the areas of nutrition, health, and education. Second, in January 2003 the Bank's Board approved the Heads of Households program loan for US$600 million which has already been made effective. To help support economic recovery, we have been restructuring our investment loans portfolio after the clearance of arrears at the end of January 2003. Since the clearance of arrears, the Bank has aggressively reactivated this portfolio. Over the last six weeks the Bank has disbursed US$227 million to Argentina, which exceeds disbursements for 2002 as a whole by 50 million.
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> With regard to the adjustment of the loan portfolio, over the next several months, a structural adjustment loan, and three provincial reform loans to the provinces of Santa Fe, Cordoba, and Catamarca will be take effect. All four adjustment operations are expected to disburse their remaining tranches during this fiscal year, subject to compliance with pending conditions. The Bank estimates that the new and ongoing operations could potentially result in disbursements of up to US$2.2 billion over the first eight months of 2003. This is subject to the government's ability to prepare in a timely fashion new operations and implement the agreed actions of the new and existing loans. The Bank is intensively engaged in dialogue with the Argentine authorities on the status of our operations and the preparation of new ones based on the program discussed earlier this year. The Bank remains committed to the planned disbursement levels.
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> On the side of the government and the authorities, a number of factors have contributed to drawing on Bank funds at a slower pace than originally anticipated. One factor was that until the government cleared its arrears to the Bank, no new lending could be approved, including the Heads of Households program. In this and other operations, the government faced obstacles in implementation which are now being dealt with effectively. The Bank is making every effort to help the authorities draw on its funds, and our discussions with the authorities are progressing satisfactorily.

Mr. Zoccali made the following concluding statement:

> First of all, I wish to thank Mr. Dodsworth, Mr. Thornton, and Mr. Kincaid for their very comprehensive replies and also Mr. Levy for the additional information that he has provided. Perhaps I can briefly refer to the issue of publication raised by Mr. Zurbrugg and noted by Mr. Dodsworth.

There have been some exchanges with staff on corrections and deletions. In the middle of this process we had the Fund staff review mission to Argentina, and their recent reply to the points raised by the authorities. I hope, Mr. Chairman, to get back to the staff soon so that these documents could be included in the Web site by the end of this week.

On the debt restructuring process, I would also note that the progress made since the Stand-By Arrangement was approved has been significant. Whilst contacts in previous months may have been deemed infrequent or too slow, the fact that there is a framework in the Stand-By Arrangement, from which to base contacts and tasks going forward and this has proven very useful. I should also mention that my authorities are firmly committed not only to canvassing creditors' motivations and claims but also to providing the maximum information regarding Argentina's circumstances, while compiling the necessary creditor base and fostering the formation of the creditor groups. This is not going to be an easy task, and calls for realism in terms of the time needed to conclude the process of restructuring. What is clear is that my authorities wish to lay the basis for the new administration to proceed quite expeditiously. From some of the soundings made in meetings, that Mr. Dodsworth had alluded to, there seems to be a shared ambitiousness in terms of rapidly moving the process of debt renegotiation forward under a new administration.

It is obvious that what is needed is not only to make the renegotiation process compatible with the sustainability requirements, but also lay the basis for the timely reestablishment of access to voluntary financing. On both accounts, I can confirm that the dialogue that staff has had suggests ambitiousness in moving on this front after the elections.

On the issue of the World Bank relationship, it is clear that its continued financial support will be critical for the financing assurances of the Argentine program. The authorities are working very intensively to ensure that relevant conditionalities are fulfilled. At the same time, it is important that lending programs and their respective conditionalities be fully consistent with both prudent expenditure management guidelines so as to effectively contribute to fiscal consolidation during this period, and with the envisaged financing contribution. As figures of disbursements were given for 2003 of US$227 million, exceeding by US$50 million those of 2002 as a whole, one should also be mindful of the more sizeable set repayments that Argentina has made to the World Bank during this period. All in all, my authorities are intent in doing their part to deepen the collaboration with the World Bank and look forward to the financing assurances of the program being in place, as a result of their efforts and also of the effort of the World Bank to find a pragmatic common ground in this regard.

Having said this, Mr. Chairman, I wish to thank you, the management, and the staff for the constructive engagement with my authorities and also for the support that has been afforded Argentina. This is facilitating an orderly institutional transition and the process of stabilization. It is also serving, as Mr. Dodsworth mentioned, to start the thinking process and to lay the basis for the reforms needed for medium-term sustainability.

I assure colleagues that my authorities will be giving very careful consideration to the thoughtful comments in the preliminary statements and in today's discussion, which will be faithfully conveyed. As Mr. Padoan has already noted, the Fund program has already supported the stabilization of expectations. The conclusion of this first review is also an important milestone to help counter the uncertainty that normally is expected during a pre-electoral period.

What is important to stress, perhaps, is that the congress has remained engaged in supporting macroeconomic consolidation, notwithstanding delays, as evidenced by recent measures such as the elimination of the tax exemption and the competitiveness plans. Similarly, there are many converging views, as Mr. Dodsworth noted, amongst the presidential candidates; for example, regarding the need for tax reform, for a timely normalization of relations with foreign creditors, and certainly on the need to fully stabilize social conditions and underpin growth, in which banking system reform figures prominently. I consider that staff will have an important role in this regard, including providing advice that may be requested, which I am sure will be seriously considered. Economic platforms generally are still in the process of being developed, and there are differing degrees of advance in this regard among the candidates. Again, as Mr. Dodsworth has noted, it is important to conclude from this stage of the electoral process that institution- building rather than populism has been at the core of the discourse. This is a very important development.

In the interim, Mr. Chairman, my authorities remain committed to advancing the undertakings in the program with the Fund, in particular the austere fiscal policy, a prudent monetary policy without rediscounts, and a financial policy that aims at normalizing intermediation and relations with external creditors.

I should close by repeating something that Mr. Wei referred to, the continued support of the international community, both in terms of the signaling and financing assurances, will be critical for continued progress. Once again, thank you very much, Mr. Chairman.

The Chairman stated that, from the Board's discussion, it was evident that the IMF was committed to work further with the Argentine authorities. Fiscal and monetary developments had performed better than what some had feared, while fundamental structural problems remained. Looking forward, it was important for the staff and management to continue to maintain a dialogue with the authorities, and possibly also with the presidential candidates for the upcoming election, to preserve continuity over the election phase.

The Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for keeping the financial program on track and for implementing several important structural measures during the initial phase of the arrangement, including the signing of bilateral agreements by most provincial governors in the context of promoting fiscal consolidation at the sub-national level, suspension of income tax exemptions on export rebates, and the authorization to delete remaining competitiveness plans. However, they expressed concern about the delays in implementing other key structural reforms, in particular, congressional passage of needed tax measures, reform of the public banks, and revisions to the prudential banking regulations.

Directors welcomed the recent strengthening of economic activity and the lower than envisaged rate of inflation, and the authorities efforts to enhance ownership at all levels of government. They agreed that, given the many uncertainties in the economic and political outlook, the macroeconomic framework of the program can be maintained at this stage, but they emphasized that the authorities should stand ready to revisit this framework in preparing for the next program review.

Directors commended the authorities for maintaining tight control over public spending. They welcomed the better than expected outcome for the provincial finances in 2002. The early signature by key provincial governors of the 2003 bilateral agreements, which commit them to a further reduction in their deficits in 2003, augured well for continuing fiscal adjustment. Directors underscored the need to guard against risks to the fiscal position arising from the effects of lower inflation on the revenue streams and real expenditures, as well as from possible judicial decisions, likely pre-election spending pressures, and uncertainties in the successor macroeconomic framework.. In light of these concerns, a number of Directors recommended that contingency measures be considered in case of need to protect the program’s fiscal target and overall objectives.

Directors expressed concern about the shortfall in expected external financing from multilateral development banks (MDBs) in the first two months of the program, which had forced greater reliance on central bank credit. They urged the authorities and the MDBs to work together to ensure that financing flows are restored to programmed levels in the coming months.

Directors commended the central bank for slowing the growth of base money from the high levels experienced at the end of 2002, and for the progress made in deepening the market for central bank bonds. They urged the central bank to continue its cautious monetary program so as to firmly anchor inflation expectations. In particular, the authorities were advised to remain cautious with respect to the timing of lifting the remaining restrictions on time deposits. Directors encouraged the authorities to clarify quickly steps to offset bank losses stemming from the asymmetric indexation of their balance sheets and the court injunctions (amparos) to release frozen deposits.

Directors noted that the recent supreme court decision that ruled unconstitutional the pesoization of a province's bank deposits could have wide implications for the banking system, and was likely to add to fiscal costs. In view of the prospect of increased market sensitivity ahead of the elections, they urged the government to take appropriate measures and provide assurances to deposit holders and the banks that the system would be safeguarded in the event of further court decisions in this area.

Directors noted the slow progress on the structural reform agenda. They urged the authorities to make strong efforts to place structural reforms fully on track by the time of the second program review. In particular, in support of efforts to strengthen the banking system and public confidence in it, it would be important to strengthen the regulatory framework by revising prudential regulations to ensure that meaningful and accurate bank statements are prepared. Also, passage of the amendments to the financial institutions law to facilitate bank resolution needs to be expedited, and central bank autonomy strengthened so as to give greater credibility to monetary policy. Directors stressed that ensuring legal certainty and protecting creditor rights would be essential to the success of private debt restructuring efforts. The authorities were encouraged to make continued efforts to foster an environment in which a social consensus in favor of structural reforms is created.

Directors welcomed the authorities' request to participate in the program on the review of standards and codes (ROSC) regarding anti-money laundering and combating the financing of terrorism.

Directors considered that the authorities should continue to develop a revised regulatory framework for the privatized utility companies, and draft legislation on tax reforms and the reform of intergovernmental relations, which would smooth the way for the new administration. Directors looked forward to early discussion of a substantial successor program once a new government takes office, but also noted the present administration's commitment to prepare for such a program and encouraged them to continue their efforts in this regard.

Directors welcomed the appointment of an external advisor on debt restructuring, and the recent increase in contacts with external creditors. They agreed that the steps taken by Argentina to date put it in compliance with the

Fund's lending into arrears policy. At the same time, Directors urged the authorities to strengthen their relations with external creditors and to make progress in technical work, such as a database and a menu of options for debt restructuring.

Directors welcomed the authorities' commitment to transparency and their intention to publish the relevant documentation for the first review of the transitional program.

The Executive Board took the following decisions:

Stand-By Arrangement—Review, Modification, and Waiver of Performance Criteria

1. Argentina has consulted with the Fund in accordance with paragraphs 3(c) and 3(d) of the Stand-By Arrangement for Argentina (EBS/03/5, Sup. 1, 1/24/03) and the third paragraph of the letter from the Minister of Economy and President of the Central Bank of Argentina dated January 16, 2003, in order to review program implementation and reach new understandings concerning conditions under the Stand-By Arrangement.

2. The letter from the Minister of Economy and President of the Central Bank of Argentina dated March 3, 2003 (the Letter), together with its Supplementary Memorandum of Economic Policies (the Memorandum) and Technical Memorandum of Understanding (the TMU), and the letter from the Minister of Economy and President of the Central Bank of Argentina dated March 14, 2003 (the Supplementary Letter), shall be attached to the Stand-By Arrangement, and the letter from the Minister of Economy and President of the Central Bank of Argentina dated January 16, 2003, with its attachments, shall be read as supplemented and modified by the Letter, Memorandum, TMU and Supplementary Letter.

3. Accordingly:

(a) The quantitative performance criteria for May 31, 2003 and June 30, 2003 referred to in paragraphs 3(a)(i) through 3(a)(v) of the Stand-By Arrangement shall be as specified in the TMU.

(b) New paragraphs 3(b)(vi) and 3(b)(vii) shall be added to the Stand-By Arrangement to read as follows:

"(vi) by May 15, 2003, revision to banking regulations to strengthen the banking supervisory and prudential framework, as specified in paragraph 29 and Box 1 of the memorandum attached to the letter from the Minister of Economy and President of the Central Bank of Argentina dated January 16, 2003, and as specified in Box 2 of the Memorandum, or" "(vii) by May 15, 2003, conversion of the fuel tax to an ad valorem tax, as specified in paragraph 7 and Box 1 of the memorandum attached to the letter from the Minister of Economy and President of the Central Bank of Argentina dated January 16, 2003, and as specified in paragraph 2 of the Supplementary Letter and Box 2 of the Memorandum."

4. The Fund decides that the first review and the financing assurances review contemplated in paragraphs 3(c) and 3(d), respectively, of the Stand-By Arrangement for Argentina are completed, and that Argentina may make purchases under the Stand-By Arrangement notwithstanding the nonobservance of the structural performance criteria on banking regulations, conversion of the fuel tax to an ad valorem basis, and elimination of the income tax exemption on export rebates specified in paragraphs 3(b)(i) and 3(b)(ii) of the Stand-By Arrangement, on the condition that the information provided by Argentina on performance under these criteria is accurate. (EBS/03/32, Sup. 1, 3/17/03)

Decision No. 12963-(03/26), adopted
March 19, 2003

Exchange System

1. Argentina maintains an exchange restriction subject to Fund approval under Article VIII, Section 2(a) arising from a freeze on certain banking system time deposits.

2. In the circumstances of Argentina, the Fund grants approval of the retention of this exchange restriction until March 19, 2004 or the conclusion of the next Article IV consultation with Argentina, whichever is earlier. (EBS/03/32, Sup. 1, 3/17/03)

Decision No. 12964-(03/26), adopted
March 19, 2003

2. WORLD ECONOMIC OUTLOOK—SUMMING UP

Documents: Prospects and Policy Issues (EBS/03/22, 2/24/03; Cor. 1, 2/26/03; and Sup. 1, 3/13/03); Issues for Discussion, Boxes, and Appendices (EBS/03/24, 2/25/03); Statistical Appendix (EBS/03/25; 2/25/03); and Background Material on World Economic and Market Developments (WEMD) (EBD/03/26, 3/11/03)

Staff: Rogoff, Robinson, Ostry, RES

Length: 45 minutes

The Chairman made the following summing up:

Executive Directors noted that the pace of the global recovery has slowed since late-2002, amid rising geopolitical uncertainties and the continued adverse effects of the fallout from the bursting of the equity market bubble. Industrial production has stagnated in the major advanced countries; world trade growth has slowed; labor market conditions have remained soft; the recovery of global fixed investment is tentative; and forward-looking indicators have generally weakened. Against this backdrop, global equity markets have weakened, and government bond yields in industrial countries have declined. At the same time, bond spreads for some emerging markets have narrowed—partly reflecting clearer signals about future macroeconomic policies in these countries—and substantial tiering has emerged.

Directors had a wide-ranging discussion on global economic prospects against the background of the pronounced geopolitical uncertainties and rapidly changing conditions. They noted that the global economy has been resilient so far and that in many industrial countries the fundamentals remain sound. On the assumption that current geopolitical uncertainties are resolved quickly, Directors agreed with the view that the global recovery should gradually reassert itself, achieving global GDP growth of just over 3 percent in 2003 under the baseline scenario. Such an outcome would be supported by a pickup in confidence, the ebbing of the headwinds to growth from the bursting of the equity bubble, the policy stimulus in the pipeline, and the inventory cycle. In addition, with corporations in both the United States and Europe having relatively high cash balances, it is possible that investment could respond relatively quickly. Nonetheless, Directors acknowledged that the considerable uncertainties and risks give cause for concern for the economic outlook, given the fragility of the global recovery and the likelihood that the resiliency of the world economy to shocks may now be weakening. Developments in the oil market will need to be monitored closely.

Directors recognized that the economic impact of conflict can be significant, although it is very difficult to quantify. Most Directors felt that a relatively rapid resolution of the conflict might do only limited damage to growth prospects—although it was acknowledged that there could still be lasting effects on some countries—while a prolonged and destructive conflict could have a severely adverse impact on global activity. Directors considered that the balance of the other risks to the outlook is principally on the downside, and that sluggish growth could persist even in the absence of a war. Three elements underpin this caution. First, the global recovery remains heavily dependent on the United States, and there is no obvious candidate to take up the slack if growth in the Unites States falters. A disorderly adjustment in response to global imbalances—involving a sharp depreciation of the U.S. dollar—remains a risk. Second, the possibility of further declines in mature equity markets cannot be ruled out, as earnings expectations remain relatively optimistic, and an adjustment in housing prices in some industrial countries is also possible. Third, despite recent progress, a number of emerging markets remain vulnerable to a deterioration in the global environment. Notwithstanding these downside risks, Directors regarded sustained global deflation as being unlikely, although they did not rule out price declines in individual countries.

With inflationary pressures in general quite moderate, Directors agreed that monetary policies in major industrial countries will need to remain accommodative. With regard to fiscal policies, the situation differs between countries. In the short run, Directors acknowledged that the scope for fiscal tightening is constrained by the current cyclical situation. Most Directors agreed that automatic fiscal stabilizers should generally be allowed to operate, although it is clear that fiscal consolidation will remain a central medium-term priority in many industrial countries with high public debt levels and mounting pressures from aging populations. Directors also urged an acceleration of structural reforms to boost confidence and domestic demand growth—particularly in Europe and Japan—in order to reduce global dependence on the U.S. and foster an orderly reduction in global imbalances.

Directors underscored that policymakers will need to remain vigilant to changing circumstances, and be flexible and ready to adapt to them as events unfold. Close international cooperation and dialogue and concerted efforts will be required to confront global uncertainties and boost global confidence. Directors considered that a strong push to advance multilateral trade negotiations under the Doha Round should be a key ingredient of such efforts. In addition, the international community, including the IMF, should stand ready to proactively advise and support member countries adversely affected by the economic implications of a conflict scenario, using all instruments available to it.

Major Currency Areas

Turning to the prospects for the major currency areas, Directors expected the United States to continue to lead the global recovery. They observed that while some U.S. economic fundamentals—notably productivity performance—have remained strong, recent U.S. economic data have been disappointing, reflecting weakening consumer confidence and spending. Several factors appear to be contributing to downside risks to the U.S. outlook. These include the possibility of war in Iraq, uncertainties about whether the bubble-period excesses have been fully worked out, and the emergence of fiscal deficits alongside the large current account deficit. Directors observed that the current stance of monetary policy is broadly appropriate, but further easing may be necessary if downside risks to growth materialize, although several noted that the scope for doing so is becoming increasingly limited. On fiscal policy, Directors viewed the U.S.

Administration's recent tax proposals as having some merit from a structural perspective. Directors nonetheless generally felt that these proposals, if implemented, would significantly worsen the medium-term fiscal position, and may well be pro-cyclical if the economy picks up as expected under the baseline scenario. They underlined the importance of restoring investor confidence to underpin the recovery, and called for strict enforcement of enhanced corporate governance rules.

While the euro area is not experiencing serious imbalances and its fundamentals remain generally strong, Directors viewed recent developments in the area with concern. Growth has continued to disappoint, and forecasts for 2003 have been revised down sharply. The appreciation of the euro, balance sheet strains, and prospective fiscal tightening in a number of countries are all likely to weigh on the regional economy going forward. Within this overall picture, the situation in Germany—where the economy has stagnated and the financial sector has come under increasing strain—was viewed with particular concern by Directors.

The ECB's recent move to cut interest rates was welcomed, and many Directors saw scope for further monetary easing to reinvigorate growth. In the fiscal area, with budgetary positions in a number of countries in Western Europe having become more difficult over the past year, Directors noted that the challenge in the near term will be to avoid adding unduly to economic headwinds through fiscal retrenchment, while strengthening the credibility of the Stability and Growth Pact (SGP). To achieve this, Directors believed that structural deficits would need to be reduced toward the medium-term norm of a fiscal position of close to balance or in surplus. Most Directors supported the full play of automatic stabilizers around the consolidation path, even if this were to result in deficits in 2003 above the 3 percent of GDP deficit limit. A few Directors, however, considered that an overshooting of the deficit limit in the present circumstances is not warranted, as it might undermine confidence in the fiscal framework without bringing significant short-term benefit to economic activity.

Directors called for a greater sense of urgency by European countries to address structural rigidities in product and labor markets. While a number of important steps have been taken, they noted that European unemployment rates generally remain high, and participation rates are much lower than in other advanced countries. Most Directors agreed with the view that labor market rigidities play an important role in explaining the persistent unemployment in a number of industrial countries. This is shown by the contrasting experiences of countries that have undertaken comprehensive reforms—and observed a steady decline in structural unemployment—and those that have made little progress—and seen further increases in unemployment rates. They called for comprehensive labor market reforms in the euro area which, particularly if complemented with product market reforms, would yield significant gains in the form of lower unemployment and higher output. In this connection, Directors welcomed proposals recently put forward by the German authorities to improve incentives to work and begin dismantling excessive job protection. If the detailed measures are bold and implemented in full, Directors considered that they would have a favorable effect on business confidence and job creation.

Directors noted that the economic situation in Japan remains difficult. While the economy experienced a modest cyclical recovery during 2002, growth is expected to remain subdued in 2003. Moreover, deflation continues, and survey evidence suggests that deflationary expectations are becoming more widespread and persistent. Most Directors urged the Bank of Japan to be more aggressive in both its monetary policy actions and in its communications strategy to arrest deflation. It was noted also that the effectiveness of monetary policy would be improved by measures to strengthen the financial sector. Given the large budget deficit and high public debt levels, Directors emphasized the need for the authorities to establish a credible medium-term fiscal consolidation strategy and to implement key fiscal reforms. Most Directors were of the view that a gradual start toward fiscal consolidation is now needed, unless the authorities push ahead with a much more aggressive structural reform agenda. The recent reforms to strengthen banks and corporates were welcomed, although Directors underscored that they did not go far enough to resolve the longstanding problems in these sectors.

Directors shared insights on asset price bubbles based on recent staff work. They noted that the recent busts in equity markets have so far been quite similar to earlier episodes in terms of magnitudes, lengths, and cross-country synchronization of the price declines. Some Directors expressed concern about the substantial increase in housing prices in some industrial countries and the associated risks of busts in this asset class. Directors observed that the stock market booms in Europe and North America in the late-1990s led firms to borrow and invest well ahead of demand, thus increasing corporate vulnerability to a decline in stock prices and aggregate demand. Directors also noted concerns about the high levels of corporate debt compared with equity, especially in Europe, which could dampen investment spending during the recovery.

Emerging Markets

Directors considered that growth prospects in emerging market countries generally remain relatively favorable, although performance and prospects vary significantly within this group. Many countries are implementing disciplined fiscal and monetary policies and advancing with structural reforms, and are in a better position to withstand external shocks. Nevertheless, there remain downside risks, given the weaker outlook in industrial countries and uncertainties related to the situation in Iraq.

Directors welcomed recent signs of a pickup in activity in much of Latin America and the improvement in market sentiment, although they noted that the situation in a number of countries remains difficult. In Argentina, the economy may now be over the worst, but policy continuity will be fundamental, and the signals that presidential candidates send to markets will be crucial in shaping expectations. In Brazil, the new government's decisive actions to maintain macroeconomic stability and fiscal discipline have helped reduce uncertainties in financial markets. Chile and Mexico are relatively more sheltered from deterioration in external financing conditions, reflecting their strong policy record and relatively high integration with the world economy. For the region as a whole, Directors emphasized the importance of sustained efforts to lower public sector debt levels and improve the maturity structure of the debt. Other key policy priorities for the region include orienting monetary policy to achieve low inflation with exchange rate flexibility, deepening domestic financial intermediation, and introducing reforms to liberalize trade, improve social safety nets, and increase labor market flexibility.

Directors commended the impressive economic performance in emerging Asia underpinned by both exports and domestic demand, with countries moving most vigorously to implement structural reforms generally seeing the most robust growth. Going forward, growth in emerging Asia will remain reliant on the global economic environment. Directors viewed the continuation of accommodative monetary policies as generally appropriate, and believed that the automatic fiscal stabilizers should be allowed to operate in most countries. Further progress with structural reform, particularly in the financial sector, was seen by Directors as necessary to underpin stronger domestic demand and help contribute to a reduction in global imbalances. Directors noted that the generally comfortable external sector positions in the region provide the foundation for pressing ahead with the unfinished agenda of structural reforms.

Directors noted that growth in Central and Eastern Europe has continued to be underpinned by strong foreign direct investment, as European Union accession nears. Directors saw significant challenges lying ahead, as governments look beyond accession to the requirements associated with adoption of the euro. They observed that, although the picture varies across countries, the need for fiscal restraint will likely remain a central focus of policy for most countries in Central and Eastern Europe to underpin market confidence and bolster growth. In Turkey, following a better than expected performance last year, economic and financial conditions have deteriorated in recent months, and Directors underscored the urgent need for the government to pursue fiscal restraint and structural reforms to sustain confidence.

Growth in oil-exporting CIS countries has been buoyed by rising energy prices. Directors expressed concern that slowing structural reforms could dampen investment spending, particularly in Russia, and weaken medium-term prospects. Directors called upon the authorities in the CIS countries to reinvigorate the reform process, including by strengthening banking systems. The seven low-income CIS countries (the CIS-7) should give priority to fostering investment towards diversifying industrial production and strengthening the services sector, in order to help address the high public debt levels which threaten fiscal sustainability.

Growth in the Middle East continued to weaken in 2002, although countries where reforms have progressed fastest experienced more rapid growth. Directors observed that the increase in oil prices is benefiting many countries in the region, but that the regional security situation is weighing on foreign investment and tourism. Over the medium term, the key policy challenge across the region will be to achieve sustained high GDP growth in order to reduce unemployment and absorb the rapidly growing labor force. Efforts to energize the private sector, liberalize trade, and develop human resources should remain at the core of the reform agenda.

Macroeconomic policy and structural reform implementation have improved in many African countries. Nevertheless, growth in Africa slowed in 2002 due to poor weather and continuing political turmoil affecting several countries. The central challenge in Africa will be to put in place the conditions to reach the Millennium Development Goals. As stressed in the New Partnership for Africa's Development (NEPAD), this will require a substantial improvement in the climate for private investment, which in turn will depend on actions to restore peace and political stability; improve governance, infrastructure, health and education; liberalize markets and trade; and address the HIV/AIDS pandemic. Directors underscored that achieving these goals will require the financial support of the international community and greater market access for the exports of African countries.

Directors welcomed the opportunity to discuss the impact of institutions on economic performance. They observed that improvements in institutional quality are found to raise the level and growth rate of GDP per capita, and lower the volatility of growth. Based on these findings, Directors agreed that developing countries would significantly strengthen their economic performance if they improve the quality of their institutions, while maintaining sound macroeconomic policies. Directors considered that some general principles may frame the strengthening of institutions. For example, successful market-based economies need institutions that protect property rights, uphold the rule of law, provide appropriate regulation of markets, support macroeconomic stability, and promote social cohesion and stability. Directors stressed that institutional design and reform will inevitably have strong country-specific elements requiring adaptation and innovation to suit local conditions. Some key elements of institutional reform include greater competition, including through trade openness, which can help rein in the power of vested interests, and stronger information flows and transparency, which can improve policy choices and reduce the scope for corruption. In addition, external "anchors", such as those associated with the EU accession process, have also proved effective for strengthening institutions. In the final analysis, Directors felt that firm domestic ownership and commitment remain the most vital ingredients for institutional reform.

3. INTERNATIONAL STANDARDS—STRENGTHENING SURVEILLANCE, DOMESTIC INSTITUTIONS, AND INTERNATIONAL MARKETS

Documents: Strengthening Surveillance, Domestic Institutions, and International Markets (SM/03/86, 3/6/03; Sup. 1, 3/6/03; Sup. 2, 3/6/03; Sup. 3, 3/10/03; Sup. 4, 3/6/03; and Sup. 5, 3/6/03)

Staff: Geithner, Metzgen, PDR; Enoch, STA; Bhattacharya, IBRD; Kisselevsky, ECB

Length: 2 hours, 30 minutes

Mr. Portugal submitted the following statement:

The Fund's initiative on international standards and codes has been fully embraced by the membership and is starting to produce positive results in terms of identifying vulnerabilities, helping countries to address weaknesses, and encouraging good practices. Up to now 343 ROSCs have been produced for 89 countries. There are indications that private financial sector participants are now paying more attention to this effort, which will increase incentives to participate. While a voluntary initiative, the demand for participation now seems larger than the supply capacity to the point that the staff proposes prioritizing.

It should be noted, however, that the initiative was difficult and contentious in the beginning, mainly due to the idea of making it compulsory by an explicit link to surveillance and to the difficulties caused by the low participation of developing countries in the establishment of the standards. The decision to maintain participation fully voluntary was critical in ensuring broad acceptance of the initiative and its full embracement by the membership.

While I think that we should learn from the experience obtained so far, take into consideration country circumstances during implementation, and strive to achieve cost effectiveness, I am still concerned by what I perceive to be an approach of targeting the initiative to mainly developing countries, emerging markets, and transition economies while reducing the intensity or the extent of coverage of industrial countries. This was explicitly proposed in the staff paper relating to the FSAP reviews (paragraph 102 of SM/03/77) and is implicitly and more subtly proposed in the present paper, where the criteria suggested by staff —members with material vulnerabilities and higher developmental impact— will effectively result in targeting developing countries and reducing coverage of industrial countries.

It seems that the staff's main rationale for these proposals are resource constraints, although this is not clear because the staff never discusses explicitly in the paper the main reasons and problems that led to the proposal, nor other alternative ways to deal with the possible problems. While there is a Supplement on the resource costs to the Fund, the staff does not discuss what would be the costs savings of the proposed changes, neither the resource reallocation within the current resource envelope. I would like to know, for instance, what is the current repressed demand for ROSCs that cannot be met at the projected rate of 127 ROSCs per year, and by how much the demand will be reduced or postponed by the proposed changes. However, even if cost containment and cost effectiveness were the rationale, I find ill-advised any proposal that would reduce the speed and extent of coverage of industrial economies compared to that of developing countries, emerging markets, and transition economies. Proposals of this nature would go against the principle of even-handedness of treatment and could seriously undermine the support for the initiative among the membership.

Coverage of industrial countries, and especially those that are large and systemically relevant, in the ROSC and FSAP programs is very important for two basic reasons. First, because the impact that this group of countries can have on the world economy is much larger than that of developing countries, emerging markets, and transition economies. Oftentimes developing, emerging market countries, and transition economies experience financial difficulties as a consequence of developments in the core industrial countries, with their financial boom and bust cycles, which can generate adverse effects worldwide. While it is true that industrial countries are less vulnerable, and hence problems in this group of countries may be less frequent, when a problem occurs it can have wider and stronger repercussions on the rest of the world. Second, it is important for developing countries, emerging markets, and transition economies to learn the best practices and lessons from the best performers, i.e. the industrial countries.

Indeed, it is disappointing that not all systemically important countries, especially some that were very vocal in pushing for the FSAP and ROSC programs, have yet to volunteer to participate. It is also disappointing that, for those industrial countries that participate, the number of ROSCs undertaken already tends to be lower than the number of ROSCs undertaken in emerging markets and transition economies, as a perusal of Table A1.1 indicates. I also noticed that the list given by staff in paragraph 7 of systemically important countries that are close to complete a full set of ROSCs comprises mainly emerging markets and transition economies. While, for instance, seven economies of Latin America, including some of the largest, have undertaken 27 ROSCs, with an average of four per country, the G-7 countries undertook only 15 ROSCs, an average of about 2 per country. It is particularly disappointing that there has not been a single ROSC on corporate governance and accounting and auditing completed in industrial countries.

The criteria suggested by the staff in the paper for prioritizing new ROSCs are incomplete and insufficient. How to judge material vulnerabilities without a proper assessment, except through preconceived ideas? I would like to know the staff's definition of material vulnerability. Prior to the current difficulties having started, few would suspect material vulnerabilities in corporate governance and accounting in the United States, or in the Japanese financial sector, for instance. Prior to the Asian crisis, probably the same would apply to Korea. Existing vulnerabilities should not be the exclusive prioritizing criterion for an initiative aimed at prevention, which needs also to be forward looking. Moreover, some findings of ROSCs indicate some general problems that do affect industrial countries. For instance, quasi-fiscal and off-budget activities are said to be an issue where continued vigilance is recommended even in industrial countries. Similarly, the powers of financial sector supervisors to require banks to strengthen lending practices and provisioning are reported to be a problem even in advanced economies.

The criterion of higher developmental impact, while important, is also incomplete and insufficient. Certainly, the developmental impact for the country concerned is important. But equally important are the impacts—either positive or negative—that developments in a given country can have for other countries, for a given region, or for the world economy. Indeed, this is the only justification for country surveillance conducted by international organizations. Such criterion should remain high on any prioritizing effort. Similarly, assessing best performers to learn from their experiences should also be a main prioritizing criterion.

When the FSAP and the ROSC programs were launched, the staff was extremely ambitious about the scope, depth and pace of these programs and, at the same time, too optimistic about its costs. Developing countries' chairs made these points on a number of occasions, such as for instance when the list of 11 standards was agreed, or when an increase in the pace of implementation was proposed, or during budget discussions. If lack of adequate resources were the problem to be solved, my preference would be to increase resources rather than the proposed targeted reduction in country coverage suggested by the staff. If increasing resources were not possible, my second preference would be to revisit the list of standards covered or the pace of implementation for all countries.

Another alternative would be to curtail reassessments and updates, rather than curtailing initial assessments. I failed to understand staff's preference for curtailing new ROSCs rather than reassessments. It is indicated that if the proposals are implemented, there would be a reallocation of resources from new ROSCs to reassessments and updates. How many new ROSCs would be postponed? Which would be the countries for which the staff would suggest postponement or not to undergo a ROSC based on the proposed criteria?

I ask management to reflect more carefully on these issues and be prepared to alter the proposal to incorporate views that carry support in the Board. I also believe that these issues need to be solved by broad consensus amongst the membership. Consensus decision-making is already a strong tradition in the Fund, but in the case of voluntary initiatives, such an approach is all the more important.

The papers provide evidence of the more important and common findings of ROSCs, which in about one-third of the cases have raised issues of macroeconomic relevance, and have thus been incorporated in surveillance. There is also evidence that members are trying to address the weaknesses identified during ROSCs. This evidence shows the contribution that ROSCs can make to surveillance, reducing weaknesses and, possibly, improving crisis prevention.

I agree that ROSCs should more explicitly prioritize their recommendations. However, I am concerned with the suggestions that blunter language should be used and a clearer sense of weaknesses be conveyed. It is an agreed feature of the standards initiative not to adopt a pass and fail approach, to indicate the progress already made by the country towards the standard, and to put the analysis in perspective, taking into consideration the country's stage of development. I fear these understandings may be jeopardized by the proposal for presenting a clearer sense of weaknesses. I share the concerns expressed by some assessors who indicated in their responses that the use of overly blunt language could undermine the efforts to improve the identified weaknesses (footnote 27). There may be a potential conflict in using ROSCs as a tool for identifying weaknesses simultaneously for the authorities and for markets. There are benefits to the authorities from a clear indication of weaknesses and recommendations. On the other hand, in cases of weaknesses that would take time to redress, making public assessments with blunt language on weaknesses might reinforce herd behavior of private markets. The current system of sharing with the authorities the draft ROSCs is extremely valuable to correct factual mistakes and should be continued.

The provision of technical assistance should be a major component of the standards and FSAP initiatives. There is little gain in identifying weaknesses and not being able to correct them. I welcome the increase in technical assistance provided to the standards initiative so far. I also wish to commend and thank the United Kingdom, Canada, and Switzerland for their financial contribution to technical assistance through the FIRST initiative. However, the 28 staff years of technical assistance to be provided in FY 2003 for the standards initiative still seem a small number compared to the 285 ROSCs already completed for 78 developing countries, transition economies, and emerging markets. It would be useful if staff could inform the overall demand for technical assistance under the standards filter and if requests had to be turned down. I would suggest that reassessments and updates are undertaken only if there are no pending requests for technical assistance, and only after allowing sufficient time for the implementation of technical assistance recommendations.

I agree with the staff's recommendation that, at this stage, no further standard be added to the list of standards relevant for the Fund work. It seems that there are already resource constraints with the current list of relevant standards, let alone with an enlarged list. Moreover, as the staff indicated, for some topics such as public sector governance it may be very difficult to achieve consensus on what the standard should be, and which institution would be responsible for assessment. Standards for multinational corporations and international trading practices may be interesting to pursue at a later stage. Staff should follow closely developments in these two areas and keep the matter under active consideration. At this stage, and given the short circulation period of the paper, it is not possible for our chair to express a view on the proposed change in the assessment of securities payments and settlement systems. We suggest more time be given to members to express an opinion on this issue.

There is encouraging evidence that internationally active private financial institutions are increasingly using the observance of standards in their decision-making. The figure of 23 percent (58 percent of the 40 percent that responded) of the top 10 banks adopting this practice is, however, still low.

I found too short and general the paragraphs reporting on the literature that found benefits of the adoption of standards, while the promised staff working paper that discusses the issue (footnote 22 of SM/03/86) is still forthcoming one day prior to the meeting. Therefore, I ask the staff to cover this topic in detail in a next review.

I welcome staff attention to the issue of increasing developing countries' participation in the process of periodically reviewing standards and codes. This could result in better standards and increased ownership of the initiative. It could also allow for better taking into account different stages of economic development, and different institutional and legal traditions across countries, while preserving a minimum universal content with respect to principles that any standard must meet. Unfortunately, some standard setters still have very low input from developing countries, emerging markets, and transition economies.

I wish to thank and compliment the staff for the papers and for the extensive outreach efforts that have been undertaken. The supplements to the report indicate that the review effort has been comprehensive and profound. Unfortunately, the late circulation of the papers, in breach of the minimum period, has compromised a detailed input from several of my authorities.

Mr. Kanaan and Mr. Sakr submitted the following statement:

Assessments of standards and codes, and the related ROSCs, have indeed been quite useful to the membership as a diagnostic tool to reveal weaknesses and vulnerabilities and to guide technical assistance and reforms. However, as the rigorous and comprehensive staff paper and supplements indicate, the Fund's work in this area has been expanding significantly, adding an increasing burden on its resources. This increased burden raises the risk of diluting the Fund's focus on its core areas of responsibility, and, given the limited resources, could adversely affect the quality of the ROSCs themselves. This is a most serious side effect and, unless addressed squarely, would inflict serious damage to the institution. This point cannot be understated. The review before us today provides an opportunity to streamline and prioritize our work in this area in order to rationalize resources and improve effectiveness.

The paper rightly concludes that covering most members by ROSCs in all 12 areas of standards would be too ambitious. Such a daunting objective would also be undesirable and would adversely affect the quality of the work and the Fund's ability to adequately fulfill its core responsibilities. It would therefore be important to maintain the selective country and topical coverage of ROSCs, based on staff's initial assessments of countries' weaknesses and systemic risks. In considering systemic risks, adequate attention should be given to larger industrial countries, in which weaknesses can have significant externalities and global implications. In this connection, we welcome the paper's well-placed concern with the lack of ROSC assessments of accounting and auditing standards and their inadequate enforcement in industrial countries, as well as the important gaps in existing international standards in this area. More attention should also be accorded to vulnerabilities of the financial sectors in these countries. With regard to developing and emerging economies, emphasis should continue to be placed on fiscal and corporate governance ROSCs as well as FSAP reviews. In order to maintain adequate coverage of areas that are core to the Fund's work in both developed and developing countries, additional resources need to be allocated, otherwise we run the risk of crowding out the work on core areas.

We share the view that it would not be desirable to add to the existing long list of standards and codes at this time, as the list already goes beyond the core responsibilities of the Fund and places a heavy burden on its resources. In this connection, we caution against the often-used technique of over-estimating the resource savings from strengthening cooperation in standards assessment with other bodies. The need to safeguard quality, uniformity of treatment, and accountability would always require substantial staff involvement in work done by other experts and bodies. In addition, in view of the diversity in legal and institutional settings, as well as stages of development of member countries, we do not believe that international standards should be established for all aspects of economic and financial activities. At the same time, in a continually changing world, it would be beneficial to periodically review existing standards and revise them as needed. In reviewing these standards, it would be important to integrate the views of developing countries in order to remedy their current inadequate input in the design of existing standards.

In appraising progress in implementing standards and codes in member countries, updates on previously conducted ROSCs are clearly a preferable option to repeating such ROSCs from scratch. Here, we share staff's views on the need for selectivity in follow-up work, focusing on areas most central to the Fund's concerns. However, there may be a need to register the progress countries make in non-core areas such as anti-money laundering, especially in cases where the original ROSC had identified important weaknesses which were subsequently remedied.

The paper suggests that the ROSC exercise can improve further by providing a clearer presentation of the assessments' findings and their significance, as well as more explicit prioritization of recommendations. In doing so, however, the Fund should be careful not to act as a rating agency or give "pass or fail" assessments, as this could discourage countries from requesting ROSCs. In this connection, it is noteworthy—as discussed in the paper—that some rating agencies, major investors, and risk spreads, are being influenced by ROSCs findings. We are inclined to view the implications of such a use less positively than staff does, given that the ROSC was not designed as an instrument to influence ratings, but primarily to help authorities in identifying and correcting institutional weaknesses. The risk of misinterpretation of ROSCs by the market underscores the importance of preserving the current practice of discussing with authorities the details of ROSCs drafts prior to finalization, and of maintaining the voluntary nature of ROSCs publication.

In our continued involvement in the area of standards and codes, it would be important to preserve the voluntary nature of the assessment and to safeguard confidentiality. (At the expense of repetition, when we say voluntary we mean voluntary, without any form of pressure; we need to be very clear on that point.) These two principles should not be compromised by the effort to strengthen surveillance through the systematic integration of ROSCs' results. Therefore, we find the current practice of selective and careful references to assessments' findings in Article IV staff reports appropriate. A more automatic, or unduly detailed coverage of such findings risks not only to overload Article IV consultation exercises, but could also discourage countries from requesting such assessments, especially given that surveillance is an obligation for all members, while ROSCs are voluntary.

We believe that the sharing of drafts of ROSCs with the authorities is a good practice which ensures accuracy and is consistent with the cooperative and complex nature of the exercise. As staff stress, assessment of standards is a complex task and the authorities' feedback is essential to take into consideration local realities and circumstances. These country-specific considerations should be adequately taken into account in the assessment, and be reflected in the tone of the ROSCs, as well as the expectations for what countries can do. Introducing international standards is a burdensome and time consuming task, especially in developing countries with inadequate technical and implementation capacities or more urgent priorities. Such considerations of capacity constraints and competing priorities should also be fully reflected in the ROSCs. Furthermore, costs and benefits should be carefully appraised both for undertaking a ROSC exercise and for implementing any of its recommendations. The implementation of recommendations should be supported by adequate technical assistance and guided by a clear identification of priorities and appropriate sequencing. Only with such an approach would developing countries truly benefit from this initiative.

Mr. Daïri and Mr. Rouai submitted the following statement:

Keys Points

The extensive review of the international standards and codes initiative provides a balanced and encouraging assessment of the experience;

the staff are right in focusing on how international standards could strengthen surveillance, domestic institutions, and international markets, and could contribute to crisis prevention;

our authorities consider that preparation and publication of ROSCs are contributing to the identification of shortcomings in policies and weaknesses in domestic institutions;

the conduct of financial-sector ROSCs under the FSAP has a number of additional benefits over stand-alone ROSCs;

outreaches conducted by staff are helpful and should continue;

we strongly support additional resources for the preparation of ROSCs and encourage industrial countries to share with the Fund the costs involved in the preparation of their ROSCs;

assessors are encouraged to improve the quality of ROSCs and to offer clearer and prioritized recommendations. We do not support calls for blunt language;

staff's analysis on the interactions between ROSCs and surveillance is welcome;

concerning staff's proposal to include an assessment against the new Recommendations for Securities Settlements Systems (RSSS), we appreciate any budgetary implication associated with this addition;

we are disappointed by the limited number of ROSCs on market-integrity standards, and we support recent efforts by staff to back increased work in these areas, particularly on industrial countries;

on areas for standards assessments, we share staff's conclusion that there is no basis for expanding the formal list.

At the outset, we thank the staff of the World Bank and the Fund for the high quality of reports and their outreach efforts to assess and promote international standards and gather feedbacks on their usefulness. The extensive review of the international standards and codes initiative, together with the progress reports on fiscal transparency and data modules, provide a balanced and encouraging assessment of the experience to date. They also identify important issues for the Board to improve this initiative and its contribution to crisis prevention.

When the Board reviewed standards and codes in 2001, the emphasis was on their development, coverage, and the process of implementation. With growing recognition by member countries and market participants of the usefulness of international standards in promoting financial stability, the staff are right in focusing the current review on how international standards could strengthen surveillance, domestic institutions, and international markets and to contribute to crisis prevention. In addition, we note that the international standards and codes initiative should contribute, together with our transparency policy and within coherent external communications and outreach strategies, to promoting the role and image of the Fund in member countries.

Before commenting on the issues for discussions, we wish to present a few remarks on our experience with the implementation of international standards and on Reports on the Observance of Standards and Codes (ROSCs).

We are generally satisfied with progress achieved since the last review and with the strong participation of all countries in our constituency in this initiative, with the exception of Afghanistan. Our authorities consider that the preparation and publication of ROSCs are contributing to the identification of shortcomings in policies and weaknesses in domestic institutions.

The conduct of the financial-sector ROSCs under the FSAP has additional benefits over stand-alone modules. A comprehensive analysis of the banking, insurance, and securities sectors allows, inter alia, identification of weaknesses in the financial sector supervision and regulation that need to be addressed prior to capital account opening. It also illustrates that, in order to achieve financial stability, it is not enough to have adequate supervisory agencies. It is equally important for these agencies to communicate and collaborate among themselves in view of the linkages between markets and corporations and the growing complexity and sophistication of financial instruments and operations.

Outreaches conducted by staff are helpful and should continue, and we encourage staff to make better use of the Annual Meetings as a cost-effective opportunity. It is appropriate to maintain focus on the international dimension of standards and codes to better inform foreign investors and institutions in their risk assessment. We, therefore, continue to support the program of visits to major international financial centers, in order to promote ROSCs and seek feedbacks from market participants. Our authorities confirm staff findings that participants in capital markets are aware of Fund work on standards and codes and that they regularly use the published information. Staff's outreaches to emerging market economies, similar to the one organized last year in Tunisia, offer an additional benefit in that they provide an opportunity for a broad exchange of views with local market participants, academia, and other interested parties on the benefits of transparency, good governance, sound regulatory framework, and efficient institutions for the development of domestic capital markets and investors base. We, therefore, encourage staff to increase their visits to emerging markets.

Turning to the issues for discussion, we have the following comments which complement those we have already made in the Board meeting on the FSAP review.

At the outset, we are disappointed by the lack of reference to work on AML/CFT and its impact on other standards and codes initiatives. Our reading of the reports by the review group and the Task Force on MAE signals the importance of looking into the resources and management implications of Fund's involvement in AML/CFT and its impact on other work by the Department.

We strongly support additional resources for the preparation of ROSCs and encourage industrial countries to share with the Fund the costs involved in the preparation of their ROSCs. However, if there is no consensus on increasing the budget for ROSCs, we can accept the staff's proposal to adopt more realistic targets regarding country, policy, and standards coverage and to prioritize assessments. We agree on the importance of seeking the right balance between being responsive to members' requests, on the one hand, and "targeting areas where institutional challenges are most significant," on the other. In this regard, a number of staff's proposals, detailed in Paragraph 45 of the main paper, are sensible and have our support. However, the indication of giving priority to members with material policy and institutional vulnerabilities covered by the standards initiative may put a stigma on countries agreeing to a ROSCs and discourage voluntary participation. We suggest deleting this proposal. We join Mr. Portugal's call for an inclusion, in the ROSC and FSAP programs, of large and systemically industrial countries so as to achieve balanced coverage of the membership.

Assessors are encouraged to improve the quality of ROSCs and to offer clearer and more prioritized recommendations. We note that this request was also presented by respondents to the Fund survey and that it is in line with the Fund general external communications strategy. We appreciate the comments made by Fund area department mission chiefs, contained in Paragraph 27 of the main report. We are surprised, however, by their call for blunt language and share the views expressed by assessors in footnote 27. This being said, we agree that candidness in the assessment should be preserved. We continue to support the current practice of sharing draft ROSCs documents with the authorities. Our experience has shown that this is useful for at least two reasons: (i) as pointed out by the staff, this process will ensure accuracy, given the high technical content of ROSCs; (ii) second, this will allow to put into perspective staff's and authorities' views on the issues at hand and to prevent any misunderstanding on the rationale for recommendations and their prioritization.

We welcome staff's analysis on the interactions between ROSCs and surveillance. In this regard, we note with interest staff reviews of country cases, including Ghana (Box 2), where ROSCs contributed to sharper surveillance. The implementation of the agreed framework to address cases where a member did not volunteer for a ROSC is satisfactory, and we note that, in most cases, countries were responsive to calls from the Board. Table 1 in Supplement 1 to the main report contains important findings. While the report indicates, paragraph 24, that securities, insurance, and payments systems ROSCs did not raise important macroeconomic surveillance issues referenced in Article IV staff reports, a similar conclusion could be drawn for the ROSC on Monetary and Financial Policies Transparency (MFPT). Staff may wish to use this finding either to improve the coverage of ROSC issues in Article IV consultations, or to review these ROSC modules. We note also the limited mention in ROSCs of the authorities' views. While this observation should be mitigated by the opportunity offered to the authorities to comment on the draft reports, these comments are not necessarily taken into consideration in the final version of the ROSCs.

Staff are proposing to include assessment against the new Recommendations for Securities Settlements Systems (RSSS) as part of the payment and settlement ROSC, and we endorse the proposed change to the formal list of 12 codes and standards, adopted by the Board and detailed in Box 1. Could staff confirm our understanding that in Box 1, under Group 2, "payments systems" will be renamed "payments and settlements systems," and RSSS will be used only for members with large and complex securities systems? Staff elaboration on any budgetary implication associated with this addition is also appreciated.

The limited number of ROSCs on market-integrity standards is disheartening; and we support recent efforts by staff to back work in these areas. Although we welcome the World Bank program to produce about 40 assessments a year, we would like to be assured that such figure, equivalent to all market-integrity ROSCs finalized to date, is realistic. In addition, we note that a number of FSAP reviews for industrial countries, together with recent incidents in corporate governance, accounting and auditing, point to shortcomings related to market-integrity, and we hope that industrial countries would volunteer for such ROSCs and cover the resource costs involved.

On areas for standards assessments, we share staff's conclusion that there is no basis for expanding the formal list. Staff indicate that there are various initiatives by other institutions, including work to improve transparency in the exploitation of natural resources. In addition, the recent Global Financial Stability Report (GFSR) refers to the design by rating agencies of a standard for assessing net pension liabilities and calculating funding gaps in private companies' defined benefits pension funds. Staff are encouraged to follow-up on these and other initiatives, and to report back to the Board, while focusing on areas of significant relevance to Fund work.

FAD's paper on assessing and promoting fiscal transparency provides interesting conclusions. Our Pakistani authorities confirm the significant role played by the fiscal ROSC in informing technical assistance, strengthening institutions, and improving transparency and data quality (SM/03/86, Supplement 2, Box 4).

We thank STA for the paper on the Fund's experience with data module ROSCs, and we take this opportunity to commend the department on the recent enhancements to the SDDS and GDDS websites. It is unfortunate that STA could not satisfy calls from authorities to update data ROSCs because of budget constraints. Staff are encouraged to give priority to updating data modules prepared for countries that subscribed to the SDDS prior to the introduction of the Data Quality Assessment Framework (DQAF).

The detailed dollar costing of the international standards initiative, provided in Supplement 4 to the staff report, is helpful. The importance of travel costs is perhaps unavoidable in view of the size of missions. We are, however, surprised by the high costs of travel to advanced countries compared to other countries.

Finally, we observe that the use of ROSCs is high among New York-based private institutions and low among the Japanese ones. Could this be explained by the low number of ROSCs completed by countries in Asia (only 8 percent of total completed modules)?

Extending his remarks, Mr. Daïri supported Mr. Portugal's point regarding the issue of ROSCs in industrial countries, which he considered as a matter of evenhandedness, but which effectively went beyond that. In the past, there had been episodes where severe vulnerabilities were uncovered in major advanced economies, and such events had a significant negative impact on emerging markets and developing countries. The previous Global financial Stability Report had pointed, for example, to areas of serious vulnerabilities in the financial sector, particularly in the banking sector and the pension system as well as the corporate sector in large industrial countries. The Board should not underestimate those potential vulnerabilities and should ask the staff to adapt its focus accordingly. Also, the idea should be avoided that the entire initiative was a means for the large economies to strengthen their control and dictate their preferences and policies to emerging markets.

Mr. Bischofberger and Mr. Harzer submitted the following statement:

Key Points

The risk of financial crises will always be present and we would caution against the presumption that the more standards are being assessed, the more stable the international financial system will become. However, the international standards and codes initiative has clearly contributed to reduce the risks of financial crisis. The developments since the last review of the initiative, in particular the increase in the number and the (country) coverage of ROSCs, are welcome and prove that the initiative broadly meets its targets.

Therefore, high (resource) priority should be given to the ROSC exercise (as well as to the FSAP) when it comes to the internal prioritization of the Fund's work program.

At the same time, we concur with staff that greater prioritization and streamlining of assessments is necessary in order to make the standards initiative sustainable. While we broadly support staff's proposals in this respect, we would caution against extensively tailoring ROSCs to country-specific circumstances, since this would undermine the usefulness of this instrument for the private sector.

While we are in principle open to a possible further expansion at a later stage, like staff, we currently do not see a need to add new areas to the list of 12 existing standards.

The provision of Technical Assistance to implement ROSC recommendations must be prioritized in parallel with and according to the same principles which apply for the prioritization of assessments.

Even with the most sophisticated crisis prevention instruments at hand, it will never be possible to fully prevent the outbreak of financial crises and one should, therefore, not presume that the more standards are being assessed, the more stable the international financial system will become. However, the international standards and codes initiative has certainly reduced the risk for such financial crises to occur by improving overall stability of both the national as well as the international financial systems. Developments since our last review of the initiative are encouraging and prove that the instrument broadly meets its goals: the number and (country) coverage of ROSCs has sharply increased, they are playing an increasingly important role in Fund surveillance and they have a growing impact on decision making of financial market participants. One important reason which makes standards a highly valuable instrument is their significant external effect on international financial stability through increased information (i.e., transparency) for private market participants.

Given the usually very large economic and social disruptions associated with financial crises, the cost of the initiative to the Fund appears reasonable. As we already mentioned during the recent FSAP review, crisis prevention represents a core task of the Fund. When it comes to internal prioritization of the Fund's work program, high priority should, therefore, be given to the ROSC exercise, not least in the allocation of staff resources. At the same time, we concur with staff that without greater prioritization and streamlining of assessments, there would not only be the need to significantly increase the resources assigned to ROSCs but the outside perception of ROSCs could easily become less focused and blurred as well.

Updates to ROSCs will logically play an ever growing role compared to new ROSCs. Staff's proposal to limit such updates to Data, Fiscal, Monetary and Financial Transparency, and Basel Core Principle Modules is reasonable. Such a focus would also be in line with the results of the survey of mission chiefs, who rated fiscal and banking ROSC modules most important for Article IV surveillance purposes. Special efforts are needed to bring the so far relatively low number of data modules more in line with the critical role which data issues play for Fund surveillance. More comprehensive follow-up assessments and new ROSCs should be concentrated on members with systemic importance and with vulnerabilities in the area covered by the respective standard. Country-specific limitation of assessments to those areas and modules, from which the highest return in terms of identifying weaknesses of macroeconomic importance can be expected, is another tool to make the standards initiative sustainable. In this regard, while we agree that Article IV staff reports could be used to indicate the suitable standards, the final decision on what specific standard assessments a member is volunteering for must remain with the authorities. Furthermore, the extent to which tailoring the ROSCs to country-specific circumstances is feasible and realistic is clearly limited by the reasonable call of the private sector for easy cross-country comparability of ROSCs.

Internal and external user-friendliness of ROSC documents is a precondition for further improving the effectiveness of ROSCs. The proposed clearer focus on their main findings and conclusions and a greater prioritization of recommendations will constitute a major contribution to that end. To the extent possible, a uniform structure of ROSCs as well as appropriate succinctness would also further that goal.

Collaboration with other international agencies in producing and updating ROSCs will not only allow to spread the financial burden of the initiative more widely but will also help to ensure that the Fund and the Bank limit their activities to their respective mandates and to those areas in which they have unrivaled expertise. The recent approval of a comprehensive methodology for the joint assessment of the AML/CFT standard by the Bank/Fund and the FATF may serve as a model in that respect. In any case, close coordination between involved parties will be critical to avoid duplication of efforts.

It did not come as a surprise that staff pointed out that the areas where the need to adjust existing standards is most pressing are corporate governance, accounting and auditing. While we concur with this assessment, these areas clearly do not fall within the Fund’s core competence. Although a possible expansion of the list of standards at a later stage should not be ruled out categorically, we fully support staff’s conclusion that, for the time being, there is no need for further additions. In this context, it is worth recalling that the Fund, while assessing standards, must avoid to be engaged in any kind of “micro-management” which is not compatible with its monetary mandate and which could undermine the ownership of the member country concerned.

For many member countries, the provision of adequate technical assistance is an indispensable precondition for the thorough implementation of recommendations resulting from ROSCs. However, in order to channel technical assistance resources into those areas where their return in terms of improved financial stability is maximized, the general principles for prioritization proposed by staff should be applied to technical assistance as well. technical assistance should not be viewed as a tool to foster a broad-based application of standards across areas and countries.

We endorse staff's proposal to include an assessment of the new RSSS into the payments and settlement system ROSC for those members with large and complex securities settlement systems. The addition of the RSSS to the Financial Stability Forum's list of standards for sound financial systems has already set the stage in that area.

Continuation of the current practice of discussing ROSCs and their recommendations with the authorities is a key element in order to build and maintain the ownership necessary for transforming these recommendations into concrete reform measures. Given that the propensity of the authorities to consent to the publication of ROSCs is particularly low in the case of financial sector ROSCs, staff may emphasize to the authorities that a decision not to publish a ROSC usually negatively affects the country's appraisal by the private sector.

Finally, we think that the relatively low utilization of ROSCs in the decision making by private financial institutions in Canada and Europe (as shown in Table 1, Appendix V, Supplement 1) could be improved by future outreach activities.

Mr. Yagi and Mr. Miyoshi submitted the following statement:

General Comments

We highly appreciate the set of informative staff papers. We believe the international standards and codes initiative can be useful in enabling governments to assess their own economic policies and institutions, with the assistance of objective assessments by outside experts. At the same time, it can provide beneficial information to the markets to help them judge country risks and determine portfolio investments. This process can also help identify countries' policy and institutional vulnerabilities and encourage governments to take corrective actions, which would contribute to the prevention of crises.

We are reassured to know that the number of countries volunteering for standard assessments and producing ROSCs is increasing, for this indicates a growing recognition among members that the initiative is beneficial. A survey of financial institutions has found that ROSCs are becoming an important information source for the markets and are increasingly used for risk management purposes by the private sector. We welcome this survey outcome for it certifies that the initiative is also perceived to be beneficial by the private sector.

It is somewhat regrettable that the rate of participation in ROSCs is lowest in Asia, and that partly because of this the use of ROSCs is lowest among Japanese financial institutions. That said, footnote 12 of the main paper indicates that some Asian countries have said they intend to improve their observance of standards before undertaking ROSCs. We think that the international standards initiative is acting as a strong incentive to introduce sound policies and institutions even in countries that have not yet requested assessments.

The increased importance of the initiative, both in the public and private sectors, calls for greater objectivity and appropriateness in standard setting and observance assessments. Since some international standards did not fully take into account the opinions of developing countries when they evolved, staff and assessors should take into greater consideration the specific circumstances of a country, including the stage of economic development and the background of existing institutional frameworks. A "one-size-fits-all" approach is inadequate in observance assessments and should be avoided. Although judgmental factors in making assessments cannot be eliminated, staff and assessors should make the utmost efforts to avoid insisting on a specific interpretation of standards based only on their own legal and institutional background, or demanding observance of standards that surpass internationally recognized standards. In the area of standard setting, we expect Fund/Bank staff to base their opinions on their experience of assessments when standard setters produce or modify international standards.

To encourage more countries to produce ROSCs, it is important to show how ROSCs can be beneficial in creating sound economic policies and institutions, and thereby contribute to crisis prevention. In this context, it was reassuring to read that the theoretical and empirical literature has produced encouraging conclusions on the benefits of countries' adopting policies in line with internationally recognized standards. We also heard similar remarks from staff at the informal seminar on effects of financial globalization on developing countries. We look forward to further research and analysis in this area. In this connection, staff states in paragraph 21 of the main paper that countries with more transparent policies tend to have lower inflation and lower fiscal deficits. We would appreciate if staff could provide us with information about the research on which this analysis is based.

Specific Comments

Following are our comments on the Issues for Discussion in the staff paper.

We support the basic concepts outlined in the staff paper of greater selectivity in country and policy area coverage of assessments. It has become evident that the standards initiative is costly and takes significant time and effort on the part of Bank/Fund staff and recipient countries. From the standpoint of making effective use of limited resources and of reducing the administrative burden of recipient countries, the staff proposal is broadly appropriate. We think that more resources should be set aside to update ROSCs and undertake reassessments because the increased use of ROSCs for risk assessment by the markets calls for more frequent updates of information.

We agree in principle with the idea that new ROSCs should be focused on members and policy areas where they can be most useful. However, as a number of Directors noted at the Board meeting on the FSAP last Friday, it is not easy to prioritize and streamline the standards assessments when many members are requesting them. Improving the effectiveness of the initiative as a whole requires strong discipline in the management of assessments. Staff proposes in paragraphs 26 and 46 to develop a more systematic internal mechanism such as an interdepartmental task force and to strengthen collaboration between the Fund and the Bank. We suggest that staff inform the Board of the measures to be taken to strengthen the mechanism and their implementation.

With regard to country selection, priority should basically be given to systemically important countries and emerging market economies. However, the Fund should not stress too much that it selects countries with material vulnerabilities in policies and institutions. If the markets come to believe that the Fund is focusing on such countries in standards assessments, it could adversely affect the markets' country risk evaluation. Therefore, while we believe that ROSCs should be focused on systemically important countries and emerging market economies, we think it is appropriate to ensure even-handedness in the selection of countries to be assessed from these categories of countries, based on requests from authorities. Concerning the area coverage of new assessments and ROSCs, we support the staff's proposal that it should be tailored to a country's specific circumstances.

We concur with the proposed modalities of updates and reassessments described in the second bullet of paragraph 45 of the main paper. We can agree to limiting updates to ROSCs by the Fund basically to the four areas that are most central to the Fund's concerns, namely Data, Fiscal, Monetary and Financial Policy Transparency, and Basel Core Principles modules, on the assumption that other standards (particularly those of the payment system) could be assessed in cases where the areas covered by the standards could have systemic ramifications.

Staff proposes that industrialized countries should cover the costs involved for assessing their observance of market integrity standards, the area where the Bank plays a leading role. We think that this proposal would reduce the incentives for industrialized counties to request market integrity ROSCs, although it is understandable in light of the limited resources of the Fund and the scope of the Bank's mandate. However, the Fund should take up this area in the context of Article IV consultations when it considers that a review of the regulatory framework and the appropriateness of supervision and enforcement in the area of market integrity are necessary to its surveillance of an industrialized country, taking into account the magnitude of the implications of inappropriate accounting for the securities markets and the economy.

We welcome the proposal to ask other international agencies to produce or collaborate on ROSCs and ROSC updates. The collaboration of international agencies is essential because of the limited number of experts on international standards globally. Having said that, we would like to reiterate the comments we made previously in relation to the pilot program of AML/CFT assessments: that Fund/Bank staff should be responsible for undertaking a quality review that covers not only the format but also the substance of reports. Such a review is essential because it is the Fund and Bank Boards that approve the reports as ROSCs.

We support strengthening the linkage between ROSCs on one hand and the Fund's surveillance and technical assistance on the other, with a view to enhancing the effectiveness of ROSCs. We concur with the staff proposal that ROSCs need to be clearer and more explicit about weaknesses in policies and institutions, and the differences of opinion between the staff and the authorities, in order to better serve the needs of the authorities and contribute to the effectiveness of surveillance. At the same time, it should be recognized that greater candidness of the ROSCs could increase market sensitivity. While recognizing the role of ROSCs in providing information to the markets, the interpretation of "market sensitivity" needs to be broadened, under the principle that the publication of ROSCs is voluntary. We support continuing the current policy of sharing draft ROSCs with the authorities because of the need to ensure the accuracy of the detailed assessment.

Prioritizing the recommendations in ROSCs is crucial to making them a more effective tool for strengthening surveillance and improving technical assistance, and we therefore support the staff proposal to achieve greater prioritization. The implementation of standards must be sequenced, for example according to the country's stage of development as well as the degree of openness and liberalization of its banking system. In many cases, it is not a matter of urgency for a developing country to improve risk management and banking supervision up to the level of industrialized economies. Also, the financial sector of developing countries tends to be dominated by banks, and addressing vulnerabilities in the securities and insurance sectors is not a priority issue in such countries. It is unrealistic and counterproductive to recommend that a country's authorities correct all the weaknesses found in the standards assessments at once. Therefore, to better serve the Fund's surveillance, ROSCs should make clear which weaknesses need to be addressed urgently from the standpoint of macroeconomic and financial stability of the country concerned. In relation to technical assistance, we agree with staff that the technical assistance recommended by ROSCs should be appropriately prioritized in the context of an overall national technical assistance plan for the recipient country.

Mr. Bennett submitted the following statement:

Key Points

Judging by the growth in the number of ROSCs, the staff has made great progress in implementing the standards and codes initiative.

It is clear that the market finds the initiative useful. More should be done to highlight the benefits of compliance.

For the ROSCs to maximize their impact on policy, their recommendations should be clear. The staff should work with the authorities to delineate a "road map" of steps which would lead to full compliance.

Given the potential scale of the ROSC process, and its resource cost, prioritization is essential. We would focus on those standards most closely linked with crisis prevention and on those countries which are either systemically important or have a good track record in implementing the staff's recommendations.

The Standards and Code Initiative Progressing Apace

The staff has now completed 343 ROSCs. This represents a 50 percent increase in the number of completed ROSCs from April 30, 2002. Moreover, the number of economies covered has risen by 24 percent over the same period. These data indicate that the initiative is progressing rapidly. However, there is potentially a lot of work left to be done. If all twelve standards were to be assessed with respect to all 183 Fund members, this would result in about 2200 ROSCs. Moreover, this stock of ROSCs would require constant updating as members compliance changed and as the standards themselves evolved.

This is clearly an enormous task and one which would require significant national and official resources. Given other draws on these resources, we must constantly assess the efficiency of the standards and codes initiative in furthering the goal of crisis prevention. It is worth allocating increased resources to the standards and codes initiative as long as we believe that the marginal benefits, in terms of crisis prevention, outweigh the marginal costs.

The initiative reduces the likelihood of crises through two channels. First, it improves economic and financial management by outlining international best practice with respect to a given standard and encouraging countries to implement this practice. Second, it enhances transparency by making the market aware of the extent of compliance through publishing the ROSCs. This review of the initiative gives us a chance to assess how well these channels are working.

The Market Taking Notice

From the point of view of national authorities, the standards and codes initiative is a resource-intensive and time-consuming process. Moreover, capacity constraints, in terms of qualified personnel, can impede progress. The benefits of compliance with international standards may appear small vis-à-vis those of competing priorities. It is, therefore, important to show that the market is cognizant of the standards and codes initiative and that there are benefits to the country from compliance.

In this context, the staff's work to assess the extent to which the market takes notice of the initiative is very welcome. We were heartened to observe that most of the 40 major financial institutions surveyed by the staff reported that the standards and codes were an important element in their financial decision making. Moreover, ROSC's impact on the analysis of credit rating agencies is also testament to their usefulness. Finally, the numerous private sector initiatives on standards shows just how important this issue is for the market.

It is, however, one thing to show that the market takes notice of the initiative and another to show that compliance results in tangible benefits for the country. The IIF has done some empirical work that shows that, holding other factors constant, compliance with the Special Data Dissemination Standard lowers country risk premia by between 200 and 300 basis points. We understand that the staff has done some additional quantitative work in this regard. Since it is important that countries understand that there are benefits to compliance, we would urge the staff to make the results of their research public as soon as possible.

Clear Guidelines

While dissemination of compliance to the market and the receipt of improved market access is an important aspect of the initiative, the continuous upgrading of country practice is even more crucial.

Following the staff's assessment, it is imperative that the authorities have a clear sense of what the major vulnerabilities are and how they should be addressed. We are, therefore, concerned that the mission chiefs surveyed have found that the ROSCs need to be clearer about weaknesses, blunter about shortcomings, and more explicit about the magnitude of non-compliance. We strongly agree with the staff that it is vital that the ROSCs be very clear about their conclusions and provide explicitly prioritized recommendations. Indeed, we suggest that the staff work with the authorities to establish a compliance "road map" as part of each ROSC. This road map would be a summary table of the ROSC's main findings that listed, in order of priority, the principal initiatives needed to address the main vulnerabilities. It would be the reference point for periodically assessing progress on compliance, a process which could be carried out as part of the annual Article IV Consultation exercise. This procedure would provide a clear link between the ROSCs and surveillance. It would also enhance oversight by the Board as to the authority's progress in implementing the ROSC's findings. Moreover, it would inform reassessments and factual updates.

While we support greater candor in ROSCs, including blunter language where shortcomings are serious, a careful distinction needs, where appropriate, to be made between statements which identify a legislative or regulatory deficiency and those which could be interpreted as reflecting adversely on the competence or integrity of an identifiable person. In the case of the latter, blunt language could negatively affect the dialogue with the authorities to the detriment of the success of the ROSC exercise.

Prioritization of the ROSC Process

As we noted above, completing the "full set" of 2200 ROSCs and keeping them updated is a daunting task. Prioritization is therefore necessary and can be undertaken along two dimensions.

It is possible to prioritize among the various codes and standards. Given the initiative's goal of crisis prevention, we believe that the focus should be on those standards that address macro-prudential weakness since it is vulnerabilities in these areas that are most likely to lead to crises. However, for the larger advanced economies with systemic importance, a focus on corporate governance, accounting, and payment systems, may be appropriate.

It is also possible to prioritize among countries. Countries which are systemically important, either globally or regionally, deserve more immediate attention because their vulnerabilities can affect their neighbors. Since we would want to be sure that resources were being put to best use, we would also give a priority to those countries that were making progress in compliance as evidenced by their performance vis-à-vis the “road map”.

We are also of the view that the ROSCs should clearly identify technical assistance needs. Given the large potential demands, we would prioritize technical assistance according to the dimensions noted above. Countries that are systemically important would, where needed, be priority recipients as would other countries that were making demonstrable efforts toward full compliance. Priority for technical assistance would also be given to address those vulnerabilities most likely to result in crises.

Mr. Le Fort and Mr. Pereyra submitted the following statement:

We thank staff for a useful paper, which describes the role that the ROSC initiative has played in strengthening domestic and international financial systems and members’ institutional capacity, and suggests ways to optimize results by making standard assessments more instrumental and carefully prioritizing their implementation.

Paragraph 45 broadly provides a blueprint aimed at enhancing the effectiveness of ROSCs and ROSC follow-ups within the existing resource envelope. In the first place, selectivity in country and policy area coverage should be refined so as to prioritize: (i) members with significant vulnerabilities in the policies and institutions covered by the standards initiative; and (ii) members for which ROSC exercises would have a significant developmental impact. Article IV staff reports and Country Economic Memoranda/ Development Policy Reviews would give an indication of the members and the standards that could most usefully be assessed.

Regarding the first group of countries, we agree that ROSC provision would be more useful if priority is given to addressing vulnerabilities that could have regional and global implications. This notion is consistent with the kind of selectivity proposed in the context of the FSAP review, and reflects the urgent need to address the weaknesses in key economies and sectors that currently pose significant risks to the stability of the global financial system. In particular, the establishment of best practice benchmarks in advanced economies should be emphasized. Efforts in this field are urgent, given the insufficient coverage of such countries attained so far.

The experience of many developing/emerging countries—some of them in our constituency—points to the value of ROSC exercises, not only for development considerations, but also from the point of view of economies striving to gain or maintain access to international capital markets. In this regard, we attach great importance to the information provided by staff regarding the extensive use of ROSCs in the financial decision-making of large internationally active financial institutions. Notably, observance of international standards is a factor that seems to be increasingly used by credit rating agencies, and quantitative exercises suggest that various indicators of observance of standards are associated with lower spreads and higher credit ratings. It can be concluded that, in the present world context, ROSCs can play an important role in enhancing investor discrimination, and thereby countering the "feast or famine" syndrome that affects capital flows to emerging market economies.

As for the intensity and frequency of follow-ups, we can support staff's proposal to replace the short updates currently in use with more substantive updates focused on areas that require close attention. The greater resources demanded by such approach would be justified by the production of more useful updates than the current ones, which are largely descriptive in nature. We also agree that, when there have been substantial changes in a member's practices, a reassessment—presumably at a lower cost than the original ROSC—would be warranted.

We, however, have reservations concerning the suggestion to reduce the frequency of market integrity reassessments undertaken by the Bank. Vulnerabilities in the sectors addressed by market integrity ROSCs—corporate governance, accounting, auditing, and insolvency and creditor rights—have been at the root of the major crises of the last years, and are still a source of concern. Therefore, the frequency of such reassessment should not be reduced indiscriminately, but prioritized on a case-by-case basis. Also, it is suggested that updatings by the Fund could be limited to data, fiscal, monetary and financial policy transparency, and banking supervision. Nevertheless, other fields merit attention and proper follow-up, for example the insurance sector, currently besieged by serious problems in a number of countries. Hence, more than an across-the-board rule, a certain degree of flexibility is warranted.

We also concur that industrial countries requesting assessments of the market-integrity standards could cover the resource costs involved. Moreover, linking this proposal with staff's suggestion that the Fund should limit updatings to ROSCs that are closer to its core responsibilities, it could also be considered that developed countries contribute to financing follow-ups regarding other fields—mainly securities and insurance—in view of the current resource strains facing the ROSC initiative and their relevance for global stability. More specifically, the need for streamlining underscored by the staff report should not lead to cuts in areas that have utmost importance for the Fund's surveillance duties. Therefore, it is essential for the continued success of the ROSC initiative to explore views for greater cost-sharing with industrial countries.

We note staff's remarks that, from the results of the survey conducted on the occasion of this review, a quarter of ROSCs undertaken so far needed to (i) make a clearer statement of the most serious weaknesses detected, and (ii) explicitly prioritize recommendations. We agree that, with sharper conclusions and recommendations, ROSCs would become a more useful tool for highlighting the profile of existing concerns and uncovering new issues, especially in the course of discussions of draft versions with the authorities. Nonetheless, we share Mr. Portugal's concern that blunter remarks on existing weaknesses could pose problems when it comes to publication, namely reinforcing herd behavior in private markets.

We attach importance to remaining attentive to improvements and new contributions by the standard setters, in particular in areas that are critical for global financial stability. In this regard, we find merit in staff's recommendation to expand ROSC coverage to assess members with large and complex securities settlement systems. Therefore —in consistency with the need to prioritize economies whose stability can have considerable systemic ramifications— we support changing the current "payments system" area to a "payments and settlement system" area, in order to incorporate the recently developed Recommendations for Securities Settlement Systems (RSSS).

ROSC exercises undertaken in developing member countries have been instrumental in underscoring the need for fundamental reforms in a wide variety of areas. At the same time, implementation of standards can be very costly and burdensome, and so careful sequencing and prioritization are essential in this group of countries in order to ensure that their scarce resources are used in the most effective possible way. Support from the Bretton Woods Institutions (BWIs) is, therefore, crucial in assessing the cost and benefits of the implementation of standards. Moreover, additional efforts in this field should be complemented with technical assistance to those countries that need more implementation support. A careful focus on the areas deemed more significant for stability and development would be in order, keeping in mind that the provision of technical assistance is also a source of significant financial stress for the BWIs.

We are glad to learn about the ongoing comprehensive review of the OECD's Principles of Corporate Governance, which is geared to fill gaps in important areas such as board independence, audit and remuneration committee independence, and the accountability of CEOs and CFOs. In addition, recent events in the advanced economies underscore that international standardization of accounting and auditing principles is a major priority. The paper also reports that UNCITRAL and the BWIs are currently working on a standard for insolvency and creditor rights, but suggests that both institutions may have been working somewhat independently in the first stages of the review. In this regard, we recommend fine-tuned coordination with standard setters from the outset, in order to profit from synergies and avoid duplication of efforts.

Given that ROSCs play a significant role in signaling the level of observance of key international standards, and thereby contribute to assessments by market participants, addressing certain additional fields would seem valuable —public debt management and public sector governance could be strong candidates. However, undertaking existing ROSCs constitutes a heavy burden on the BWIs staff and financial resources, considering the ambitious coverage envisaged for 2003 and onwards. Moreover, assessments of other key areas can be undertaken in the context of Article IV consultations and fiscal sustainability assessments, and standard setters and the BWIs are working together to enhance principles and modifying standards in order to fill possible gaps. Therefore, while encouraging staff to remain attentive to potential additional needs, we agree that for the moment there does not seem to be sufficient basis for expanding the list of standards.

Ms. Indrawati submitted the following statement:

We thank the staff for a set of comprehensive papers on the review of progress made in the implementation of the Fund and Bank's joint standard initiatives and their well-thought recommendations on further steps for strengthening them.

Through the standards and codes initiative, the Fund and the Bank encourage member countries to improve transparency and accountability of their policy decision making, such as those for sound monetary and fiscal policy, the efficient supervision of financial sector, and good corporate governance. The increasing number of members' participation in the ROSC and the financial sector assessment over the past years reflects its crucial function in improving the operation of domestic and international financial systems.

We also believe that there remain scope for improvements in the quality of ROSCs and the standards to strengthen its effectiveness as a sustainable diagnostic tool for identifying institutional weaknesses and external vulnerabilities

Standards Assessments and Fund Surveillance

Although the results of ROSCs and standards assessment are increasingly integrated into the Fund surveillance, country program design and provision of technical assistance, some mission chiefs indicated that ROSCs need to be more clear about weaknesses and priorities for reform.

Against this background, we believe that the contribution of ROSCs to the Fund surveillance could not be measured precisely so far and that the incorporating of standards assessment into routine surveillance should be considered on a case-by-case basis. Based on the voluntary nature of standards and codes, the observance of standards should not be integrated in a mandatory way into the Fund surveillance. We also believe that for the developing countries, the implementation of standards should be supported by the technical assistance that would help them to strengthen their capabilities in this area.

Prioritization of Standards Assessments

Recent experience has shown that there is a growing demand for ROSCs and standard assessments, and follow up to ROSCs. Given the limitation of the Fund and the Bank resources and member's institutional capacity, staff pointed out the need to prioritize the standard assessments in terms of country selection and the areas to be focused where the standard assessments would be most useful. We would encourage staff to strike a balance between the provision of more systematic standard assessments and resources constraints in order to meet the need of priority countries. A greater emphasis should be given to the members with institutional and policy vulnerabilities, as well as the systematically important countries. We believe that a better process of prioritizing would enhance the efficiency and effectiveness of standards assessment. Moreover, additional resources would be required to accommodate the growing demand for standards and codes assessment and ROSCs instead of reducing the country coverage.

With the recognition that countries are at different stages of development and have different levels of institutional capacity, we concur with staff that the choice of standards to be assessed and ROSCs produced should be based on the countries circumstances. However, it is very important that under the same standards and ROSCs the assessment should be subjected to the similar criteria and treatment, an evenness of quality. We would welcome the staff's comment.

Sharing Draft ROSCs with the Authorities

It is also critical that the diagnostic nature of the ROSCs take into consideration the level of analysis and knowledge that the expertise have in order for the assessment to be effective. The proposal to allow for a separate reply from the authorities in response to a blunt recommendation from staff on the ROSCs should be studied further as the impact could be serious on both the IMF and members' image and integrity. The avenue provided during discussions between the IMF staff and the authorities should be utilized toward identifying such weaknesses and a subsequent provision of technical assistance to rectify the shortcomings. We underscore the importance for the standards assessments to be periodically updated in order to obtain the maximum benefits of the ROSCs exercises.

Adding New Areas to the List of Standards and Codes

Staff proposed an idea to expand the present list of standards and codes if there are other areas that require the standard to add up in order to promote the international financial stability. In our view, the present list of international standards in twelve areas is appropriate, as it has covered the most relevant issues in strengthening a member country's institutional and operational framework of macroeconomic management and its financial sector, and contributing to crisis prevention. While the stepped-up efforts to promote international financial stability are desirable, such activities should not overburden the members and the international financial community. We therefore agree with staff that, at this time, an additional standard is not warranted.

Balance of Coverage

Recent corporate scandals in the U.S. economy has indicated that there is a need to strengthen standards assessment in the advanced countries, as done so in emerging markets and developing countries. Standards and codes should also be confined to the industrial countries, particularly economies that their development creates a significant impact to others and global economy. A comprehensive review of international principles on corporate governance, market integrity standards assessment and accounting and auditing standards are needed in the industrial countries. We support the Bank and the Fund's intensified efforts, in cooperation with other standard setters, to develop stronger regulatory frameworks for accounting and auditing, corporate governance and insolvency and creditor rights.

Technical Assistance

Staff's assessment on members' participation in the ROSCs and FSAP initiatives has been rather positive, as the usefulness of standards is evident in identifying the institutional weaknesses. However, the implementation depends on members' capacities and this calls for follow-up technical assistance to redress identified weaknesses. We commend the Fund and the Bank's effort to mobilize assistance from other institutions and bilateral donors to facilitate the activities in this area. Establishment of the Financial Sector Reform and Strengthening (FIRST) initiative aimed at providing financial support for the FSAP/ROSC efforts is a welcome development. We would suggest that more work is needed in this regard.

Extending her remarks, Ms. Indrawati responded to comments in the statement from Ms. Jacklin and Mr. Epstein that countries in her constituency did not participate in a ROSC.

While the importance in the continuation of ROSCs for financial stability was recognized, resource constraints of the countries in her constituency forced them to prioritize their resources for the most important activities. She also noted that, while Ms. Jacklin in her statement on page 2 had mentioned that Malaysia was among those countries that had not yet participated in any ROSC, Table 1, Appendix I of the staff paper showed that Malaysia was actually participating in a ROSC. Certain ROSC modules were extremely demanding, especially for countries with limited capacities. The idea to develop participation based on a phased approach was important in that regard. Also, the possibility of allowing members to undertake only one or two financial sector modules at a time, in view of their resource constraints would be considered. That was important in particular for ASEAN countries in her constituency, given that they were very important in terms of the issue of systemic vulnerability. It should be recognized that their commitment remained very strong and that the main factor standing in the way of increased ROSC participation were resource constraints.

Mr. Ondo Mañe submitted the following statement:

We welcome the opportunity to discuss International Standards and their role in strengthening surveillance, domestic institutions and international markets. The development and implementation of well-defined standards acceptable across the membership in areas relevant to the effective functioning of members' economic and financial systems are key for strengthening Fund surveillance, domestic institutions and crisis prevention. Indeed, the international standards and code initiative launched in the aftermath of the crises in the late 1990s to promote a more stable financial system is gaining momentum, as it is generating increased attention from member countries, financial market participants and rating agencies. The recent wave of corporate scandals in advanced countries highlights the need to expand the coverage of standards and codes, so as to encompass more countries with a systemic impact on the global economy and areas such as corporate governance and accounting rules. At the same time, it is essential to continue to underscore the importance of ownership and voluntary implementation of standards, taking into account the different circumstances, stages of development and institutional capacity of members. In this context, we believe that the provision of technical assistance is crucial for helping member countries to implement those standards deemed more relevant to their individual circumstances. Against this background, we would like to make some comments on the issues for discussion.

Standards Assessment, Surveillance and Capacity-Building

On the quality of ROSCs, we share the view that ROSCs have generally helped clarify and raise the profile of existing concerns, and in some cases uncover new issues. Nonetheless, in order to further improve the quality of ROSCs and meet the needs of authorities, we concur with staff that ROSCs should give a clearer sense of the weaknesses, main conclusions and their significance and more explicitly prioritize recommendations. In this context, it is important that the member and the Directors receive a report that clearly identifies institutional weaknesses and prioritizes recommendations. In order to translate these changes into reality, we call for the revision of the operational guidance on the structure and content of ROSCs. We also support staff's proposal to continue to share draft ROSCs with the authorities, as sharing this will allow for greater dialogue, and ensure more accuracy, given the technical nature of ROSCs. While we agree that presenting the views of the staff and the authorities separately or with accompanying documents can help clarify the judgments made in the ROSCs, we are of the view that this exercise should not become a pass and fail exam, which can be misinterpreted by market participants on the performance of the member country concerned.

As regards the link between standards and surveillance, it is to be noted that on the one hand, the preparation of ROSCs and compliance with the related standards and codes are voluntary. Surveillance , on the other hand, is an obligation for all members. While ROSCs can help inform surveillance discussions, we should not attempt to create an automatic link between compliance with ROSCs and Fund surveillance. Having said that, we recognize that ROSCs and standards are serving as an important tool for surveillance, by raising the profile of institutional weaknesses important to surveillance. In this regard, the review is revealing, as 80 percent of ROSCs were considered to have identified important surveillance issues, including substantial off-budget or quasi-fiscal expenditures and weaknesses in the banking system. We are also appreciative of the progress achieved so far in using standards to improve surveillance on a voluntary basis. In the case of Ghana, ROSCs have helped the authorities identify a number of vulnerabilities in the financial sector and implement remedial actions. In this context, we encourage Bank and Fund staff to continue to work closely together and build on priorities for standards assessments across members and standards.

We believe that the more logical linkage of the observance of standards would be technical assistance. In this regard, we support the request of developing country authorities for adequate technical assistance to help them address weaknesses identified in standards, and further work on the appropriate sequencing of the implementation of standards. We welcome progress made thus far, in providing technical assistance to developing and transition countries which have completed ROSCs and FSAPs. Nonetheless, we advocate a more systematic diagnosis and prioritization of technical assistance needs within the framework of national technical assistance priorities, taking into account domestic capacity to implement changes and the availability of external support. Given their resources and expertise, the Fund and the Bank would be in the best position to provide or help in the mobilization, utilization and coordination of technical assistance to support the implementation of standards.

Coverage of the Standards and Modifying Standards

We endorse staff proposal to include assessments of observance against the new RSSS as an integral part of a payments and settlement system ROSCs for members with large and complex securities settlement systems. To this end, it will be important to add the RSSS as a standard to the list of areas and associate standards where standards are important to the conduct of comprehensive analysis under Fund surveillance. In the areas of corporate governance, accounting and auditing where most fundamental changes to existing standards are needed, we share staff's view that the Fund and the Bank should continue to support various initiatives underway to strengthen the standards, guidelines and oversight or regulatory mechanisms in these areas. These changes will help address the shortcomings of corporate governance related to the recent corporate scandals in advanced countries, particularly in areas of board independence, audit and remuneration committee independence, the accountability of CEOs and CFOs and conflicts of interest between financial analysts, rating agencies and financial institutions. They will also fill the gaps related to the lack of internationally-agreed codes for the accounting and auditing professions and the inappropriateness of accounting standards for small and medium-sized companies that are not publicly traded.

On public debt management and public sector governance issues, despite their importance for improving the management of public resources, we agree with staff that at this time, it is not necessary to add them to the list of standards. At best, the guidelines for public debt management can be seen as useful benchmarks which can evolve over time. On public sector governance, we concur with staff that agreement on a broad code on this matter may be difficult to achieve for the time being and its monitoring would lead to duplication of effort with existing standards on fiscal, monetary and financial transparency, corporate governance and anti-money laundering and combating the financing of terrorism. Thus, on these issues, we invite standard setters to fill gaps where needed by enhancing or modifying existing standards.

Sustainability of the Standard Initiative

We believe that ROSCs are a useful diagnostic tool that should continue to provide input into Fund surveillance and Bank Country Assistance Strategy, while remaining a catalyst for members' reforms. We also think that the expansion of Fund activities beyond the core mandate should be met with increased resources, so as to avoid the crowding out of important activities such as the ongoing work on standards or FSAP reviews in member countries.

In light of the current resources constraints, we support efforts to improve flexibility and prioritization of assessments in the production of new ROSCs. In this context, the choice of standards assessed and ROSCs produced would be tailored to country-specific circumstances, so as to avoid the "one size fits-all" approach and ensure an efficient use of Fund resources. Accordingly, we agree with staff that all Article IV staff reports and CEM/DPRs should include an indication of areas in which standards assessment would be most useful and new ROSCs should be focused on those areas.

As regards selectivity in country and area coverage, we believe that Fund's priority for new ROSCs should go beyond members with material vulnerabilities in the policies and institutions. Thus, we share Mr. Portugal's view that additional criteria should be considered, including countries with a systemic impact on the global economy and countries which can help identify best practices, so as to cover also advanced countries. Regarding selectivity in updating, in the context of the Article IV consultation, the Fund should limit updates to ROSCs to more substantive reporting of information or to areas most central to the Fund's concerns, including Data, Fiscal, Monetary and Financial Policy Transparency and Basel Core Principles, in order to focus resources on the areas of highest priority and to avoid overburdening the Article IV consultation process. In this context, it will be important that the Fund and the Bank continue to work closely, in order to strengthen mechanisms to prioritize the coverage and update of ROSCs. In a similar vein, we believe that staff should be provided with adequate resources to undertake this important work. While we understand that changing economic conditions make it necessary to add to the coverage, we would also like to add that all steps must be taken not to reduce the resources provided to the staff to cover our traditional responsibilities.

Mr. Andersen and Mr. Kropas submitted the following statement:

General Remarks

We welcome the opportunity to review the role of international standards and codes initiative and thank staff of the Fund and the World Bank for a well-focused paper. The development, dissemination, and adoption of internationally accepted standards and codes have developed into an important part of the Fund's efforts to strengthen institutional capacity in member countries. It informs Fund surveillance, serves as an important framework for countries to focus their policy and institutional decisions, and promotes better risk assessment by market participants. The World Economic Outlook documents just discussed reminded us about the significant merits of developing strong institutions to which the standards and codes initiative can be an important contributor and catalyst. Moreover, we were pleased to note that the initiative has clearly contributed to reducing the risks of financial crisis.

We are in broad agreement with the main findings and recommendations of the staff. While retaining the voluntary nature of ROSCs, we would like to emphasize the importance of adequate monitoring, including a structured follow-up in order to evaluate the extent to which Fund recommendations have been implemented. Furthermore, while coverage has increased significantly, it is far from complete. However, given that the costs in producing the ROSCs are substantial, it is important that they are well targeted both with respect to countries surveyed and the standard chosen for examination. Also, we would encourage further work on the overall costs and benefits of the initiative. There are already several analytical studies underway that look at the link between the initiative and the robustness of the financial system, including perceived credit risk. We encourage such work and to make it public.

We support a more selective approach to coverage as suggested, focusing on countries and areas with the highest return to domestic and international financial stability and to members' institutional capacity. We concur with the need for a sharpened focus of individual ROSCs and strongly support efforts to strengthen the use of ROSCs by the private sector, and note with satisfaction that the program of outreach will continue. A repeated review of the usefulness of ROSCs for the private sector, as done in the earlier report by the Financial Stability Forum in 2001, might be warranted. We also believe that attention should be paid to the observations made by the private sector on the importance of frequent updates and a standardized structure. We concur with Mr. Bennett that it is important to show that markets are cognizant of the initiative and that there are significant benefits to the countries from compliance.

Issues for Discussion

We strongly endorse the proposed efforts to improve the selectivity in country and policy area coverage of ROSCs as listed in paragraph 45. We also support staff's request for allowing greater prioritization of standards assessments for members and in areas where they can be most useful. Furthermore, we agree that all Article IVstaff reports and CEM/DPRs should include an indication of those areas in which a standards assessment would be most needed.

We concur with staff's proposal that ROSCs should give a clearer sense of weaknesses identified among the participants. Also, we agree that the main conclusions and their significance could be clearer, and there appears to be a need to prioritize the recommendations more explicitly.

We support the suggestion that the payments and settlement system ROSC should include an assessment of observance against the new RSSS in order to make ROSCs even more useful for members with large and complex securities settlement systems.

We commend the steps taken by the Fund and the Bank to buttress the strengthening of existing standards, guidelines and regulatory mechanisms in the areas of corporate governance and accounting and auditing. The OECD work should be supported as well as the World Bank/OECD Regional Corporate Governance Roundtables for developing countries and transition countries. Recent experience of corporate mismanagement has clearly demonstrated the need for vigilance in both developed and developing countries. As pointed out by staff, the IAS standards are adapted to large publicly held companies. We fully endorse the efforts of the Fund and the Bank to support standard setting bodies in developing accounting standards suitable for small and medium-sized companies.

We agree with the assessment that for the time being there is not a strong case for adding to the area of standards that are part of the initiative. When assessing other areas in which standards might be added to the list of standards at a later stage, an appropriate balance between useful general principles and detailed rules has to be found. We concur with Mr. Bischofberger and Mr. Harzer that the Fund should avoid being engaged in any kind of "micro-management" which would not be consistent with its monetary character and which could undermine the important ownership of the member country concerned. Guidelines can be useful in areas such as debt management where approaches vary and benchmarks may be warranted. Also, we agree that a public sector governance standard is impractical as it would be very complex and cut into several areas where standards already exist or are being developed. Having said that, we strongly welcome that the AML/CFT was added to the list of standards, codes and principles for ROSCs.

It is necessary to avoid overburdening the Article IV consultation process. We, therefore, support that only data, fiscal, MFPT and BCP modules are routinely followed up in the context of Article IV consultations. We agree that the Fund's priority for new ROSCs should be given to members where vulnerabilities exist especially of systemic importance. However, the line does not necessarily have to be drawn between advanced and developing countries. The choice of standards and ROSCs produced would inevitable be decided on a country-specific basis.

We concur with the staff's desire to keep the initiative within the available resource envelope and prefer a better targeting of the use of the resources within the existing framework. We would like to make a few suggestions for further consideration:

There appears to be a potential for some resource saving in streamlining the Fund's Code of Good Practices on Transparency in Monetary and Financial Policies, as there is currently some overlap between the Transparency Code and the other standards and codes—we look forward to the review later this year;

Self-assessments should be used to a larger degree to identify important issues ahead of missions. This way, the focus could be sharpened and the number of issues addressed could be reduced before arriving in the country. Such evaluations could also be a useful tool for the countries to disclose weaknesses in their system and thereby trigger appropriate measures to meet the standards. However, it needs to be clear that these self assessments cannot replace the independent assessments that are provided by ROSCs;

We welcome that some updates on ROSCs (fiscal transparency, financial sector) have been initiated and prepared on the basis of information provided by national authorities. To save resources at the Fund, we would like to encourage that more updates are done this way. It would be useful if the Fund could improve its guidance on how to report on such updates;

Progress in implementing standards is an ongoing concern, especially, in the newly industrialized and developing countries. In these countries, progress is largely in the hands of the authorities. Sharing draft ROSCs with the authorities should improve the sense of participation, accuracy and responsibility and ensure better implementation of standards and codes. It remains important though to safeguard the integrity of the process where the Fund identifies weaknesses and how recommendations are implemented. Involvement of country authorities in the process must not compromise this integrity.

Mr. Mozhin and Mr. Lissovolik submitted the following statement:

We welcome the discussion on international standards and thank the staffs of the Bank and the Fund for high-quality papers prepared for this discussion. The process of upgrading international standards through ROSCs has made important progress in identifying key vulnerabilities within countries' institutional and policy frameworks, in propagating information concerning the benefits of applying international standards and raising the awareness of economic agents on the role of international standards in today's world economy. At the same time, there is clearly a long way to go in incorporating the ROSCs framework into the actual decision-making of the public as well as the private sector. With respect to the latter, further efforts on the part of the Fund to intensify outreach activities would serve to bolster the use of ROSCs in the private sector, thereby providing incentives for individual countries to engage more actively in developing standards.

We now proceed with our answers to the questions posed by the staffs of the Fund and the Bank as well as some observations concerning the role of

Fund surveillance and the private sector in the implementation of the standards initiative.

Issues for Discussion

With respect to most of the questions posed by the staff, we share the views of the report, though on a number of issues we take a different perspective:

A1: we support measures aimed at improving the prioritization of assessments, including those pertaining to the prioritization of standards evaluations in Article IV staff reports.

A2: the quality of ROSCs would benefit from their ex-ante prioritization across countries as well as sectors, while prioritization of recommendations needs to be closely intertwined with the agenda emanating from the surveillance exercise.

A3: we agree with the staff proposal to include an assessment of observance against the new RSSS for members with large and complex settlement systems.

A4: we agree that some important progress has been made in assisting developing countries in improving their standards. In this respect we found the insights provided by the staff in Box 2 of the main report highly instrumental in assessing the effectiveness of ROSCs in some of the developing countries. Sequencing and prioritization are the main areas in which there is further room for improving ROSCs.

A5: the main contribution of the Fund to strengthening standards in such areas as corporate governance lies in analyzing and identifying key vulnerabilities in the sector as well as addressing these in collaboration with the World Bank.

A6: we agree with the staff that at this juncture there is no need for adding new areas to the list of standards.

B1: We agree with the assessment of the staff on the important progress attained thus far in developing ROSCs and their linkage with surveillance.

B2: while there is a case for streamlining the standards initiative via enhanced selectivity of issues routinely pursued in surveillance, the criteria for selecting such indicators need to be clarified. Also, we strongly support the prioritization of ROSCs to cases with the highest degree of material vulnerability in the relevant policies and institutions. At the same time, there also needs to be a mechanism in place that ensures that the selection process does not give rise to moral hazard and adverse selection problems.

B3: We support the staff proposal to maintain the current practice of sharing draft ROSCs with the authorities.

Standards and Surveillance

We welcome the section of the report that explores the sustainability of the standards initiative, for it provides an appropriate framework for attuning the initiative to the pressing needs of the surveillance process and accordingly to greater prioritization of the relevant projects. In this respect we note that while in most of the cases, fiscal ROSCs do emerge as the most important exercise in the standards initiative, sweeping generalizations would prove to be misplaced, as the pressing needs of individual countries in the context of surveillance may necessitate extensive and detailed evaluations of other key vulnerabilities. In other words, the road-map of the standards initiative should be grounded in the trajectories of key priorities identified in the course of Fund's ongoing surveillance. Finally, we note that an important role in efforts to emulate international best practice and to foster greater harmonization of standards and codes should be accorded to regional institutions, including the regional technical assistance offices of the IMF, such as the AFRITACs.

Role of the Private Sector

We appreciate the information provided by the staff in Supplement 1 of the staff report on the feedback from the private sector concerning the usefulness of ROSCs. The staff report clearly highlights the key role of the private sector in rendering international standards and codes operational. A number of suggestions advanced by the private sector merit attention, most notably concerning the prioritization and updating of the relevant ROSCs. At the same time, we believe that the compilation of rankings of countries on the observance of standards and codes by the Fund (as indicated in SM/03/86, para 64) would lead to duplication with the private sector, given a veritable cornucopia of such projects and initiatives in the private sector (para 67 of supplement 1 lists several such cases). Furthermore, ratings agencies could also make their contribution in this sphere, which would also serve to operationalize the use of standards and codes by the rating agencies. Thus far, the role of rating agencies in expanding the use of standards and codes in the private sector has been modest at best. More generally, complementarity in the efforts of the Fund, its multilateral counterparts and the private sector in expanding and improving the use of standards and codes is crucial for attaining the goals of the standards initiative. This virtuous circle in the development of international standards by countries' authorities, the private sector and international organizations should guide further efforts of the Fund in developing ROSCs and other aspects of international standards.

Mr. Reddy submitted the following statement:

We welcome and appreciate this paper along with supplements of a detailed background paper and those relating to experiences with assessments of fiscal transparency, data modules and Reports on Observance of Standards and Codes (ROSCs). These well written papers provide a comprehensive picture about the Fund's experience, the major findings emerging out of these exercises and the resultant lessons. The important proposals for refocusing several features of the current efforts, as part of the general surveillance process are also found to be broadly well conceived and useful. It is quite thoughtful that this discussion on standards assessments closely follows the previous week's discussion on the review of Financial Sector Assessment Program (FSAP). As we have stressed earlier, these two aspects are very much closely interlinked. We would like to offer some general comments and observations before expressing our views on specific issues raised for discussion in the main paper.

General Comments and Observations

At the outset, it would be useful to consider at this stage of discussion the changing role of international standards in the current context compared to the situation in which this initiative was taken, in the aftermath of Asian financial crisis. Soon after the Asian crises there was an assumption that the dominant factor behind the crises was the fragility of the domestic financial system and hence the emphasis upon the development of standards and codes and importance of their implementation particularly in emerging and developing economies. There was also a second assumption that the advanced financial centers and markets had better standards and also compliant with them and hence, such standards can be codified for universal adoption. While there is no denying of the fact that better standards and practices by themselves can promote development of markets on healthier lines, the above two underlying assumptions have proved to be somewhat wrong, necessitating some refocus and reorientation of policy. More recent events have shown that the vulnerability and crises can occur even when the domestic institutions in some emerging countries were significantly compliant with the acceptable standards and codes. Therefore, vulnerability to crises and sources of crises are much broader in scope than mere compliance with a set of standards and codes. On the other hand, it has also become evident, that the standards developed in advanced financial centers or markets themselves are susceptible to fundamental weaknesses causing widespread market uncertainties and dislocation. In this light, we fully share the concern of Mr. Portugal and the risk for the Fund to perceive standards and codes initiative as something to be targeted at mainly developing countries, emerging markets and transition economies and at the same time reducing the pace and intensity of coverage of advanced financial markets and centers in industrialized countries. It would also be very difficult to conclude in a preconceived manner that emerging market countries are more vulnerable than developed markets and countries. In our view, for the reasons stated, this approach is misplaced.

Second, the development and implementation and monitoring of standards and codes are all important from the angle of developing financial markets on sound lines and there is a need to help this developmental process among all the economies in particular in less developed financial markets. As Mr. Wei pointed out during discussion on FSAP, the technical assistance in such areas should be extended to even those countries who have not volunteered to participate. Because of the weak relationship between standards and codes and country vulnerabilities and the private sector interests still not fully and strongly established, the developmental role of this initiative is much more important than its surveillance role. From this angle, the rationing of resources for this important activity will not be an appropriate goal. Given the importance of this activity, any constraints on budget should be resolved through alternative means of augmenting resources.

Third, there is need for changes in some of the standards and codes and hence the development of standards and codes is to be treated very much as an on going exercise. Also, the fact that the sources of crises have gone beyond the fragility of domestic financial sectors demands attention towards building up stronger institutions and codes of good practices at the multilateral/global levels promoting more effective surveillance and monitoring of international capital markets and flows. From this angle, we are very much encouraged by the discussion in paragraph 40, which addresses the gap in the existing tool kit of standards in promoting the international financial stability. In this regard, we do not believe that there are no new priorities for addition to the existing set of standards. We would like to emphasize that it would be useful to consider on a priority basis bullet point 3 viz., guidelines for multinational corporations, pension fund regulation etc., all of which involve extra-ordinary international cooperation in the development of standards. More particularly, this category involves cross-border transactions and market activities which remain less governed by any commonly accepted laws or statutes or even healthy conventions. While we agree that the available literature promoted by agencies and institutions like the United Nations, OECD and other international associations are useful, it becomes extremely important to bring these scattered ideas together and develop a set of codes and good practices. We would urge the IFIs along with the Financial Stability Forum to seriously consider them as thrust areas for further study and development. In this regard, we cite as a good example, of the efforts in respect of developing an orderly debt workout mechanism viz. Sovereign Debt Restructuring Mechanism and the related standard format for Collective Action Clauses and a code of conduct for market participants.

Fourth, as we have emphasized in our statement on FSAP, a discussion on the international standards assessment cannot be separated from the FSAP. The importance of both these exercises emanate from the common objective of promoting international financial stability and strengthening international financial architecture, reduce the likelihood and/or severity of financial sector crises and cross border contagion so that domestic financial sectors get sufficiently strengthened and the international cooperation and globalization process become smoother. In fact, it may be recalled that the FSAP paper also addressed issues relating to assessment of standards. Therefore, strategically, FSAP, standards and codes and ROSCs exercises should be considered together in terms of their benefits, cost and resources involved, to develop an integrated approach for appropriate follow up by the Bank/Fund. While we welcome the discussion on these different approaches, based on a set of comprehensive study papers, we strongly suggest that the staff should attempt an integrated strategy paper on all these issues for consideration by the Board, combining the discussions of last week and this week, as integral part of significant steps towards strengthening surveillance and crises prevention. We welcome the staff comments on this approach.

Last, we reiterate in relation to international standards assessments, the other important aspects stressed in the context of discussion on FSAP initiative, such as the need for taking into account the country specific circumstances, the necessity to follow a flexible approach in the selection of standards for monitoring purposes, and flexibility in the use of resources, and above all, the voluntary nature of participation and publication of reports by member countries in such programs.

Comments on Certain Specific Issues

As regards the objective of the international standards and codes initiative, while we agree that the emphasis inter alia could be upon reducing the risks of financial crises, even though we cannot eliminate them, the objective also should be, as far as possible, to eliminate the possibility of the same type of crisis being repeated. The lessons learnt from one crisis should be effectively used for preventing the occurrence of similar crisis. And crises prevention exercise should go beyond looking at mere compliance with a set of standards and codes.

The record of studies on assessment of international standards and ROSCs by both the Bank and the Fund are quite impressive. This is clearly evident from the increasing demand for standards assessment and ROSCs. This has naturally given rise to the issue of choice among countries and standards for prioritization. We very much welcome the discussion on the variety of ways in which such prioritization can be achieved, as discussed in the paper.

Apart from the quantitative record of progress, the quality of the assessments by the Bank/Fund staff is evident from the very critical findings of these reports summarized in Section II-B. The findings show some general weaknesses in critical areas. The findings also include weaknesses of governance of banks and inadequate regulatory and supervisory systems related to the insurance sector. It is revealing that standards for financial reporting, accounting and auditing are observed to be not sufficient and in the absence of robust regulatory framework, there are inadequate monitoring and enforcement. of even the available standards. This finding, which has become evident in even industrialized countries, has far reaching influence in the behavior of international markets causing pricing uncertainties and market dislocations. These findings are extremely relevant for working out a suitable strategy for surveillance of such activities, both at the domestic and multilateral levels.

We are also convinced by the spill over benefits of these exercises, in terms of added interest shown by the credit rating agencies, private market participants and above all by authorities themselves in identifying core areas for improvement and taking necessary steps. All these benefits must be kept in view, and should not be lost sight of, while planning to reorganize these activities on a sustainable basis in the medium term. We would like to offer a few comments on certain specific aspects covered, particularly from the angle of issues raised for discussion.

We agree with the observation that a better selectivity of country and also policy areas coverage could be made on the basis of feed back received from members themselves, and from Article IV consultations and the Country Economic Memoranda/Development Policy Reviews. But, we reiterate that industrialized countries are no exception, by any rule.

We also agree with the adjustment of intensity on frequency of follow up but, this should be done in consultation with the member countries concerned. Applying greater selectivity in updating may be useful. Here again, we would recommend that once a detailed assessment has been made, the updating could be taken by the member countries themselves in many respects. These updating are done in our perception, also as part of Article IV consultations. Staff may please clarify this.

As regards collaboration on assessment of standards with other institutions, particularly the major standard setting bodies, there is a need to strengthen this effort in a more qualitative manner, as part of taking an integrated view on standards assessments by BWIs. It is quite possible that the standard setting bodies may also involve themselves in peer reviews. They should be encouraged to bring about such assessments of the compliance as useful inputs for BWIs assessments. Where some vulnerabilities have been identified in select areas, the concerned standard setting bodies could make an initial assessment. While the rating agencies do take into account some standards and codes, there is no evidence to show that they are giving significant weight to the assessments made by IMF. The implementation problems have perhaps been seriously underestimated. There are legal aspects, institutional aspects particularly of regulatory nature, and policies and procedures. Many of these, particularly the way regulatory agencies function cannot be separated from the broader standards and governance. Perhaps, the assumption that the creation of regulatory bodies would improve over all governance may not be entirely right. However, the importance of standards and codes in the context of economic reform and improving the developmental infrastructure in many countries cannot be denied. However, each country has to have its own package, in implementing standards and codes and improving upon particularly in designing the sequencing. Another option is to encourage self-assessments or peer assessments before assessments by BWIs. On the whole, in the process of collaboration with other institutions and member countries and regional bodies, the BWIs should be viewed more as facilitators than as overseers or supervisors by attempting to concentrate in capacity building and harnessing expertise from a variety of sources.

We agree with the principle in paragraph 27, in that the ROSCs may come out with main conclusions and their significance and more explicitly also prioritize recommendations from the angles of transparency and candidness. But, at the same time it is important to guard against use of any extreme language and reporting should duly take into account the market sensitivities. Furthermore, we emphasize that the publication of these reports will continue to be voluntary and the draft of these findings should be circulated to authorities and if published, it should be along with the comments of the concerned member countries.

We endorse the proposal for including assessment of observations against the new RSSS as part of the ROSCs module for members with large and complex securities settlement systems. As regards the observation in paragraph 29, relating to technical assistance and the work on appropriate sequencing for implementation of standards, if there is continuing and genuine need from member countries, it is the obligation of Bank/Fund to cover these requests as part of Technical Assistance Program.

We fully share the view in paragraph 38, that in the current context, there are significant gaps in standards relating to accounting and auditing. This should be treated as a thrust area and added emphasis must be placed upon assessing these standards in major financial centers in major industrialized countries.

As regards new areas of emphasis for the development of standards and codes of good conduct, we reiterate our view expressed in the beginning of this statement that codes of good practices for multi national corporations, pension fund etc., the coverage of which are in the nature of improving the cross border transactions and activities requiring extra-ordinary international coordination and incentives, are required to be pursued by the multilateral institutions like Bank/Fund. This will go a long way in the promotion of the objective of orderly development and smooth functioning of international capital market. This could also help containing the current pessimism towards financial globalization and strengthen private capital flows.

As regards the modalities of integrating standards with surveillance, as we have observed in the beginning, we would welcome a comprehensive strategy paper combining the discussion on review of FSAP and international standards along with other parallel efforts for really taking an integrated view on international standards assessment as a step towards strengthening surveillance and crises prevention, and as part of improvements in global financial architecture.

Mr. Usman submitted the following statement:

We welcome the opportunity to review once again the experience of assessing and implementing international standards and to discuss next steps in this evolving area. We thank staff for the preparation of the informative set of papers and commend both Fund and Bank staffs for their effective cooperation and their efforts in producing more than 340 ROSCs since the launching of the initiative. However, we find that part of the information contained in the main report and in the background paper is duplicated and we, therefore, wonder whether staff could consider merging both reports into a single report for the next Board discussion.

There are indications that the international standards and codes initiative is positively contributing to promote the stability of the international financial system and to strengthen the functioning of markets and institutions by encouraging best practices, identifying potential weaknesses and improving transparency. To this extent, the examples presented in Box 2 of the main report and also in Box 2 of the background paper are well illustrative of how ROSCs are being effective in helping the authorities of different countries to address important shortcomings in their economies and to strengthen institutions in relevant areas. We observe the inclusion of Uganda in Box 2 of the main report and are pleased to note that significant progress has been made in the area of fiscal transparency and institution building since the completion of the first ROSC in 1999. In addition, our Ugandan authorities, are also currently addressing some other key recommendations contained in 2002 fiscal ROSC.

We also note that participation in the initiative has generally been increasing as about 90 country members have completed or are in the process of completing one or more ROSCs. Although participation across regions has been uneven, we note that several Asian countries have recently committed to a ROSC, which may certainly contribute to the adjustment of the current regional imbalance. Nevertheless, we believe that more industrial countries should avail themselves to participate in voluntary ROSC exercises. Indeed, industrial countries, particularly large economies, have volunteer less for ROSCs than any other cluster of countries. To this extend, we share Mr. Portugal's concerns that the ROSC initiative may be perceived as being targeting mainly developing countries, emerging markets and transition economies while reducing the intensity or the extent of coverage of industrial countries. In addition, we also share Mr. Portugal's views that the impact that the group of industrial countries can have on the world economy is much larger that of developing countries, emerging markets, or transition economies and it is important for these countries to learn and implement the best practices and lessons from the best performers. We, therefore, urge all large economies, including the United States and Japan, to volunteer for ROSCs, particularly in the areas of market integrity and financial sector.

As regards sub-Saharan Africa, ROSCs modules have been completed in 20 countries, which we consider to be an adequate coverage. More than half of these ROSCs were fiscal modules, a key area in the observance and building-up of transparency. We recognize the important role ROSCs can play in strengthening institutional capacity and providing an enabling environment for growth in African countries. However, it is imperative that ROSCs' recommendations be tailored to country specific circumstances to reflect the differences in country characteristics which mirror countries' level of development. Indeed, many of our country authorities have been expressing concerns that the implementation of the standards is arduous and costly. Moreover, limitations in institutional capacity is also an indication of limited human capital and technical expertise. To this extent, we are of the view that most African countries need adequate technical assistance to assist them address weakness identified in standards. We also believe that further work on the cost and benefits of the implementation of standards and on the appropriate sequencing of implementation is needed.

Regarding resource constraints, we strongly support the allocation of additional resources for the preparation of ROSCs. We also agree with staff that, at this stage, no further standard be added to the list of standards relevant for Fund work, as this will create additional budget pressures. Moreover, by cross-checking information from other reports, namely the report by the Task Force on MAE, one gets the impression that the use of additional resources in favor of the AML/CFT initiative is crowding out other important Fund work such as the ROSCs. Staff comments on this matter are very welcome. Meanwhile, in the event that a majority of members oppose an increase in the budget for ROSCs, we could go along with staff proposals for more selectivity in country and policy area coverage. However, we concur with Mr. Portugal and Mr. Daïri/Mr. Rouai's observations respectively that the criteria suggested by staff for prioritizing new ROSCs are incomplete and insufficient and that the priority based on material vulnerability in policies and institutions may put a stigma on countries agreeing to a ROSC and discourage voluntary participation. We therefore request staff to improve the criteria, in particular by establishing a more standardized and transparent framework.

Mr. Scholar and Mr. Joicey submitted the following statement:

Key Points

Standards and codes have had a significant impact since their introduction in the late 1990s: promoting strong policy frameworks, strengthening surveillance, and enhancing risk assessments;

the key challenge is to build on this success. We broadly support the staff's recommendations for achieving this and addressing the remaining weaknesses;

it is essential that all countries are able to participate in the standards and codes initiative. Technical assistance is vitally important;

given limited resources, it is also important to ensure that assessments are initially focused on those members and policy areas (in developed and developing countries) where they can deliver the greatest benefit;

we agree that ROSCs should give a clearer sense of the weaknesses and main conclusions, and identify priorities more explicitly. It is also important to distinguish clearly between the views of staff and the authorities. Structured follow-up is also essential;

enhancing standards on corporate governance, accounting and auditing, and promoting their take-up, should be a key priority for the Bank & Fund;

the codes will only be as effective as the quality of the assessment, so it is important that the effectiveness of ROSCs is regularly monitored as part of a broader assessment of the effectiveness of Fund surveillance.

International standards and codes have had a significant impact since their introduction in the late 1990s. They are a central part of the IMF and World Bank's work on strengthening crisis prevention and responding to the challenges of globalization.

At a national level, the codes and standards emphasize the importance for all countries of clear and sound long-term policy objectives; strong institutional frameworks in the public and private sectors; and greater transparency. The benefits of this approach are discussed in the staff report, but also Chapter 3 of the *World Economic Outlook* and the IMF's recent study on "The Effects of Financial Globalization on Developing Countries". The latter concluded that "the Fund's work in promulgating codes and standards for best practices on transparency and financial supervision, as well as sound macroeconomic frameworks is crucial" in helping developing countries derive the benefits of globalization.

At an international level, the standards provide a framework for strengthening IMF and Bank surveillance. Over 300 ROSCs have been completed over the last four years. They have become an integral part of our surveillance activities. And are increasingly helping to identify capacity building and technical assistance needs.

And beyond the IFIs, the report finds that large-scale financial institutions and market participants are increasingly using standards and codes to inform their investment decisions and improve their risk assessments. We welcome the outreach so far, and look forward to this being extended further.

The challenge now is to build on this success. The excellent staff reports bring out the main weaknesses and we broadly agree with the recommendations for addressing them.

First, the need to ensure that all countries secure the benefits from ROSCs.

We are still some way from achieving the original implicit target of enabling all countries to be assessed against all 12 ROSCs. Over half of IMF members still have to complete a ROSC module and there are strong regional variations in the take-up. Yet the report also highlights that resource constraints make it difficult to achieve this objective in a short time-frame.

The standards and codes process should be open and applicable to all countries. This emphasizes the importance of providing technical assistance to help countries follow-up the findings of ROSC assessments. We agree with staff that the Fund and Bank need to do more to address the concerns expressed by developing countries. The FIRST initiative and the Africa Capacity Building Initiative are useful developments. As they have demonstrated, this is an area where bilateral donors could play an important role. We welcome also the emphasis in the staff report on the importance of considering ROSC technical assistance alongside national technical assistance priorities and developing a country action plan.

Yet to maximize effectiveness, prioritization is also essential in conducting full ROSC assessments. As the staff suggests, there needs to be a mechanism to determine where and when a full assessment would be most useful. But it is important to ensure that the staff's specific proposals are consistent with the principles underlying Fund surveillance—namely the need to apply the same rigorous, objective and consistent surveillance to all countries.

One option might be for staff to use the Article IV staff report as an opportunity to consider the case for undertaking new or updated ROSCs: i.e., looking at whether a country has undertaken ROSCs; the case for undertaking them; and progress since any previous ROSC assessment.

Second, how to ensure that ROSCs are a useful tool for identifying and addressing vulnerabilities?

We agree strongly with the recommendations in the staff report that ROSCs should give a clearer sense of the weaknesses and main conclusions, and priorities more explicitly their policy recommendations. This prioritization should again be linked to the provision of technical assistance and capacity building—and should entail close collaboration between the Fund and Bank.

On the candor of the recommendations, the staff report notes that ROSCs (unlike Article IV staff reports) are shared with the authorities in draft. There is a case for this consultation, given the level of technical detail. But clearly this should not lead to negotiated recommendations or advice. We strongly support the proposal that the guidelines should be strengthened to emphasize that the staff should give their own judgments in the ROSC (and distinguish clearly between their views and those of the authorities).

Third, how to ensure the advice in ROSCs is acted upon and ROSCs are updated

As the staff note, for ROSCs to be a catalyst for change, countries must know that the steps they take to improve observance will be recognized in ROSC updates and communicated to the markets. ROSCs' usefulness to markets also depends on them being kept up-to-date.

We agree that, given the intensive resources needed for an effective follow-up report, prioritization is essential. We broadly agree with the staff's proposals for adjusting the intensity and frequency of follow up, although it will be important to implement this pragmatically.

Fourth, how to promote enhanced standards and principles on corporate governance, accounting and auditing, and stronger national practice in these areas.

The IMFC emphasized the importance of enhanced standards last September. Indeed, given the economic and social impact of recent corporate governance failures, these standards should be central to the ROSC process. The Fund and Bank should therefore play a leading role in promoting their development and use, working closely with the standard setting bodies.

Fifth, the case for extending the coverage of ROSCs

We believe there is a good case for developing a standard based on the Fund-Bank Guidelines for Public Debt Management, although the potential cost also needs to be considered. Staff comments would be welcome. In other areas we agree with staff that there is no need to develop new ROSCs.

Conclusion

Finally, the codes will only be as effective as the quality of the assessment, so it is important that the effectiveness of ROSCs is regularly monitored as part of a broader assessment of the effectiveness of Fund surveillance.

To sum up, we strongly welcome this staff report and broadly agree with its recommendations. We were surprised, however, at the report's conclusion in para 44 that: "For the initiative to remain viable, ambitions will need to be scaled back". The proposals set out in the report build on the significant achievements over the last four years. The report sets out an ambitious but realistic agenda for further reform.

Ms. Jacklin and Mr. Epstein submitted the following statement:

Summary

We welcome the opportunity today to review the progress in the Standards and Codes Initiative. The memoranda were particularly clear and well-presented. At the outset, however, we would like to note that we view these papers as a companion report to the FSAP report we discussed last week, and that in our view it would have been more useful and efficient to consider the two reviews in one Board meeting.

Reports on the Observance of Standards and Codes (ROSC) have made a substantial contribution to IMF surveillance, World Bank development work, the strengthening of financial systems in many countries, and more efficient financial markets. We broadly agree with the series of recommendations proposed by the staff. In terms of the Fund's operational focus, the process has contributed to the strengthening of data, fiscal, monetary and financial policy transparency as well as banking supervision, and those areas that are assessed mainly under the joint Fund/Bank Financial Sector Assessment Program (FSAP).

While we accept the need to prioritize ROSCs due to resource constraints, we would not like to see this result in a failure to conduct ROSCs on payment systems, securities regulation and insurance supervision in those countries where risks and vulnerabilities may exist. Inadequate institutions and regulation in these areas can have adverse effects on financial systems and the economy.

As of end-2002, 343 ROSCs have been produced for 89 countries, of which 63 percent have been done in the context of the FSAP, while the remaining ROSCs have been completed as stand-alone modules. This is a huge undertaking. We should continuously evaluate the use of resources in the ROSC exercise to ensure that benefits exceed costs.

Surveillance

One key benefit of the development of ROSCs is to provide more objective components of surveillance reviews. This also lends a degree of consistency and reduces elements of discretion in surveillance. The same benefit of greater objectivity flows from the newly developed debt sustainability analysis. We therefore also look forward to PDR's proposals on a Vulnerability Assessment (where ROSCs can also play an important role).

The staff notes that payment systems, securities regulation and insurance supervision ROSCs have not made significant contributions to IMF surveillance, while other ROSCs (such as banking supervision and the three IMF-issued codes) have on several occasions helped Article IV consultation missions identify key issues relating to macroeconomic stability. This appears to us to be an implicit rationale behind the proposal to reduce the scope of the FSAP and to limit ROSC updates to banking, fiscal, data, and monetary and financial policy transparency (MFPT) ROSCs, all of which are of course very important. But, while past financial crises have generally not been caused by events relating to ineffective securities regulation, payment systems or insurance supervision, we feel it would be unwise for the Fund to relax its guard in respect of these potentially important areas of vulnerability in some countries and areas in which sound development is important for deepening local financial markets.

As we noted during the recent FSAP discussion, we discourage any arbitrary reduction in the scope of that program. Similarly, we believe there is a need for continued attention to ROSCs and ROSC updates on the standards associated with the Committee on Payments and Settlements Systems (CPSS), International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS). Both the Fund and the Bank should include outside experts, as needed, on these assessment teams, and Article IV consultation missions ought to more closely consider the implications of these sectors and their associated standards on macroeconomic stability in appropriate cases.

Participation and Sequencing Issues

We agree with the assertion that "priority for new ROSCs [should] be the members with material vulnerabilities in the policies and institutions covered by the standards initiative". However, we note that despite APEC's relatively early response to the standards initiative, Asia is lagging behind in ROSC participation. China (excluding Hong Kong), Malaysia, Indonesia, and Thailand are among those countries that have not yet participated in any ROSCs, and where the benefits to those economies and to regional and international stability can be significant.

The staff report refers to China and the United States as two countries that have failed to volunteer for an FSAP review. Our commitment to full participation in this initiative is strong. Nonetheless, given resource constraints and the number of countries seeking these valuable assessments, we will defer our request.

We note that the U.S. fiscal ROSC is nearing completion.

Universality and Applicability of Standards

The staff report notes that market participants have urged increased clarity, wider coverage and comprehensiveness, but also states that authorities prefer focused comments on shortcomings. We stress that these audiences are both important, and encourage the staff to make sure each ROSC can be used both by country authorities to identify gaps and by third parties to better understand to what degree countries have implemented the standard.

We view the data transparency standard as a key component of the ROSC initiative in which the authorities can directly benefit from strengthening their policy management. Sound and comprehensive data collection and transmission are essential for effective policy implementation. Moreover, the SDDS is an important vehicle for countries to publish available data, and we continue to support further implementation of comprehensive, high quality, and frequent data production through these standards. In the latest Global Financial Stability Report, disproportionate focus was placed on the United States. This was stated by the staff to be due to the comprehensive and timely data we produce relative to other countries. This reinforces the need for others to attain the higher standard.

Finally, under the current voluntary publication standard for ROSCs, countries have chosen to publish only 70 percent of completed modules. As we noted at the FSAP review, we would also encourage a policy of presumed publication of ROSCs. This will increase the amount of information available to market participants and the public, thereby helping to build national consensus for the reform process and lead to more efficient markets.
The Director of the Policy Development and Review Department

The Director of the Policy Development and Review Department (Mr. Geithner), in response to questions and comments from Directors, made the following statement:

This review was a relatively positive assessment of the initial experience with this initiative. The principal recommendations of the review, are three: first, that we adopt a somewhat more selective filter for assessing the best use of the resources across countries and standards areas and follow-up mechanisms; second, that we design a more viable strategy for follow-up; and finally, to build on recent progress to try to ensure that assessments are as focused, and recommendations are as clear and prioritized as possible.

There are several sets of questions to which I should respond at the beginning. First, let me say something about the assumptions that underpin the exercise at a general level and that are relevant to resources. Our operating assumption was to look at how to make this work within the existing resource envelope, how to make more efficient use of the existing resources with some capacity for reallocation across the various strands of the initiative. That premise was based on a judgment that the existing level of resources seems broadly adequate for meeting the requests that we anticipate for assessments and follow-up, and broadly adequate to meet the objectives of the initiative.

There is a significant pipeline of requests for new assessments, and it is our judgment that we have the capacity within this existing resource envelope to meet those requests within a reasonable period of time. Within this resource envelope we can significantly expand country coverage and standards coverage over time. As a result of this, we are not offering the Board the prospect of any significant cost savings as a result of the proposals, nor are we recommending or do we see the case for recommending any increase in resources at this stage.

Second, on the broad question of the allocation of resources between initial assessments and follow-up, the slight shift in trajectory that we are proposing would envision a modest reduction in initial assessments and a moderate commensurate increase in resources devoted to follow-up work. That conclusion rests on a couple of judgments. One is, of course, that the stock of initial assessments grows over time. Therefore, it makes sense that there be some shift in resources from initial assessments to follow-up. However, it also rests on the judgment that it is important that we have the capacity for follow-up so that we can continue to provide advice and assistance to countries who are seeking to take action on the recommendations that came out of these assessments, but also to make sure that countries have a vehicle for demonstrating progress after there has been an initial assessment, particularly an assessment that identified weaknesses or areas for change.

There was a set of questions and concerns raised about our proposed framing of the device for prioritization. Our objective is to ensure that the resources that we deploy in this context are deployed where they can be most effective in terms of the returns on domestic and international financial stability. That is our objective, and we want to try to find a balance that reflects that basic objective. It is true, and very important to state again, that we need to have the capacity to assess the major economies where there is a basis for concern about aspects of the institutional framework that could have systemic implications, and that objective is encompassed in, and important to, the proposed filter which we laid out in the paper.

There was a set of questions about whether one could assess or define material vulnerability. We did not anticipate trying to offer a definition of material vulnerability. We take note of the concerns raised that that particular framework could be stigmatizing, and it would be important to avoid any such implication. In the same context, there was a question raised about how we would know whether there was a material vulnerability or some institutional gap without having undertaken a full assessment. That is a reasonable concern as well. We can rely on two things at least. One is that we have requests from our members, and sometimes those requests come with an acknowledgement that they see value in the assessment in this context, not necessarily because they are concerned about shortfalls or institutional weaknesses, but often because of that. We also have the knowledge that comes from sustained engagement with the membership of the Fund, and that gives us some capacity to make a judgment, too, about where these resources could best be used.

There were some questions about what we are proposing for follow-up mechanisms and how they relate to the Article IV consultations. At a general level, we envision three types of follow-up mechanisms: brief factual updates, somewhat more in-depth selected updates, and reassessments. The first two of these would be done in the context of the Article IV consultations. The third would be done in a context more similar to that of initial assessments, although our objective is to make sure that these provide input into the surveillance process over time.

There were several questions about when the Board would be exposed to the analytical work that the staff had undertaken on the benefits of transparency and the benefits of adherence to standards and codes. We have two papers in train, which are forthcoming soon. Rather than foreshadow the conclusions of those papers, I would like to leave it to the papers themselves.

Finally, there was a question about whether we could elaborate on the reference that we made in the paper to strengthening our internal procedures with regard to prioritization. At this point I would just like to say that there are mechanisms that have been in place for some time such as the TAMS process. We are looking at ways to make sure that those approaches work as well as they can and that they serve us as a device for making sound judgment as we look at requests across countries and at the judgments of area departments with regard to priorities. We are looking for ways to ensure we make judgments that makes sense across the membership of the institution and that balances the broader objectives to which I referred initially.

The Deputy Director of the Statistics Department (Mr. Enoch), in response to questions from Directors, made the following statement:

TAMS is the Task Force on the Assessment and Monitoring of Standards and it is an interdepartmental group which meets every month. It brings together the functional departments conducting the ROSCs, the area departments, and PDR and other interested departments. It reviews each month the prospective program for ROSCs and discusses issues concerning ROSCs, such as the process for updating and different forms of updating.

There were questions on technical assistance demand arising from ROSCs. We would expect that demand for technical assistance under the standards filter will continue to increase possibly substantially, in part because the technical assistance follow-up is increasingly seen as an integral part of the ROSC process, in part because the stock of ROSCs is rising, and in part because standards and codes are increasingly seen as a valuable framework within which to set a technical assistance program. As an example, from the Statistics Department, we estimate in the present financial year that 57 percent of our total technical assistance delivery will have been in support of standards and codes. This, of course, is not all ROSC-related, because much of it derives directly from countries' work in the context of their SDDS subscription or their GDDS participation.

On the question of how much excess demand there is for standards-related TA, although there is substantial overall excess demand for TA, all departments performing ROSCs put a high priority on TA, related to standards and codes initiatives in line with the Board discussion on technical assistance in 2001, because of the high priority that we attach to it and also because of the availability of external financing for this form of technical assistance. I There is not very much turned-down TA, which is in line with the objective of furthering standards and codes.

Mr. Daïri explained that he had noted in his statement that it would not be appropriate to indicate that priority would be given to countries with significant vulnerabilities, because of the risk that—similar to the CCL—a stigma would be associated with the conduct of ROSCs, which in turn could prevent countries from volunteering for the exercise. That would not benefit the world economy at all. Therefore, instead of focusing on countries with existing vulnerabilities, it is better to refer to areas of potential vulnerabilities. It was clear that in all major markets, there was potential for vulnerabilities in the insurance system, the pension system, the securities market, and, more generally, the financial system. These vulnerabilities could pose risks to the country concerned and to the world economy; and the Fund's priorities should be refocused accordingly.

Mr. Portugal asked whether staff and management accepted the two additional criteria that he had suggested in his statement and which had received substantial support from a number of Directors, namely that countries where developments could have an impact either on the region or on the entire world would be considered as high priority areas as those with material vulnerability. Furthermore, best performers should also be considered as priorities, with the objective of learning from their experience. If the staff accepted that proposition, it should be reflected in the summing up.

With regard to the substantial pipeline of requests for ROSCs mentioned by Mr. Geithner, Mr. Portugal wondered whether the staff could provide a specific number on those requests, and on requests for technical assistance. It was important to know the overall demand, and the number of requests that had been turned down. While the staff had indicated a percentage, it would be useful also to know the absolute numbers.

Mr. Lombardi made the following statement:

> Introduction
>
> We strongly welcome the opportunity of discussing the experience gathered so far on International Standards and the way forward. We want to commend the staff for producing a very detailed, informative and helpful assessment.
>
> At the outset, let us state that we share the thrust of the staff appraisal and therefore limit our comments to the following remarks.
>
> Integrating International Standards into Surveillance: a Two-Way Feedback Mechanism
>
> ROSCs reflect the growing relevance attributed by academia, policy-making and the Fund itself to the importance of institution- and capacity-building in delivering high and sustainable growth.
>
> Though the experience gathered so far is broadly positive, there are some areas for further improvement. One is definitely how to integrate

ROSCs more effectively into the surveillance framework. We largely see it as a two-way feedback mechanism: on the one hand, surveillance should help to focus on the most vulnerable and critical areas in the policy framework of a member country, thus identifying the need for a thorough assessment to be pursued by the appropriate ROSC module. On the other hand, the assessment following a given ROSC should help to inform policy discussions with the relevant authorities.

In this setting, for ROSCs to be effective in enhancing surveillance, the assessments need to be clearer about weaknesses in the areas under scrutiny, blunter when shortcomings are serious, more explicit on the magnitude of nonobservance.

We agree with the staff's views that the assessment on a given module should more clearly reflect that of the staff and should be kept distinct from the authorities' view, which could be expressed in a separate document. However, this should not prevent staff from sharing the technical aspects of the draft with the relevant authorities to save on resources and to ensure greater accuracy.

Another aspect on which we would like to insist is the prioritization of recommendations. This is necessary in order for the authorities to have more effective advice on which reforms need to be pursued first and also for the staff to know where surveillance should focus following a ROSC assessment.

A resulting implication of integrating ROSCs into surveillance is that we need to have follow-ups as well. This is crucial for the staff to assess the quality of the efforts put by the authorities in addressing weaknesses. By the same token, follow-ups would provide the same authorities with important feedback in terms of where they stand with regard to a particular issue.

International Standards and Technical Assistance

We believe there is a further scope for integrating ROSCs and technical assistance. For instance, prioritization in ROSC assessment would help to deliver more focused technical assistance. Meanwhile, we welcome that ROSCs have been used as filters for prioritizing technical assistance. We encourage staff to further pursue this avenue also in order to provide members with greater incentives in undertaking assessments of standards and codes.

We are pleased to see that greater coordination with the other agencies that provide technical assistance has been achieved and we welcome those initiatives like FIRST and Afritac, which will increase both coordination and delivering of technical assistance. In this context, we note that the papers do not mention bilateral contributions that some countries have made available to the IMF precisely for the purpose of providing technical assistance for standards' implementation. We believe that although small in size, such contributions are worth mentioning. (FYI: Italy established a $2 million technical assistance Sub Account in Nov 2001)

International Standards and the Private Sector

We regard the private sector as one of the main beneficiaries of ROSCs and we are pleased to note that the feedback available so far has been generally positive. We also appreciate that Staff have carried out some analytical work documenting the impact of ROSCs on selected member countries.

We commend staff for their outreach efforts, but we feel that much more can still be done. With this in mind, we encourage the staff to make ROSCs more user-friendly, by increasing their timeliness, providing updates and by streamlining and focusing their assessment.

However, for a dialogue with the private sector to be effective, there should be a two-way feedback mechanism also in this case. We welcome that the private sector is asked to provide constructive feedback on how to strengthen and improve the assessment of standards and codes by the Fund.

Market Integrity Assessments

We commend the World Bank staff for their commitment in delivering more assessments on market integrity by raising the number of related ROSCs from 16 to more than 30 in the forthcoming FY.

As we know, the Fund staff have started to provide Safeguard Assessments on relevant member countries' central banks, focusing on issues related to governance, accounting, and auditing. Though central banks have peculiar features in some respects, we wonder whether the experience gathered by the Fund staff could be of any help in performing market integrity assessments. Staff views would be welcome.

Concluding Remarks

Judging from the initial response, we should expect an increasing demand for more assessments in the future. In this respect, we would like the staff to cooperate with other multilateral institutions to ease resource constraints. Along these lines, the cooperation agreed upon between the Bank and the IDB on market integrity assessments is a very welcome step.

Finally, the results described by the staff point to the benefits of publication and, conversely, the adverse effects of lack of publication. We support a more open publication policy and we share others' view that we should move towards the presumption of publication.

Mr. Faulend made the following statement:

We thank the staff for a well-written set of papers, and also the staff who do the field work, as they are responsible for making the initiative a useful diagnostic tool in practice. I welcome the Board discussion on the issue, which is timely, especially given the tension between the increasing demand for ROSCs, on the one hand, and limited resources, on the other. Therefore, the increased demand is a positive development, and it is the best indicator of ROSCs' success.

Before commenting on particular issues, let me say at the outset that I share the thrust of the staff's main findings, and I support their main proposals. Having said that, I do see room for further improvement. The staff has articulated several issues that could help in this respect and, in my view, they could be divided into two broad categories or sets of issues. The first set of issues is the one which deals with measures that might improve the quality of ROSCs, per se. The second set would include issues that should make the whole initiative viable. These two sets of issues will be the focus of my comments before touching on the experience with ROSC publication.

To start with the first set, the ones that are attendant to improve the quality of ROSCs, it was striking to learn that only one third of ROSCs gave a clear sense of the main weaknesses and their significance, as well as prioritization of recommendations. I also noted the staff's argument that clarity could be affected by the usual practice of sharing draft documents with the authorities. Although this could indeed be the case in theory, it does not have to be a problem in practice. I note, for instance, the case of safeguards assessments whose drafts are also shared with the authorities but do not affect the clarity of documents and neither the prioritization of recommendations in them.

Against this background, I would like to underscore that sharing draft ROSC documents with the authorities should remain the practice, particularly in light of their technical nature and the consequent need for greater dialogue between the staff and the authorities. However, such a practice should not be claimed as a reason for less clarity. Thus, I would urge the staff to improve clarity as well as prioritization of recommendations, and perhaps for this purpose safeguards assessment documents may serve as a reference or a roadmap. In the same vein, I would very much welcome if each ROSC document would include a clear summary table, articulating and identifying institutional weaknesses, the significance of each weakness, and prioritized recommendations. Finally, let me point to an additional element crucial for prioritization of recommendations in particular, and that is good cooperation and coordination between the staff of area and functional department.

Turning to the second set of issues, one that hopes to make the whole initiative viable, I completely agree with the staff that it is time to start prioritizing new ROSCs and their reassessments. In this context, my understanding is that staff intends to work further on developing a more systematic mechanism for determining when a standards assessment is important for Fund surveillance, and I support this approach in full. Nonetheless, the staff's proposal for the short run that the priority for new ROSCs could be given to members with material vulnerabilities, including where those vulnerabilities would have systemic ramifications, seems reasonable, too, and it deserves support. Having said that, I do see merit in including in all Article IV staff reports an indication of those areas in which a standards assessment would be most useful. I do not see this as being particularly burdensome for the Article IV consultation process.

However, the intention to decrease the frequency of stand-alone reassessments and follow-ups in general by putting an additional burden on the Article IV consultation process could end up in overburdening the process, at least in certain cases. Having said that, although I see merit in such an approach in principle, I do have some concerns. In particular, we have a number of countries under arrangements and in such cases, the Article IV consultation cycle is usually longer than 12 months. Furthermore, it is not unusual that for these countries Article IV consultations are combined with UFR missions, which might imply that the additional burden could be too demanding for the staff. On the other hand, the authorities might be willing to see a reassessment as soon as possible, once corrective measures have been enacted. Hence, this approach requires further consideration in my view, or at least it ought to be applied with caution.

Finally, I wanted to comment on our experience with ROSC publication, in particular on the private sector's reaction. The survey shows that all respondents that were aware that the country had undertaken a ROSC but chosen not to publish it would negatively affect the appraisal of the country. At first glance, this finding seems to be a self-encouragement in favor of publication. The only question is whether it is possible to receive a positive reaction from the private sector for having the courage to undertake a ROSC even if the standards assessment is not a positive one. Perhaps there is a successful strategy to cope with this, and I would appreciate the staff's comments in this respect. In particular, I would welcome if the staff could quote some real cases, if there are any.

In concluding, let me link this issue with the market acceptance of ROSC documents, and raise my vote for further encouragement of the use of ROSCs among market participants.

Mr. Beauregard made the following statement:

We thank the staff for a well written set of papers for today's Board meeting. The topic for today's discussion is of utmost importance since international standard and codes have become, in a relatively short period of time, a key element in the surveillance role of the Fund. As noted by some Directors, standard and codes have played a fundamental role in assisting country authorities in further advancing in the implementation of sound and internationally recognized practices.

We join Ms. Jacklin and Mr. Epstein in their recommendation that these papers could have been merged with the FSAP review, even more so when 63 percent of the ROSCs produced have been done in the context of FSAP reviews.

Before commenting on the issues for discussion, I would like to offer our views regarding some of the opinions expressed in the preliminary statements.

As we stated last Friday when we discussed the Financial Sector Assessment Program, we think that ROSCs, like FSAPs, have increased their popularity in an impressive manner. As mentioned in our preliminary statement on FSAP reviews, a key element in achieving this result rests in the ROSCs' nature as voluntary assessments and the fact that they have been applied in an evenhanded manner across the membership, hence minimizing the risk of "negative signaling". This being said, like Mr. Daïri, we are concerned that some of the criteria mentioned by staff for assigning priority to conduct new ROSCs are the existence of "material vulnerabilities in the policies and institutions covered by the standards initiative including where those vulnerabilities would have systemic ramifications". By adopting these criteria, we might be creating a negative signaling problem, hence scaring potential candidates to request ROSCs. Furthermore, as stated by Mr. Yagi and Mr. Miyoshi, "if the markets come to believe that the Fund is focusing on such countries in standard assessments, it could adversely affect the market's country risk evaluation". We thus think that caution should be used in using these criteria so explicitly, although I agree that at some point of the discussion these criteria would have to be applied. We also support Mr. Portugal's suggestions regarding additional criteria to be used by staff to identify potential candidates to request ROSCs.

I fully share other Directors' concerns that, in practical terms, this approach seems to be targeting mainly developing countries, emerging markets and transition economies. Furthermore, staff is now recommending reducing the intensity or the extent of coverage when ROSCs are applied to industrial countries. Given the impact of these countries in the global economy, we would have welcomed a higher participation of advanced countries in the ROSC process. In this regard, we would like to commend the United Kingdom and Canada for setting the example among G7 countries. As noted by Mr. Scholar and Mr. Joicey, "the standards and codes process should be open and applicable to all countries".

Many colleagues have raised the point that given the good results achieved with this initiative, it would be convenient to increase the amount of resources attached to this program. We fully share this view and we would like to stress a point made by Mr. Portugal, that if additional resources are not available, then an alternative would be to curtail reassessments and updates, rather than curtailing initial assessments. This way, all member countries would have the opportunity to participate in this important assessment process. Updates could be done in the context of Article IV consultations, and reassessments would then be limited to those cases where substantive changes have taken place. But the emphasis should be that all countries participate in this process.

The main goal of ROSCs should be to help country authorities identify vulnerabilities and possible avenues to correct them. The use of ROSCs by market participants and analysts should be encouraged further by the Fund. In this regard, I fully associate with the views expressed by Mr. Le Fort and Mr. Pereyra that ROSCs could play an important role in enhancing investor discrimination; but to achieve this goal, publication of ROSCs seems to be a necessary condition. We also encourage staff to broaden the section in which they analyze the extent to which ROSCs are being used by analysts and market participants, and to provide more evidence that ROSCs really make a difference. This could be used as an important incentive to member countries that have not yet participated in this process.

Issues for Discussion

The staff proposes that ROSCs give a clearer sense of the weaknesses found in the assessment. If this means that ROSCs would highlight only the vulnerabilities found in the assessment, then I can not agree with staff's proposal. Staff will find both vulnerable areas as well as areas where progress has been achieved, and both need to be included in the final report in a candid way. I fully share the concern of many that staff should make it explicit the areas where reforms are needed and their recommendation regarding the sequencing of reforms. Closely linked to this area, I concur that for many countries, Technical Assistance is crucial to further work on the implementation of the reform process.

Given the resource constraint the Fund faces, we share staff's view that it would not be viable to extend new areas to the list of standards. We also support that the Fund should focus on the areas of highest priority so as not to overburden Article IV consultations during ROSC updates. This will also help to use the Fund resources in a more efficient way. We agree that Bank staff should continue to take the lead in assessing standards concerned with market integrity, as well as their follow up, including for the advanced economies. Similarly we coincide with staff that other international agencies could be asked to produce or collaborate on ROSCs and their updates. Finally, we agree with staff that it is essential that they share draft ROSCs with country authorities. As mentioned by staff, given the technical nature of the issues, this provides a good opportunity to ensure accuracy. As noted by Mr. Scholar and Mr. Joyce, this process should not lead to negotiated recommendations, and in order to avoid this, I concur that the reports should distinguish clearly between the views of the authorities and those of the staff. We support that the Fund and the Bank work together to develop updated standards on corporate governance, accounting and auditing. Given the recent experience in this area, this work seems to be urgent.

Mr. Callaghan made the following statement:

I took note of what Mr. Geithner said at the very start of the meeting but, rightly or wrongly, I thought one message that seemed to be coming from this paper is that the ROSC initiative has to be scaled back. I think it is always interesting to look at the headline that is in the staff policy newsletter, the Current Account, to see what is the main message or the main message the staff thinks is in the paper. The headline in this week's Current Account is that the staff says ambitions must be scaled back.

Now, I think we have to ask ourselves whether this is the message that we want to convey, that we want to scale back on the ROSC initiative. We discussed external communications a week or two ago now. When it comes to communicating messages, I do not think that is the right message. More generally, I think that what has been coming out of some of the comments that are in the preliminary statements is that we do seem to have a bit of a problem with some of the messages coming from some of the words in this paper. Words are very important and we are all interpreting them slightly differently, so I think we need to look very carefully at how we are expressing things.

But I think a more important difficulty I had with this paper was in trying to work out what exactly the proposals actually mean in practice for the membership and, in that sense, I thought that was the thrust of Mr. Portugal's comments in his preliminary statement. ROSCs seemed to be working well, and demand certainly has grown very strongly, although it is still 47 percent of the membership that has undertaken any ROSC module at all and only 33 percent of non-market access economies have had any involvement with ROSCs. So, it is against that background that I do not think the message should be that we want to scale back on a program that is working well, but remains to be extended to the majority of members.

Furthermore, there is a tension between our promotion of the initiative as an important part of crisis prevention, and this message of wanting to scale back. We have been promoting the use of ROSCs as a symbol of a country's implementation of standards, and this is shown in the Fitch ratings 2002 report on transparency and disclosure surveys. It is working. We are getting ROSCs used by market participants. In doing so, we have created a demand for ROSCs to allow countries to demonstrate that they meet international standards, because this has a positive impact on risk assessments. But now we are proposing to scale back.

Paragraph 43 of the main paper says that the implicit target for the ROSC assessment process is that most members would ultimately, and I think the emphasis has to been on ultimately, be covered by ROSCs in all 12 areas. The paper goes on to say, however, that staff believe that such a target, when considered in light of requirements for a sustainable initiative, is too ambitious. Is the paper saying that it is too ambitious to ultimately be in a position where most members of the Fund could be covered by ROSCs? If we thought it was reasonable to aim for ultimately most members being covered by ROSCs before, why is it now considered excessively ambitious? Sometimes it is good to have ambitious objectives, but the real issue is quickly we attempt to realize these. I think that is the point that is raised in Mr. Scholar and Mr. Joicey's preliminary statement.

I think that this already has been recognized. As noted in paragraph 43 of the paper, it says, in meeting this target the Boards have recognized the need for flexibility and prioritization in the production of new ROSCs, and this certainly came out of the discussion we had in January 2001 on ROSCs. Yet, again, the paper goes on to say, for the initiative to remain viable, ambitions will need to be scaled back. I thought it was more a case of whether we can accommodate the current rate of growth of ROSCs, should this pace be sustained. Certainly, it has grown very strongly: 51 ROSCs completed in 2000; 61 in 2001; 106 in 2002; and 127 planned for 2003. I thought the issue was can we satisfy the demand we have created. I also thought that the main point that was coming out was, have we made sufficient allowance for the resource costs of doing timely updates on ROSCs, for updates are essential.

The paper says that in scaling back ambition, several parameters need to be adjusted. Key issues in this regard are the need for strict prioritization of ROSCs and follow-up within the resource envelope. However, as already noted, recognition of the need for prioritization is not new. In the January 2001 review of standards, the Board talked about the need for prioritization in undertaking ROSCs and focusing ROSCs on country needs. The existing operational guidance note says, area departments, in consultation with appropriate functional departments, are responsible for identifying which of the agreed standards are relevant, given the circumstances and stage of development of a particular member. The operational guidance note refers to the need for prioritization in the preparation of ROSCs, and the step-by-step guide for staff says that an annual ROSC plan is established setting out which countries are priorities for ROSCs as agreed between area and functional departments. You would think that such a plan would already have regard to have available resources, so the issue then: what is new with the current focus on prioritization?

Perhaps one thing that is different in this paper is that it talks about focusing ROSCs for members with material vulnerabilities. This is another term, I think, that is causing a lot of difficulty, and the messages seemed to be mixed. I certainly share Mr. Portugal's concern over this expression of material vulnerabilities and the stigma that may be attached to it, something that Mr. Beauregard has already highlighted. By proposing that we narrow ROSCs to countries that are seen to be crisis-prone, if that is what the interpretation of material vulnerabilities means, we would seem to be changing the nature of the program and could, in fact, deter countries from participating due to signaling effects being placed in a vulnerability category.

I think we do have to provide some clarity on this issue. It is very important, because the problem is putting whatever we say now into practice, putting it into operational guidance notes, making it effective. In this regard, the management of the process is critical; the guidelines must be applied. When it comes to determining priorities, I think the starting point should be that we should ask what is in the best interest of members; what are members' needs, which members can get the most out of it, and which members will get the most out of it relative to each other. I think this is the way to approach it rather than starting to introduce some vaguely specified filter, and certainly one that starts raising misconceptions and people interpreting it in different ways.

Another conclusion that comes from this paper is that, after the rapid growth in ROSCs, we are now proposing to put a cap on the number of new ROSCs of 127 per year, for the next five years; that is the number expected to be completed in 2003, and this is what is outlined in Supplement 4 of the paper. A number of Directors have raised this question of resources and the resources that should be applied to undertaking ROSCs. There are two ways we can approach this. We can start from the demand side, what is the current and expected demand for ROSCs to determine what level of resources would be required to meet this demand, and then make an assessment of what is the most effective use of resources given competing demands, and decide the amount to be allocated to undertaking ROSCs. This is something that you think would be part of our standard budget approach to the budget.

Alternatively, we could start with a given resource constraint or a given resource envelope and say, how are we going to accommodate ROSCs within this resource constraint, and that is the approach that the paper has taken. We are all living within a resource envelope and resources are limited they certainly have to be prioritized. We have to decide, first, what is the appropriate size of the resource envelope. To answer this question, we do need some indication of the extent of the expected demand for ROSCs and the implication to members if we scale back our ambitions, as proposed. We need to take into account the competing demands and resources.

Ms. Jacklin and Mr. Beauregard have already raised this question of the relationship between ROSCs and the FSAPs. In the paper we discussed last Friday, we proposed or we agreed to reduce the number of ROSC modules undertaken in FSAP reviews from five to three, and I see in the most recent quarterly report on ROSCs that approximately 70 percent of ROSCs are undertaken in the context of FSAPs. So, I was a bit surprised that this issue and this relationship between what we have decided on FSAPs and ROSCs is only noted in a footnote, or mainly noted in Footnote 41, which says that this will have a marked impact on the growth in the stock of ROSCs. But the proposal is to stick to 127 ROSCs per year. I am trying to work out how that fits in if we are going to have a marked impact on the growth of ROSCs via the decision we have taken on FSAP reviews. Also, I did not quite understand that if we are trying to make resources available for doing follow-ups, then where will they come from if we expect the number of new ROSCs to stay at 127 per year. Perhaps I might be interpreting what is in Supplement 4, too, literally, but I would appreciate it if staff could try and give a little bit of what exactly are the implications of what we are deciding in terms of the decision on the FSAP, what it means for ROSCs, and where the resources are all going.

On the question of the role of ROSCs in surveillance, this paper, as with past reviews, says that standards assessments are increasingly integrated into Fund surveillance. I do not know how we reconcile this statement with the finding that only in one third of the cases did a ROSC module raise issues considered important to macroeconomic objectives and policies, because I thought that was the heart of surveillance. Moreover, only 5 percent of securities insurance and payments system ROSCs raised issues important for surveillance, and it seemed particularly surprising that only 11 percent of monetary and financial policy transparency ROSCs raised macroeconomic issues.

In addition, the paper states that ROSCs for industrial countries generally did not raise issues with macroeconomic implications and this is why they were not integrated into Article IV staff reports. Yet, if I go back to the operational guidance note it says that all ROSCs should be incorporated in the Article IV staff report. To quote, the main findings of ROSCs need to be discussed in the Article IV staff report. The guidance note also says that ROSCs should be limited to 10–15 pages, and yet we see ROSCs in excess of 150 pages. Another surprising result from the paper is the finding that only 32 percent of ROSCs gave a clear indication of the priorities among the recommendations but, again, if I go back to the step-by-step guide to staff in preparing ROSCs, it says the need for prioritized recommendations, this prioritization needs to take into account capacity constraints.

So, there does seem to be a problem in terms of implementing the existing policy expressed in the operational guidance note on ROSCs, so we pose the question how will it be different in implementing the proposal raised in this paper. Mr. Yagi in his preliminary statement raises this important point about management, because I think it is perhaps the most important issue we need to address. What seems to be going wrong in some respects we could say is the application of what is the already agreed policy. I therefore think that management of the process is perhaps the most important issue in which we need to focus.

On the question of private sector use of ROSCs, there does seem to be tension in terms of differing objectives, to use ROSCs as an instrument to identify weaknesses that need rectifying, or as an indication of how well a country meets a standard and how this will influence credit assessments. With so much emphasis on the latter, I find it not at all surprising that many countries in developing Asia say that they want to address the shortcomings before undertaking a ROSC.

Mr. Boitreaud made the following statement:

Let me thank the staff for their well written and very comprehensive papers. We share the thrust of their analysis and recommendations. Like previous speakers, I believe that international standards and codes have had and continue to have a significant impact on international financial stability and integrity. I therefore welcome the regular increase in the number of ROSCs and of countries covered over the past years. Another positive point concerns the overall quality of the ROSCs issued so far, even if their main recommendations could be written more explicitly and thereby provide a clearer road map for the authorities, but I will go back on this point later. What is more worrying with our experience with ROSCs is their rising costs. As mentioned during our meeting on the FSAP last week, we believe that these costs could be partially reduced without sacrificing the quality of the final product, by streamlining some procedures, fighting resolutely the bureaucratic trends that always emerge in such complex processes and insisting on resource management. We have to acknowledge, however, that the overall objective of covering the entire membership while regularly updating members’ compliance is a daunting task, if not an impossible one, and we therefore fully support the staff’s efforts to improve the prioritization of assessments.

Having said that, I would like to stress the following points for emphasis.

Like many directors, we support the staff's proposal that ROSCs give a clearer sense of the weaknesses, main conclusions and more explicitly prioritize recommendations. Mr. Bennett's proposal that the staff work with the authorities to establish a compliance "road map" as part of each ROSC is very interesting from this point of view. More generally, we favor measures aimed at providing a more direct link between the ROSC and surveillance. We also support proposals to make it clearer that the judgments expressed in a ROSC are those of the staff, while the views of the authorities are reflected in an accompanying right of reply.

The prioritization of policy recommendations in the ROSCs should also be linked to the provision of technical assistance and capacity building and, as mentioned by Mr. Scholar and Mr. Joicey, should entail close collaboration between the Fund and the Bank.

Although we support the proposal to ask other international agencies to produce or collaborate on ROSCs and ROSC updates, we fully share the comment made by Mr. Yagi and Mr. Miyoshi. We should remain cautious so as not to weaken the Fund's involvement and expertise in the assessment of each of the standards and codes that it covers. Furthermore, it is the responsibility of Bank and Fund staff to undertake a quality review of the substance of the reports. Pressures on costs should not result in the Fund and the Bank limiting their responsibility in any ROSC.

We support the proposal to limit updates to ROSCs by the Fund to the four areas that are most central to the IMF's concerns, namely Data, Fiscal, Monetary and Financial Policy Transparency and Basel Core Principles modules. Nevertheless, we would like to insist on the importance of a close monitoring of developments with regard to the AML/CFT ROSCs, particularly for countries in which weaknesses and vulnerabilities have been spotted in previous assessments.

On the various areas in which new standards might be added to fill a gap, I slightly disagree with the staff and would prefer not to conclude at this stage on the need or lack of need to add new areas to the list of standards. More precisely, I believe that we should examine further how we could elaborate a ROSC on public governance standards, based notably upon the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. I have noted that many of these issues are already covered in existing ROSCs but I still believe that a comprehensive standard on this crucial subject would significantly help countries that face institutional and governance problems. Recent programs and Article IV consultations have clearly underscored the importance of improving public governance and fighting corruption in macrofinancial stability and economic growth. Developing such a ROSC will not be an easy task but I believe that its potential benefits outweigh its costs. Further reflections on the other issues

> raised by Staff, notably guidelines for multinational corporations, pension fund regulations and international trading practices, are also warranted in our eyes as they cover central aspects for the integrity, stability and strengthening of the international financial system and play a key role in our efforts to promote a better globalization. All in all, I think it is a bit too early to draw a conclusion on the basis or lack of basis for extending the number of ROSCs.
>
> Finally, like Ms. Jacklin and Mr. Epstein and Mr. Lombardi, we would encourage a policy of presumed publications of ROSCs in order to increase the amount of information available to market participants and to the public. The current rate of publication, particularly concerning ROSCs undertaken in the framework of an FSAP review, is too low and needs to be significantly increased for the ROSCs to deliver on their promises.

The Director of the Policy Development and Review Department (Mr. Geithner), responding to Mr. Portugal's question about the demand in the pipeline for new assessments, noted that the current number was 214 across all countries and standards areas. That was a number which the staff could meet over a reasonable period of time and within the current resource envelope. In the same context, the figure of 127 quoted by Mr. Callaghan in reference to a table in the Supplement to the staff paper was the number that the staff anticipated for coverage during 2003. The staff was not implying that it would be optimal or desirable to view that number as a ceiling on initial assessments going forward. With regard to the trajectory of initial assessments, the rate of growth over time needs to come down somewhat to become sustainable in the current resource envelope. Therefore, the staff anticipates a modest reduction in the number of initial assessments going forward. However, there would continue to be significant increases in the coverage across countries and the standards areas over time. It would not be helpful to express in terms of numbers what a "modest decline" would mean, as the staff wanted to avoid establishing excessively firm targets or expectations. That should be avoided in view of the conclusion of the current review that there was a need for a somewhat higher degree of flexibility going forward.

Responding to questions raised about the proposed filter, the Director noted that the staff had not used the words "crisis-prone." However, it was true that if the headline conclusions of the Fund would give prominence to the word "vulnerability" as a way to frame the filter, that would probably have a somewhat negative and stigmatizing effect. What the staff was trying to do, was, as Mr. Callaghan had put it, to address the needs of members and the needs of the system and to ensure that the assessments were used most effectively to that end. It should not be difficult to find an affirmative way to frame that approach of prioritization that avoided the negative implications of a stigma. Those were fair reservations that the staff took seriously.

On Mr. Portugal's questions about what he described as additional criteria for prioritization, the Director considered that his first suggestion to take account of regional and systemic impact of a particular country's policies was already accommodated in the context of the staff's proposals. It was particularly important to have the capacity to do assessments where there was a reasonable basis for concern about the external implications of a particular institutional feature of a member country. On Mr. Portugal's second suggestion to take into consideration the virtue of assessing the best performers, it would be ensured that, going forward the staff would continue to assess industrial countries, as had already been done so far, and to learn from their experiences.

With regard to Mr. Daïri's comments on the use of the word "potential" vulnerability, the Director concurred that those considerations regarding potential dimension of a country's institutional framework that could give rise to some systemic implications represented a reasonable basis for focusing resources in that area. The general problem was that, if too many areas were identified, prioritization would fail. While the staff had described those areas as priorities, they should nevertheless not be regarded as exclusive or constraining tests.

Referring to Mr. Callaghan's remark about the formulation in the most recent edition of Current Account, the Directors noted that his department did not draft the Current Account. If the staff's main proposal at the conclusion of the review had been to scale back the initiative substantially, the staff would have said that clearly in the interest of transparency. However, the staff was assessing whether the pace and the rate of growth in the initiative to date would remain sustainable within the current resource envelope, and how best to respond to the tensions stemming from that. The staff proposed to alter that trajectory somewhat and to use the room created by that change in order to focus additional resources on follow-up work. While some inferences could be made on the basis of the experience so far, it was difficult to project demand going forward with a high degree of confidence and to arrive at firm judgments in that regard.

With regard to Mr. Callaghan's remarks about apparent discrepancies between performance and current guidelines, the Director confirmed that the numbers quoted in that context had been correct. They suggested that there was unexploited potential within the existing guidelines to improve on the quality of these assessments, which was, in some sense, the purpose of reviews. Regarding the low ratio of assessments that raised issues of macroeconomic significance, Table 1 on page 13 of Supplement 1 to the staff paper and paragraph 17 in the text indicated that in areas where issues of macroeconomic significance would be expected to materialize, the proportion reported was within a 75 to 80 percent range. If issues relating to regulatory regimes and the capital market more generally were included, that percentage declined, also bringing down the overall average. However, the numbers were by no means very discouraging in the core areas where issues of macroeconomic significance would be expected.

Mr. Daïri considered that, at the outset of the process, the issue of macroeconomic relevance had been extremely important and had influenced the choice of ROSC modules. If the conclusion was now that there are areas with little macro relevance, they should be dropped from the ROSC. Some clarification is needed.

The Director of the Policy Development and Review Department (Mr. Geithner) responded that it was perhaps necessary to revisit the data shown in Table 1 somewhat more closely. There were a number of lines for which no data were being reported or for which there had been no response. That was the case for the monetary and financial policy transparency module. That was obviously an area of considerable potential macroeconomic significance. The figure of only 11 percent reported for that category could not be interpreted as suggesting that the area was not relevant. It only indicated that in the cases where that area was covered, no substantial weaknesses had been reported. The lowest number in the table referred to the payments and settlements system. That also was an area which could have substantial systemic ramifications. One could infer two different things from a low number. One, that there was some sort of bias in the sample, such that the initial assessments had been done in relatively strong-performing countries. Alternatively, one could say that the assessments themselves had failed to discern weaknesses in that context. He could not with confidence provide an explanation at the current stage as to which of the possible explanations applied.

Mr. Portugal thanked Mr. Geithner for his response, but considered that the rationale for his proposition was somewhat confusing, given that he had initially stated that there was no resource problem and that, within the current envelope, coverage could even be expanded. From reading the staff proposals and also some statements by Directors, the impression was that there actually was a resource problem. Thus it was highly regrettable that, according to Ms. Jacklin's and Mr. Epstein's statement, such an important country as the United States wanted to participate and had to defer because of a lack of resources. However, according to Mr. Geithner, who had indicated that there were 214 ROSCs in the pipeline and that a sustainable rate would be 127 ROSCs per year, there was obviously no such problem, given that, with a rate of 127 ROSCs per year, the 214 ROSC requests in the pipeline could be dealt with in a time span of two years. Similarly, 343 ROSCs done so far in 89 countries represented an average of 3.8 ROSCs per country. Hence, with 127 ROSCs per year and the average of 3.8 ROSCs per country, it should be possible to cover 33 countries. Since there were still 93 out of 182 members that never had done a ROSC, that part of the membership could be covered within about three years. In view of those considerations, the rationale for the staff's proposal was not quite clear.

With regard to the criteria for prioritization, Mr. Portugal disagreed with Mr. Geithner's view that the currently proposed first criterion already satisfied his chair's proposition regarding covering countries whose developments would have significant externalities for their regions or the world economy as a whole. That was not the case, since, under the staff's proposal material vulnerability was the main criterion, whereas the criterion that he had suggested would apply irrespective of whether there was a material vulnerability. The size and importance of an economy and the potential effects from changes within that economy on others should also be a criterion for prioritization. Learning from best performers was another very important criteria. Therefore, the question remained whether staff and management accepted the two additional criteria that he had suggested.

The Acting Chair (Mr. Aninat) stated that the process under consideration was still rather new and that the number of areas covered by ROSCs had been extended. There appeared to be consensus that this should be consolidated and no further areas should be added to the list. One had to take into account that participation was voluntary and that, consequently, demand could not be predicted precisely. It was welcome that the initiative had been progressing well and that participation had expanded. However, hesitation on the part of some as well as capacity constraints had to be taken into account also with regard to the technical assistance derived in that context. It was not possible that any given country could rapidly do all types of ROSCs, given, for example, their different stages of development. Hence, one could not look at those issues in a mechanistic manner. Many of the questions that had arisen with the evolution of the process, were matters of judgment. The process was still relatively new, and, as had been said both by the staff and in several statements from Directors, there was room for optimization and a certain reallocation of resources without producing a major impact on the coverage envisaged going forward. It should also be borne in mind that the resource allocation necessary, when particular members participated in certain types of ROSCs, might at times be higher than expected. There was the additional problem related to the pricing of ROSCs, a matter to be discussed in the upcoming Board session on the forthcoming charges policy paper.

Mr. Daïri reiterated his chair's disappointment that the review had not covered AML/CFT assessments and noted that there had been hardly any information with regard to the work done in that area. He wondered whether this meant that there had been no macroeconomic issues involved.

The Director of the Policy Development and Review Department (Mr. Geithner) responded that this would not be the reason for that conclusion.

On Mr. Callaghan’s question regarding the need to alter the presumptive trajectory for initial assessments in view of the current resources envelope and the committed pipeline of requests, the Director stated that an extrapolation of the current rate of growth in initial assessments with the intention of also financing a reasonable capacity for follow-up, a massive increase in resources devoted to this initiative would be necessary. A trajectory along those lines would, in the view of the staff, be unsustainable for the institution. Therefore, if one was of the view that it was important to the initiative to have a capacity for follow-up work for the two reasons identified—to help countries upgrade their institutional framework and to provide broader incentives and demonstration effects generally to contribute to that—it was important to make additional resources available for reasonable follow-up. Mr. Portugal had argued that the trade-off should go the other way. However, that did not reflect what many beneficiaries of the initiative had indicated with regard to the importance of their capacity for appropriate follow-up. Mr. Portugal’s proposal differed from that presented in the staff paper. One could put the question differently. If there were two requests, one from a member who might be described as a perfect performer against the relevant standards, the other from a member with a narrow gap between the existing institutional framework and what the member considered desirable, the question was whether the staff should give the same level of priority to both those requests for an assessment, given the different types of need and implications for the system. That was the choice that the Fund had to make. However, as was becoming apparent in the discussion, the trade-offs were not very acute in the near term. The question was as well how quickly and to what extent the pace of growth in the number of initial assessments would change over time and what that would mean for the relative mix of initial assessments and follow-up.

Mr. Callaghan wondered about the implication of the decision to cut down on the number of ROSC modules in the FSAP, in view of the fact that a very large proportion of ROSCs were currently undertaken in that context. Footnote 41 of the staff paper said that this was expected to have a marked impact on the growth in the stock of new ROSCs. It appeared thus that a decision affecting the trajectory of the rate of growth had already been taken, and it was advisable that it be factored into the paper currently before the Board

The Director of the Policy Development and Review Department (Mr. Geithner) informed that those papers had been produced in parallel, and the paper on ROSCs had been produced with full knowledge of the evolution of the proposals presented in the FSAP paper. However, many of the conclusions in the FSAP paper had been reached at a point in time rather close to the circulation period and the date of the Board meeting. That was the reason why not too much prominence was given to the relationship between those papers. The staff therefore accepted the view expressed by several Directors that this was regrettable. On the substance of the question, the FSAP-based pool of demands for initial assessments will decline as a result of the proposals approved by the Board in the context of the FSAP review, which was a significant additional factor affecting the trajectory. Although, it was not certain that it would be the dominant factor, this factor alone would probably imply a reduction in demand for new ROSCs in the order of magnitude of 10 percent relative to what could be called the baseline trajectory of 127. However, that was only an indication as to the order of magnitude and not a forecast made with much certainty.

Ms. Jacklin considered that the Fund, like all other institutions had to work within certain budget limits and that the standards initiative was not different from other initiatives in that regard. While Mr. Portugal's desire to increase the number of ROSCs dealing with the more sophisticated financial systems and economies as a way of learning from them was a legitimate interest in value, it should not be forgotten that the ROSCs themselves were derived from best practice. Those who developed the ROSC had reviewed best practice and had used it in developing the standards. Hence, the learning aspect was already captured by the formulation of the ROSC modules. While more benefit could be derived from doing a ROSC against practices in those countries, it was not clear whether the added benefit necessarily matched the cost. When looking at the hard costs of a ROSC for some of the more advanced countries, that was not a one-to-one relationship. Both in terms of Fund resources and country resources, for preparing the answers for the ROSCs by one of the more sophisticated countries under a fixed budget, one might have to give up ROSCs for four or five other countries that were not so large and not so complex. Hence, there were clear choices to be made by the Fund. With regard to the formulation of the criteria, Ms. Jacklin agreed strongly with Mr. Callaghan and Mr. Beauregard on the need to ensure that the criteria did not stigmatize the users. However, it was important not to lose sight of the fact that this process was one that aimed at strengthening the system and thus, by definition, aimed to try to bring everyone up to the highest standards. That and the real budgetary trade-offs that the Fund had to face in reaching that objective should be kept in mind, no matter how the criteria for prioritization were formulated.

Mr. Daïri thanked Mr. Geithner for his candid responses and considered that there did not appear to be a conflict between his views and those expressed by Mr. Portugal, given that the staff had indicated that prioritization did not mean the exclusion of certain countries. Hence, it seemed to be understood that countries with an assumed best-practice performance against the standards would be assessed as well.

Mr. Portugal reiterated that it was still not clear which was the real constraint faced by the initiative, particular given that there were currently 242 requests for ROSCs, which represented the entire current demand. Also under a voluntary program it was conceptually difficult to suggest that one could establish criteria and pick up countries to participate. That could only happen if those countries volunteered. Hence, only if the demand from volunteers were to be higher than the capacity to conduct ROSCs, would the prioritization criteria be needed. In the current situation with a total number of requests of 242 and an annual performance of 127 ROSCs, it was not clear that there was a problem necessitating the introduction of prioritization criteria. When the staff argued that under the assumption of a continued trajectory of demand there would be a problem some time down the road, one could counter by asking why one should not wait and see if that expectation would really be fulfilled, particularly in view of the fact that this was a voluntary program.

With regard to the additional criteria that he had suggested for consideration by the staff, Mr. Portugal noted that the Acting Chair's suggestion had been that, at least the first one, was already implicit in those proposed by the staff but requested that this be made explicit, if that was possible. One question remained whether his suggestion that had been supported by nine or ten other Directors would be acceptable to management. The other issue was how material vulnerability would be defined. The staff had indicated that it did not have a definition for that. However, the staff had to have some notion of what that term should mean, given that that criterion had been proposed by the staff and in view of the fact that, as a consequence of the introduction of the criterion, the staff expected a reduction in the number of ROSCs. Therefore, the question remained as to how that criterion would be applied in practice.

Mr. Joicey, responding to points raised by Messrs. Portugal, Callaghan, and Daïri, considered that it was important for ROSCs to cover the full range of the membership and to include countries with a best-practice performance and industrialized countries. Mr. Daïri's point that those two characteristics did not necessarily go together. He also agreed with Mr. Daïri that, with regard to prioritization, there was not necessarily a divergence of view between Mr. Portugal and the staff. The U.K. chair believed that it was essential to cover all countries. The United Kingdom and a number of other industrialized countries had volunteered for a ROSC, and it was hoped that further industrialized countries would follow that example.

At the same time, there were clearly resource constraints, Mr. Joicey considered and stressed that in the context of the question regarding resources, both initial assessments and follow up played a role for the sustainability of the initiative. Those constraints were not mainly financial in nature, but referred also to expertise and knowledge and to the question of the value engagement of Fund staff with a country in the context of a ROSC. Hence, some form of prioritization was warranted to balance initial ROSCs and follow-up. The issues raised by the staff and Mr. Callaghan about the trajectory were very important points with regard to focusing on the needs of members and the needs of the system. That could be taken forward quite pragmatically within the context of the Article IV consultation missions and process, and the staff could perhaps elaborate on that point.

With regard to Mr. Callaghan's comment about the overall message presented in Current Account, Mr. Joicey noted that the paper did conclude at one point that ambitions would need to be scaled back. His chair was of the view that that was somewhat out of tune with the overall tone of the paper in other respects. It would be more appropriate to state that the question was about how to build on the success of the initiative and how to sustain and strengthen the impact of ROSCs. In that way, one could strike the appropriate balance between the importance of new ROSCs but also its follow-up aspect.

Mr. Steudler made the following statement:

> I welcome the increased participation in ROSCs in all areas endorsed by Bank and Fund, which indicates the high level of acceptance and importance of the standards and codes initiative. I am convinced that standards and ROSCs contribute to strengthening the functioning of markets, and I am encouraged by theoretical and empirical findings that following standards and codes can be associated with sounder macroeconomic as well as financial policies. The fact that adhering to the initiative can be associated with lower spreads and higher credit ratings should be especially enticing for countries in need of access to international financial markets.
>
> For reasons of credibility and given that financial markets turn to the standards initiative more and more, the Fund should strive for a higher publication rate. However, this should not come at the expense of candor in the Fund's assessments. I agree with staff that ROSCs can only be effective if they give clearer sense of institutional shortcomings, and sources of stress and their significance. Their conclusions and prioritized recommendations for reform must be absolutely clear. Accordingly, we find merit in Mr. Bennett's suggestion to establish a compliance "road map" as part of each ROSC. At the same time, the practice of showing draft ROSCs to the authorities should be maintained. In order to preserve the value of the Fund's advice, the views of the staff and of the authorities should be, as suggested, clearly distinguished.
>
> As the ROSC initiative is quite resource intensive, its sustainability can only be achieved via prioritization. Clearly, quality needs to come before quantity. Selectivity should be applied both with respect to country and policy area coverage. On country selection, aiming at a full set of ROSCs including all systematically important countries is certainly desirable but not realistic. Like Ms. Jacklin argues, this should however not lead to countries being left out despite existing risks and vulnerabilities. I would therefore put the priority for new ROSCs particularly on members with material vulnerabilities, especially in the presence of systemic ramifications. Addressing a fear by Mr. Portugal, this would also ensure that no particular group of countries

would be a priory excluded. On a relating note, it is somewhat worrying that Asia is lagging behind in ROSC participation. On policy area selection, country-specific circumstances should determine the choice of assessed standards and ROSCs.

I also welcome the proposed selectivity in updating. Updates are only necessary when substantial changes occur. Follow-ups should be substantial rather than descriptive. In this regard, technical assistance is an important complementary element. As Mr. Portugal has put it correctly, “there is little gain in identifying weaknesses and not being able to correct them.” The FIRST initiative mentioned by Mr. Scholar goes in the right direction. Of course, support should be well focused on countries that have a clear lack in institutional capacity.

It is clear that existing standards in the areas of corporate governance, accounting, and auditing may be in need of modification. Initiatives underway to strengthen existing standards should thus be supported. To this aim, coordination and collaboration with other standard-setting agencies is crucial to identify priorities, avoid duplication, and make use of synergies.

We endorse staff’s recommendation that the payments and settlement system ROSC should include an assessment of observance against the new Recommendations for Securities Settlement Systems (RSSS). This should only be done, as staff suggest, for members with large and complex securities settlements systems. This restriction will allow taking into account, first, of the necessity of prioritization and, second, of the fact that ROSCs other than data, fiscal, MFPT, and banking supervision are less crucial for macroeconomic surveillance.

With the exception of the RSSS there is for the time being no area in which a standard may be considered as ripe enough to be added to the list under consideration. Staff should come back to the Board with this matter in the future.

Mr. Wei made the following statement:

I would like to thank staff for the well-written report. Since my positions are basically the same as Mr. Shaalan, Mr. Mirakhor and others, I will focus my comments on the issues for discussion listed in the report.

I agree with others that while the Fund has substantially improved its surveillance function, there is still a lot of room for improvement.

I agree with the argument that Fund surveillance may “not be the predominant influence on member’s policies and performance” and “the best the Fund can realistically hope to do is contribute over time to building or maintain a consensus…on the broad policy". In order to enhance the effectiveness of surveillance, I believe that the views of the authorities should be fully reflected in the staff report. On many occasions, it is quite understandable that the policy advice presented by the Fund might not be accepted by the authorities not because the advice itself is not correct, but the economic circumstances do not allow the authorities to do so. Another point is the equal treatment principle to all members which should be emphasized in the Article IV consultation process. In this regard, I share Mr. Portugal's view in his preliminary statement. Fund surveillance over major industrial countries should be further strengthened due to their larger impact to the global economy. On the two specific issues, the coverage in the Global Financial Stability Report and focusing of ROSCs, I also share Mr. Portugal's points.

Another point is the surveillance of the private sector. It is important to include both the public and private sector in the coverage of surveillance. Up to now, most of the effort has been devoted to strengthening public sector surveillance. Surveillance on the private sector, especially on various institutional investors such as pension funds, mutual funds and the key financial centers has not been strengthened to the extent that is deemed sufficient. While we understand the division of labor between the Fund and other IFIs as well as the budgetary constraints on the Fund, we would like to encourage the staff to make extra efforts in conducting surveillance on the above areas. If additional budget is needed, we would like to support to increase budget allocation on this purpose. On the issue of financial sector surveillance, the progress made in carrying out FSAP reviews in selected countries on a voluntary basis is encouraging and we think that continuing this work on a voluntary basis is appropriate. Meanwhile, it is more cost effective to strengthen the institutional capacity of a member's central bank and financial supervisory institutions by enhancing their regulatory arrangement and unifying supervisory standards with international norms. In this connection, Fund technical assistance is of critical importance.

I share the two points made by Mr. Shaalan on the "capacity to mobilize political consensus in favor of needed adjustment measures" and the issue of surveillance in program countries. I believe that the Fund should confine itself to the key economic areas in line with its mandate and expertise. Program countries should be treated by the same policies and procedures in the surveillance process.

I also agree with many others on the voluntary nature in the publication of Article IV staff reports. Ms. Indrawati has made very helpful comments in her preliminary statement which I fully share.

Mr. Alazzaz made the following statement:

I thank the staff for a well-written set of papers on the experience and next steps regarding implementation of international standards as part of the Fund surveillance process. I am encouraged by the positive assessment this review provides. In particular, I welcome the finding that the demand for Reports on Standards and Codes (ROSCs) has been high and is growing rapidly. This underscores the success of the voluntary approach as well as the perceived benefits of ROSCs. The increased use of ROSC findings by the private sector should further raise the demand.

With higher demand for ROSCs and the increasing costs of updating the ever growing number of completed ROSCs, the delivery by the Fund is facing resource constraints. To address this issue, the staff is proposing to reduce the number of ROSCs produced each year by being more selective in country and policy coverage. While the Fund should always strive to enhance cost effectiveness, it is not clear that cutting down a service that is valued highly by member countries is the best approach. However, if there is broad agreement that the resource constraint for this activity should not be relaxed, some prioritization would be necessary.

The staff criteria for prioritization appear reasonable. However, it is not clear that vulnerabilities are readily apparent especially in the major economies with complex financial systems. Mr. Portugal rightly questions the validity of judging material vulnerabilities without a proper and detailed assessment. I found the examples he provided regarding this issue very illustrative. Moreover, if it is perceived that the focus of ROSCs is on countries with material vulnerabilities, this may make countries reluctant to request a ROSC and may adversely affect the risk perceptions about the country. Therefore, it is important to do ROSCs for a mix of systemically important industrial countries, emerging markets economies, and developing countries. In this regard, while material vulnerabilities will need to be considered when prioritizing ROSCs, the desirability of a ROSC should not be flagged in the staff report. This would not only detract from the voluntary approach, but also create adverse market reaction, and could tax the staff resources, if the need for too many ROSCs were flagged.

On improving the quality, there is merit in prioritizing the recommendations of ROSCs. This will help improve surveillance, as well as the delivery of technical assistance. More importantly, it will facilitate a well-sequenced implementation of reforms by countries with limited capacities. Here, I welcome the progress made in providing technical assistance and fully agree that further work on the costs and benefits of the implementation of standards and sequencing of implementation is needed. I am less convinced, however, by the proposal to be more blunt. As a number of Directors have noted, even assessors feel that overly blunt language could undermine efforts to implement standards and address weaknesses. Indeed, it could reduce the demand for ROSCs and increase the reluctance to publish. In any event, it is essential to continue the practice of sharing the draft reports with the authorities.

I can go along with the staff's proposal to include in the payments and settlement system ROSC an assessment against the new Recommendations for Securities and Settlement systems (RSSS) for members with large and complex security systems. I also agree not to add any new areas to the list of standards at this time. While there appears to be a need to strengthen standards on corporate governance, accounting, and auditing, I am of the view that this is an area mainly for the Bank and others concerned with the setting of those standards.

Mr. Abel made the following statement:

Arguably, surveillance is not only becoming the Fund's most important responsibility but also one of its most successful activities. It is gratifying to see how broadened scope of Fund surveillance, and its adaptation to current needs, has improved the Fund's performance in other areas. Properly designed and performed, surveillance helps identify the areas where the Fund's assistance is most needed and where its advice can be most useful.

The initiatives jointly launched by the Fund and the World Bank to promulgate codes and standards has been broadly successful in meeting its objectives, although it is true, as the staff suggests in paragraph 27, there is still room to identify its weaknesses, increase the clarity of its main conclusions, and better prioritize its recommendations.

We also support the staff's efforts to improve the prioritization of assessments, by including in Article IV staff reports an indication of the areas which would benefit most from a standards assessment. To direct resources to the areas of greatest need, and avoid overburdening the Article IV consultation process, we also support the staff's suggestion for selectivity.

But efficient use of the Fund's resources requires more than selectivity in choosing the areas and countries to be covered. We must seek a good balance, to make our approach to different countries accurately reflect their current needs. Although in most cases, ROSCs can take the place of technical assistance, there are a number of countries where the traditional technical assistance approach still works best. It would be unfortunate if exaggerated efforts in the "outreach activities" to propagate standards would take away resources from more badly needed technical assistance, or slow our progress with currently planned ROSCs and FSAPs.

Mr. Daïri wondered how many of the 214 requests in the pipeline came from industrial countries. It would also be interesting to learn why the cost for ROSCs in industrial countries was so much higher than for other countries. Also, in view of the fact that peer review was a very important feature of the process, the staff was encouraged to make greater use of experts, especially from developing countries.

The Deputy Director of the Statistics Department (Mr. Enoch), responding to Mr. Portugal's question regarding technical assistance delivery, informed that 16 1/2 person years out of a total of 29 person years of total technical assistance had been in support of standards and codes. There was further information country-by-country in Table 2 of the background paper on statistics. On the fiscal side, Appendix IV of the background paper presented country-by-country information on the technical assistance provided as follow-on to the fiscal transparency ROSCs. The Fiscal Affairs Department could provide further detailed information bilaterally. The Monetary and Exchange Affairs Department would also provide their figures bilaterally.

The Director of the Office of Budget and Planning (Mr. Potter), responding to questions on the resource envelope and related issues, noted that Supplement IV to the staff paper had been an attempt to be as comprehensive as possible about the measurement of the overall costs involved. An attempt had been made to take account of the amount of time spent on the missions, the amount of time spent at headquarters, the indirect costs of support staff in the departments, and the support costs more generally in the institution. It also included the travel costs. It was important to look at the fundamental trends shown in Supplement IV and in Table 3. The costs of the initiative had been doubling every two years and had risen from about $11 million in 2001 to 19 million in 2002 and an estimated $27 or 28 million in the current year.

On the question of how the data for the year 2003 had been obtained, the Director noted that, because of the known lags in the system, the information was available only after about six months. With regard to the labor input, the data had been based on the assumption that the situation would be similar to the average per ROSC in terms of staff years over the three preceding years. Data on travel costs had however been available and had shown an increase by nearly 50 percent between fiscal year 2002 and 2003. With travel cost data having become available in recent days for three quarters of 2003, it had become clear that hopes that earlier findings had perhaps been exaggerated were disappointed, as the figures were only marginally lower than the originally estimated $60,000 per ROSC, at $58,045. Another important finding had been a sharp increase in the amount of total staff days spent on mission, which was one of the factors behind the high travel costs. It also led to a higher overall average staff input per ROSC, which included also support staff at headquarters. Average costs had risen by around 11 percent between FY 2002 and FY 2003.

As Mr. Callaghan and Mr. Geithner had already noted in different ways, the underlying trend of demand pointed to a doubling every two years, the Director recalled, which raised the question as to what would be a reasonable resource envelope. The Table in Supplement 4 assembled estimates that had, by and large, been confirmed by the information that had become available after the end of the third quarter. It suggested that spending on the ROSC exercise as a whole was somewhere around $27 or 28 million.

With regard to the question of what could be performed within the current resources envelope, the Director observed that with 214 requests in the pipeline, it would appear that within a couple of years, they could all be performed. However, that conclusion did not take account of the updates and represented simply a mechanical extrapolation of past trends coupled with the assumption of a certain slowdown in pace of requests for new ROSCs and of more importance and weight being attributed to updates, thus using resources freed up as a consequence of a lower number of requests for initial assessments. That could be accomplished within a resource envelope of between $27 to 28 million.

It should be borne in mind that those numbers were not cast in stone, the Director emphasized, neither in terms of accuracy nor in terms of representing an absolute resource constraint. Each functional department operated under its respective departmental budget and would make judgments across their own priorities.

With regard to the question raised by Mr. Portugal about the 214 requests and the capacity to perform 127 assessment per year, the Director noted that this excluded the factual updates, and there was some considerable uncertainty about precisely what the resource consequences of those updates would be. That could vary considerably from a relatively straightforward exercise performed through the process of Article IV surveillance missions to an assessment that might be almost indistinguishable from undertaking another ROSC in that country. That issue was still under consideration and was not part of the calculations presented.

Mr. Kanagasabapathy considered that, particularly with regard to the publication of the staff paper but also in the context of the summing up, a reference, as in paragraph 45, to material vulnerability as a criterion for prioritization should be avoided. It would be preferable to refer to the need expressed by the member concerned and to the existing status of a particular standard. Also, while it was understandable to refer to vulnerability in institutions, mentioning of vulnerabilities in policies did not appear to be an appropriate wording, given that the Fund only had transparency codes but not codes of good policy. The staff should clarify what was meant by a reference to vulnerabilities in policies. In that context, the question also arose what was the purpose of FSAPs and ROSCs, if the criterion of material vulnerability would be retained for prioritization. It was the very purpose of ROSCs and FSAPs to assess vulnerabilities, and it was difficult to understand how the staff could have a preconceived notion there was an element of vulnerability in a country where no FSAPs or ROSCs had been undertaken. In view of that, the wording “material vulnerabilities” should be avoided and the text should be amended.

The Acting Chair (Mr. Aninat) noted that he had already accepted the first point raised by Mr. Kanagasabapathy and that he had also supported avoiding language suggesting, even if indirectly, any stigmatization.

Mr. Kanaan supported Mr. Kanagasabapathy's view that the concept of material vulnerability needed to be clarified, and agreed with Mr. Portugal on all points relating to expanding coverage to include industrial countries, especially larger and systemically relevant ones. That the notion of material vulnerabilities was not a good guiding principle for prioritization was evident from the recent experience with the latent material vulnerabilities that had been building up in the area of corporate governance and accounting and auditing standards in some of the larger countries. In that case, some of the larger companies had been able to devise complex and sophisticated transactions and schemes to avoid detection. That example was particularly apt, as it illustrated the fact that both other countries, for example developing countries would have benefited from an early detection of such vulnerabilities, but also that there were lessons to be learned about new methods of early detection of ways to avoid having complex companies establish very complex and possibly fraudulent schemes. Hence, the usefulness came both from the detection of vulnerabilities in addition to the area of the spillovers. Thus, following up on a point that Ms. Jacklin had made, there was an important learning experience in updating some of those standards.

Mr. Portugal noted that, according to the more recent information during the Board meeting, the issue was not any more the demand for new ROSCs, which was only 214 against a rate of annual performance of 127. Given that the program was voluntary, so were updates and reassessments. In that context, it would be useful to learn what the actual demand for reassessments and updates was and how the costs of reassessments and updates compared with those of an entire new ROSC. Without that information it would be difficult for the Board to judge the need and the rationale of what staff was proposing.

Mr. Beauregard shared Mr. Portugal's concern and considered that an update could be conducted in the context of an Article IV consultation which would bring economies of scale, whereas reassessments required an explicit request and was not something that would occur automatically.

The Acting Chair (Mr. Aninat) considered that there had been a sea change in the information provided during the discussion compared to the debate two years before when many of the relevant databases were still rather weak or incomplete. While he agreed that the change in demand for initial assessments and the envisaged consolidation did not produce dramatic effects, there was a need to keep in mind that, in cases of program countries, the Board and the authorities more often than not tended to request and support more assessments.

The Director of the Policy Development and Review Department (Mr. Geithner) reiterated that the figure of 214 only referred to ROSCs that had already been committed and did not incorporate fully a range of expressions of interest or otherwise identifiable potential interest. Also, it only referred to initial assessments and not to any of the range of follow-up demands—factual or in-depth updates in the Article IV consultation process or a reassessment, for all of which the actual resource implications varied. With regard to Mr. Daïri's question about the distribution of the number of committed ROSCs in the pipeline, 51 of the 214 commitments were for ROSCs in industrialized countries, 8 in so-called advanced countries, one of which is a ROSC for the United States.

Responding to Mr. Portugal's question on the number of requests for follow-up and re-assessments, the Director acknowledged that the staff did not have a good sense of that. If a fixed regime for deciding those matters were in place, one would be able to make inferences about the demand for that on the basis of the trajectory of initial assessments. Part of the staff's suggestion was to have more flexibility regarding the modalities pertaining to reassessments to avoid making it excessively formulaic. On the basis of the information currently available it would be difficult to specify a projected claim on resources going forward.

Mr. Portugal thanked Mr. Geithner for his response and concluded from the discussion that the staff was proposing a criterion to filter the demand, which had been somewhat contentious among Directors, to solve a problem the magnitude of which the staff could not determine.

The Director of the Office of Budget and Planning (Mr. Potter) noted that the differences in costs of assessments in different groups of countries was essentially a matter of the number of staff that would go on the missions. In a particular year, that could be influenced by the particular selection of countries. For example, the differences were most significant for the FSAP review exercise and for the MAE Department, particularly when they were engaged in looking at countries like the United Kingdom or Japan. In those cases, the mission work was extremely resource-intensive. The differences were rather small for the Statistics Department, with some difference in the Fiscal Affairs Department. The cost differentials were essentially a function of the size of the team.

The Acting Chair made the following concluding remarks:

> Executive Directors welcomed the opportunity to review the experience with the standards initiative, in order to build on its success and to discuss the role of the initiative in strengthening domestic institutions, international markets, and surveillance. They had a frank discussion on possible re-prioritization of efforts in the light of experience to date and the current resource envelope and taking into account the need to maintain the momentum of the initiative and ensure adequate follow-up of Reports on the Observance of Standards and Codes (ROSCs) already undertaken. Directors believed that standards and codes, together with the Financial Sector Assessment Program (FSAP), have benefited both participating countries and the international financial community. They also noted the contributions of these initiatives to enhancing the effectiveness of Fund surveillance and its crisis prevention efforts.
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> Directors highlighted the broad and growing acceptance of standards and codes by member countries, notwithstanding their voluntary nature. They noted the sharp increase in the number of ROSCs since the January 2001 review, and that ROSCs are now produced in all areas endorsed by the Fund and Bank Boards. They welcomed the rise in Bank-led ROSCs covering the

standards concerned with market integrity. Directors noted that most systemically important countries are participating in the initiative. However, many Directors felt that industrial countries need to step up their participation rate in order to bring about a more balanced coverage of the standards assessments.

Directors agreed that standards assessments are being increasingly integrated into Fund operations. ROSCs are providing an important input for surveillance, raising the profile of institutional weaknesses in discussions with country authorities. ROSCs have also helped to pinpoint concerns, propose specific areas for policy action, and focus technical assistance. Directors stressed the importance of adequate technical assistance in implementing and sequencing the ROSC recommendations. They welcomed the contribution of the Financial Sector Reform and Strengthening (FIRST) initiative.

Directors believed that the practice of sharing draft ROSCs with the authorities to allow for greater dialogue and ensure accuracy has worked well and should continue. They emphasized that member countries and the Executive Board should receive reports that clearly identify staff views on institutional weaknesses and their significance but also progress achieved and explicitly prioritize recommendations. A number of Directors, however, cautioned that the language in ROSC reports should strike a balance between candor and restraint, taking into account the potential impact on markets and on the policy dialogue with countries.

Directors noted that the standards initiative is generating increased attention from financial market participants and ratings agencies, and is thus informing risk assessment and investment decisions. They believed that the program of outreach to the private sector should continue as a mechanism for both publicizing and gaining feedback on the initiative as it evolves.

In view of the growing demand for standards assessments and ROSCs, and for follow up to ROSCs, a number of Directors supported the allocation of additional resources to the ROSC program. Other Directors considered that, for the initiative to remain effective, careful prioritization and management of the process would be necessary and that the mix, coverage, and frequency of new ROSCs and updates to ROSCs would need to be adjusted accordingly. More external partnership in the implementation of the initiative could supplement the resources devoted to it.

Directors saw greater prioritization of assessments as key to focusing the scarce capacity of members and Fund resources on areas where reforms are most needed. They encouraged Fund and Bank staffs to examine ways to allow greater prioritization of ROSCs. Resources should be allocated to deliver the greatest benefit in strengthening domestic and international financial systems and members' institutional capacity. The focus should be on identifying areas of potential vulnerability with a view to addressing them while building confidence in member countries. Moreover, many Directors saw as important the development of a more systematic mechanism for determining when a standards assessment is important for Article IV surveillance. They noted that Fund and Bank staffs will work more closely together and build on the existing mechanisms for exchanging views in the prioritization process.

Most Directors thought that, as regards new ROSCs, priority should be given to (i) members where the exercise would have the highest return in terms of stability for the country and the international financial system; and (ii) members for which the developmental impact is likely to be important, including in a regional context. Article IV staff reports would indicate the standards that could most usefully be assessed for a member. Many Directors, in this regard, emphasized the need to ensure uniform treatment of countries' requests for assistance, noting that assessments for advanced countries are important in providing information on best practices but also for systemic reasons. A few Directors also expressed concern about the pace of Bank-led assessments in the areas of market integrity for advanced economies and encouraged the establishment of procedures that would allow such assessments to inform Article IV surveillance. In this context, it was suggested to explore the possibility of a cost-sharing arrangement with industrial countries.

Directors also agreed to adjust the intensity and frequency of follow up work to keep ROSCs current and informative to meet the needs of members and markets within the given resource envelop. Accordingly, Directors agreed that factual updates for the transparency standards (i.e., data, fiscal, and monetary and financial policy) could be supplemented with more substantive updates when warranted and depending on the availability of resources. When there have been substantial changes in a member's practices, a reassessment or new ROSC might be prepared. A few Directors thought that it would be preferable to focus on new assessments and rather curtail follow up to existing ROSCs.

Directors also agreed on the need for greater selectivity in updating. In particular, the Fund should concentrate on updates to ROSCs in those areas most central to the Fund's concerns (i.e., the data, fiscal, monetary and financial policy transparency, and the Basel Core Principles modules—the last in collaboration with the World Bank if undertaken in the context of the FSAP). Some Directors, however, suggested to implement this guideline flexibly. In this context, the importance of ROSCs on payment systems, securities regulation, and insurance supervision was underscored. The results should be reported in updates to ROSCs or staff reports.

Directors stressed that the current policy regarding the voluntary nature of ROSCs and their publication is working well. They encouraged the authorities to publish the ROSC reports in order to enhance transparency and the usefulness of the ROSC process. While a few Directors, in this context, suggested to establish a policy of presumed publication, it was agreed to take up this matter in the context of the next Board review of transparency policy later this year.

Directors agreed that the central role and responsibility of the Fund and the Bank in this exercise should be complemented with stepped up efforts by other international agencies and standards setters in producing ROSCs and ROSC updates in their areas of competence.

Moreover, Directors encouraged staff to continue to support various initiatives underway by other standards setters to fill current gaps, particularly in the areas of corporate governance, accounting, and auditing, while noting that any revisions should take into account the views and needs of countries at all stages of development.

Most Directors agreed that at this time there does not seem to be sufficient basis for adding other new areas to the list of standards important to the work of the Fund for which ROSCs are undertaken. Where gaps in existing standards need to be filled, standard setters are enhancing principles or modifying standards, generally with broad support from the international community. Looking forward, a few Directors expressed an interest in considering the usefulness of additional standards, such as public sector governance, public debt management, and guidelines for multi-national corporations. Directors asked the staff to monitor the emerging need for additional standards and bring the matter to the Board periodically.

Directors noted that the standards setters for payments and securities have developed Recommendations for Securities Settlement Systems (RSSS) that identifies the minimum requirements and best practices for securities settlement. They agreed to include assessments against the RSSS as a complement to a payments and settlement system ROSC for members with significant securities trading.

Directors agreed that the next review of the experience with standards assessments should take place in two years' time. There will continue to be periodic reviews of international standards.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/03/25 (3/18/03) and EBM/03/26 (3/19/03).

4. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 02/127 and 03/2 are approved.

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Advisor to Executive Director as set forth in EBAM/03/30 (3/17/03) is approved.

APPROVAL: June 13, 2003

SHAILENDRA J. ANJARIA
Secretary