November 28, 2001
Approval: 12/5/01

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 01/94

10:00 a.m., September 13, 2001

Contents

Executive Board Attendance

A. Krueger, Acting Chair
E. Aninat, Acting Chair

Executive Directors	**Alternate Executive Directors**
	A.S. Alosaimi
	A. Ismael, Temporary
	K. Kpetigo, Temporary
T.A. Bernes	J. Chelsky, Temporary
M.J. Callaghan	
R.F. Cippà	
K. Bischofberger	R. von Kleist
	D. Kranen, Temporary
P.C. Padoan	H. Vittas
	B. Bossone, Temporary
D.I. Djojosubroto	Low K.M.
V.L. Kelkar	R.A. Jayatissa
W. Kiekens	J. Prader
O.-P. Lehmussaari	A. Törnqvist
R. Quarles	M. Lundsager
P. Duquesne	G. Bauche
A. Mirakhor	M. Daïri
A.V. Mozhin	A. Lushin
	L. Palei, Temporary
H. Oyarzábal	F. Varela
S. Pickford	S.P. Collins
M. Portugal	
	I. Usman
	G. Campos, Temporary
	S. Farid, Temporary
Wei Benhua	
J. de Beaufort Wijnholds	
K. Yagi	
A.G. Zoccali	

S.J. Anjaria, Secretary
O. Vongthieres, Assistant

Also Present
IBRD: B. Esdar, Policy Reduction and Economic Management Office. Asia and Pacific Department: M. Cerisola. European I Department: C. Cottarelli, N. Mates. External Relations Department: G. Hacche, Deputy Director; M. Bell. International Capital Markets: G. Haeusler, Director; W.E. Alexander, M. Fisher, A. Kirilenko, C.H. Lim, C. Medeiros, P. Papi, E. Psalida, K. Srinivasan, R. Thorne, S. Wolfson. Legal Department: F.P. Gianviti, General Counsel; W.E. Holder, Deputy General Counsel. Policy Development and Review Department: J.T. Boorman, Counsellor; T. Geithner, Associate Director; M. Allen, Deputy Director; N. Blancher, U. Jacoby, G.R. Kincaid, A. MacArthur, C. Rosenberg. Research Department: K. Rogoff, Economic Counsellor and Director; M. Kumar. Secretary's Department: S. Bhatia, K. Friedman, L. Hubloue, A. Mountford, P. Ramlogan, T. Turner-Huggins. Western Hemisphere Department: M. Alier. Office of the Managing Director: A.A.E. Bertuch-Samuels, Special Advisor; C. Salmon, Personal Assistant; S.B. Brown, H. Mendis, R. Moghadam, B. Potter. Advisors to Executive Directors: M.P. Bhatta, A. Baukol, M. Beauregard, J.A. Costa, B. Couillault, P.R. Fenton, A. Fidjestøl, N. Jadhav, F. Manno, M.F. Melhem, Y. Patel, H.E. Phang, K. Sakr, A.A. Tombini, R. Villavicencio, M. Yanase, F. Zurbrügg. Assistants to Executive Directors: V. Bhaskar, J.G. Borpujari, P.A. Brukoff, N.J. Davidson, M. Di Maio, N. Joicey, C. Josz, F. Haupt, R. Manivat, P.A. Nijsse, C.A.E. Sdralevich, J. Sigurgeirsson, J. Sipko, Sugeng, D. Vogel, Wei X., A.Y.T. Wong.

1. INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE—DRAFT PROVISIONAL AGENDA

The Executive Directors considered the draft provisional agenda for the Fourth Meeting of the International Monetary and Financial Committee (EBD/01/77, 9/6/01).

The Acting Chair (Ms. Krueger) informed the Board that no decision had yet been reached on whether to hold the Annual Meetings and the meetings of the International Monetary and Financial Committee and of the Development Committee. Board discussions should therefore continue on the basis of no change in the schedule. There had been genuine concerns about a number of issues, and a debate on the best options. Management hoped to have a clearer idea by the end of the current Board discussion of how to move forward over the next several weeks. The Managing Director was still in Germany and was in close contact with headquarters.

Management would call a meeting of all Fund staff at 3:00 p.m., the Acting Chair continued. Mr. Mirakhor, on behalf of the Board, and the Acting Chair, on behalf of management, would deliver brief remarks, followed by two minutes of silence for the victims of the tragic events of September 11.

The Acting Chair (Ms. Krueger) said that, if the Annual Meetings and the IMFC meeting moved forward as planned, the draft agenda of the International Monetary and Financial Committee (IMFC) would be revised as necessary, in consultation with the Chairman of the IMFC, Mr. Gordon Brown. Thereafter, a revised draft agenda would be issued to the IMFC for adoption.

Mr. Quarles suggested that Item 6 of the agenda—private sector involvement—should be expanded to cover crisis prevention and resolution, of which private sector involvement would be an important element. Such a change would require some changes to the relevant footnotes; footnote 3 could be broken down into two footnotes to clarify how some of the Fund's ongoing work could contribute to crisis prevention and resolution.

The Acting Chair (Ms. Krueger) noted that the Board would have an opportunity to discuss in the next session a draft report of the Managing Director to the IMFC on private sector involvement in the prevention and resolution of financial crises. It was not clear if Mr. Quarles's comment pertained to the substance of that document or only to the title of Item 6 of the draft agenda.

Mr. Quarles clarified that it would be useful for the IMFC agenda to make it clear that the discussion would be on a broader topic of crisis prevention and resolution, not merely on private sector involvement (PSI). His suggestion was limited to the draft agenda, and did not imply any redrafting of the draft report of the Managing Director to the IMFC on private sector involvement in the prevention and resolution of financial crises.

Mr. Wijnholds said that he could agree to Mr. Quarles's proposal, provided that the word "private sector involvement" remained explicitly as part of the title.

Mr. Lehmussaari suggested that the topic of private sector involvement be discussed in the main session, instead of during lunch as proposed, given its importance on the Board's agenda over the past six months and the major crisis cases of Turkey and Argentina. Issues related to the HIPC Initiative and financing under Item 5 of the agenda, which were of a stock-taking nature and thus less important, could be moved to a luncheon session and should also be discussed in the Development Committee.

As regards Item 3 of the agenda, Mr. Lehmussaari asked what aspects of globalization were expected to be discussed by Ministers and whether the Managing Director's statement would be circulated before the IMFC meeting. As the topic was rather broad, such a statement would serve as a useful guidance to ensure a more focused discussion.

Mr. Cippà, supporting Mr. Wijnholds, stressed that the discussion of crisis prevention and resolution should focus on private sector involvement, which was the main issue that required guidance from Ministers. He also supported Mr. Lehmussaari's proposal to switch Items 5 and 6.

Mr. Duquesne made the following statement:

> Whatever the outcome is, this agenda is really ambitious, considering the limited time frame allowed this year for the IMFC meeting. There is therefore a need for streamlining the discussion among Ministers. I understand that this is what colleagues had in mind.
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> The World Economic Outlook (WEO) is a very good topic and, clearly, there is a need for discussion. My question is whether there would be a revision of the assessment that was contained in the *WEO* report to a certain extent, assuming once again that the meeting takes place as scheduled.
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> Second, as we assume that there will be demonstrations, Item 3 of the agenda on responding to the challenges of globalization would be the topic to which Ministers would attach great importance.
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> Finally, as pointed out by Mr. Lehmussaari, Item 6 on private sector involvement is probably more important than the prevalence of the HIPC Initiative, which should be discussed in the Development Committee, and might be discussed at lunch. So, if we had to choose among the topics, we would take Items 2, 3, and 6.

Mr. Quarles said that he shared Mr. Duquesne's comments, but noted that the time allocated for the IMFC fall 2001 meeting had not been cut down, as it was scheduled to begin at 8:30 a.m., one hour earlier than previous IMFC meetings.

Mr. Portugal made the following statement:

I think my first comment is in the same line as what Mr. Duquesne has said, and it has been a permanent comment that I make every time we discuss this IMFC agenda, on the importance of having a small number of items that can really be discussed in depth. I think that a small number of items is one of the most important elements to make this meeting more interactive and more effective. Ideally, we should bring to ministerial discussions basically things where we need to have a negotiation of a political compromise on an issue that is difficult, but that has already been substantially discussed in the Board. So, my general plea during this discussion is to have a small number of topics in the agenda, two, maybe three. Unfortunately, it is very difficult do so, because what we usually do is either to have items with a number of sub items, or to have items with footnotes, which expand very extensively on a number of sub-items. I think none of this is really streamlining.

Coming to the current agenda, I think the most important topic is clearly Item 2. I believe it is very important to focus the discussion not only on the risks and vulnerabilities, as it has been mentioned in the bullet point below this topic, but also on the policy responses that could avoid those risks from materializing and mitigating the vulnerabilities.

I agree with the suggestion that Mr. Quarles has made of making Item 6 broader than it is, putting it in the context of crisis prevention and resolution. And, perhaps, we could consider taking out of Item 3 some of the very large number of sub items that are listed in the footnote. Indeed, I would say that some of these items in the footnote include issues that are not new and that there is nothing to discuss again. We would simply be repeating. I know this is just for the comments of Ministers in written statements, but there are topics like standards and codes, financial sector, and sequencing of capital account liberalization on which we do not have anything really new to add now. So, perhaps missing the suggestions of Mr. Quarles and Mr. Duquesne, we could take entirely out of the agenda some of the topics that have already been extensively discussed and to leave, together with private sector involvement, some of the other issues that have not yet been fully discussed, and then to leave the Item "Responding to the Challenges of Globalization" really to deal with what the political implications could emerge, as Mr. Duquesne has suggested.

I am not sure that moving a topic from the main discussion to the lunch session is an indication that we are reducing the importance that we give to that topic. I would think the contrary would be true, because usually during lunch Ministers can have a much freer and more frank discussion than during the IMFC formal meeting. So, sometimes for difficult topics on which it is difficult to come to a consensus, it might be better to have that discussed during lunch. I agree with Mr. Lehmussaari that perhaps we do not need to have on the agenda this time an update on the HIPC Initiative, because there is nothing new there right now. It is an issue that is going to be discussed in the Development Committee, which is a joint committee with the Fund.

Mr. Yagi made the following statement:

Concerning the general trend, I support Mr. Duquesne and Mr. Portugal. I have no figures about the hours allotted to this IMFC meeting compared to the previous meetings. But, the agenda listed here is extensive relative to the time frame. It will therefore be important to focus the discussion. In view of the current situation, I believe enough time should be reserved for Ministers to discuss extensively the World Economic Outlook and responses to the challenges of globalization.

On the discussion topic for lunch, we do not have strong ideas, but we think private sector involvement is not a good topic to be discussed at lunchtime. As Mr. Portugal said, lunchtime discussion allows for a rather free and frank exchange of views. As the topic of private sector involvement itself is very technical and involves legal matters, we do not want Ministers to speak very freely and frankly on this technical or legal matter. So, we think that it will be rather appropriate for the luncheon session to have issues surrounding globalization or something on this rather politically succinct topic.

On the last point, which I always have to say, it is regrettable that footnote 3 does not refer to the review of quotas and members' representation. These are the issues that the IMFC asked for progress on, and we already discussed them informally. This issue, thus, should be included in footnote 3 to invite Ministers' comments.

Mr. Bernes made the following statement:

This is all a bit surreal. Largely, I agree with Mr. Duquesne and Mr. Portugal. If we are talking about streamlining the meetings, and indeed we are, because of the circumstances, I think this is also an opportunity that we might want to seize to streamline the agenda, and I would go further and streamline the IMFC communiqué. This may be an opportunity, that allows us to get rid of the alphabet-soup approach to our agenda and communiqué where everything has to be covered. I really think we should reflect on that.

As Mr. Duquesne and Mr. Portugal said, the World Economic Outlook, even more so after the events of this week, is clearly where the focus is going to be, both in the meeting and outside—in terms of financial markets and the media. And, unlike the last meeting where we were in a more benign environment, it is going to consume time.

I would say on Items 4 and 5 of the agenda, we are not expecting serious decisions or new directions from Ministers; these are things in progress, and I think, at most, they should be reflected as informational reports, but not form part of the agenda.

I think PSI is useful to broaden it out. PSI is part of crisis prevention and resolution, and should be in that context.

On globalization, what may be happening outside the meeting room is something Ministers will probably want to talk about. Frankly, I think that might be a good topic for the luncheon conversation, similar to what we did the other day, which, I think, was a good discussion. That is the sort of discussion, in fact, Ministers need to have. I would just end with a plea for streamlining.

Mr. Padoan made the following statement:

First, I think that, to streamline discussion, one should take stock of what Mr. Quarles rightly said—that there is not really a problem with the time available relative to previous meetings.

Second, one should distinguish between the time Ministers dedicate to discussion and what is in the communiqué, which might reflect some old issues, and on that I agree with what Mr. Bernes just said. Also, given the exceptional circumstances, messages should be sent out on what are key issues. In that respect, I share the view that Item 2, with specific emphasis on vulnerability and policy responses, is important.

Item 3 on globalization is, of course, on top of the agenda, but again, I strongly suggest that we choose some specific issues where the responses from Ministers and this institution are more relevant rather than more technical issues.

I would join other colleagues in stressing the fact that PSI should be kept explicitly on the agenda, although it is closely related to crisis prevention and resolution. From that point of view, I politely disagree with what Mr. Yagi said. Of course, it is a very highly technical issue, but not just a technical issue. It is, in many cases, much less and much more than a technical issue and, from that point of view, I have confidence in the technical capabilities of our leaders and governors to discriminate between what is technical and what is less technical but highly sensitive. So, I would not be against the idea of having PSI discussion at lunch, exactly because it is a key issue where frank discussion is very much welcome.

Mr. Pickford made the following statement:

Let me react to some of the suggestions that have been made.

On the issue of broadening out PSI, I think it would be helpful in the agenda to have a broader reference to crisis prevention and resolution, though I am sure that PSI will feature quite heavily in that, for the reasons that Mr. Padoan spelled out. I am with those who think it would be best actually to have that free and frank discussion over lunch, because we would want to reflect on the experience over the last few months, especially in terms of the cases of Turkey and Argentina. To be quite honest, it would be better to have that discussion in a very restricted session when Ministers can talk to each other freely and exchange their views on those issues.

On the question of globalization, I have some sympathy with the length of the footnote and I have some sympathy with those who complain about it. I guess what I imagined was behind this was that, at the meeting, Ministers would talk about the big issues related to globalization. There are a number of issues in the footnote that I would not, frankly, expect to come up in the discussion, but Ministers would feel free, if they want to, to focus on them in their statements. I can imagine that different Ministers will pick on different aspects. Some would, for instance, want to pick on capital account liberalization to focus on in their statements, and so on.

On the globalization issue, I think one of the problems is that we are also trying to send messages through this agenda. At least until two days ago, we thought the major focus of the meetings would be the demonstrators outside, and the issue is whether globalization was actually a good thing or not. And, in that regard, I think we would prefer to see the low-income country topic coming up and being seen as part of the globalization issue—not necessarily for detailed discussion, because, as many have said, there is not that much new to say about it. But, there is a question, if we are going to send a strong political message about the benefits of globalization—which I think is what the Managing Director has in mind, and I think is right—one of the issues there is whether we can demonstrate that the poorest countries are also benefiting from that process.

I think it is correct to say that the WEO discussion, in particular the vulnerabilities facing the world, will be very much more at the center stage than have been in previous meetings when the outlook has been more benign. And, I look forward to some productive discussion at the meeting on that, if it happens. As Mr. Bernes said, all of this is rather surreal at this stage, but I guess this is part of the process of returning to normal as much as we can.

Mr. Portugal requested that the Secretary explain the reasons for having an extensive list of issues in footnote 3 for Item 3 of the agenda. Of the seven topics listed, some had not been sufficiently discussed by the Board and would have been controversial, such as early warning systems and framework for vulnerability assessments. If, as suggested by Mr. Pickford, Ministers were free to choose to comment on any issues listed, it would be difficult to reach any consensus. The purpose of an agenda should be to limit the topics of discussion so that each topic would receive full attention by Ministers. Mr. Bernes had correctly stressed the importance of streamlining the communiqué. As a means of communicating the decisions and views of the IMFC to the public in a transparent manner, the communiqué should include only those topics that were properly and substantively discussed by Ministers. It would be unacceptable if the use of footnotes for sub-topics became a nontransparent instrument for some participants in the drafting of the communiqué to give instruction to the Fund's Board and management. That seemed inconsistent with the objective of promoting good governance.

Mr. Kelkar made the following statement:

> We agree with Mr. Duquesne and Mr. Portugal, and I think the agenda could be streamlined to focus on Items 2, 3, and 6, with Item 6 being discussed in the larger context as suggested by Mr. Quarles. The modification I would suggest to Item 2 is that, as Mr. Padoan and Mr. Portugal mentioned, it should contain policy responses as an explicit mention, because this would mean also what policy responses the international community would recommend.
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> Regarding Items 4 and 5 of the agenda, perhaps they could be presented in a progress report, submitted for the information of Ministers, so that we fulfill our responsibilities. In a progress report, one could also add a report on the Independent Evaluation Office (IEO), as it was requested at the last IMFC meeting.
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> Regarding what should be the topic of the lunch discussion, I also tend to agree with Mr. Portugal and Mr. Padoan that perhaps we should assign the largest quantitative-based topic for the lunch discussion, and have the PSI item discussed in the larger context of crisis prevention and resolution, where we can encourage a more frank and open discussion.

Mr. Zoccali made the following statement:

> I would fully endorse what Mr. Bernes has said. I think these are exceptional circumstances and we must seize the opportunity to shy away from this alphabet soup-type approach that we have followed regarding the agendas in prior IMFC meetings. The opportunity presents itself for a very strong message of political unity behind the underlying themes that require policy action. In this regard, I would also support what Mr. Portugal has said. In terms of the priorities, the World Economic Outlook and the policies responses at this juncture of reinforced slowdown of the global economy seem to be paramount. In this regard, I would hope that the issue of trade comes out

as part of the message that our Ministers could be giving on this occasion to reinvigorate the world economy.

Responding to the challenges of globalization is certainly expected to be touched on this occasion. Again, Mr. Portugal has touched on the methodological aspect and on some issues. There is little prospect of advancing clear recommendations. We should be quite selective, and make sure all our Ministers will be focusing on the major issues at the same time so that we may be able to derive the appropriate consensus.

On the issue of PSI, I would agree with the formulation put forth by Mr. Quarles in terms of the broader presentation for crisis prevention and resolution. I think that we should not be scared of the political guidance that our Ministers might be able to give on this broader issue, keeping in mind not only the intricacies that we all know surround these issues, but also the political consequences that follow from them. In this regard, I think the issue of PSI would benefit significantly from a frank discussion over lunch.

Mr. Kiekens made the following statement:

I have four comments. First, on the World Economic Outlook, I propose a second bullet. We should not only discuss risks and vulnerabilities, but also policy responses. Mr. Padoan made that observation already.

Second, responding to the challenges of globalization is a main topic, but as it is presented now, in my assessment, it looks only a fashionable rewording of what we called a couple of years ago strengthening the architecture of the international financial system. I agree with Mr. Portugal and others that we should not touch under that heading all the technical issues we have already discussed for years under the title of the architecture of the international financial system. What are the topics we should discuss under challenges of globalization? I see two main topics.

First is the poverty issue. It would be a tragic mistake, particularly at this juncture, to eliminate the Fund's involvement in poverty reduction entirely from the agenda. It is a prominent part of our job and that is also how the public sees it. It is very much linked to the challenges of globalization, and I agree with what Mr. Pickford had to say on that. So, my first topic under the heading of responding to challenges of globalization is poverty reduction. A second, equally important topic is how we can reduce the volatility and the crisis-prone aspects of the international monetary system. We can come to the more traditional topics, but I think it should be good to take this approach.

My third point is on private sector involvement. Yes, this is part of a broader mandate of the Fund in crisis prevention and resolution. But, I agree with Mr. Wijnholds and other Directors that we need, at this juncture, guidance on private sector involvement from our Ministers. So, I think this should be an important technical discussion that should be discussed in the main session, rather than in the luncheon session, because we have no reporting from the luncheon session, and we are not sure what is discussed. That is my experience. So, to be pragmatic and clear, on private sector involvement, I suggest that this is discussed in the main session, but that the chairman can discuss more political aspects of that delicate topic also at lunch.

Mr. Wei made the following statement:

Generally, I share the comments made by Mr. Portugal. I believe that, in order to streamline the agenda and also make the meeting more focused and more fruitful, items that have been discussed before should not be discussed this time. We should focus on more important issues.

Secondly, I agree with those speakers who favor moving the topic of PSI to the main session.

Thirdly, I share Mr. Yagi's comment on the quota issue. We had an informal discussion of this matter, and I remember that Mr. Yagi sent a memo to the Secretary, as he is not happy with the removal of this item from the Board's agenda before the Annual Meetings. I wonder what would be the response from the Secretary. Like the PSI issue, I believe we also need guidance from Ministers on this quota issue. It is a rather important topic, and should be mentioned somewhere.

Mrs. Farid made the following statement:

I am in full agreement with Directors who are making a strong plea for streamlining the agenda. We have been trying to do this for a number of years now, and we think it is time that we should look seriously at that.

I would like to agree with Mr. Kiekens. We are fully in agreement with what he said and the specification of the topics under Items 2 and 3.

We also agree that higher priority needs to be accorded to PSI and that the topic should be placed in the wider context of crisis prevention and resolution.

We also feel that issues on which work is already in progress and we have nothing new to present to Ministers should be presented as progress reports. But, we do agree that the communiqué should refer to what is being done in streamlining conditionality and on the HIPC Initiative.

We also fully share Mr. Portugal's comments about footnote 3. We find that, for all the topics listed in footnote 3, there is nothing new to be presented. We are also concerned that many of these issues have not been discussed recently by the Board. So, we do not think that it is appropriate to include them in the agenda. Also, it is not appropriate to include them in the communiqué if not all Ministers made their views known on these issues.

Mr. Oyarzábal made the following statement:

First, I agree with Mr. Portugal's suggestion with respect to the streamlining of Items 2, 3, and 6 of the agenda. I think the suggestion is also to change the title of private sector involvement to crisis prevention and resolution, and we can make the PSI issue an explicit topic under that title. The suggestion that this topic can be discussed at lunch is a good one. I would accept that proposal.

I would also like to see the issue of trade being brought out more in the agenda as a subject for discussion, probably under Item 2 on the World Economic Outlook. I think that Mr. Kiekens's suggestion with respect to policy responses is an essential part of the WEO, and it should also be brought out in the agenda.

A suggestion to include poverty reduction in Item 3 on responding to the challenges of globalization is also a good one, and I agree with it completely. I think that the Acting Chair's presentation on the topic of globalization at the recent lunch is extremely important in that it stresses the positive elements that have already been in place for a long time. I think it is a very strong message that should be sent out, because it is not being brought out anywhere, and I think it is a rather lose-lose situation here. We want to go back to a win-win situation.

Mr. Callaghan made the following statement:

Two speakers have mentioned that this is a surreal exercise, and Mr. Pickford said that this is part of business as usual, but it is not business as usual. I think we should be pragmatic and come back to the fact and keep in mind that if we go ahead with the IMFC meeting, people will be expecting something tangible from this meeting. We will be in an environment where a lot of people think the Annual meetings should not go ahead. Thus, we cannot have business as usual, and we cannot have an alphabet-soup communiqué coming out. We need to have a very focused meeting, a very focused discussion, and a very focused communiqué, keeping one eye on the environment in which this meeting will be taking place.

I think that, at the moment, a lot of people are concerned about the World Economic Outlook along with, the tragic events on September 11, and what might be their impact. They are looking for leadership. If this meeting goes ahead, it has to be focused on that discussion, with a very tangible, direct outcome. I think we should be thinking about that. We cannot have a long communiqué, as people will ask what was the point of it.

What that means is that the World Economic Outlook is going to be crucial, and will have a direct, different focus from what we thought it was going to have. It will have to have a degree of leadership coming out of it, responding to some of the concerns, and that will require a very meaningful discussion, more so, perhaps, than in previous discussions. We have to try and work toward achieving that.

I also consider the question of globalization important, and how the Fund is going to respond to that is going to be very much a focus of to meetings.

Other issues are important, but secondary at the moment, given the current environment. In terms of what that means, as I say, I think the WEO is important, and we really should be starting to think about how that should take place.

PSI is also very important, and I thought Mr. Kiekens's comments were good and we should follow them up.

The footnote for Item 3 of the agenda on globalization is misleading. At the moment, the question of globalization should be a direct one of how the Fund should be responding to many of the concerns, especially those of the anti-globalization protestors. I think we should aim for an extremely focused discussion.

Mr. Alosaimi made the following statement:

I also agree with others that the agenda before us is ambitious, especially with regard to footnote 3, which is loaded with many items. So, I think we need to be more focused.

I also agree with others that the topic of PSI should be discussed in a broader context, as part of crisis prevention and resolution.

Finally, like Mr. Bernes and Mr. Callaghan, I think now is the time to be more focused with regard to the communiqué.

Mr. Usman made the following statement:

First of all, I would like to support Mr. Portugal on the streamlining of the agenda. I believe the shorter the number of items on the agenda, the more focused the discussion and the more beneficial. More time should be spent on important issues. The meeting should be focused, and as few items as possible should be discussed, so that we can focus our attention and send the right kind of message.

On the poverty issue, I think it is important, if we want to send the right kind of political message, to have it discussed in the main session and, as indicated at our lunchtime last time, and to show that not only are we emphasizing the good side of globalization, but we are also taking steps to address the downside or the negative side of globalization. PSI was to have been discussed at the Spring Meetings, but because it had not been discussed at the Board, it had to be taken off the agenda. This time around, we need to discuss it.

Mr. Kranen made the following statement:

I would like to associate myself fully with the comments made by Mr. Callaghan. I also think that the agenda under consideration is appropriate for the Annual Meetings under normal circumstances. But, I think for this year, we should not over-burden Ministers with this kind of agenda.

Allow me one question on the WEO. Is there any thought given to producing an additional chapter concerning the impact of what happened on September 11?

The Acting Chair (Ms. Krueger) responded that the terrorist attacks on the United States were recent events that had brought about some short-term uncertainties in the stock markets and microeconomic aspects. In the intermediate term, however, there was not much basis for anticipating major changes in the macroeconomic prospects. This view was also shared by the Director of the Research Department. Therefore, the body of the *World Economic Outlook (WEO)* would not be changed, but some introductory new material might be added, if needed, on a preliminary basis. Assuming that the IMFC meeting would take place in two weeks' time, it would not be possible to reassess the whole picture, and the information available thus far did not suggest that the macroeconomic prospects would be significantly changed.

Mr. Portugal remarked that, while he broadly agreed with the Acting Chair, there was one aspect of the *WEO* that might need to be revisited, that is, the outlook for oil prices. In the current *WEO*, a point had been made that if oil prices increased substantially above the expected levels, additional, different policy responses—and perhaps even more financing—might be needed. The initial reaction to the terrorist attacks on the United States had been an increase of 13 percent in oil prices, but uncertainty remained as to how the situation would evolve.

The Acting Chair (Ms. Krueger) responded that the *WEO* already took note of the increased uncertainty about oil prices. While the event might add more uncertainty in the oil markets, it did not necessarily affect the outcome.

Mr. Kranen noted that that message was very important in light of the growing concern among the public, the media, and even within the Fund, that the recent terrorist attacks might put the world economy at risk. There was a need for some ministerial guidance on that question. The Board, however, should return to discuss the provisional agenda for the IMFC meeting after the decision regarding the Annual Meetings had been made.

Mr. Pickford, supporting Mr. Kranen, said that the current Board discussion was not the end of the process in setting the agenda for the IMFC meeting. The problem was that it was predicated on one or two possible outcomes, while the decision on the Annual Meetings had not been made. The Board should return to the IMFC's provisional agenda once a decision had been taken on the Annual Meetings. The role of the agenda and the scope of the meetings would then be clearer.

Mr. Ismael made the following statement:

> I agree with Mr. Bernes and others on the need to streamline the agenda.
>
> On Item 2 of the agenda on the WEO, I agree that it should be the main focus of our discussions, and I share many of the views expressed by Mr. Callaghan on this issue. I also agree with many others that policy responses should be an important sub-item under this topic.
>
> On Item 3 of the agenda on globalization, my views are similar to those expressed by Mr. Portugal and Mr. Alosaimi. I think that the proposed scope in footnote 3 is too extensive, covering too many issues. It needs to be more focused and streamlined. Also, I think Mr. Kiekens has made an important suggestion as regards poverty reduction.
>
> On PSI, my view is the same as those who think that it should be part of the broader context of crisis prevention and resolution.
>
> Finally, on Item 5, I hope the financing issue will also be part of the report.

Mr. Mirakhor made the following statement:

> At this point, I do not have anything to add on the world economic outlook, but I shall just make a few comments on other items.
>
> On item 3 of the agenda, we really do not know what will be covered in the statement of the Managing Director. Therefore, it is premature to try to

de-emphasize that. The Managing Director has always had a very clear message on globalization—that we need to ensure that there is a framework in place where the costs and benefits of globalization are shared more evenly. I think this is a very important message, particularly at this time. I appreciate very much the comments of Mr. Callaghan. Events of September 11 showed that we are all one family, we are in this together. Moreover, globalization touches us all in perhaps a more familiar sense now than ever before.

Under the presumption that the IMFC meeting would be held, I think this is a very good time to give a clear message that we need to ensure that the costs and benefits of globalization are evenly shared. As Mr. Oyarzábal said, giving the message as you, Madam Chair, have done that human experience is not discontinuous, that globalization has been going on for a long time, and that efforts should be made to ensure that all benefit from it is important, particularly at this time. My hope is that whatever report the Managing Director will make will be one that contains two messages: first, that this is a human experience for all, not only for rich countries, and, that it is continuous and has been going on for a very long time. Second, that all efforts should be made to make globalization an inclusive process, particularly for the poor. It is an important juncture for us to make that statement. I want to appeal to my colleagues to wait at least until we see what the Managing Director wants to say to the world and then decide how much weight we should give it.

On items 4 and 5 of the agenda, I think the world is interested to know how far we have advanced with the HIPC Initiative. While not much time is given, not saying anything would be a mistake. These are also continuous events and concerns. We are dealing with debt relief issues virtually every month. Like Mr. Bernes, I believe it would be more appropriate to issue a report so that Ministers can comment on it if they wish. The Board should be proud of its track record on the work it has done on the HIPC Initiative, and the world needs to know that we are constantly concerned with and aware of the problems of highly indebted poor countries and that we are doing our best to carry our mandate in this regard.

Similarly, on streamlining conditionality, again, the Board has a record to be proud of. We need to give a report on our activities. We need to tell the world what we have done. So far, it has been very effective for the HIPC Initiatives that have come to the Board in which conditionality has been streamlined in line with the Interim Guidance Note on conditionality. These programs have streamlined conditionality and enhanced program ownership, but also have managed to strengthen the programs and make them more focused.

On PSI, I do not think we can emphasize enough the importance of this issue. Under whatever rubric, whether as part of crisis prevention or resolution, this is a very crucial issue. As a Board, we have a message to relay to the private sector, that it needs to become more productive. For two years, we have waited for the private sector to come up with some solution. But, Turkey and Argentina have proved to be quite disappointing, and I think that the tension in the Board is underestimated, even underreported. There are those who were willing to give volunteerism a chance, but free riding it is not really compatible with a globalized world. Our political authorities ought to be able to begin to seriously discuss how long they are willing to wait for the private sector to get on board when their role is desperately needed. Basically, whether it is discussed during lunchtime or in a main session, it does not matter. The main question is what message shall we, as Board and management, give to the political authorities, and what kind of response shall we receive.

Mr. Mozhin made the following statement:

I broadly share the main sentiment around the table that it would be appropriate to streamline the agenda for the IMFC. I really see two main topics of the agenda, Items 2 and 3 on the World Economic Outlook and the challenges of globalization, as important topics the IMFC will be expected to comment on.

As for the rest of the list, including private sector involvement, I do not think we can realistically expect a lot of new things to be said. We have not had many discussions on these issues, and I have not heard about any new ideas in these areas. I would say that this list of issues perhaps should be seen as more like a progress report type of business.

Mr. Duquesne agreed to Mr. Kiekens's suggestion regarding the use of sub-headings under Item 3 on responding to the challenges of globalization. That would help avoid the expansive list in footnote 3. However, all topics listed in footnote 3 were important, especially anti-money laundering initiatives, and could be discussed under the sub-heading of financial vulnerability. Although not all the topics listed had been fully discussed or concluded by the Board, the IMFC could still discuss them, not only as a full body of the Board, but also as a political body that should give guidance to the Board.

Mr. Djojosubroto supported the idea of having a more focused agenda, stressing the importance of Items 2, 4, and 6 of the proposed agenda. Item 6 on private sector involvement could be incorporated into Item 3 on responding to the challenges of globalization; the sub-topics under the latter should, however, be streamlined. Item 4 on streamlining conditionality and enhancing ownership could be discussed at lunch.

The Acting Chair (Ms. Krueger) remarked that Board discussions and the staff's work had to proceed on the assumption that the Annual Meetings would still take place as scheduled, and it was hoped that uncertainty would be removed shortly. It was clear that Directors favored a more focused IMFC discussion, and most considered footnote 3 too expansive. Footnote 3 had been intended to inform Ministers that they would have before them a report of the ongoing work, on which they could comment in their statements. It could be presented in a more concise format to avoid any misunderstanding.

The Managing Director's statement on globalization was being prepared, and would be circulated together with a background paper on the topic, the Acting Chair continued. The background paper—about 20 double-spaced pages—would provide historical background along the lines suggested by Mr. Mirakhor and others. The Managing Director's statement would be more succinct and geared to open up discussion. Both documents would cover trade-related issues.

Under the World Economic Outlook, a second bullet point on policy responses could be added, the Acting Chair noted. Nevertheless, while the recent events might have increased uncertainty in the world economy, their impact on the macroeconomic outlook was still limited, taking into account currently available information.

Discussion on public sector involvement might start before lunch in the open, plenary session, and continue into the lunch, restricted session, the Acting Chair suggested. On balance, there were enough issues worth considering by Ministers.

The Secretary said that the aim had been to produce a balanced agenda. However, it was difficult to balance the many different aspects while streamlining the agenda at the same time. As noted by the Acting Chair, footnote 3 was intended as a record of the work in progress, rather than to suggest that Ministers should discuss the specifics of each topic. On the question of what items should be taken up at lunch and what items at the plenary, Directors' comments would be taken into consideration, in consultation with the Managing Director upon his return.

It was the Secretary's understanding that the focus of the Development Committee meeting would be on the topic entitled the "United Nations Financing for Development Conference," the Secretary explained. The progress reports on the HIPC Initiative and Poverty Reduction Strategy Papers were included in the Development Committee agenda under the heading of items for comment in circulated ministerial statements.

Clearly, management, the Secretary's Department, and the IMFC Chairman's office would prefer to see a shorter, more focused press communiqué, the Secretary continued. As those participating in the previous communiqué drafting process might be well aware, the drafting group met simultaneously with the plenary session of the IMFC. One way to have a shorter, more focused communiqué would be to break down the communiqué into three shorter, more succinct parts—the first part discussing the World Economic Outlook; the second part containing a political statement on globalization along the lines suggested by Directors; and the third part reporting, in the form of succinct bullet points, work in progress and directions for the future, covering several of the points mentioned in footnote 3. That vision had been discussed internally, but remained subject to change after further discussion with management and the Chairman of the IMFC.

Mr. Portugal commented that, while he agreed with the Secretary's idea regarding the composition of the communiqué, he saw some problem with the proposed contents of the third part—report of work in progress and future work. It would be rather difficult to draw out directions for the future without the topics being fully discussed by Ministers. That option would, in effect, not differ from the present footnote 3 format in the sense that, in order to discern directions for the future, Ministers would be requested to include their comments on those issues in their statements.

Mrs. Farid said that she fully agreed with the comments made by Mr. Portugal, and expressed concern that the staff paper on one topic in footnote 3, i.e., the framework for vulnerability assessments—which was expected to be discussed by the Board just a few days before the IMFC meeting—had yet to be issued. There should be a cutoff date for topics that would be discussed by the IMFC, as the Board needed a reasonable amount of time to brief Ministers on the outcome of Board discussions.

The Secretary said that, regarding Mr. Kelkar's reference to the Independent Evaluation Office, footnote 3 had been drafted in such a way that readers could recognize that the report on the Independent Evaluation Office would not be drafted by the staff. The first part of footnote 3 mentioned a report—traditionally known as the umbrella paper, which was the stock-taking paper—with comments on how Ministers might wish to address those issues identified without going into details. The report on the Independent Evaluation Office, on the other hand, would not be a product of the staff; it would take the form similar to the two-page factual report, entitled "Progress in Making the Independent Evaluation Office Operational," circulated on September 12, 2001, by Mr. Cippà to the members of the evaluation group, with copies to all Executive Directors. Such a report could be made available for the IMFC deputies and put before the IMFC, but, on this topic the communiqué would simply mention that the IMFC took note of the work that had already begun.

As regards the quota issue referred to by Mr. Wei and Mr. Yagi, the plan had been to have a Board seminar on alternative quota formulas before the Annual Meetings. However, given the time constraint, it was not possible in the Board calendar to both schedule the item before the Annual Meetings and to allow sufficient time for the Board and/or for capitals to consider the matter. It had therefore been decided that the paper on that topic would be issued to the Board before the Annual Meetings, and scheduled for Board discussion in the seminar soon after the Annual Meetings.

Mr. Baukol commented that, without prejudging the three-part plan, the idea to shorten the communiqué was reasonable. As pointed out by Mr. Pickford, the Board might need to revisit the IMFC agenda, depending on the decision regarding the Annual Meetings. He asked for clarification whether the PSI discussion would be part of a broader discussion of crisis prevention and resolution, and whether it would take place at lunch or in the regular session.

The Acting Chair (Ms. Krueger) said that she took the point that many Directors preferred to have crisis prevention and resolution as the agenda item. The topic of the discussion would be broadened accordingly. In fact, that was already the title of the paper, but the paper basically focused on the role of the private sector in crisis prevention and resolution. The PSI discussion could start before lunch and continue into lunchtime on the broader topic of crisis prevention and resolution and the role of the private sector.

Mr. Kelkar agreed with the Acting Chair's concluding remarks. He, however, wondered if the sub-topic of poverty reduction would become part of Item 3 of the agenda, as suggested by Mr. Kiekens.

The Acting Chair confirmed the inclusion of the sub-topic in the Managing Director's statement, and ensured that the topic would be covered adequately. Subject to Mr. Pickford's stricture that the Board might need to reconsider the IMFC agenda, depending on the decision regarding the Annual Meetings, the work of the Board and staff in preparation for the IMFC meeting would proceed as originally planned. Directors would be kept fully informed of any new developments.

Mr. Kiekens requested that Mr. Pickford give some indication about the Deputies' meeting scheduled to take place in London on September 17, 2001.

Mr. Pickford explained that the authorities took account of all the logistical difficulties and the appropriateness of going forward with the meeting, but were cautious about taking an immediate decision, as it could prejudice the decision on the Annual Meetings. The U.K. authorities were in contact with the U.S. authorities at the moment. It was understandable how uncertainty had caused great difficulties for the member authorities in terms of meeting arrangements. Directors would be informed of the decision as soon as it was made.

2. PRIVATE SECTOR INVOLVEMENT IN PREVENTION AND RESOLUTION OF FINANCIAL CRISES—DRAFT REPORT OF THE MANAGING DIRECTOR TO THE INTERNATIONAL MONETARY FINANCIAL COMMITTEE

The Executive Directors considered the draft report of the Managing Director to the International Monetary and Financial Committee on private sector involvement in the prevention and resolution of financial crises (EBS/01/160, 9/7/01).

Mr. Kelkar and Mr. Jayatissa submitted the following statement:

> This is a clear and concise report. It has rightly focused on the present status of the private sector involvement in the prevention and resolution of financial crises, progress that have been made since the last IMFC meeting and an agenda for the future. While we fully endorse the report, we have the following few comments.

Box 1: Crisis Prevention Measures

This Box article, which provides a good summary of the steps/measures taken or should be taken to enhance private sector involvement, would also be helpful if mention is made about the availability of several Fund facilities, including the CCL for crisis prevention and resolution.

The article indicates one reason for the disappointing situation with regard to the availability of contingent credit lines from the private sector. Some scholars as well as market players consider that the preferred creditor status of the Fund also as one of the reasons for lack of private sector enthusiasm. We welcome staff's comments.

On collective action clauses, could the staff comment on whether in cases where such collective action clauses have incorporated private sector involvement has been effectively enhanced. Is pricing affected by the inclusion of such clauses? In particular, are there any examples? We would also appreciate staff comments on how the international community could encourage the inclusion of collective action clauses in other countries.

Recently, in an article in Financial Times, Prof. Metzler and his colleagues have put forward the idea of the Fund setting a floor price for its involvement in purchasing debt as a mechanism for encouraging private sector involvement. Would the staff have any views on this suggestion?

Conclusions from Recent Experiences

This section could also highlight the importance of providing markets with updated information on the status of Fund's dialogue with the member countries as a confidence building measure, particularly as the Fund has been making some progress in this area.

We appreciate that the report has clearly acknowledged the difficulties in implementing tough policy measures and has stressed the need to frame policies on cautious assumptions. We fully support this idea and would like to stress the importance of sufficient flexibility on the part of the Fund to take account of political realities in member countries. We also would like to emphasize the importance of the catalytic role of Fund involvement and financing at early stages for crisis prevention and resolution.

Agenda for the Fund

We welcome the proposed work program for the Fund in this area, in particular the further work on access policies. We hope that the new capital markets division would undertake further analytical work and play a key role in enhancing Fund's contribution to facilitate Private Sector Involvement.

Mr. Yagi submitted the following statement:

Let me begin by welcoming the draft report and thanking staff for their efforts in producing it. The report is a good summary of the progress we have made so far on private sector involvement (PSI). But, more importantly, this report clearly presents the lessons we have learned from recent experiences, in particular the difficulties we faced in operationalizing the Prague framework, and the challenges that still lie ahead. I can generally support the report, but would like to offer from suggestions for its improvement.

One editorial improvement I would like to suggest is to make Chapters III, IV, and V more related. In their current form, each of these chapters is totally independent from the other two. As a result, I am afraid it may not be clear to readers how the subjects covered in Chapters IV and V, namely the appropriate scale of official financing and the issues on stand stills, are connected to the overall lessons learned from the recent crisis, as described in chapter III. Some editing would make this important report much easier for the general reader to understand.

I think the agenda for our future work as described in Chapter VI is appropriate. By discussing the various agenda items, the Board's understanding on PSI will doubtlessly be enhanced. I would stress, however, that in applying the PSI framework to various diverse crises, flexibility is key. Clarity and transparency are of course necessary, but we all know they must be sacrificed at times in order for the Fund to fulfill its mission and help our members. Let us not, therefore, set our expectations too high. Even after these discussions, there will be no clear-cut rules that we can apply mechanically to actual crises.

I would now like to comment on some specific points on the agenda as described in Chapter VI. First, I welcome further consideration of policies regarding access to the Fund in the context of resolving capital account crises. This is an important issue in that it can determine our overall strategy for this kind of crisis. In discussing access policies, there is one important issue we need to consider: how to ensure fair treatment on access for all members. As we have seen, there have been substantial differences in the amount of assistance countries hit by capital account crises received. Such disparity of treatment can result in feelings of abandonment by and distrust of the Fund in countries that receive fewer resources as well as moral hazard in countries that receive abundant resources. We should, at least, do a better job in explaining to countries why some countries receive more resources than others. As a precondition for our discussion on access policies, there is no doubt that our knowledge of capital account crises needs to be improved. I therefore strongly welcome that further work on the nature of capital account crises and ways to address them will be done, building on the informative paper distributed in August.

Second, the reason behind the recent frequent occurrences of exceptional access cases is that increases in actual quotas for most of the emerging market countries have not kept pace with the increase in trade and capital flows. The Board has a responsibility to face up squarely to the necessity of adjusting quotas in response to developments in the world economy, and I call on my fellow Directors to take this responsibility seriously.

Third, while it is important to strengthen the Fund's ability to assess the viability of a member's financing plan in the context of program design, we also need to consider how we should respond in cases where the actual outcome of the financing turns out to be very different than programmed. However the Fund's assessment ability is improved, there are bound to be cases where the financing outturn is very different from that envisaged under the program. As our recent experience shows, it is in such cases that we will face difficulties in applying the PSI framework. For example, if we originally assume a catalytic approach, and this does not turn out as expected, what should we do? We need to discuss ways to respond to such cases.

Fourth, in assessing medium-term debt sustainability in the context of PSI, we need to think more deeply about the impact of private financing, in particular how to assess the adequacy of the amounts and cost of private financing. As we have sometimes seen, when a country is in distress, the only private financing available is at a high price. This high cost of financing that a country must pay in order to fulfill the PSI requirement often significantly erodes the country's medium-term debt sustainability.

Fifth, it is obvious more effort is needed to expand our arsenal of tools for program countries in order to ensure that there is adequate PSI, and we agree to consider establishing a legal framework to provide support for voluntary restructuring. We need to acknowledge, however, that this is a very difficult task, and we should not be over-optimistic. Our discussions of this matter will be long-continuing, and we need to be well prepared. In addition to consideration of the legal framework, I believe further discussion on strengthening the usefulness of our current policy on lending into arrears will be useful.

Sixth, and last, I am concerned that the idea of so-called domestic PSI seems to have come into place without sufficient consideration by the Board. I believe it is time for the Board to look into this issue and I would like to request that staff incorporate it in one of our future PSI discussion.

Mr. Oyarzábal submitted the following statement:

At the outset, I would like to thank the Managing Director for his report on Private Sector Involvement (PSI). It is a well balanced paper that puts forward a fair account of our discussions, how far we have gone, and helps focus on the work program that should be addressed in the near future.

Due recognition must be given to the recent seminar on PSI, where important conclusions were reached in bringing forward the discussions on this issue.

It is opportune to touch on the subject of appropriate scale of official financing. The sentence on paragraph 13, page 9 of the report, which states "while the access to Fund financing was large when compared with normal access limits, it was not large when compared with the size of the members financing needs." It has been clearly brought out in our discussions that there are important implications for Fund financing derived from capital account crisis. As the crises have occurred, it has become increasingly evident that the amounts of resources to fill financing gaps have to be very large. The statement quoted before is a recognition of the inadequate adaptation of the Fund to new economic realities that should have been reflected in a timely manner through the quota exercise.

As stated in paragraphs 14 and 15, which also relate to the volume of resources available to the Fund for crisis resolution, I concur with the need for flexibility in the terms of Fund financing under the catalytic approach. Efforts to face a crisis' situation must come through the member countries' implementation of adjustment programs, Fund financing, as well as private sector involvement. Considering that PSI will depend substantially on both of the first two issues, this would imply that the Fund should put its best foot forward in terms of volume, as well as upfront loading of financial support to the country in need; financing which would be supported by the countries' adjustment program.

It is not realistic to attempt to fix ex ante with rigidity Fund financing limits, as the overall financing gap would depend substantially on market expectations, credibility, and success of policy adjustment. The contribution of the program Fund financing and PSI would signal the need for flexibility on Fund financing. It must be sufficient to convince markets of the medium-term sustainability of the economy. At the same time, the programs must be realistic, especially if they involve higher and front loading financing. In this context, it is also appropriate to take into account issues relating to the exchange rate regime, which might have a relationship to the size of Fund financing. This should strengthen the catalytic role of the Fund. Anticipating a vivid level of PSI, may be counterproductive if it does not materialize in practice, thus leading to a higher overall financing need.

In determining PSI, it would seem useful to differentiate between foreign direct investment (FDI), and portfolio investment. The fact that FDI is of a long-term nature and acts as a stabilizing factor cannot be put aside easily. Moreover, when taking into account the contribution put forward by FDI in the financial or banking sector, which helps strengthen the domestic quality of management, one must also consider other important contributions to the domestic scene. On the one hand, you have sizable resources present which can be instrumental in avoiding liquidity and solvency crisis. There is also the capacity for debt rollovers, new lines of credit, and financial engineering that can be seen as elements of support in times of crisis. They should be given due consideration when determining involvement at a time of crisis. FDI contrasts profoundly with foreign portfolio investment.

The costs for PSI should be equal in the case of FDI, as well as foreign portfolio investors. It seems illogical that a foreign direct investor would have to assume the costs associated with the value of claims, plus the possible balance sheet losses in the event of a crisis.

For countries that need external resources because of lack of domestic savings for growth and development, creating a negative bias against FDI, would do great harm. Maintaining FDI flows as well as portfolio investments are essential for emerging markets.

Lastly, it would be useful that PSI be measured more accurately by using indicators that could reflect elements such as the level of FDI, especially in the financial sector, the degree of liquidity and maturity of investments, level of country exposure, and other qualitative criteria.

Mr. Collins made the following statement:

I welcome this opportunity to assess progress on private sector involvement in the prevention and resolution of crises. However, we do have some concerns about the draft paper. First, we are concerned that it focuses too heavily on the use of official money and too little on PSI other than the catalytic approach. It gives the impression that, in a capital account crisis, official money should be increased until combined with debtor adjustment, it is sufficient to restore confidence, and efforts to involve the private sector in such a crisis have either a neutral or possibly negative effect. Second, we would welcome a more practical and operational focus to the future work program. In particular, there are areas of work identified a year ago that still need to be addressed. Third, while we welcome the focus on crisis prevention, we think there should be greater concentration on the role in which the private sector itself ought to play. This relates back somewhat to the discussion we had on the agenda earlier. Let me elaborate on those three points.

My first concern is that the paper focuses too heavily on the use of official financing and insufficiently on PSI other than the catalytic approach. The paper seems to argue against a concerted approach to private sector involvement, noting that resort to concerted techniques to resolve a particular payments issue may have far-reaching ramifications, which are alleged to be wholly unattractive. While this would point to a voluntary approach, the paper also notes that the voluntary approach has only limited effectiveness in reducing the scale of net outflows under circumstances in which confidence in financial markets is slow to recover. Once confidence has slipped, its effectiveness is further reduced. Given that confidence in a crisis is likely to be low, this seems to cast doubt on the effectiveness of a voluntary approach. Taken together with the comment in paragraph 13 that, if a catalytic approach is taken to encourage private sector involvement, sufficient financing must be provided to help the member cover its needs fully until market support returns, this seems to suggest that official financing, combined with adjustment, will have to fully meet any financing gap until market confidence is eventually restored and the country can re-access private markets.

The Fund’s assessment in the paper on recent experience with capital account crises suggests that the assumptions regarding catalyzed private financing have been overly optimistic in recent cases. We think that, in light of recent experience, the official sector needs to consider in advance what to do if that voluntary support does not materialize in sufficient quantities or on sustainable terms. The program is predicated on a catalytic approach that needs to include explicit contingency plans for dealing with a failure to catalyze sufficient market response. As a corollary, we do not believe that the Fund can afford to give the impression that official finance will, in every case, be sufficient to ensure that the involvement of private creditors will always be on a voluntary basis, and that the official sector will always be able to make up the difference.

Even aside from concerns about moral hazard, the current rate of growth, with more countries opening capital accounts to international markets, and the size of capital flows makes it inevitable that the use of a catalytic approach needs to be supplemented with more robust private sector involvement. Indeed, the paper acknowledges that even recent exceptional financing packages have been small in relation to the financing needs of only a limited number of capital crisis cases. Therefore, would it be appropriate and feasible for the Fund to rely on a catalytic approach alone? Hence, it is increasingly important to ensure that exceptional access to official resources is only granted in situations where it is most needed and most likely to be effective.

This also underlines the importance of giving greater attention to work intended to facilitate intermediate forms of PSI between the two extremes of default and indefinite amounts of official finance, including further analysis of the role of standstills, concerted rollovers, and rescheduling. Yet, the paper implicitly discounts the value of this approach, contending that intermediate approaches have proved to be elusive. This dismissal of intermediate forms of PSI contrasts sharply with the staff's assessment in the paper on experience with capital market crises, which suggests that concerted efforts to secure financing commitments from private creditors can actually be instrumental in restoring confidence and mitigating the heavy adjustment burden that such crises impose on countries.

Second, I want to turn to other concerns about the need for a more practical focus on the future work program. As part of the overall framework, I think we need to determine the case of exceptional access and the terms on which it will be provided. The paper rightly summarizes the Prague framework to the effect that there must be substantial justification for granting exceptional access. Yet, neither this report nor recent program documents include sufficient analysis of the factors that should determine our approach to PSI in individual cases. We have argued, for example, that there should be a requirement to provide a full assessment of the potential for systemic risk or contagion in program documents to justify the case for exceptional access. Clearly, Directors and the staff may not always agree with the implications of that assessment, but it is essential that we have a rigorous assessment in the first place on the way in which exceptional financing could be provided.

I have already noted my concerns about the scale of official financing that is implied in the paper, but also there needs to be greater clarity on the terms, in particular, of the relative use of the Stand-By Arrangement (SBA) and Supplementary Reserve Facility (SRF). The report is ambiguous on this front, suggesting, on the one hand, that the SRF is appropriate for large-scale catalytic financing, but, on the other, that its terms of repayment may discourage the private sector and, therefore, credit tranche terms are more appropriate. This last point seems to be new and prompts a number of questions, in particular about burden sharing between the official and private sectors.

My second point under the work program relates to assessing medium-term financing needs and prospects. The report notes that the approach to be taken in individual cases is based on the assessment by the Fund of the member's underlying payment capacity and its prospects of regaining market access. This is central to the PSI framework. We cannot decide between the various options set out in the framework without such an assessment. That is why the last IMFC communiqué called for further work on an improved basis for assessing debt sustainability and on prospects for regaining market access and, hence, our desire to see analytical frameworks developed to assess medium-term debt sustainability and prospects for market access.

While recent program documents included some of the relevant indicators, better information is needed for making judgments about the appropriate degree and form of private sector involvement, burden sharing, and about medium-term sustainability. As such, we need for each program an assessment of the country's financing position and evaluation of the country's prospects for regaining market access consistent with medium-term sustainability, a detailed financing plan covering the short and medium term, and an assessment of potential spillover effects on other markets. I recognize that this is not straightforward, but I would note that all forecasting is difficult and subject to error, and all forecasts have a probability distribution around them. We should, of course, take account of this in the program design and in any ex post assessments. We are asking the staff to make explicit and explain what is implicit there already. The financing gap analysis must contain an implicit assumption about private sector flows.

Third, reaching an assessment that a country has strong prospects for an early return to capital markets is not very different from forecasting capital flows. All cases will, by necessity, involve difficult judgments and tough choices. But, the Fund should focus attention on analytical tools to assist in making these judgments and developing program documentation that spells out the assessments in full.

My third point on the work program is on measuring private sector involvement. The paper refers to Argentina and Turkey; both cases underscore the need to develop other techniques for measuring and assessing the level of PSI and judging its effectiveness. It is essential that we measure the price as well as the quantity. For example, the Argentine debt swap in June 2001 is expensive in terms of future financial costs, and also has a negative impact on Argentina's private contingent repo facility, with a number of banks swapping debts that reduced their obligations under the repo facility. We need to consider how to measure such a swap and its effects in terms of PSI and legal issues. The paper rightly notes that recent developments raise the prospects of legal difficulties in future debt rescheduling, and we, of course, agree on the need for further work. This should include an analysis of the issues involved in standstills and should cover what changes might be necessary to the international legal framework to facilitate debt restructuring.

Fifth, on the work program, it is an ex post assessment where we need to strengthen our ex post evaluation and transparency of individual Fund programs, including, upon completion of the program, publishing the Fund's adherence to the framework and, where appropriate, the justification for any decision to grant extraordinary access to Fund resources. Although this is not for today's discussion, we might also consider what role the Fund's Independent Evaluation Office could play in the process of ex post evaluation.

I just want to say a word on my third topic briefly, that is, on crisis prevention. As I said at the outset, while we very much welcome the emphasis on crisis prevention and agree that this must be the main priority, we think that the focus in this report should be on the specific role that the private sector itself should be playing. Thus, for example, paragraph 11 is a general—and rather platitudinous—statement of the need for prudent economic policies, with no particular value-added in relation to the PSI debate. My other main concern in terms of drafting is the reference to private contingent credit lines in Box 1 where we think it is premature to conclude that the prospects are less promising. Overall, I think the tone there is too negative. The paper is right to note that a calling of a contingent credit line has led to a reduction in the private sector's exposure elsewhere. Our challenge must be to find ways to address and work around this problem. We would also be very concerned about the signal this sends to the private sector, given the emphasis we have put on contingent credit lines as a means of encouraging private sector engagement.

In general, there is a need to address the bias in the paper in favor of the use of official money and against any form of PSI other than through the catalytic approach, particularly in paragraphs 8-15. More specifically, we need to ensure that the work program addresses a number of outstanding practical issues in determining the case for exceptional access and the terms in which it will be provided; assessing medium-term financing needs and prospects to be included in program documents; contingency planning in Fund-supported programs, particularly catalytic ones; measuring PSI in Fund-supported programs to ensure that we consider price as well as quantity; outstanding legal issues; and, finally, ex post assessments of programs and PSI.

Mr. Kiekens made the following statement:

The staff rightly points out that it is critically important to have a sound framework for interactions among troubled debtors, including sovereign debtors, the official sector led by the Fund, and private creditors, be they residents or non-residents. A framework for the orderly resolution of the problems of troubled debtors having international debt obligations would reduce the risks resulting from the integration of financial markets.

Although there has been some progress, there are obviously many issues still to be clarified and resolved.

I am pleased to see that, at the end of the report, the staff outlines a preliminary agenda for further work, to be discussed in detail following the Annual Meetings. I broadly agree with that agenda. I think that studying the legal aspects of a debt resolution should receive primary attention, covering the full range of issues. But such studies should not be limited, as the staff suggests, to "preliminary consideration of the feasibility of establishing a legal framework that could provide greater support for a voluntary process."

Our research should be much more ambitious and include unilateral standstills, restructurings, and debt reductions preferably to be endorsed by an independent international authority. In practice, the adoption of clear and effective rules for such decisions by the debtor country and at the international level will provide the best incentive for voluntary restructuring agreements, provided mechanisms are available to prevent free riding by minority creditors who refuse to accept restructurings or debt reduction arrangements that have been accepted by a vast majority of the creditors. Too many years have been lost for establishing this necessary legal framework. The Fund's Legal Department, in cooperation with experts from other Fund departments, central banks, academia, and the private financial sector, should make a comprehensive study and devise proposals.

Short of an effective legal framework for the orderly resolution of the problem of insolvent debtors, there will always be strong pressures on the official sector to provide ever larger credits in the hope of preventing the excessive costs of a disorderly debt resolution. This approach itself has costs that are clear but difficult to quantify: how can we know how much unconsidered risk creditors will accept because they expect official support to protect them against losses? And, how can we balance the costs of the probably more severe crisis that would follow an unsuccessful rescue supported by very large Fund credits, against the benefits of very high access and high risk programs that have a chance of ultimately succeeding, as did the programs for Mexico, Korea, and eventually Brazil? It is certainly useful to consider the problem of moral hazard, as suggested by the staff. But I am skeptical about the possibility of quantifying that risk in any reliable way.

Related to the legal risks and obstacles that hamper restructuring is the lack of sufficient technical expertise on the part of official debtors that are negotiating the terms of their credits with investment banks, especially contingent credit lines; and in times of trouble and distress, the terms and conditions of debt reschedulings, debt swap operations, and other agreements that ought to alleviate the debtor's financial problems instead of ultimately adding to them. The Fund, the World Bank and the authorities of emerging market countries should consider how they can better equip themselves to manage external debt successfully.

I would now like to comment briefly on Chapters II to V of the report itself.

In paragraph 8, the staff correctly observes that debt exchanges for improving the debt profile can be very expensive during times of stress when there is serious doubt about sustained policy implementation. The staff further remarks that when the banking system is strong enough, restructuring domestic debt may be easier than restructuring external debt. And finally the staff concludes that intermediate solutions, between purely voluntary agreements and "the applications of concerted techniques," which I take to mean unilateral decisions, seem to be elusive.

To me, these conclusions are regrettably correct, because we lack the framework, and the ability, to achieve an orderly restructuring of external debt, if necessary without the consent of creditors. I would like to suggest that, in paragraph 8, the staff should make it clear that intermediate approaches between voluntary agreements and unilateral standstills might be much easier to find if there were clear and credible international bankruptcy procedures for sovereign creditors.

Such a framework would also enable the Fund to apply stricter rules and limitations on its own financing, as is indeed suggested in the last sentence of paragraph 9, while at the same time making room for judgments within admittedly more stringent limits than those applied today by the Fund.

Paragraph 13 of the draft report suggests that "if a catalytic approach is taken to encourage private sector involvement, sufficient financing must be provided to help the member cover its needs fully until market support returns." As now written, this sentence gives the impression that the catalytic approach is compatible with unlimited financing as long as the Fund believes that market confidence will eventually return. This is too simple an interpretation. There is obviously a trade-off between the amount and the duration of official financing required by the catalytic approach and the strength of the Fund's belief in the return of market confidence. The catalytic approach is only consistent and credible if Fund financing remains limited—though it can be large—and brief. What constitutes largeness depends, inter alia, on the country's financing needs.

In paragraph 14, the staff observes that capital account crises tend to be larger and more sudden than the more traditional current account crises. This is certainly true. However, it might be useful to mention that the depth and speed of crises tend to increase greatly under fixed exchange rate regimes.

Paragraph 15 deals with the delicate balance between the necessary assurances that Fund credit will revolve rapidly and the need for the Fund's financing to last long enough to reduce the risk of a near-term liquidity crisis. This is a matter for additional consideration, as suggested in the second bullet point of the agenda for further work. I would like to observe already today that the Fund's credit should not take the place of a consolidation of short-term private credit. And, while it would be counterproductive to adopt maturities that are too short to allow market confidence to return, in capital account crises, the Fund's credit, unlike the World Bank's credit, should always be a bridge loan to prompt new private financing and not a medium-term substitute for private credit. This last issue shows how important it is for the Fund to correctly evaluate the time it will take for countries emerging from crises to regain market access. The Board will discuss this subject next week.

Mr. von Kleist made the following statement:

I thank the staff and management for the preparation of this report, which is timely indeed for at least two reasons. We have recently gathered additional valuable experience and knowledge in the area of PSI, and it is abundantly clear today that we still have difficult work before us to operationalize the PSI framework. The draft before us is a reasonable basis for a report but, to be frank, parts of the report did not meet my expectations. I am in broad agreement with the first six pages, which essentially summarize previous discussions and recent experience, and which are largely factual by nature. Also, the proposal for an agenda seems, on the whole, to be well thought out, and I shall come back to this.

However, Sections 3 and 4, while offering some valid observations of recent experience, do not appear to draw the appropriate conclusions from this experience. I cannot avoid the impression that, with the undeniable difficulties experienced thus far in achieving PSI, the staff seems to conclude that we have to relax the criteria and perhaps give up on our objectives of achieving PSI. I am pretty confident that I am not the only one who believes we can do better than that. To illustrate, let me give four examples.

First, paragraph 8 seems to give up on any meaningful PSI. That is not good enough. We have to do something better than that. If we are content with what paragraph 8 reads of PSI and we continue to call this PSI, we might end up in a situation like that described by the Danish poet and writer, Hans Christian Andersen, in his delightful tale of The Emperor's New Clothes—"Somebody will call, but he is naked." So, we should certainly look at that.

Second, paragraph 9 begins by stating that, as a conclusion from recent experience, concerted techniques of PSI may have far-reaching ramifications. This is certainly a valid and important concern. But the recent few cases in which concerted techniques have been applied seem, if anything, to alleviate such a concern. This is also confirmed by the beginning of Box 2. Hence, addressing this issue by way of a conclusion from recent experience introduces an unjustified bias against PSI. Also, not achieving PSI may have far-reaching ramifications for the country concerned. If this were an easy problem with easy solutions, we would not have to discuss it today.

Third, Section 4 on the appropriate scale of official financing focuses almost entirely on the so-called catalytic approach to PSI and on the need to retain a large degree of freedom as regards the volumes and terms of official financing. However, we feel quite to the contrary; rather than making rules on the provision of official financing more flexible, PSI requires constraints, for instance, through more rigid ex-ante rules on the provision of financing and through rigorous criteria for the exceptional circumstances clause. This proposition is completely lacking in Section 4, as evidenced, for instance, in sentence 2 of paragraph 13, which has been quoted by Mr. Collins.

I would also like to come back to the sentence that says, if a catalytic approach is taken to encourage private sector involvement, sufficient financing must be provided to help the member cover its needs fully until market support returns. To make my point more clearly, I looked up in the dictionary once more what "a catalyst" means. A catalyst is defined in the dictionary as a substance, usually used in small amounts relative to the reactants, that modifies and increases the rate of reaction without being consumed in the process. One important observation here is that the term "catalytic" means something is taking place at the same time, not before something else. I think it was Confucius who observed that when words lose their meaning, people would lose their liberty. So, I would encourage the staff to look at what we are doing now, what is being put on the table that can be called a catalytic approach still, or whether it should be called the locomotive approach, that is, public money goes in and hopefully encourage some private money to follow. So, that would just be a suggestion here. The locomotive approach is an option to crisis resolution that hinges on the country having good prospects of a return to market access, and the solution being consistent with medium-term debt sustainability.

Fourth, another example relates to the aspect of capital account crises and the ensuing large-scale financing needs addressed in paragraph 14. Obviously, such crises can often be mitigated through flexible exchange rate regimes. I recognize that the crucial preventive role played by prudent macroeconomic policies is already being dealt with in paragraph 11. But a brief reference to exchange rate policy in paragraph 14 would produce a more balanced presentation.

Lastly, sentences 4 and 5 in paragraph 15 are, in my view, highly problematic, since they call into question our understanding that it is the SRF rather than other facilities that should be the main instrument to deal with capital account crises. I certainly hope that we are not opening up our recent understandings on facilities through the backdoor here. This is an important topic that needs a discussion of its own.

Turning to the agenda for further work, the suggestions addressed several important issues that need to be tackled if we want to make real progress on our PSI framework. These issues include, in particular, points 2–5 in the report. On the other proposals, I would caution, like others, that we should not expect too much from further empirical work to quantify such phenomena as contagion and moral hazard. On point 3, regarding medium-term debt sustainability, there is a need to make this important exercise more explicit in the documentation of concrete country cases. Finally, on point 2 concerning Fund access, I would like to recall that this is essentially the missing part of our recent discussion on access policy, and that this gap should be filled sooner rather than later.

To conclude, let me say that I look forward to a revised version of today's draft report to be presented to the IMFC.

Mr. Törnqvist made the following statement:

When we were discussing the Managing Director's draft report on PSI to the IMFC in April, this chair called for a more forward-looking report, setting out the PSI agenda before us. I am glad that the report we are discussing today has such a forward-looking element in it. This is an important part of the report, and I would agree that the points listed there should be dealt with urgently, maybe with the exception of the last point about quantification of moral hazard. It does not seem as urgent and I have some doubts about its feasibility.

In general, I find that the report is better designed than the one we discussed prior to the Spring Meetings, to meet the request of the IMFC for further work on PSI, focusing in part on further articulation of the Fund's role and on practical issues involved in applying the framework. Another issue is, whether it reflects properly where the Board stands on these issues. I will return to that matter.

A similarity with the April draft is that it is again evident from the report how little progress we have made on PSI . We have only had one Board discussion, and that was on an issue that hardly was central for making progress on PSI, even if it is important in its own right. The seminar, held in July, did not involve the Board as a whole and I am in some doubt as to whether it should be reported as progress made by the Fund on the issue.

The MD's report examines the recent experience of PSI and draws a number of conclusions from it. As we all know, the views on PSI in the Board are quite diverse. It is important that the report reflects on this diversity adequately. I have some problems with the report, like previous speakers.

I note that in paragraph 8 it is stated that "intermediate approaches between purely voluntary ageements on the one hand, and the application of concerted techniques on the other hand, have proved to be elusive." I am not sure what is referred to here, but I generally find that the tentative conclusions from recent experience with PSI, generally write off the prospects of debt restructuring too easily.

In paragraph 13, the catalytic approach of the Fund is defined in the following way: Under this approach, sufficient financing must be provided to help the member to cover its financing until market support returns. This is a very far-reaching definition. To meet such a requirement is a tall order. It cannot be accepted without thorough discussion in the Board.

Paragraph 15 discusses in what cases Fund assistance may have to be given on credit tranche terms, rather than SRF terms. Also, this is a controversial issue, where there is no agreement in the Board.

Finally, I am glad to see that the issue of standstills has been given its own section. It poses a number of important questions, particulary regarding the Funds role in standstills. These are issues that we have to consider seriously.

Mr. Bossone made the following statement:

We would like to thank the Managing Director for this very informative and comprehensive draft report, which also represents an occasion for the Board to touch base on these difficult issues and to express its views on the work ahead.

We all now agree that dealing successfully with financial crises needs to rely on an effective PSI. Implementing sound economic policies and nurturing strong economic and financial systems is key to this purpose. However, the form PSI can take in any given set of crisis circumstances depends on the characteristics of the country in question and the type of crisis unfolding. Preparing for crisis prevention and mitigation, therefore, requires a strong analytical basis and a tailored approach to the country economy and the events in place. We appreciate the work undertaken by the Fund in this regard, also through the creation of the International Capital Markets department, and we believe that, for an effective PSI to be possible, the analytical underpinnings of a tailored approach should systematically encompass relevant institutional and legal features.

We therefore welcome the analytical inclination of the draft report, and we recommend that the work that follows be as much operationally oriented as possible. For instance, the different levels of involvement of the private sector described in paragraph 3 well cover the range of possible circumstances in the event of crises, but considerable work will have to be done to determine when and how these different levels of PSI should be triggered. Work will have to be done also on the definition of medium-term financing need profiles, and on the systematic inclusion of such profiles in the Fund programs.

Legal and Institutional Innovations

As noted, the analysis of the economic and financial systems should eventually lead to defining an operational policy framework aimed at reducing the frequency of crises and at containing their effects, including crucially through the participation of the private sector. Thus, the importance of identifying appropriate legal and institutional instruments and innovations cannot be overemphasized. We believe that a fundamental cooperative dimension for an effective PSI is the creation of an international, incentive-compatible legal infrastructure that gives certainty to investors. Great attention, we believe, should be devoted to this issue in the work ahead.

There is also ample room for improvement in the area of instruments at our disposal. Looking at the recent experience, for example, the methods recently employed to involve the private sector have led to somewhat disappointing results. The debt swap, both in the case of Argentina and Turkey, have been quite costly and have not fully succeeded in restoring market confidence in a sustainable manner (even though, to be sure, they have helped improve the debt servicing profile). Also, the contingent credit lines in the case of Argentina have proved to be less useful than previously thought, due to the built-in protecting clauses for the commercial counterparts and the drastic decrease in the available securities that could be used for the purpose. Looking forward, an area where analytical and creative effort is needed is the use of standstills and how to implement them in an orderly and effective fashion.

Amount of Fund Financing

The draft report rightly points out that the available program financing in terms of quota could be insufficient to address crises with a pronounced capital account component. This bears the important implication that, since Fund resources are not unlimited and their allocation to members should reflect the quota system, financing limits must be rigorously enforced. This would also contribute to reducing moral hazard on the part of private investors. (Let me add incidentally, on the Fund’s financing facilities, that there should be a presumption for the SRF to be employed where it is essential both to increase the credibility of a country and to help revert market sentiment, as is typically the case in a crisis with a strong capital account component.)

Work Agenda

We agree with the proposed directions for further work, with some qualifications. First, the medium-term sustainability and viability of financing plans should be considered as part and parcel of our approach to PSI, and it is wholly appropriate that considerable work in this area be envisaged. Second, as I have already indicated, further analytical work is much needed on the legal implications of debt restructuring. Third, we think that work on the impact of debt restructuring could be very useful, provided that the analysis of the benefits and the costs associated with it be as comprehensive as possible. Finally, we consider ex-post evaluations of the efforts to achieve PSI as well as their outcomes to be very useful, and we would recommend that such evaluations be carried out as part of the assessment of PSI.

Mr. Bauche made the following statement:

I welcome this discussion on PSI. Indeed, our recent discussions on the subject have shown that the Board remains committed to moving forward in this area. As recent high profile country cases have demonstrated, if at all, our framework needs to be refined. I am glad that, unlike the paper we had for the Spring Meetings, today's paper attempts to include more comprehensive analytical parts, and has an agenda for further work. This agenda could probably be made more operational. Also, I feel that the report is still leaning toward a minimalist approach to PSI.

I would start with the analytical part. The principle that no class of creditors should be inherently privileged should be more clearly reaffirmed. I have four points to illustrate that.

First, I am uncomfortable with paragraph 8, which draws on the distinction between resident and nonresident creditors. When I read that more substantial results may be possible in the case of domestic investors than with nonresident investors, I have a feeling that, as presented—and even with the caveats added in the report—this can give the wrong impression that nonresident investors could be less involved than others. I believe we should make it clear that no class of private investors should be protected from participating in crisis resolution. Indeed, we saw in recent cases that the authorities have more room for maneuver sometimes to deal with local creditors, but questions in relation to the long-term sustainability of such an approach should not be downplayed.

Second, in paragraph 9, on the far-reaching implications of concerted PSI techniques, we deal here with the crucial issue, which is the search for the optimal balance between public financing, domestic adjustment, and PSI. Clearly, the two main justifications for providing exceptional access to the Fund's resources should be avoiding excessive domestic adjustment while preserving financial stability, both domestic and international. The staff appropriately points out that the financing mix depends on the assessment of the potential consequences of concerted restructuring, and indeed such consequences are very difficult to assess, and more work is needed to understand the mechanisms at play. But the costs of excessive adjustment on the population are, unfortunately, well-known. Too far-reaching a program is very likely to fail and, ultimately, can harm the credibility of IMF recommendations.

Third, in paragraph 13, it is stated that if a catalytic approach is taken to encourage PSI, sufficient financing must be provided to help the member cover its needs fully. My concern here is that, first, in this paper, we give the impression that we make the catalytic approach the central strategy in terms of PSI; and, second, here we give the impression that the IMF can have a lender of last resort role, hoping that, to borrow the expression used by Mr. von Kleist, sufficient financing will follow the bandwagon.

Fourth, on the framework defined on page 3, the term "official financing" should be clarified. Our discussion on the comparability of treatment between private creditors and the Paris Club has shown that, once restructuring is required from the Paris Club, we are no longer in a catalytic approach. So, to avoid any misunderstanding, it should be clear that, once Paris Club debt restructuring is required, the Fund should ensure that there is an appropriate balance between the public and the private sectors.

Turning to the work agenda, I think that we have a very useful roadmap, but I have three additional comments. First, I believe there is a need for prioritization in this agenda. In this sense, the analysis of the legal aspects is a critical element of the framework, since greater predictability of the framework would certainly help debtors and creditors to reach agreement. Nevertheless, the wording in the paper, and I quote, "preliminary consideration of the feasibility of establishing a legal framework that could provide greater support for the voluntary restructuring process," in my view, is too cautious, and I believe that more straightforward work is needed here.

Second, while the analytical work in the first three bullets is necessary, I believe that we would go in the wrong direction if we were too cautious to undo the expansion of the catalytic approach, both in terms of cases where it should apply and on the use of Fund resources. The implication of a catalytic approach is, in my view, not sufficiently substantiated in this paper, and needs further work and clarification.

Third, I think there are a few areas that have been left aside from this agenda. First, the last sentence in paragraph 8 stated that intermediate approaches have proved elusive. I believe that these are precisely the cases for which we need more work and a more predictable framework to trigger voluntary agreement before the situation deteriorates to a full crisis. In fact, my general feeling from this paper is that it is too much focused on corner solutions, either default or catalytic approach, and not on intermediate approaches. Second, there are few recommendations on how the Fund can help countries to handle crises. For instance, the use of private credit lines could be a market-friendly solution for private sector involvement provided, of course, that it can work efficiently. The Fund can, and should, monitor these aspects of PSI. More generally, there is a need for monitoring the actual involvement of the private sector once it has been decided, which would help the Fund gather and disseminate more information on the PSI framework as it is applied. Let me say, in general, that I associate myself with the comments made by previous speakers.

Mr. Portugal made the following statement:

I want to thank the Managing Director for this concise report on a difficult topic on which we are still building consensus, and I would like to start with a general observation of what I see is the nature of our discussion today. I think we are not discussing the topic of PSI today in a substantive way. We are simply considering a progress report of the Managing Director on where we are now. It is not a discussion of where some Directors would like us to be now. It is very difficult to think that we would be able to resolve, during a discussion of the progress report of the Managing Director about of where we are, issues on which we were unable to reach consensus when we had the substantive discussion. So, I think that is the nature of our discussion today.

I also have some observations on the report, but, before that, let me say that I join Mr. Kelkar on the questions that he raised with respect to Box 1 in the third and fourth bullet points of his preliminary statement.

My first comment is on the format of the report, on whether we really would like to have this as a stand-alone report or as part of an overall report of the Managing Director, which would deal with crisis prevention and crisis resolution more generally. The other point I would make in this respect is that, perhaps as we did last year, it would not be wise to discuss in detail cases that are still unfolding, such as those of Turkey and Argentina, first, because we still do not have sufficient experience and time to draw any firm conclusions on these cases and, second, because whatever we say about them might affect how the issues would unfold. So, perhaps we could use here the same approach that we used in the EVO discussion. Whenever we agree that a case is unfolding, it would not be subject to an evaluation assessment; and that, at least in public discussions, we should discuss only cases that are closed.

I have an observation on paragraph 8. This paragraph mentions that, once confidence has slipped and risk premia have risen, it is possible to get private sector involvement only by paying exorbitant prices and that debt exchanges in times of distress can be very expensive. First, I am not sure that our experience so far with one case would really bear that conclusion. Second, by making this reference in a document that is intended to be public, I wonder if that would not sort of defeat the efforts that we are making in supporting Argentina for having perhaps another debt operation.

My second point is that a number of paragraphs, paragraph 8 and especially paragraphs 18, 19, and 20, make reference to the case of domestic debt restructuring as part of the PSI framework. I think this is something new, which was never discussed in the Board in detail and which I do not think is appropriate to raise in a document such as this. I think the objective of PSI is to close an external financing gap, a gap in foreign exchange. It is true that in a number of countries that have a fully open capital account, this might be a relevant point. But for countries that have less than a fully open capital account and still have restrictions on residents as opposed to nonresidents, I don't think this issue should be discussed. There is, for instance, the question of whether we can properly restructure obligations of nonresidents while continuing to service those of residents? We had that experience in the 1980s, and I think it was possible.

I agree with the arguments presented in paragraphs 13 and 15 about the appropriate scale of official financing. It has been said here that a catalytic approach should not be the main approach of the Fund. I think it should be the main approach. I think in a number of cases where the level of access is high, that would be the main approach. I do not think that we are using the word catalytic here in a way that would contravene the dictionary, because if I remember correctly, the Fund finances 11 percent, on average, of financing gaps. I agree also on this question of the size of access with the observations that Mr. Yagi has made in his preliminary statement. I think we have to consider that the aggregate increase of Fund quotas has lagged behind the increase of global output, of trade, and of capital flows, and that for a number of members, individual quotas also may not capture any more the change of their positions in the world economy. So, whenever we discuss what is too large or too small, I think we have to bear that point in mind.

There has been a discussion here whether paragraph 9, which talks about the far-reaching implications of PSI, is an exaggeration or not. I do not know if it is or if it is not. But, the point I would like to bring is that net private capital flows to emerging markets, which were US$273 billion in 1998, declined to US$58 billion in 1999, and to just US$1 billion in 2000. It will be negative this year, and the staff hopes that it will increase next year to probably one third or one fourth of what it was in 1998. Some are preoccupied with the disappointing results of PSI in one direction, but there are people who are also preoccupied with the disappointing results of PSI in this other direction.

> I have one minor point of wording, and this is at the end of paragraph 2, where we say that the success of crisis prevention is for a member to manage its economy in a way that does not leave it vulnerable to changing market sentiment. I think this is an impossible task. I think we should tone it down a little bit, by saying that the action of crisis prevention for members is to manage their economy in a way that reduces vulnerability to changing market sentiment. But, to eliminate it completely, I think it is too big a task for some members.

Mr. Törnqvist said that he agreed with Mr. Portugal's point that the current discussion should focus on the status report on where the Board stood on PSI. However, the problem with the report under consideration was that it basically reflected the views of the staff and some Directors, while ignoring the stances of a number of other Directors.

The Acting Chair (Ms. Krueger) remarked that she had joined the discussion on this topic at a late stage and had discovered the difficulties faced by the staff in an attempt to respond to Directors' requests for additional work on this difficult subject. It was almost impossible to find a balance between voluntary and compulsory approaches. While measures imposed by the official sector risked discouraging voluntary private capital flows, they would beg the question of how the voluntary approach, which was desirable, could be applied effectively. That was a very difficult question and a major constraint on making further progress. The staff had hoped to be able to report more progress on this front, but there existed the risk of throwing the baby out with the bath water.

The Director of the Policy Development and Review Department (Mr. Boorman) made the following statement:

> It does not surprise me that there is a certain negative reaction to the contents of the paper. We know the differences that have existed among Directors, and there are strong differences around the table. There have been a number of papers that have came out from the staff and from the Bank of Canada and Bank of England—the EFC papers, for example—which take very different views on this. My fear and concern, though, is that there is a certain disconnect between discussions where the general issue is on the table and the specific cases in which the staff has involved. Virtually, everybody wants a different world than the one that we have been working in and they would like to see different results in the individual cases.
>
> A strong part of the difference that exists among Directors, or among Directors, the staff, and all other parties—which, as Ms. Krueger says, has not been solved—concerns judgments on actual individual cases. For each case, we know the alternatives and the results of choosing particular alternatives, and we are willing to take a risk on those alternatives. I think everybody wants intermediate solutions. There is considerable discussion about standstills, for example, where there is great fear, at least amongst some of us, about what the

results of a unilateral imposition of a standstill by a debtor country would be, and whether that would lead to a disorderly, chaotic situation.

There are also suggestions in a paper produced in the seminar on interest rate caps. Once again, that is a unilateral breach of contracts. If the country decides to impose an interest rate cap, what will be the result? I hope we are not seeing in this a rejection of these possibilities.

Directors pointed out the fact that the staff is only dealing with corner solutions. That is not at all the intent of the staff. The staff, as much as I think everybody in this Board, wants alternative approaches. The problem is that they are not there in a way that is legally friendly to the debtor country, or in a way that gives some hope of protecting the debtor country from disorderly processes or chaos, if they were to choose those alternatives.

The fact of the matter is that there are specific cases like Argentina, and, in particular, Turkey, where the authorities have seen and discussed with the staff the options that would be laid before them and have considered the uncertainties of all the different options and the possible results of those options. They have, in most instances, chosen to take very dramatic fiscal action to maintain debt servicing, so as not to risk either legal results as a consequence of the imposition of a standstill or interest rate cap, or other results within the system. This is the message that the staff intends to say in one of the paragraphs in the paper. The banking sector, for example, if it is a large holder of very large securities, has to take a hit in the context of some kind of rescheduling, regardless of whether that is related to a solvency or liquidity case. In the cases of Turkey and Argentina, this has been the case.

So, there is no doubt that there is full agreement that, on both analytic and legal bases, we need more. The fact is that we are not there. It is very difficult to do the financing gap exercises with precision. It is even more difficult, as the EFC papers call for, to have a rather precise prognostication of where the gap is going to be filled from and what kind of financing is going to be forthcoming from the private sector. Clearly, the legal basis is not there. In any of these intermediate solutions that have been thrown up, there is at least the risk of disorderly processes, because a unilateral breach of contract could lead to an acceleration clause and other kinds of disorderly exits. Even if 90 percent of the creditors were willing to negotiate and find a reasonable solution for the country, there are rogue creditors who can bring the situation to chaos. Something needs to be done to bring legal powers into the system that would facilitate intermediate solutions.

We need to pursue that matter with some urgency. But, past attempts have not succeeded. The proposed amendment to Article VIII, Section 2(b) was put off basically by the argument that there have been cases where the country has successfully negotiated with its creditors to resolve the problem. It is true that it has worked in a number of cases; Ecuador is a case in point, despite tremendous weaknesses in the way that process unfolded. However, it has no assurance.

In cases that are critically important to the functioning of international capital markets, I am willing to take a risk that I can approach creditors and bring them to the negotiating table to try to find a solution when I know that the legal power is on the side of the creditors. That is the way the international legal system works today. I think that suggests that we need to revisit, as implied in the work program, Article VIII, Section 2(b), and other kinds of mechanisms that were put forward in the first days of the PSI debate to make these intermediate solutions more feasible.

The Acting Chair (Ms. Krueger) indicated that Mr. Sugisaki would chair the afternoon session.

After adjourning at 1:05 p.m., the meeting reconvened at 3:30 p.m.

Mr. Callaghan made the following statement:

Before lunch, Mr. Portugal made the remark that what we should be talking about today is not the substantive issue of PSI but the Managing Director's report, and that is quite right. We should be focusing on what is in the report in the sense of, is it going to provide Ministers what we think they need in terms of having a stock-take of where we are on this issue, drawing some tentative conclusions on what has emerged from the experience to date and our analytical work, identifying problems and difficulties and trying to provide something of an outline on a way ahead. In terms of that, it certainly does these things, but we thought there was something missing.

Listening to Mr. Boorman's comments just before lunch seemed to confirm what we thought was perhaps missing but he highlighted it a bit more, and that was the emphasis on the difficulties of implementing the Prague framework and more directly linking it to what needs to be done to try to make further progress on this, that is to more directly relate what it will take to get where we want to go. One thing that the report should acknowledge is that our concept of PSI, in the context of our work on PSI as part of crisis resolution, has evolved. This is one thing that has come up in the discussion we have had on, for example, Turkey and Argentina since April. As I recall, the Managing Director acknowledged in one of the discussions on Turkey that, post-Prague, he thought he had a clear idea of what we meant by PSI; but, listening to the discussion that had been taking place on PSI in that context, he was now a bit confused. I think that was an honest assessment of the state of the debate on PSI.

I think we need to acknowledge that our concept of the private sector in terms of PSI has changed over time. We are now talking about domestic creditors with obligations in domestic currency, and including that in PSI. I don't think that this is what we were really thinking about when we first went down this path. In many respects, the initial focus on PSI post-Asia crisis was in response to the perception that the Fund was insuring external liabilities of countries and, thus, encouraging risky lending. Moral hazard was the buzz word. The feeling was that Fund lending had allowed creditors to exit the country, and part of the rationale for ensuring that the private sector was involved in the resolution of the financial crisis was that the burden of adjustment should be shared.

There does not seem to be much talk of the concept of burden sharing these days. In fact, in the Managing Director's report, the main rationale for the Fund's interest in this area is because the institution does not have the funds for programs large enough to resolve capital crises. This seems to lead to the conclusion that the Fund seems to need just greater resources, and I don't think that is really the conclusion that we should be giving. I would say that the focus on PSI should be what does it take to resolve a financial crisis and minimize the cost of doing so, and how do we get the solution? We talk about, for example, that a market-friendly approach will be a less costly solution than a nonmarket-friendly approach to resolving a crisis. Well, this is fine, provided we get to the end point, namely the solution; the thing we choose, will it actually resolve the crisis.

The report refers to the cases of Argentina and Turkey, and certainly it is still premature to declare success in these situations, but I think we cannot just ignore these cases at this stage. One point that comes from these cases is that assessing whether an approach is successful or not is not simply a case of the portion of program funding supplied by the private sector, but also issues of the cost and speed at which access is expected to be regained. This point is covered in paragraph 8 of the paper, where it refers to the fact that once confidence has slipped, a member may have to pay a exorbitant price for market access. This is not PSI which is part of the resolution of the crisis. And I think that references to the experiences with Turkey and Argentina need to highlight the problems in implementing the Prague framework.

There has been a lot already said about the concept of the Fund's catalytic role, and I think this is appropriate because this is very central, the key question we have to determine which way we are going. It goes to the heart of trying to operationalize the Prague framework. The Managing Director presents four categories in the draft report on page 3 of crisis cases taken from the Prague framework. The first and fourth cases seem straightforward, or at least the first does, namely that is where a member is likely to regain reasonably full market access. The fourth case is where a member resorts to temporary payment suspension. The problem is that most of the cases with large access in capital account crises will probably fall in the middle, or at least we may start off hoping that they will be in the first category, and that is that a catalytic approach will work; there will be reasonably full market resumption, full market access. But we just don't know. It is in this gray area that we need some clarification.

For example, referring to the cases on page 3, in the third case, it seems to suggest that even when restoration of market access is unlikely in the medium term, the Fund will continue to provide whatever resources are required to assure that the member does not have to resort to involuntary PSI. Now, this has been referred to a number of times this morning. It does sound like the Fund is still attempting to play the catalytic role, even though market confidence isn't there. A possible consequence of this is that a wrong message is being sent to the market. We are creating the moral hazard and the market distortions that we set out to try and avoid. Is it that we have come to the conclusion that the Fund would have to provide the resources, even though market confidence is not likely to be soon restored, because, given the difficulties, we cannot resort to involuntary PSI?

I suppose this is the question I pose: is this the meaning behind the statement that everyone has referred to in paragraph 13, that is if the catalytic approach is taken, then we have to provide sufficient financing until market support returns? Are we saying there is not an alternative, or at least not at the moment? There simply is no intermediate solution that we can choose until we are forced down that route, because there is just no other way to go, and this comes back to the issue of the difficulties I think that seemed to be where Mr. Boorman was pointing in his comments this morning. I had come to the conclusion that one lesson from the recent cases was that taking the initial decision to go down the catalytic route was vital, and this needed to be linked to access to Fund resources. The burden of proof whether you soon would get a resumption of market access should rise and be on the person arguing that there will be a resumption to market access. Rather, it seems to be the reverse.

The options seem to narrow as creditors build ever stronger defenses against both voluntary and involuntary approaches to PSI. We do seem to get into a vicious circle. We embrace the catalytic approach and there is an incentive to do so because, if it is successful, the cost will be lower than an involuntary approach. But, once you get in there, it does seem you are stuck in the sense of continued, ever larger access to Fund resources. What I am not sure now is, are we saying that we don't have a choice; we don't have an alternative of an intermediate option that we can choose? Unless it becomes the default option, the country is forced to go down that path, because there is simply no other way. So, it is a case of the question of the difficulties with PSI. Are they such that we have no other choice until we can find a way to reduce those costs? The costs currently are such that involuntary PSI will not give us the solution that we are looking for?

To sum up, I think the report would be more effective if difficulties were more clearly stated and more directly linked to the forward agenda. We need further work on certain aspects to overcome the difficulties that have been identified. As it stands now, the forward agenda is very general in its description. For example, the reference to legal risks and obstacles that hamper restructuring is very general. But, as Mr. Boorman outlined, what is vital to make headway in PSI is to try and move from the general statements to the specifics, when we get down to the real-time cases of trying to operationalize it and apply it. In the report, we need to make it very clear as to what we see are the problems, and the need to directly relate it to what we have to do to try to overcome these problems.

Mr. Wijnholds made the following statement:

Before I start commenting on the report, I would like to react briefly to something Mr. Portugal said in this morning's session. He referred to the figure of 11 percent that represents the average Fund contribution to the financing needs of programs. I think one has to qualify that. The 11 percent is in a way an accurate figure, but related only to nonexceptional cases. When we talk about exceptional circumstances—and that is really the bulk of the resources that we have been providing—the amounts we are talking about are much higher, up to 70 percent of the financing need in the case of Turkey. As I mentioned during our discussion on access policy, the fact is that between 1995 and 2000, I believe 76 percent of the resources that we provided to countries were made under the exceptional circumstance clause or through the SRF. So, this puts the matter in a somewhat different light.

We have here a report that is in part good. I generally agree with the agenda and forward-looking part. But, there is also a part that is not so good, and quite disappointing. I share word for word, frankly, what Mr. Collins said about the report. I personally think that changing a few words here and there will not do justice to what a number of Directors have been putting forward here. The report would have to be rewritten substantially. I am somewhat surprised that we were confronted with such a product that clearly does not reflect the middle of where the Board is on this matter.

There is too much of an attempt to justify what we have been doing up until now, and I think we have to put less of a spin on this and be more forward-looking on a number of these matters. I would also feel that, as Mr. Callaghan has just explained, we have a problem with the definition of PSI, and that is a very fundamental problem we are facing. I am quite worried that there seems to be such a difference of views on what PSI means. I think the concept has been stretched too much by the staff recently, and it is going well beyond what we originally used in our PSI policy papers. Now, sometimes any kind of private financing, regardless of the financing terms, is regarded as PSI. Even privatization has been used as an example of PSI, and this causes considerable confusion, I am afraid. So, personally, my definition of PSI would be that PSI, whether voluntary or not, should contribute to both the mitigation of cash flow constraints and the improvement of medium-term debt sustainability. Typically, this would imply that private creditors incur, and accept, some kind of loss, whether in terms of an increase in exposure or an unremunerated increase in risk. I know we will not immediately agree on all of this, but I think we cannot quite skirt the issue. Perhaps, among the agenda items, we should come back and get a little more grip on what we understand on PSI. Otherwise, we are talking in different wavelengths, and it becomes very hard to have a debate.

Related to the previous point, I think the paper may want to clarify which program countries the discussion pertains to. We have something like 60 plus countries with programs, of which a large number are PRGF-supported programs. I think we should make clear that we could draw a distinction by the degree of financing required. This would give us one set of programs where the Fund uses a traditional catalytic approach and provides financing intervention within access limits. Second would be a case where the Fund is asked to provide exceptional access. Another point relates to the experience in Turkey and Argentina, and I think the paper should actually acknowledge candidly, in the first instance, that the catalytic approach failed in both cases, and that the Fund was asked to augment the programs. Additionally, in Turkey, the exchange rate was, of course, forced to float. We are now continuing with the catalytic approach, but we should recognize that this is the second phase and Ministers should be aware of how fluid market confidence can be.

Also, in the box on Argentina, if we want to do full justice to the situation, perhaps we should not say too much about these cases, which is a thought that struck me later, as they are still ongoing. There is this problem Mr. Collins alluded to where, as Argentina was preparing this mega debt swap, the credit that somehow got to them in terms of collateral and the repo contingency facility was very much impaired, which was a great pity and damaging to PSI. I hope that, for instance, the new International Capital Markets Department will develop expertise and skills so that it can point out these dangers to the countries that are facing this behavior from the side of the banks.

Like others, I also have some difficulty with particular paragraphs that I do not need to spell out, because that has been done very eloquently by a number of speakers. They pertain to paragraphs 8, 11, and 13. The language is really not appropriate. Perhaps, just to round off, in paragraph 11, on top of page 9, we have the general sentence about the experience gained from involving the private sector in crisis resolution and analytic work has heightened the importance of an approach to economic policy formation. That is a little vague, of course. I use this to make the point that I am somewhat worried that we have all these references to countries doing their best to stay the course and pay their debts, and so on. That is all good and fine. Then we have reference also to Article I, to avoid policies that would impair prosperity, domestically and internationally. What I am worried about is that if we emphasize such points, we may in fact be advocating a very deflationary policy in some of the cases, and I have a particular case in mind. So, we need to think about that too.

Finally, on the matter of the agenda, I think the points are generally well taken. I would simply add that, as regards the last bullet on moral hazard, it has already been mentioned that the quantification of moral hazard is a difficult project. Anybody who has some knowledge of econometrics knows that this exercise—to prove or disprove the existence in a quantitative way—is very difficult. However, what I would say is that I think we can try. Of course, the staff has already told us in a few papers that they were not able to quantify it very well, and I do not expect them to come up with much different conclusions. Therefore, I would suggest including a qualitative assessment, as well as perhaps a survey, of views of banks and anecdotal evidence. I would say that virtually every single banker that I spoke to confirms that there is a significant degree of moral hazard associated with Fund lending. Just mention Russia and you will get a reaction, and significant food for thought.

Mr. Kiekens, responding to Mr. Wijnholds's comment about Fund financing for Turkey, noted that the gross financing needs of Turkey for 2001 had been estimated at US$54 billion, including short-term debt, as of the beginning of 2001. That number had been reduced later to US$49 billion. The Fund's financing was US$9 billion plus an augmentation of US$3 billion, totaling US$12 billion dollars, which certainly was not 70 percent of the gross financing needs.

Mr. Zoccali made the following statement:

The circumstances of capital mobility and open capital accounts pose particular challenges, and crisis prevention and resolution is the right focus for PSI. Unfortunately, neither recent experiences nor the analytics, including our understanding of the legal risks as reflected in the draft report, have advanced sufficiently to warrant changes in the framework on involvement of the private sector endorsed by the IMFC at its meeting in Prague. Implementation of PSI requires a robust assessment by the Fund of a member's underlying payment capacity and its prospects for regaining market access. Mr. Boorman has pointed to the difficulties in this regard, and many substantive issues have been skirted.

Considered judgments are necessary. They are inevitable, given the context of greater uncertainty associated with developments in global financial markets and other external conditions mentioned in Box 2 of the draft report, that largely fall outside the control of members. Fund support for voluntary catalytic solutions of private sector involvement has produced significant successes. At the same time, the implementation of concerted approaches in the current international financial architecture has created, and continues to give rise to, significant costs for members that, for differing reasons, have seen their market access curtailed. In this regard, we remain unconvinced of the merits of the proposed stand-alone report of the Managing Director centered on recent experiences with PSI.

Allow me to elaborate, first, on the country-specific information provided. Official financing has been critical to help countries, such as Argentina and Turkey, withstand intense pressure while strong corrective measures are being put in place. These cases are unfolding, and the right signaling of support constitutes an essential element for the success of the authorities' intense efforts to re-establish market confidence. By focusing on these cases, however, the report continues to raise doubts regarding these countries' capacity to sustain the respective adjustment strategies, as well as on the willingness of the international community to maintain international support in light of debt stock adjustments taking place in the context of open capital accounts. In fact, these two specific cases are presented with insufficient differentiation and an oversimplification of the dynamics involved.

In contrast, references to earlier experiences that included forced debt restructurings, in particular of Ecuador, Ukraine and Pakistan, omit any assessment of the cost or extent to which market access may have been hampered either for the country itself or the borrower class, more generally. In short, the draft report seems to downplay the costs while highlighting, without substantiating, the benefits of "reasonably, timely, and orderly agreements that help move member's balance of payments toward medium-term viability."

Box 3 on Argentina puts the accent on market concerns regarding the sustainability of its fiscal position and the exchange rate regime in the context of weak growth prospects rather than on ownership and consistency of the recent policy response. It omits altogether the role played in the crisis by unanticipated domestic political events, or the impact on Argentina and on the regional economy of nontariff trade barriers particularly in agriculture, the devaluation in Brazil, the strength of the U.S. dollar, and the volatility in exchange rates of the major currencies.

Thus, despite the importance of external factors for the speed and intensity of the recovery, the tentative conclusions drawn from recent experiences make no reference to the impact of the external environment either in paragraph 7 or in the summary paragraph 11.

More specifically, regarding the conclusions advanced in paragraphs 8-10, the first and second seem to follow from the stylized representation of the Argentine case. Regrettably, the statement that "debt exchanges to improve the debt profile can be very expensive in times of stress," which coincides with the characterization in Box 3, does not capture the fact that the cost of the recent voluntary exchange for Argentina was only 35 additional basis points, but with an important reduction in debt servicing requirements over the next five years and an increase in the average duration of the bonded debt of 3.5 years. In addition, the characterization of the cost of the exchange needs to be weighed against that of the available options.

The second conclusion offered is more difficult to understand and calls for some clarification, as results seem correlated to the strength of the "public pension system," notwithstanding the role in many emerging market countries, and not least in Latin America, being played by private pension systems, both to strengthen public sector finances and to create the conditions for more developed and broad-based domestic capital markets. In any event, neither the transitional cost of such reforms nor their contribution to covering the financing needs are duly recognized in the report.

The fourth conclusion on moral hazard on the part of debtors should weigh in, as the report notes, that some debtors have been willing to go to extraordinary lengths to deliver fiscal adjustment to avoid having to approach creditors for concerted restructuring. In any event, the last sentence of paragraph 9 seems to indicate that, if we could prove that the costs of forced restructuring were not as high as they are now being perceived, then the member may not need to make such an adjustment and the Fund may not have to make such sizable disbursements. We consider this sentence voluntaristic to say the least. It may be read as not only questioning the wisdom of the policies currently being supported by the Fund, but also as downplaying the limitations of the available instruments to provide confidence to members affected by capital account- driven crises. What is most troubling is that the entire sentence stands on the condition that is far from specified, namely how the costs of a forced restructuring, which we all know to be extremely high, can be lowered.

Regrettably, we have not had the benefit of substantive analysis and discussion of the economic and legal costs of forced restructuring variants implied for members that are highly integrated in capital markets. As importantly, we consider insufficient our understanding of the dynamic effects of such PSI recommendations, keeping in mind that financing gaps change over time and, in turn, may be influenced by signaling and the way that the financing gap is expected to be covered. We would hope that such work on the good and bad equilibrium dynamics could also be included in the future Work Program mentioned in paragraph 20 of the draft report.

Bullet 5 on the Agenda for the Fund, which moves to the "design" and impact of debt restructuring programs in situations where a substantial portion of the debt of the sovereign is held by the domestic banking sector, seems to imply that less costly variants may be arrived at simply through "design," irrespective of the legal constraints, international linkages, or their impact on depositor or investor confidence in subsequent periods. The analysis and costs should, therefore, be broader in scope, and not limited to the impact on the cost of capital for the member. Other aspects, such as the magnitude of capital flows to emerging economies and their composition, should be covered, keeping in mind the considerations governing foreign direct investment raised by Mr. Oyarzábal.

The fifth conclusion is not novel, since it has been known all along that legal constraints can have consequences for the implementation of forced restructuring. The legal risk is a main consideration behind proposals to give the Fund or others the ability to endorse a temporary stay on creditor litigations and should be explored further. In the interim, the existing conditions impacting on countries, in particular those trying to emerge from crises, cannot be disregarded.

Finally, if there is to be a stand-alone report, it should be forward-looking. In this regard, we see merit in strengthening the framework by focusing on ways to improve further the dialogue between creditors and debtors in good times, the explanations given to markets concerning countries´ structural reform efforts and their transitional costs, which often exacerbate perceived vulnerabilities, as well as on voluntary forms of private sector involvement, as more countries seek to adhere to internationally best practices and standards.

Ms. Lundsager made the following statement:

Following up on the remarks that others have made, it strikes us that this report makes a good attempt to present some conclusions from recent experience, and I give the staff credit for making some important improvements on our previous discussions of PSI. Let me just highlight what we think is important that has been recognized here.

The basic principles are that contracts should be honored; official financing is limited; and debtors and creditors must take responsibility for their decisions to borrow and to lend. The paper, we believe, correctly emphasized the reliance on market-oriented solutions and voluntary approaches, and highlights the difficulties inherent in coercive approaches to obtaining private financing. Another welcome refinement in this report is the more nuanced categorization of potential cases that emerged from our discussions in Prague, the four—instead of two-corner—solutions. There is certainly an improvement in those cases that fall into the fourth category, where a temporary standstill may be unavoidable, pending adjustments. We have acknowledged all along that this is a possibility, a rare possibility that a country will have to impose a standstill. Nevertheless, it is the belief that the Fund will not be encouraging countries to do this—the Fund will not be the one pushing countries to such coercive approaches—and that the emphasis should continue to be placed squarely on finding ways to make voluntary, market-oriented debt reprofiling work.

The report addresses the difficult issue of the appropriate scale in terms of access to Fund resources in capital account crises. While we recognize that the current liquidity position of the Fund is quite strong, we have emphasized that the overall resources of the Fund are limited. Over time, expectations about access levels will need to recognize these overall limits on Fund resources. That is inevitable. The expectation should be that when spontaneous capital flows to emerging markets resume, the volume of Fund resources relative to private flows will start to shrink. That said, we are concerned about the discussion of the merits of providing exceptional access under Stand-By Arrangement or SRF terms included in this report, given that we have not really considered these issues yet at the Board. As we recalled from our recent discussion on access policy, where that issue was set aside while a number of people raised concerns, we did not reach conclusions and recognized that we have to come back to that. Determining the appropriate criteria for deciding exceptional access during capital account crises continues to be extremely difficult, because this complex subject will require much more thought and discussion, and we have not had that discussion. We just think it is premature to be drawing conclusions in this report.

Finally, the Managing Director's report highlights several areas for continuing work, which others have touched on. Most of those I would endorse, but I would like to raise just a few concerns. First of all, we are concerned that the work program has its focus on legal obstacles to restructuring, for several reasons. The text seems to lean toward examining the case of providing an instantly sanctioned stay or the endorsement of unilateral action, which I take to be a reference to a possible amendment to Article VIII, Section 2(b), which everyone understands what that would do. In our view, such an amendment may have a negative impact on inflows of foreign capital that so many countries are dependent on, and such a move would require the very difficult political steps of amending the Articles of Agreement. So, referring to legal aspects, without being very specific, just raises expectations that we are now prepared to say we are headed in that direction. I think that was a bit inappropriate.

More generally, the work program does not clearly specify which of the many potential legal obstacles would be addressed and whether these legal obstacles are expected to arise in the context of voluntary or nonvoluntary approaches. For example, we are not sure what the reference in paragraph 20, bullet 4, means—the feasibility of establishing a legal framework that could provide greater support for a voluntary restructuring process. We do not really know what the staff has in mind here. It would be helpful, before we put forward these issues, if there were more specificity and we would consider that before we speculate.

Third, in order to justify a significant IMF role, it seems that the paper appears to paint an unduly negative picture of the reaction of creditors to payment suspensions, and to draw stronger conclusions about legal risks from recent experience than we see is warranted. In particular, paragraph 17 states that creditors are unlikely to be willing to consider a suspension of payments unless there is a legal mechanism to ensure that their forbearance will not be abused by a minority who will force for full repayment. However, in recent cases of Ecuador and Ukraine, temporary debt repayment suspension does not lead to significant legal actions on the part of the creditors. The potential risks resulting from the Elliott litigation against Peru will need to be balanced against the absence of legal actions; and litigation risks, while real, should not be exaggerated.

Consequently, we think the focus of the IMF's work should continue on fostering changes in contractual provisions that would help facilitate voluntary restructuring and reduce the risk of litigation. The nature of this aspect of the work program should be clarified. We also have some concerns regarding plans for future work on the quantification of moral hazard in existing international agreements, as well as the impact of current and alternative approaches to private sector involvement in the resolution of crises on the cost of capital to emerging market economies. Additional clarity here would be helpful, as it is not immediately obvious how one quantifies moral hazard. Others have noted this in existing international arrangements. We should have some sense of that before we agree to go forward with that exercise.

I have a number of specific edits, which I will convey to the staff. A number of those edits are suggestions for deletions that I do not think we quite agreed on, and should perhaps not speculate without having had a substantive discussion, which we are not having today, as everyone noted.

Mr. Chelsky made the following statement:

That is a tough act to follow. I will try to focus on the report itself, but it is impossible to do so without commenting on the broader PSI strategy. First, on the positive side, like Mr. Törnqvist, I was pleased to note that this report, more so than previous ones, is forward-looking in identifying where the difficulties are and suggesting where we should be looking to in the future, although, clearly, there is disagreement on whether or not they are the right suggestions. That is quite welcome, because it was becoming quite apparent that we were just moving in circles while on this question. In that regard, I thought it was appropriate to spell out the issues that were raised.

That being said, I agree very much with Mr. Collins that there is a bias—an inappropriate bias in the paper toward institutional responses. As Ms. Lundsager just suggested, it seems implicit or can very easily be read into some of these references to potential institutional responses as prejudging what the role of the Fund would be in changes to any broader legislative framework that we would be putting in place. I will cite some examples of that in the report in just a second. We think that probably the best contribution that this report makes is that it raises the profile of the need to develop tools to facilitate a resolution of payments difficulties between debtors and creditors.

It seems that there are really two approaches to PSI at large—one is to take the road of the more ad hoc institutional interventions, and, regrettably, I think we focused excessively on that; and the other is to change the incentive structure. Ms. Lundsager made reference to contractual provisions that would help lower the costs of restructuring, for example. In effect, we are talking about changing the incentive structure; that is, lowering the cost of payment disruption to debtors and raising the cost of noncooperation to creditors. We need to be clear that it is a rebalancing of those powers that we are talking about, and Mr. Boorman made a comment earlier about how creditors had too much power. We need to accept the fact that, unless we are willing to address this balance or imbalance, we are not going to make progress on this issue. As we have said before, simply wishing for PSI is not going to do anything unless we have the means to achieve it.

That being said, it can be done institutionally or it can be done through the contractual side. Our preference has always been, at least initially, to look to the contractual side and to encourage the inclusion in debt instruments of contractual provisions that would facilitate restructurings, like collective action clauses and, in effect, in so doing, we almost put the Fund off to the sidelines, because we have promoted the tools for creditors and debtors to work out their own arrangements. In many ways, we minimize the need for institutional intervention, which raises the whole issue of the level of access and how finite resources are.

On a somewhat different issue, I very much agree with Mr. von Kleist and Mr. Wijnholds that there are really limits to what our analytic work is going to achieve. We could talk about calculations of medium-term debt sustainability until we are blue in the face, but when we are faced with an actual case, it becomes very difficult to bridge from that and then to know how to actually deal with the problems. Also, on Mr. Wijnholds's point about PSI definitions, I agree that there is a great deal of confusion on what those definitions are, and that was made clear to me when Mr. Wijnholds cited what his definition was, which I thought was a fairly restrictive definition. There is also a legitimate justification for a much broader definition; but, clearly, if we are talking about different definitions, then we are not going to really be making much advance on this.

Finally, with respect to the whole issue of the catalytic approach and whether it was successful, I do not know if we could actually answer that question without explicit reference to both the quality and credibility of conditionality and reform. I think the example of Turkey is a particularly useful one. The first few programs in the most recent cycle were undermined by a lack of commitment at the political level, and thus to consider whether the actual PSI approach was the right one, independent of the fact that it was being undermined in terms of the substance of the program, does not necessarily get us very far.

Also, on this whole question about domestic PSI, I still do not understand why the distinction is being made. When we are talking about PSI or countries with open capital accounts, the distinction between holders of domestic currency denominated debt and foreign currency denominated debt, is a very weak one, and I do not know if we are not just splitting hairs in trying to draw that distinction.

I will go to the report and just make a few, quick comments. In paragraph 1—and perhaps this is an example of what Mr. Collins was saying when he referred to a bias toward institutional intervention—I was just struck by the sentence that said, a sound framework for interaction between troubled debtors, including the sovereign, the official sector led by the Fund, and private creditors. I wondered whether it was a little presumptuous to suggest that this was led by the Fund. There are many ways that one could conceive of this occurring.

Also, in paragraph 4, there is some ambiguity in the second sentence where we refer to the discussions that we have had, and we make reference to the treatment of claims of private sector and Paris Club creditors that have helped clarify the treatment of the third category of cases. When I look at the third category of cases, the third category of cases is clearly both potentially concessional and nonconcessional. Our discussion of the Paris Club was explicitly focused on nonconcessional debt. Therefore, I wonder whether we may be suggesting something more than we actually have discussed, and I wonder whether we should not instead be referring to a subset of the third category, or at least be clearer when we discuss the Paris Club that we have not yet discussed the issue of concessional debt rescheduling.

In Box 2, and once again on the comparable treatment of private sector and Paris Club claims, the second sentence says, “financial market participants have been unsure how this principle would be applied in practice, given the very different structure of official sector and private sector claims, and the different techniques they reply to restructurings.” That is part of it, but we need to acknowledge that it is the nature of the official claims that often justify different treatment. As written, it sounds like it is only purely a mechanistic issue. I think there is a substantive issue that needs to be flagged there, because official debt is fundamentally different in a number of ways, both forward- and backward-looking.

In paragraph 5, we have trouble with the formulation of the second sentence, which refers to the authorities’ willingness to adopt measures deemed necessary to ensure that the exchange rate regimes could be sustained, because, for many of us, that may have been viewed as a means to the ultimate end. But, the sustaining of an exchange rate regime is certainly not an objective we had in the program, particularly not in the case of Turkey, and I would ask the staff to reconsider the way that has been characterized.

In Box 4 on Turkey, where the various sources of the financial crisis are listed, one thing that seemed to be a glaring omission was the reference to weak governance. I would ask that that also be corrected.

On paragraph 13, we have the same comments as Mr. von Kleist and Mr. Törnqvist on the use of the word “fully.”

When I got to paragraph 19, I was struck by the sentence that reads, “[t]his points to the need to keep under close review developments in the design of debt instruments and the results of litigation strategies in order to assess whether or not it would be desirable to give further consideration to the possibility of a range of possible measures.” This just seems extraordinarily apologetic—the possibility of a range of possible measures. Clearly, this is something that we are going to consider. I do not think we should try to hide the fact that that is what we are going to look at through very ambiguous language.

The bottom bullet of that page, which says, “[a]nalysis of the legal risks and obstacles that hamper restructuring and, in that context, a preliminary consideration of the feasibility of establishing a legal framework that could provide support for a voluntary restructuring process,” once again speaks to Ms. Lundsager’s comments. What is missing there is encouraging a wider use of existing contractual provisions. That may be implicit in these legal frameworks, but it needs to be made explicit that this is consistent with market-oriented approaches.

Mr. Campos made the following statement:

We thank the Managing Director for this report, which, in our view, focused comprehensively on the progress made so far on private sector involvement in the prevention and resolution of financial crises. We also have the same opinion as Mr. Yagi that the report clearly presents lessons we have learned from recent experience and the challenges that still lie ahead. At this point of the discussion, we do not have much to add, but just have a few observations.

We agree with the staff that, as pointed out in paragraph 6 regarding a general framework for resolving crises, more work needs to be done before there can be a general consensus and clarity on all the elements of the policy, which includes an appropriate scale of official financing, how the private sector can be engaged in helping the member overcome its difficulties, and the mechanisms for restructuring sovereign debt. To this extent, we are of the view that a change in the Fund's future work on PSI laid out in Chapter 6 is appropriate. If fully carried out, we believe that it would allow us to build a consensus on this important matter. Meanwhile, we agree with Mr. Bauche that there is a need for ranking different program activities by prioritizing, and that special attention and priority should be given to the work regarding legal aspects.

We agree with the suggestions made by Mr. Kelkar and Mr. Jayatissa in their preliminary statement regarding Box 1 of the report. We also concur with Mr. Portugal's observations regarding paragraphs 2, 8, 18, and 20. We look forward to the implementation of the proposed agenda, and the discussion of the technical reports.

Mr. Wei made the following statement:

At the outset, I would like to join the other speakers in thanking the staff for a very clear and concise report for today's discussion. There has been some progress on PSI since the Spring Meetings, including the seminar with outside experts and an internal discussion on Paris Club compatibility issues. The additional experience from the cases of Turkey and Argentina are also useful for our deliberation on this issue.

Now, let me turn to some of the issues for today's discussion.

First, on the issue of official financing, especially the financing provided by the Fund in the context of the crisis countries—Turkey and Argentina—I agree with Mr. Oyarzábal that "as the crises have occurred, it has become increasingly evident that the amount of resources to fill financing gaps has to be very large." The catalytic role of the Fund, if it is meaningful, has to be substantial in the magnitude of its financing to be provided to the crisis countries under Fund-supported programs. We support this. Otherwise, it is impossible for the Fund to help the crisis country convince the market and regain its confidence.

However, this point leads me to my other point, namely, the issue of quotas. Mr. Yagi has elaborated his views on this matter in his preliminary statement. I entirely share his views. The recent exceptional cases in terms of financing rising to 700–800 percent of quota has clearly demonstrated that there is an urgent need to discuss members' quotas, particularly those of the emerging markets. In this context, we would like to have a discussion of the quota issue immediately after the Annual Meetings, presuming these are going to take place.

Second, on the issue of drawing conclusions from recent experiences, we broadly agree with the staff's views in Section III of the paper. Nonetheless, we think there should be greater clarity about the framework developed so far, for example, concepts such as voluntary versus concerted PSI, foreign versus domestic PSI. We are concerned about how we can ensure that creditors on voluntary agreement will stay after the Fund's commitment to providing financial assistance. Recent experience suggests that nothing can stop them from parting with the crisis countries. Like Mr. Yagi, we agree to consider establishing a legal framework to provide support for voluntary restructuring although we are fully aware that this is a very difficult and time-consuming job.

Lastly, on the agenda for the Fund in pursuing future PSI, we agree with the bullet points expect for the last point regarding the quantification of moral hazard in existing international arrangements. It seems to be difficult to quantify the moral hazard if this is not possible. I believe staff should prioritize its work in focusing on the first five bullet points, especially on access policies as stated in Mr. Kelkar's and Mr. Jayatissa's preliminary statement.

Mr. Palei made the following statement:

If there is little progress on PSI issues, it is certainly not because of a lack of trying, or lack of effort, but rather because of the complexity of the issues involved. I have to say that I sense some inconsistency between the resolve of many Directors to have meaningful PSI based on clear rules and the individual country discussions. My comments are very similar to the points already made by Mr. Portugal.

The document we are discussing today is a progress report on what has been done since the Spring Meeting of the IMFC. When we look at what did take place, we see, that:

First, there was a seminar of high-level officials, which, if I may be blunt, was not very useful in terms of guidance to the staff. Its characteristic in the draft report is accurate, although a bit short. The key phrase in the paragraph of Box 2, devoted to the seminar is that “the views of the participants diverged;”

Second, the Board discussed the paper on the treatment of Paris Club and private creditors’ claims, and the result of this discussion was also disappointing;

Third, we do not have much more information on the specific country cases. Argentina and Turkey, as Mr. Portugal has reminded us, are very sensitive cases in progress. They are not yet ready for ex-post analyses of PSI. The Board had heated discussions on both countries, and, today, we have a better understanding of each Director’s position. I believe that such discussions are very useful for the progress on PSI, and the Board should concentrate on the PSI issues in the context of each review. In addition, the staff would have to provide a detailed ex-post analysis of the PSI issues in each country, so that we could create what Mr. Kiekens refers to as the “case law.” However, at this stage, the Fund still is not in a position to derive conclusions from these two countries’ experience.

In light of the above, I would like to repeat what Mr. Mozhin had already said this morning: “If the Annual Meetings do take place, the PSI discussion should be a second league item on the agenda.”

To be a bit more specific on the text, I have serious reservations about some of the assertions in the report. In paragraph 8, references to “exorbitant” costs of the swaps and the swaps being “very expensive” are not consistent with what the Board was told about the mega swap in Argentina. The staff insisted that, as a result of the swap, the NPV of the debt declined and that the costs were reasonable and well justified by the provided cash flow relief. I was also surprised to read paragraph 15 about the use of Stand-By Arrangements versus Supplementary Reserve Facility. I do not recall any in-depth board discussion on this particular issue.

To conclude, I share the opinion of Mr. Portugal that the material on PSI could be incorporated into a broader report rather than be presented to the IMFC as a separate document.

Mr. Zurbrugg made the following statement:

I can be brief, since my points have been made eloquently by Mr. Collins, and repeated and emphasized by a number of subsequent speakers.

This chair has consistently argued for completing our PSI framework with tools to, inter alia, improve legal security for countries that need to restructure their outstanding debt. I therefore welcome the focus that is given to this issue in the proposed agenda. I fully share Mr. Boorman's comments on the increasing disconnect between our PSI general policy and specific country discussions. Our chair has sometimes tried to bring some consistency into this disconnect, but has not always managed to get through. But, if we move forward on those important elements on the agenda, we could contribute to reducing this disconnect.

Mr. Kpetigo made the following statement:

The report of the Managing Director to the IMFC on the status of PSI is appropriate, as it focuses on the progress made so far in the prevention and resolution of financial crises, while setting an agenda that could help the Board to proceed in the future with the work program and to tackle the remaining issues. It is clear that comprehensive participation of the private sector in the effort toward establishing interaction with all debtors would constitute a significant contribution to the globalization process that could be beneficial for all.

After discussion by the Executive Board, this work program could be carried out by the Fund so as to strengthen financial market access to our members. However, we concur with Mr. Portugal that this is the Managing Director's report to the IMFC and, as such, we would need, in the course of our actions, to further improve our understanding of financial crises and ways to appropriately deal with them. This indeed calls for more experience on our part.

Also, as Mr. Kelkar points out in his preliminary statement, to get all the strength, it is important that the crisis prevention measures in Box 1 take into account the availability of several Fund facilities for crisis prevention and resolution.

Mr. Djojosubroto made the following statement:

I have two short comments. First, regarding the future agenda, like Mr. Yagi and Mr. Wei, I would like to stress that the legal framework for the restructuring process should be an important part and should become the first priority. Second, regarding access to the Fund, I would like to associate myself with Mr. Yagi that we should adjust our quota in response to the world economy.

The Director of the Policy Development and Review Department (Mr. Boorman), in response to Directors' comments, said that, on the procedural point, the staff had debated whether the report on PSI should be a stand-alone paper or part of the umbrella report to the

IMFC, as in some previous IMFC meetings. Clearly, the PSI issue was currently at a crossroads, and warranted attention by Ministers at this juncture. It had therefore been decided that the Managing Director's report on this subject should take the form of a stand-alone paper. In comparison to other initiatives under the rubric of international financial architecture, the staff had been of the view that most of the items—particularly those listed in footnote 3 of the draft IMFC agenda discussed earlier—were on relatively good track and the initiatives had become operational. While there remained a number of questions, there had been progress on many fronts, with no specifically contentious issues remaining.

With respect to the current status of PSI, while the Prague framework generally acknowledged that official support was limited, there were considerable differences in view in terms of the implications for individual cases, the Director continued. There was an argument that in cases where a loss of market access was imminent, a country in difficulty should not be forced to undertake unreasonable adjustment. Thus, there were two parameters in force—limited official support and limited adjustment—which were not easy to balance in actual cases, especially in an environment where market sentiment could shift quickly. In hat context, the questions were how to ensure a contribution from the private sector in such a way that would limit both of those two parameters—official support and the adjustment—and what should be done if the level of official support and the degree of adjustment that most considered reasonable did not suffice to the task. A case in point was the crisis in Korea, which had been the first case of recent crises. It could be characterized as an old-fashioned banking crisis, easy to resolve relatively to the more recent cases, as the main source of the problem had not been the fiscal or sovereign debt, but creditor banks overseas through banks in Korea. There were therefore no dynamic feedbacks into the system or the fiscal position, and the government was able to accept the burden of guarantee, for example, on the restructured credits of the banking system.

Other cases had arisen, and each one had been more difficult than the last, the Director observed. To some extent, it was correct to note that perhaps PSI, even as a concept, was a moving target. Clearly, the mechanisms for private sector involvement in Korea had not been that complex, compared with those in some of the recent cases where such issues as comparability of treatment and domestic versus foreign creditors had to be brought into the equation. Also, in modern capital markets and countries that were more integrated into the markets, like Argentina, there was little distinction between domestic debt and foreign debt, or between dollar-denominated and local currency-denominated debt. In those cases, it became more difficult to search for the mechanisms for private sector involvement, in particular, the mechanisms that would give reasonable confidence to the country concerned on the workability of an orderly process, with no potential threat of litigation from creditors. Although that threat could not be clearly pinpointed, as Ms. Lundsager correctly observed, the prospect of a disorderly litigation process certainly represented a major cause for concern to the authorities.

One would also have to take into account the feedback into other sectors of the economy from a particular action on a debt instrument or on creditors, and the overall effect of such an action, the Director said. In a given context where banks sold a lot of the government debt, the government's decision to write down its debt would affect banks' balance sheets, thus hampering the bank restructuring process. In the end, the burden would fall on the government budget. The reduced debt service in the government budget would be offset by the increased government support given to the banking system.

In the forward-looking exercise, the staff had not yet had answers to many of the questions, particular those of a more complex nature that had arisen in later periods, the Director acknowledged. Clearly, the debtor country should not escape the burden too easily by simply announcing its inability to service debt. That would lead to lower capital flows to emerging market countries, which was an undesirable outcome. It was important for the private markets to function properly. However, the reality was that few options were available beyond the catalytic support to assure the country that there would be an orderly process.

In some of the recent cases, the governments had accepted drastic fiscal adjustment to avoid a concerted approach to debt restructuring for fear of a disorderly process, the Director observed. At issue was the question of whether the Fund could reject that choice on the part of the member, and, for all practical purposes, suggest that the member default. Although Directors had not specifically mentioned the term “default” when referring to standstills or interest rate caps, it was important to come to a better understanding of those words. A standstill or interest rate cap was regarded as a unilateral breach of a contract that would be interpreted in courts as a default. In that light, it would be extremely difficult to resort to such mechanisms. Basically, the work program had to focus on those unknowns and try to produce more options. In effect, it had to be exploratory in the immediate future going forward.

There had been reference to collective action clauses, the Director noted. In an ideal world where all debt contracts included collective action clauses, the debtor could be assured that, in the debt workout process, if it reached agreement with the majority of creditors—regardless of how the term “majority” was defined—it would be protected against the minority of creditors. In the real world, however, even if every debt instrument issued from the following day onward had included desirable collective action clauses, it would have to take more than 10 years before a full stock of debt outstanding would contain those clauses.

In the work program, the staff proposed to explore possible options in the meantime, the Director explained. While Directors basically agreed on the work going forward, there seemed to be a range of concerns about the presentation and the tone of the report. For example, Directors had raised concern about the reference to sufficient official support to ensure the debtor country’s capacity to service its debt. That was not meant to provide an open-ended endorsement of unlimited official support from the Fund. Rather, it was intended to suggest that the catalytic approach would only work if enough resources were provided to secure market confidence, hence success of the catalytic approach. In addition, there was a feedback mechanism in place whereby the catalytic approach would not be chosen, if the size of official financing were too large.

On some difficult aspects, there was currently no clear direction how to move forward, the Director said. One example was the presentation of the cases of Turkey and Argentina. The current Board discussion had reinforced the staff’s belief that the complexities of recent cases served as the rationale and basis for planning the direction of the work program. The relevant sections of the report would be redrafted to reflect that.

The staff would carefully consider Directors' comments and revise the draft report accordingly, particularly regarding the forward-looking work agenda, the Director concluded. Decision had to be made on the Annual Meetings. If the IMFC meeting were to take place, a revised report would have to be issued for Board consideration. If there would be no IMFC meeting, it might be appropriate to move on to a more substantive discussion of the work program.

Mr. Chelsky commented that, on collective action clauses, distinction had to be made between the stock and the flow, and both had to be dealt with. Not all bonds issued at the present time had collective action clauses. He wondered what were the constraints to the wider use of such clauses in international sovereign bonds; how could they be made unexceptional in future bond issues; and what more could the Fund do, either through surveillance or moral suasion, to encourage a broader use. The report noted that some of the G-7 countries had included collective action clauses in the bonds that they issued. Perhaps the staff could go further to identify the countries that had not followed suit and push more aggressively for the inclusion of such clauses.

Mr. Törnqvist said that he supported the idea of presenting the report on PSI as a stand-alone report. As confirmed by the current Board discussion, the PSI issue was extremely difficult and controversial, thus warranting the attention of the IMFC if it were to move forward. With respect to the catalytic approach, while the Director of the Policy Development and Review Department argued that that was intended to provide greater confidence to the debtor countries, several Directors had pointed out the danger of giving false confidence, as its end result could not be known with certainty. That fact should be made clearer to the countries.

Mr. von Kleist stated that he agreed to the inclusion of Argentina and Turkey, for two reasons. First, lessons should be drawn from experience as it became available, as it might take a long time before both cases to be concluded. Second, Mr. Portugal's concern about market reaction seemed to be invalid; market participants expected to see some references to the cases of Argentina and Turkey in the published report on PSI. Transparency, in this case, would help reduce irrational fears.

On the catalytic approach, the staff seemed to stretch the limits of the word "catalytic," Mr. von Kleist noted. It might be necessary to reconsider what the term "catalytic" really meant, and how it could be used more properly.

The Director of the Policy Development and Review Department (Mr. Boorman) responded that he agreed with Mr. Chelsky's suggestion for the Fund to be more aggressive on encouraging the use of collective action clauses. In the intermediate period, one would still have to deal with cases that might emerge in the next 5–10 years before all bond issues contained such clauses.

Mr. von Kleist's point regarding the catalytic approach was well taken, the Director said. In every Board discussion on this subject, individual words seemed to be used with quite different meanings. Distinctions could be made more clearly between cases in which spontaneous market reaction was a concern and those where the action of banks or other players was important.

The Acting Chair (Mr. Sugisaki) concluded that the working assumption was that the IMFC meeting would take place at the end of September 2001, and, consequently, the draft report would be revised in light of Directors' comments. As agreed at the Board discussion on the IMFC draft agenda, the work on PSI would become part of the broader topic of crisis prevention and resolution. Therefore, that point would be made clear in the revised Managing Director's report to the IMFC, which would be circulated to the Board for information. As regards the work program, Directors could rest assured that the PSI subject would be given urgent attention, especially in light of developments in Argentina and Turkey. While acknowledging some of the difficulties and constraints, management agreed that it was important to bring as much credibility as possible to all of the issues raised by Directors, and to move them forward to the extent possible. The IMFC would take up the topic of PSI at its meeting, and some of the issues raised would be taken up later in the context of the work program in future papers. In designing the work program, the staff would attempt to reflect most of Directors' views as closely as possible on the main components of the PSI agenda.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/01/93 (9/12/01) and EBM/01/94 (9/13/01).

3. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 00/88 are approved.

APPROVAL: December 5, 2001

SHAILENDRA J. ANJARIA
Secretary