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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 02/90

10:00 a.m., August 30, 2002

Contents

Page

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

H. Köhler, Chairman

Executive Directors	**Alternate Executive Directors**
	Al Azzaz, Temporary
	J.G. Borpujari, Temporary
A. Barro Chambrier	D. Ondo Mañe
	E. Pinto Moreira, Temporary
	P.R. Fenton, Temporary
	F. Vermaeten, Temporary
	C.J. Faircloth, Temporary
M.J. Callaghan	D. Baasankhuu, Temporary
R.F. Cippà	B. Siegenthaler, Temporary
K. Bischofberger	R. von Kleist
	H. Vittas
	A. Lanza, Temporary
D.I. Djojosubroto	M.P. Bhatta, Temporary
Y.V. Reddy	R. Gauba, Temporary
W. Kiekens	C. Josz, Temporary
	J. Sipko, Temporary
Ó. Ísleifsson	B. Andersen
	A. Alber, Temporary
	M. Lundsager
	P.A. Dohlman, Temporary
	S. Boitreaud
	S. Boucher, Temporary
A. Mirakhor	M. Daïri
	S. Rouai, Temporary
A.V. Mozhin	Y. Lissovolik, Temporary
H. Oyarzábal	O.E. Garner, Temporary
	P. Moreno, Temporary
T. Scholar	M.A. Brooke
	D. Merotto, Temporary
M. Portugal	A. Rambarran, Temporary
C.D.R. Rustomjee	J. Mafararikwa, Temporary
A.S. Shaalan	M.B. Chatah
	S.A. Bakhache, Temporary
Wei Benhua	Yu J., Temporary
J. de Beaufort Wijnholds	Y.G. Yakusha
	P.A. Nijsse, Temporary
K. Yagi	T. Miyoshi, Temporary
A.G. Zoccali	G.R. Le Fort
	R. Maino, Temporary
	C.E. Pereyra, Temporary

S.J. Anjaria, Secretary
M. Watson, Acting Secretary
A. Linde, Acting Secretary
Z.R. Ahmed, Assistant
T. Davidson, Assistant
S. S-Ramos, Assistant

Also Present

IBRD: J. Klugman. African Department: N. Kirman. Asia and Pacific Department: C. Browne, Q. Hussain, T. Rumbbaugh. European I Department: M.C. Deppler, Director; A. Leipold, Deputy Director; S.M. Schadler, Deputy Director. European II Department: H. Flickenschild. External Relations Department: G. Hacche, Deputy Director; M. Bell, S. Bhatia, W. Murray S. Nardin. Independent Evaluation Office: D.J. Goldsbrough, Deputy Director; T. Tsikata. International Capital Markets Department: G. Haeusler, Director; H. Tran, Deputy Director. Legal Department: W.E. Holder, Deputy General Counsel; P. de Boeck, I. Mouysset. Middle Eastern Department: G.T. Abed, Director; D. Burton, Deputy Director; P. Dhonte, Deputy Director. Monetary and Exchange Affairs Department: S. Ingves, Director; V Sundararajan, Deputy Director. Policy Development and Review Department: T. Geithner, Director; M. Ahmed, Deputy Director; M. Allen, Deputy Director; L.J. Lipschitz, Deputy Director; B. Ames, L. Cui, M. Hadjimichael, I. Halikias, A. Kapteyn, A. MacArthur, K. Ongley. Research Department: M. Kumar. Secretary's Department: L. Hubloue, M. Miller, A. Mountford, P. Ramlogan. Treasurer's Department: E. Brau, Treasurer; B. Christensen, Deputy Treasurer; M.G. Kuhn, Deputy Treasurer; E.Canetti, S. Ding, P. Ross, H. Trines. Western Hemisphere Department: A. Singh, Director; P. Gerson, A.M. Jul, J. Nelmes. Office of the Managing Director: A.A.E. Bertuch-Samuels, Special Advisor; V. Read, Personal Assistant; R. Nord, S. Tiwari, A. Tweedie. Office of Budget and Planning: C. Vehorn. Advisors to Executive Directors: A. Baukol, M. Beauregard, S. Çakir, S.S. Farid, N. Guetat, A.R. Ismael, S. Kropas, D. Lewis-Bynoe, H. Litman, Liu F., M.F. Melhem, N. Mensah-Zekpa, J. Milton, E. Nyambal, L. Palei, Y. Patel, H.E. Phang, A.A. Tombini, F. Zurbrügg. Assistants to Executive Directors: M. Abbing, C.A. Gust, V. Bhaskar, T. Belay, Cao L., M. Di Maio, H. Fabig, N.H. Farhan, T. Hadded, C. Harzer, H.-H. Jang, N. Joicey, J.K. Kwakye, P. Lathouly, A. Maciá, B. Mellor, K.S. Oo, P.R.D. Prasad, J.W. Ralyea III, L. Rizzotti, A. Stuart, S. Urinbaev, D.B. Waluyo.

1. INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE—PROVISIONAL AGENDA

Documents: Draft Provisional Agenda for the Sixth Meeting of the International Monetary and Financial Committee (EBD/02/122, 08/12/02)

Staff: Anjaria, SEC

Length: 1 hour, 15 minutes

The Secretary (Mr. Anjaria) confirmed that the International Monetary and Financial Committee (IMFC) meeting would take place at Fund Headquarters, not at the Marriott Wardman Park Hotel.

The IMFC meeting was expected to start at 8 a.m. on Saturday, September 28, the Secretary explained. The meeting would conclude with a lunch for IMFC Members. The lunch would be followed by the joint press conference of the Chairman of the IMFC and the Managing Director, and was expected to finish by 2:15 p.m. The Development Committee meeting was scheduled to start at 2:30 p.m. The drafting session for the IMFC Communiqué was scheduled to start at 8 a.m. as well.

In light of the fact that the IMFC meeting would be shorter than usual, an effort had been made to streamline the proposed agenda, the Secretary continued. The intention was also to keep the IMFC Communiqué as focused and as streamlined as possible.

Mr. Portugal made the following statement:

> I would like, first, to compliment the Secretary and you for proposing a focused and streamlined agenda for the meeting. This is a point that we have been emphasizing on previous occasions, and I would like to say that I agree with the proposed agenda. I have only three comments or suggestions to make.
>
> The first suggestion is that we might consider moving the topic regarding the Twelfth General Review of Quotas, which now is listed as a progress report, to be another topic under Agenda item No. 2. I propose this because I think that the size of the Fund is a main aspect of the process of reform of the international financial system. It is also an issue that the Board has already discussed in some detail. In fact, we are going to have our second discussion on it this afternoon. The Review has to be completed by January 30, 2003, which means that this is the last opportunity we will have to bring this issue to the attention of Ministers. To my mind, this is an issue that could clearly benefit from political guidance from Ministers. The paper on quotas that we are going to discuss in the afternoon shows that the Fund has been shrinking in relation to global output, trade, external payments, reserves, and capital flows, and that under certain scenarios, which are within the realm

of possibility, the forward commitment capacity with the Fund's own resources could be exhausted. In spite of that, we have been divided in the Board. Therefore, I think this is an item that would benefit from political discussion.

My second suggestion is that perhaps we could consider having the drafting session for the communiqué on the day before the IMFC meeting, instead of Saturday morning. I think it was a big advantage that last time we had the communiqué ready for the Ministers and in front of them when they were meeting, because this increases the ownership and the legitimacy of the communiqué. This was possible because we had the communiqué meeting in the morning and the Ministers' discussion starting at lunch. However, this will not be possible this time. My suggestion therefore would be that we schedule the meeting of the communiqué drafting group, instead of starting on Saturday morning, start on Friday afternoon, so when Ministers start in the morning on Saturday they will already have the text in front of them in the discussion.

Finally, on this question of the change of the venue, let me express some concerns. I fully accept and respect the decision of our host government to propose this change on security grounds. Nevertheless, I think that we have to be careful in the administrative arrangements so that this changed venue does not impair the usefulness of the meetings. I would request the Secretary to consider the possibility of providing more than one room per delegation. For instance, just to give an example, in the case of Brazil, we have the Minister, the Governor, three Deputy Governors, and other people coming and to keep everyone in a single room is not possible.

The other administrative point I would like to call to the Secretary's attention is the question of the meeting rooms. I hope there are sufficient meeting rooms, because one of the reasons why we come with a large delegation is that we want to hold simultaneous meetings with representatives of the private sector. On this particular occasion, this is important for us, and this is one of the important aspects of the usefulness of these meetings. This is another reason why we are asking for more rooms.

Ms. Lundsager made the following statement:

The Agenda has been put together very well by combining those topics that are related. I think Ministers can have a full discussion and consider what other factors affect these different areas; for instance, strengthening surveillance, crisis prevention, and crisis resolution, which are very much sort of a continuum of what we do. I think this is a very useful way of putting it together.

I would ask the Secretary if he thinks or perhaps could indicate to us ahead of time if there is a suggested time frame for how long Ministers should speak, especially on Agenda item 2(a), where generally almost all Ministers speak, as this would be useful. Of course, we all circulate longer written statements, which we have been doing for quite a while.

One thing I wanted to pick up on is a point Mr. Portugal just made. I actually had somewhat of the opposite view on the Twelfth General Review of Quotas. Mr. Wijnholds's preliminary statement—and Mr. Al-Turki picked up on the point too in his preliminary statement, and we will discuss this later in the day—noted that we are not making rapid progress in this area and we are not getting close to agreement. At this point, I also do not think that Ministers could have a fruitful discussion. I think it would tend to be a repetition of the discussion that we are going to have later in the day. I was going to suggest that we not even have a progress report since, as Mr. Wijnholds put it so candidly in his preliminary statement, there really is not a whole lot of progress to report on at this time. The important point is we do have to do this by January, and we do have to report to Governors. Therefore, we have to come to some conclusion later this year. Thus, in a certain sense, I do not think there is anything that the IMFC at this stage is going to be able to do that is going to accelerate that. Consequently, my suggestion was that we not even have a progress report at this time.

Mr. von Kleist remarked that it would be appropriate to decide in what manner the item on the Twelfth General Review of Quotas should be included on the agenda after that afternoon's Board discussion of the issue. If real progress were made in the afternoon, the topic could be added to the agenda for discussion by Ministers. If insufficient progress were to be made, a short progress report could simply be submitted to the IMFC.

Mr. Portugal had made a valid point with regard to the drafting of the IMFC Communiqué, Mr. Von Kleist observed.

It was unfortunate that the Board was informed about the change in venue of the meetings simply through a short memo, which was sent during the Board recess, Mr. Von Kleist added.

Ms. Lundsager responded that it seemed most appropriate to inform the Board as quickly as possible of the decision the U.S. authorities had made in light of the security concerns surrounding the meetings.

Mr. Oyarzábal made the following statement:

I would also like to thank you for streamlining the agenda; I think it is extremely useful the way it is. I am willing to go along with it, taking into consideration the suggestions made by Mr. Portugal.

I hate to disagree with Ms. Lundsager about not adding the issue of quotas to Agenda item 2, as I think it is a very important issue. I recall that when we set up the IMFC Deputies meeting, it was to allow for a political means to discuss some of the issues that were not being solved or not moving forward at the Board level. Because of that, I think the IMFC is exactly the forum that should give this issue some consideration. That is why I think Mr. Portugal's suggestion is certainly a viable one. It might be very difficult; we may not even make progress, but I think Ministers should have a chance to address this issue accordingly.

In addition, I would like to go along with the suggestion of Mr. Portugal on the drafting issue. That is a very good suggestion, and we should begin early on Friday so that we do have plenty of time—the communiqué can be very complicated—dedicated to finish it on time without there being a last minute rush.

Mr. Shaalan made the following statement:

I very much appreciate the agenda, which is concise and more focused. In fact, maybe it is too concise in the sense that the items are quite general. For example, Agenda item 2, the Fund and the international financial system in the process of reform covers a lot of ground. Under Agenda items 2(b) and (c), it is pretty clear what we are doing, but under item 2(a) it is less clear, as crisis prevention and crisis resolution are basically almost the entire activities of the Fund. Therefore, I wonder if we can be a little selective in what we plan to address, particularly under item 2(a).

What will be the role of the Deputies in preparing the agenda?

Finally, I would like to agree very much with Mr. Portugal that we should look at the draft communiqué on Friday. I think it would make a lot more sense to have a communiqué before Ministers when they sit at the table Saturday morning.

Mr. Djojosubroto made the following statement:

We support the proposed agenda. We also support the proposal from Mr. Portugal about shifting the discussion on quotas to Agenda item No. 2. We are also in favor of preparing the communiqué the day before.

Mr. Yagi made the following statement:

We do very much appreciate the streamlined agenda. Some may feel that it may be too streamlined, but I think there is a very good balance. I agree that strengthened surveillance, crisis prevention, and crisis resolution could include almost everything. However, each IMFC Member can put emphasis on any of the issues under Agenda item 2 according to its interest. I do not see any specific item that needs to be highlighted under Agenda item 2(a).

The quota issue is a very important one. As Mr. Portugal said, this is the last opportunity for Ministers to discuss it before the deadline of January 2003. Thus, I think it is better to be put it under Agenda item 2. It is quite unthinkable that we will not have any kind of discussion on this issue, irrespective of the discussion we may have this afternoon. I therefore believe that there should be a discussion, whatever the content is.

I do not have a strong preference when the drafting meeting is held. If I were pressed, I would rather want to have it on the same day. However, it might be a good idea to have it on the previous day so that Ministers can proceed the following day according to the draft, but it may instead lead Ministers' to concentrate too much on the wording of the language of the communiqué itself rather than to discussing the broad policy implications. Thus, in that sense, my preference, which is not very strong, is to have the drafting group meet on the same day as it is currently planned.

Mr. Kiekens made the following statement:

The single most important topic on this agenda is, without any doubt, the global economy and the financial markets at this difficult juncture. Apart from that, I do not see many important issues from an operational sense. Combating money laundering and the financing of terrorism will be a ceremonial conclusion of good progress. We already had a very substantial report on low-income countries at the last meeting and, although we have to make an update, I do not see any change in policies that is necessary.

I feel that Agenda item 2(a) is everything but focused; it is excessively large. Strengthening surveillance, crisis prevention, and crisis resolution covers all of our work. My Minister may ask what does Agenda item 2(a) specifically refer to; are we going to discuss international standards and codes, are we going to discuss debt sustainability analysis, early warning systems, the Sovereign Debt Restructuring Mechanism (SDRM), or PSI? I can say to the Minister, well, you can discuss whatever you want to, but that is not the purpose of an agenda. An agenda is to indicate to Ministers the topics on which we would like to have a focused discussion.

These are my observations, and I wonder, addressing myself to Mr. Scholar, whether the Chairman of the IMFC had any particular guidance for the Ministers on what specific topics will be discussed. For example, on SDRM, I think we need to make further progress on that, as it is a difficult issue.

One of most important points in an operational sense that could be discussed by the Ministers is the Twelfth General Review of Quotas. The size of the Fund is always a very important issue, but, if you would allow me, I would like to give my opinion and my advice on that at the end of this afternoon's meeting. At that time, we will have more material to come to a conclusion on how to proceed with this issue.

Mr. Shaalan agreed with Mr. Kiekens that Agenda item 2(a) was too broad.

The Chairman asked Mr. Shaalan whether he had any suggestions with regard to which specific issues should be discussed under Agenda item 2(a).

Mr. Shaalan replied that the SDRM was one such issue, and was more relevant at the present time than the topic under Agenda item 2(b), low-income countries.

Mr. Wei made the following statement:

> I support Mr. Portugal's proposal to move the quota issue for discussion under Agenda item 2. As Mr. Yagi mentioned, this is the most important issue for the institution. We should give a last chance for Ministers to express their views, even if we know that without the support of the United States it will be impossible for us to achieve a general quota increase, but it would be beneficial for Secretary O'Neill to listen to the views of the other Ministers directly.
>
> On the item on combating money laundering and the financing of terrorism, I agree with Mr. Kiekens. The Board already reached agreement on this issue, and I do not envisage that there will be new things for Ministers to discuss under this item. Perhaps one point that still needs to be discussed regards the Financial Action Task Force (FATF). We need some final confirmation from the FATF itself on the approach it will follow. Nonetheless, I believe it is more appropriate perhaps to move this item under progress reports rather than as an item for discussion.
>
> I support Mr. Portugal's suggestion to discuss the draft of the communiqué a day earlier, as this is a rather lengthy process. Moreover, when the discussion of the communiqué is simultaneous with the IMFC meeting itself, Executive Directors sometimes do not have the opportunity to participate in the IMFC meeting itself, as we are supposed to know more about the details of the communiqué language, and we unfortunately lose our own opportunity to listen to the Ministers. Therefore, I strongly support, if possible, starting on the previous day the discussion of the draft communiqué.
>
> Finally, as we are shortening the IMFC meeting to a half day, I am wondering what is the particular item to be discussed during the working lunch for the Ministers. On previous occasions, we have suggested an item to Ministers to stimulate their lunch discussion. I do not know whether anything on this agenda will be stimulating for them, but at least we could think about that.

Mr. Scholar made the following statement:

First, let me say that this is a very good agenda. We have a limited amount of time for this meeting, which is disappointing, but unavoidable, given the security situation that we face. Therefore, it is very important to make the best use of that time and I think the agenda does a good job in doing that.

I was listening to Mr. Shaalan earlier and considering how to answer his question on what is the point of the Deputies meeting, but then Mr. Kiekens came to my rescue by answering it for me in terms of posing a second question, which is, what should Ministers focus on when they come to item 2(a) on the agenda. I think the purpose of the Deputies meeting is to help prepare the main meeting, not to prepare it in the sense of policy preparation or drawing up papers or advising Ministers; that is, of course, our role here in the Board. The purpose of the Deputies meeting is to prepare the ministerial meeting in an organizational sense. Thus, I think that a major purpose of the Deputies meeting would be to give Deputies an opportunity to discuss among themselves the challenges and the priorities that they see for the ministerial discussion, and I think coming out of that we are going to get a much clearer sense of guidance from the Deputies themselves as to how to organize the discussion of the IMFC meeting here in Washington. The only other thing I would like to add to that is that Mr. Shaalan made a very valuable contribution to the last meeting in London, and I hope that he is going to come to this one and make a similarly important contribution.

On the question of quotas, I would agree with the position of Mr. von Kleist. I think that we are not ready for a substantive policy discussion but, at the same time, it is something that certainly ought to be brought to Ministers' attention. One advantage of the agenda that we have is that if Ministers want to raise this issue there is an opportunity on this agenda for them to do that.

On the question of the communiqué drafting, Mr. Portugal and others are absolutely right to say that Ministers need to have a proper opportunity to review the communiqué before it is issued. It is, of course, their communiqué, and we have to have a proper opportunity for Ministers to consider it. I think the arrangements we have had at recent meetings have worked very well, where we have had a bit of a head start on the main meeting. At the same time, I can see some problems with actually doing it the day before. I think one of the great advantages of the previous system in terms of the efficiency of the process is having it all done in one continuous period of time. I do very much take the point that starting the two meetings simultaneously does pose a bit of a problem there, so I wonder whether we might think—this might not be a popular suggestion—of starting the communiqué drafting session earlier on the Saturday morning to give us a head start before the Ministers get going.

Finally, I agree with those who are disappointed that it has been necessary to change the venue from the Marriott. Of course, we all understand why that has had to happen, and we accept the judgment of the U.S. government on that. However, at some point I think we would like to see a return to the previous format for these meetings. Others have said this before, and we will have to come back to that at some point after this set of meetings.

Mr. Boitreaud made the following statement:

Like others, I would like to thank you for this streamlined and balanced agenda. Given recent developments, and as stated by Mr. Kiekens, the first item, the global economy and financial markets, deserves strong emphasis. We are hoping for an effective exchange of views and comprehensive discussions between Ministers at the political level on this issue. On quotas, I think Ministers should at least have a report on the discussions we have been having over almost a year here. On the venue of this meeting, I fully share what Mr. Scholar just said.

Mr. Rustomjee made the following statement:

My observation in how we try to decide on agendas for the IMFC is that in the past we have tried to take account of three factors: one, our endeavor to try to report progress that has been made or otherwise; second, to try to get guidance during these meetings, particularly where matters are clearly unresolved, but also on other occasions as well; and third, one of the purposes of putting items on the agenda of the IMFC is to try to reaffirm to the membership as a whole or to large sections of the membership areas that we count as priorities in our work. My sense is that this agenda very much addresses all three of these guiding posts.

We welcome that it is streamlined. We welcome that it has elements that focus very much just on reporting progress, elements that are asking for guidance, and elements that are trying to reaffirm the areas that we hold as important priorities for the institution. Therefore, we could go along with the agenda as it is. However, we do have a couple of issues that have actually arisen from this discussion, as well as one or two others that we would like to raise.

On the item on low-income countries, we thought that there has been some useful analysis of the progress on the implementation of the Poverty Reduction and Growth Facility (PRGF). We therefore thought that it might be useful, given that there is one single item dealing with low-income countries, to add onto that item—because it is very much linked—the progress that has been made on PRGF implementation. Thus, it would go as a cluster, the PRSP approach, the HIPC Initiative, and the PRGF implementation.

I found Mr. Portugal's suggestion on the Twelfth General Review of Quotas useful, particularly given that the matter still has some way to go before it can be resolved, and particularly given the fact that it needs to be resolved by January next year. We agree that this could be a good occasion to try to have a bit more detailed discussion on it in the IMFC meeting.

On Mr. Shaalan's point on being a bit more selective on Agenda item 2(a), I think that this is a good idea. However, I do not have any particular preference. I think Mr. Yagi's point is also very valid that perhaps each IMFC Member should feel free to bring to the table whichever particular aspect or emphasis it would like. Given that the time frame for the IMFC meeting is going to be so short this time, it might be useful just to agree upon one aspect of crisis resolution and crisis prevention that we may all want to coalesce around and then put that on the table.

On the drafting, I think it is a very, very good idea, given the very short time for the IMFC meetings. We are open to whatever time that would be or whatever day that would be. I think it is a very good idea that that be done.

Finally, on the issue of meeting rooms, most of my colleagues in my office have been here over the recess. First, I must say we very much appreciate actually being given the advice as soon as it came through that we are going to be having the meetings at Headquarters. At the same time, it sends something of a shiver up my spine, because I guess we probably have something on the order of about 200 or so, at least, people coming from my constituency, Governors, Ministers, Deputy Governors, Deputy Ministers, and so forth. This is their one and only moment to convene meetings on a bilateral basis not only with many elements of the Bretton Woods institutions, but also bilateral meetings, as many as they can, and they try to use this opportunity to do that. I think the suggestion to try to find a way to give more than one room would be useful. I can imagine this sounds very easy, but if you multiply that by 184, it is a gigantic problem. I would just appeal that in the case of large multi-country constituencies with many programs—I think 18 of my 21 countries have programs with the Fund—it is going to be exceedingly difficult for them to do any useful business in that context. As an advisory to my colleagues anywhere near Room 718 on the 11th floor, I would try to find a different way of moving around the building on that day, because you might find a lot of people near my office.

Mr. Cippà made the following statement:

I would like to thank the Secretary for this provisional agenda. I think that all the items contained in this agenda are very important. I am sure that we will take care of all of them in our written statements.

As far as the discussion is concerned, and we should not forget that we only have half a day this time, I think that further streamlining is necessary. I would say that we can focus on two aspects. First, as said by Mr. Kiekens, Agenda item 1, the global economy and financial markets, will obviously be discussed by Ministers. I think we should decide on a maximum of one or two additional topics. I agree with Mr. Scholar that the Deputies have a role to play in this respect in choosing which items are to be discussed. Personally, I would like to have a couple of specific topics under Agenda item 2(a), for instance the SDRM or access to Fund resources. However, as I said, this would probably have to be decided by the Deputies.

As to the Twelfth General Review of Quotas, I tend to share the opinion of Ms. Lundsager, but let us wait to see what the discussion this afternoon will bring.

As to the communiqué drafting, I am open. I think we can also start on Friday, but I see very much the point raised by Mr. Yagi. Nonetheless, we should not end up discussing wording during the main discussion.

Mr. Ísleifsson made the following statement:

I would like to join my colleagues in thanking the Secretary for his work on the agenda, although I would like to concur with those speakers that have made the point that it might be useful also, given the short time, to sharpen Agenda item 2(a).

Concerning the question on the quotas, it seems to me that, given where we are on that matter, quotas seem to be appropriately placed on the agenda as a progress report.

On the drafting session, we could live with having it on Friday. I would just like to make the point that this opens the risk of the meeting becoming overly long, unless there is a deadline. Thus, Mr. Scholar's suggestion of an early start on Saturday might merit looking into.

Mr. Fenton made the following statement:

I would like to join other speakers in thanking you and the Secretary for this skillfully prepared agenda. On the issue of where the quota review appears on the agenda, I share the views of Mr. von Kleist and Mr. Scholar. On the timing of the drafting session, I share the views of Mr. Yagi.

Mr. Barro Chambrier made the following statement:

Let me also extend our appreciation for this provisional agenda. I think it is well focused. I would say that all the issues are important and deserve the same attention. I agree with Mr. Kiekens that the question of the global economy and financial markets is of the utmost importance. I would like also to say that by strengthening our instruments with regard to surveillance and crisis prevention, we are contributing to the progress to improve the global outlook and situation in the financial markets. Therefore, it seems to me to be well balanced.

On low-income countries, I think this is one of the main challenges of not only the institution, but also the financial community. After the Monterrey conference and the conference that is presently taking place in South Africa, it would be surprising if the Fund does not give appropriate attention to this issue. We will be able to see the limitation of our progress and we will require the support of Ministers to make further progress, especially on the issue related to the financing aspect. I think that what Mr. Rustomjee has said with the progress on the PRGF makes sense, but I would see it more in line with the discussion that we will have later, which is how we can better align the PRSP with the PRGF. I think this is a very substantive matter.

On the communiqué, I fully support Mr. Portugal. I think it is an improvement to be able to have for the Ministers a draft on Saturday morning. I think this is going to be useful.

As another multi-constituency, the Secretary will have to help us find a solution with regard to the many Governors that will be here, but we will do our best to adjust, given the current circumstances.

Finally, I think it is going to be important that we return to the usual format of these meetings as soon as possible. I think this is in the interest of everyone.

Mr. Vittas made the following statement:

Like previous speakers, I welcome the effort that you and the Secretary have made to streamline agenda, and I find the proposal put forward acceptable. I have some sympathy for Mr. Portugal's proposal to bring forward the drafting session, but I think Friday may not be practical; some of the officials involved in the drafting session may not be available on Friday. Thus, the only practical option might be to start the drafting session very early on Saturday morning. Finally, as regards the review of quotas, I agree with Mr. von Kleist that it might be preferable to wait until this afternoon's discussion, and then decide whether there is enough basis for putting this item on the agenda or simply being satisfied with a short progress report.

Mr. Daïri made the following statement:

I join other Directors in thanking you and the Secretary for a concise agenda, although I agree with Mr. Shaalan on the need to be selective on Agenda item 2(a). I also agree with Mr. Portugal's proposals and comments.

On quotas, I would like to point to the fact that the IMFC noted the start of the work on quotas during the previous meeting, and that it noted in the meeting before that the current financial position of the Fund is strong. Therefore, if anything, we have to have some indication about what the IMFC thinks about this. In addition, in both past communiqués, the IMFC indicated that the quotas should reflect developments in the world economy. I therefore think that the issue of quotas should be put before the IMFC regardless of whatever decision is reached today, and that other related issues be put before the IMFC as well, for example the issue of quota formulas, basic votes, and governance of the institution. I would point out the fact that the IMFC communiqué of November 2001 indicated that Ministers looked forward to further work on the quota issue. I think it would be fair to bring this issue before them.

Mr. Al-Turki made the following statement:

I join others in thanking you and the Secretary for a concise and well-focused agenda that I could endorse as proposed, subject to the modification by Mr. Shaalan to item 2(a). On the quota review, I have the same views as Ms. Lundsager. If anything, I think we can make a progress report as proposed here. On the communiqué, I agree with Mr. Portugal that we could start the day before, hopefully ending with as few bracketed sentences as possible.

Mr. Yakusha made the following statement:

I think that the agenda in general is appropriate. As Mr. Wei, I have some sympathy with the idea of reducing a little bit the prominence of the anti-money laundering issue, given the fact that we may not add that much value this time to this otherwise very important issue. On the drafting session, our views are similar to Mr. Yagi and Mr. Cippà. There is a danger that we may provoke a discussion about wording during the IMFC meeting instead of discussing substance. In this light, Mr. Scholar's proposal may deserve some serious consideration.

Mr. von Kleist made the following statement:

Let me now join others in thanking you for a well-focused agenda that, as Mr. Scholar has noticed, leaves room for Deputies, Governors, and Ministers to set their own points of emphasis if they feel they would like to do so. Having listened to colleagues' comments, I think Mr. Scholar has made a very sensible proposal concerning the timing of the drafting session.

The Secretary (Mr. Anjaria), in response to questions and comments from Executive Directors, made the following statement:

> The comments of Executive Directors have been very helpful. We will take them into account as we make our plans for the meetings more specific and more concrete. I would like to make a couple of observations on a few of the points made.
>
> We will need to reflect further on the suggestion to have the drafting session on Friday. There are a couple of constraints in this regard, and one of them was pointed out by a few Executive Directors, which is the availability on Friday of the relevant officials from capitals, because there will be a series of meetings, either bilateral meetings or group meetings, that Friday, and we will need to see what is practical from that perspective. We will consult also with Mr. Pickford, who will be the Chairman of the drafting group for the communiqué.
>
> I should note that historically we have experimented with many different arrangements for drafting the communiqué. After many iterations, we came to the conclusion that simultaneous drafting, although it has some disadvantages, also has some advantages, one being that there is a definite time limit within which the drafting should be completed. I therefore think that it would not be desirable to have the drafting session start on Friday and last late into Friday night. Nonetheless, I will take all the comments under advisement, consult further with colleagues and with the Chairman's office, and then come up with something sensible as far as the starting time of the drafting session. Certainly, in principle, there should be no difficulty in starting the drafting session earlier on Saturday, but we will also look into the possibility of doing something on Friday.
>
> On the point regarding delegation offices, again, Mr. Portugal and some others have made a very important point about the constraints that multi-country constituencies, in particular, will face because of the decision to concentrate the meetings at Headquarters. In addition to the dedicated offices that each national delegation will be provided, there is a pool of meeting halls and conference rooms that will be available to delegations for their meetings. We will look to see, particularly with an eye to the constraints faced by multi-country constituencies, what more we can do to make the job of organizing their meetings more efficient and smoother. However, there is also a logistical and organizational issue, because some of these offices and conference space is available outside the main Fund building and outside the main World Bank building, so that raises some issues about where the security perimeter is

going to be. We will be looking into those issues as well, and will be working closely with the U.S. security authorities.

Regarding Ms. Lundsager's suggestion on what should be the time frame for Ministers' interventions, we will work on this and come back to you with some guidance. I would say that with regard to coming up with this structure for the agenda, in the internal discussions we have had so far we very much thought that the two main items for the IMFC this time will be the ones that Executive Directors have already mentioned, namely the global economy and financial markets, and issues related to crisis prevention, surveillance, and crisis resolution. It is understood, as some Executive Directors said, that the money laundering issue will not require as much time as some of these other issues.

One of the next steps in the process is for us to have consultations with the Chairman of the IMFC. A letter will then be prepared by the Chairman, which will reflect some of the discussions and some of the points of view that have been expressed here. Going forward, we will need to be more specific on the distribution of the agenda items, and this will reflect the priorities that you have laid out this morning.

Finally, one of the items that we will need to consult on further is the focus of the discussion at lunch. We have not yet addressed this issue. We have in the past, as you know, followed a number of different approaches. We have focused on certain parts of the agenda items during lunch, but we have not yet addressed this for the upcoming meeting, and we will be addressing this in the coming days.

Mr. Portugal noted that there should be more than one office room per country, as it would be quite difficult to fit entire delegations into one room. It would be better if there were one room for the Minister and one room for the rest of the delegation. Starting the drafting session at 5 or 6 in the morning on Saturday would not be sensible, Mr. Portugal remarked.

The Secretary (Mr. Anjaria) replied that Mr. Portugal's suggestion with regard to office space would be taken into account, especially for multi-country constituencies. However, the total number of rooms available was limited and that could cause some inconvenience.

The Chairman made the following statement:

We have a good basis for an agenda, but it has to be revised in the context of this discussion and certainly also in the context of what the Deputies add to this discussion. This does not mean that we have to wait for the Deputies, but it is always good to listen to others.

We agree that the global economy should be the major focus, and the Secretary, and possibly others, should consider how we structure the Agenda, because we are not only concerned with developments in the real economy, but also in the financial markets. I assume that Andrew Crockett will give the Financial Stability Forum's assessment during the meeting.

Regarding Agenda item 2(a), which is certainly another major topic, in principle there could be two alternatives. One is to select one or two specific items to discuss. The other is to discuss what is the purpose or the future of the Fund in light of the current fragile global economy. This institution is in the process of change, as you know, with increased transparency, focused surveillance, and streamlined conditionality. There is a lot in the pipeline that we could endorse. I do think that, over time, the initiatives taken in the last few years will pay off.

I hope that in the context of the weakness of the global economy, the critical discussion about globalization confirms that this institution has drawn lessons from experience and its mistakes. We are in the process of change and reform, and the reform will pay off by making the institution more resilient and make crises less severe and frequent in the future. However, we need to work continuously on our reform agenda, implement what has already been agreed to, and understand that this is still a work in progress.

I still have to think about what will be my own presentation to the IMFC. One idea could be that I put forward issues such as the future of globalization or integration in the global economy as a source for growth, the implementation of our crisis prevention work, and the size of the Fund. What is crucial, in my view, at this time is that we are aware of what is needed, which is building up trust, containing further anxieties, and cooperation, because if people lose trust that there is no spirit of cooperation and that the institutions do not care about cooperation in the global economy, then things could get worse. Therefore, my point is that we need to use the IMFC and Annual Meetings to underline the importance of underpinning trust for international cooperation.

On this basis, I think we can also reflect about quotas. It is absolutely premature now to say that we need to have an increase in quotas. It is also premature to say that we do not need an increase. We need to discuss the future role of the Fund in the context of this line of change, improvement, and hard work.

It is no secret that I feel the SDRM is necessary, and some are heavily opposing that. I feel some are thinking we need a larger Fund size or a quota increase, and some are heavily opposing it. Perhaps if we put these elements and others in a context, we can demonstrate not only that we know about, at least tentatively, the future role of the Fund, but also that members understand

> that this definition of a kind of package or compromise, in the end, would serve all our members.
>
> This is the first reflection of my own thinking. I do not want to go further now, because I do not want to shock you, surprise you, or give you any anxieties, but you should be aware that I am thinking about my own presentation in the light of what we worked on in the last two and half years, and where at least I feel this institution should further move ahead.

Mr. Shaalan stressed that it would be important for the Managing Director, as part of his presentation to the IMFC, to define clearly the role of the Fund. It would be difficult to discuss issues such as access policy and quotas without first having a firm sense of what the role of the Fund was.

The Chairman hoped that the public and members would get a better sense of the role of the Fund based on the discussions that would be occurring during the upcoming Fall Meetings.

It was troubling that in the context of the discussions on globalization the Fund was not receiving much support, the Chairman continued. His presentation would clearly enunciate how the Fund could help better manage the process of globalization by building up confidence in the international financial system.

It would, nonetheless, be important for the IMFC to focus on specific issues for the period ahead, the Chairman remarked. Those specific issues could then be discussed in a context.

It would be important to return the meetings to their traditional format, the Chairman noted. The meetings provided an opportunity for the membership to come together and discuss matters of common concern, and engage in dialogue with outside parties. The meetings should foster a frank exchange of views among members.

The luncheon discussion provided Ministers with an opportunity to have a frank discussion, and this time would most likely revolve around the situation facing some individual countries, the Chairman said.

Mr. Kiekens agreed that it would be preferable not to have Ministers focus on one or two points as part of a discussion on the role of the Fund, but rather to have a discussion on how the various initiatives the Fund was undertaking were part of the overall framework of the Fund’s work. For example, the topics under Agenda items 1 and 2(a) were linked in many ways, and in that light, Ministers could comment on how the Fund has responded in the past and in what ways it should proceed with its current work.

Mr. Cippà agreed that it would be important to discuss the specific issues in the context of what the role of the Fund should be. However, many of the topics that could be discussed had first emerged from the discussions a few years ago on the role of the Fund. For example, the discussion on the role of the Fund had identified issues such as access policy and PSI as issues the Fund should work on. Therefore, it was now time to discuss both specific and broader issues together.

Mr. Reddy agreed with Mr. Kiekens that it would be important to keep in mind the broader issues and the significance of confidence building.

The Chairman noted that the provisional Agenda would be refined in light of the Board discussion.

2. POVERTY REDUCTION STRATEGY PAPERS—PROGRESS IN IMPLEMENTATION

Documents: Poverty Reduction Strategy Papers—Progress in Implementation (SM/02/250, 8/6/02)

Staff: Ahmed, PDR; Plant, PDR; Ames, PDR

Length: 2 hours, 20 minutes

Mr. Mirakhor submitted the following statement:

Key Points:

While steady progress has been made, further efforts are required by countries and donors to realize the full potential of the PRSP approach;

Donors are encouraged to align their support to country priorities in line with the joint Review recommendations;

We welcome staff's involvement in identifying sources of growth and increased attention to "pro–poor growth" and "distributional changes;"

Growth projections should be based on realistic assumptions;

Contingency response to shocks should not fall entirely on domestic adjustments, but should also entail some external financing. There is also a need for increased focus on helping countries to overcome their perennial vulnerability to shocks.

We thank staff for the clear and balanced update on the PRSP implementation. As the paper indicates, although steady progress has been made, the PRSP process faces many challenges, both in preparation and implementation. The last six months following the joint Review has witnessed a welcome increase in PRSPs, signifying the strong efforts of participating countries supported by the development community. Over the period, a significant number of countries have also upgraded their interim PRSPs to full–PRSP status. Initial ambitious timetables, in the face of capacity constraints, led to an extension of preparation schedules in many cases. However, this often contributed to improved participation and content.

We agree that, to avoid overtaxing limited institutional capacities, interim–PRSPs should be brief and focused. For the same reason, PRSP preparation progress reports should be limited in length and extent. The annual PRSP progress reports are also a useful device for stocktaking and possible adjustment to strategies. In this regard, we find the JSA guidelines in Annex I helpful.

PRSP preparation has entailed a commendably high degree of participation and broad dissemination of information, although we note that only two countries (Rwanda and Vietnam) have disseminated PRSPs in local languages. It is also encouraging to note that the participation process underlying the PRSP approach is permeating other spheres of public decision–making, including parliaments. As illustrated in Mauritania, involvement of sector ministries in strategy formulation could significantly improve effectiveness of planning and implementation. Although the PRSP approach "remains on track", there is considerable room for improvement if the goals of all stakeholders are to be fully realized. There is a need to strengthen the poverty diagnosis to ensure effective targeting of poverty alleviating measures. Furthermore, the report rightly points to weaknesses in the macroeconomic content of PRSPs, particularly regarding growth assumptions, analysis of alternative policy options, trade offs, and contingency responses to shocks.

There appears to be consistent upward bias in growth projections, which, as footnote 5 indicates, is not limited to PRSPs, but permeates many documents of the Bank, Fund, and other development agencies. This tendency has also been recognized as far as WEO projections for Africa are concerned. While optimistic growth projections may be premised on implementation of the full complement of policies and reforms, they may also sometimes reflect the inability of the proposed policies to deliver the expected outcomes. In all cases, the country suffers the undesirable effects of lower growth, including consequent painful adjustments and frustrated expectations. We welcome staff suggestions to address this perennial problem, including assisting countries to identify sources of growth in order to improve outcomes. In this regard, increased attention to "pro–poor growth" and "distributional changes" will be crucial.

While formulating alternative scenarios may be appropriate, the usefulness or practicality of an "optimistic case," which "may not be in line with the most likely outcomes," is questionable. Rather, projections should be based on realistic assumptions. In addition, there should be a contingency scenario based on more stringent assumptions and comprehensive consideration of risks emanating from possible shocks. Increased attention to the need for flexibility in responses to exogenous shocks is in order. However, to be less painful, contingency responses should not fall entirely on domestic adjustments, but should also entail some external financial assistance. Moreover, the importance of helping countries to overcome their perennial vulnerability to shocks by exploiting other potential sources of growth needs to be stressed. Staff's call for early engagement of development partners in the participatory process to help with the growth projections as well as with the macroeconomic policy and financing decisions is appropriate.

The paper reiterates the effects of capacity constraints on PRSP preparation and implementation. technical assistance initiatives at regional and country levels are welcome, and it is hoped that they will be better coordinated and geared to strengthening domestic capacity. The learning events and network of regional technical assistance centers are important steps in this direction. The Bank–Fund outreach programs and other initiatives to broadly disseminate findings of PRSP reviews to stakeholders, including parliaments, CSOs, and the donor community are commendable.

It is encouraging to note that the strengthening of PEM systems, which were found to be seriously deficient in the previous staff review, and of the capacity to track poverty reducing expenditure is receiving considerable attention from the Bank, Fund, and other development partners. It is noted that both short–term and medium–term measures are being taken to this end. Commendable initiatives are also underway to increase stakeholder participation in ensuring more effective PEM systems. We welcome the broadening of PEM system assessment and hope for increased donor coordination to this end.

Monitoring and evaluation (M&E) of the results of PRSPs are important for the benefit of both countries and development partners. While it may be too early to ascertain the full effectiveness of PRSPs, it would be useful to develop an appropriate framework based on identified indicators that could be used to assess progress and eventual outcomes. This requires further strengthening of data and capacity, and the support of development partners in this regard is noteworthy. To ensure effective targeting and maximization of the benefits of PRSP policies, both ex ante and ex post poverty and social impact analysis (PSIA) is critical. We are pleased with progress in incorporating PSIA in PRSPs since the joint Review, and welcome Bank and Fund initiatives as well as donor support for this exercise.

The paper highlights the importance of aligning donor support to country priorities to enhance effectiveness. While we welcome the broad acceptance of this principle, we join staff in calling on development partners to implement alignment based on the joint Review's suggestions. Efforts by the Fund and Bank to align PRGF-supported programs and CASs to PRSPs will go a long way to enhance program effectiveness and ownership.

Mr. Padoan and Mr. Lombardi submitted the following statement:

We welcome the opportunity to discuss progress in the implementation of the PRSPs and would like to express appreciation to Staff for issuing a concise and very informative Report.

We are pleased to note that, in the interim period since March, when the last review took place, an additional nine countries have completed their first full PRSP, while some other countries have made significant progress towards the design and the implementation of PRSPs. Overall, it appears that the degree of ownership has been strengthened, as shown by the increased breadth of the underlying consultative process.

Looking ahead, countries should improve both the consultative decision–making process leading to the PRSP and the monitoring of the outcomes, while, from the Fund's perspective, we should allow for a closer alignment with the PRGF.

Since we broadly agree with the Staff Report, we shall confine our remarks to the following.

The Decision–Making Framework

As the Report confirms, targets set in PRSPs appear ambitious and decoupled from a thorough discussion about the policies most suitable to pursue them. We fully agree with Staff that PRSP countries need to be more realistic while at the same time focusing on the linkages between given objectives and the policies available to pursue those same objectives.

For the PRSP to become the framework for policy discussions and implementations, there should also be a closer link between the scenarios envisaged in the Papers and the documents issued by governments for policy–making. In this regard, as Staff points out, there is no doubt that the budget process should be more closely tied to the strategy, objectives and scenarios envisaged in the Papers.

To reinforce the credibility of the PRSP framework, we also need countries to identify a set of intermediate objectives that can be closely monitored. This should be instrumental in providing earlier feedback on the likelihood of reaching the agreed–upon final targets.

On this issue, we believe that two further steps are needed. On the one hand, PRSP countries need to intensify their efforts to produce timely and comprehensive surveys to provide the analytical background necessary for decision–making and for monitoring the strategies in place. On the other, donors should base their commitment more and more on the performance of the country with respect to the PRSP. As Staff made clear, this general principle has been accepted by the donor community. However, the challenge now lies in the operational sphere.

Along the same lines, PRSP countries' limited institutional capacity should be acknowledged. This clearly calls for a more focused and coordinated approach in delivering technical assistance both from bilateral donors and from multilateral institutions. As for the Fund, we would encourage Staff to increase coordination with countries and donors along the lines of the recent review of technical assistance policy and experience. We favorably look upon recent initiatives, such as the establishment of AFRITACS—to which Italy has contributed in a non–negligible way—as a potentially powerful tool for delivering on those objectives.

Alignment of the PRGF to the PRSP

The alignment of support to PRSP on the basis of the priorities laid out in the PRSP and the subsequent ability of the country to deliver on those priorities should affect not only bilateral donors, but also multilateral institutions. In this regard, we feel that there is more room for aligning the Fund's PRGF to the PRSP, as we underscored during the last PRSP and PRGF review.

On the one hand, as PRSPs aim to be more focused by relying upon more realistic assumptions and establishing closer links between policy choices and projected outcomes, it allows Staff to align the PRGF more closely with the PRSP. On the other hand, there should be an increased effort in drawing PRGF conditionality from PRSP priorities. We believe this is a two–way process that can fruitfully help in strengthening the credibility of both the PRGF and PRSP.

Public Expenditures Management

We see Public Expenditures Management (PEM) as the weak spot in the framework set so far for PRSPs. The ability of PRSP countries to track and report on poverty–reducing spending is still somehow limited. Unfortunately, until significant progress is achieved in this area we cannot be adequately reassured that the aims underlying the PRSP have been reasonably met. In this regard, we encourage Staff to go ahead with their crucial efforts in assessing PRSP's PEM system and in delivering related technical assistance. Importantly, countries performance over PEM should also feed into PRGF conditionality. In this regard, we do welcome recent PRGF-supported programs as outlined in the Report—whereby conditionality also includes performance on certain aspects of PEM—and strongly encourage Staff to continue along this avenue.

Mr. Reddy submitted the following statement:

We commend the staff for providing a critical account of the progress, since the comprehensive review earlier this year, on different aspects of the PRSP. We agree with the broad thrust of the assessment that the PRSP process has taken hold, with a significantly improved country ownership, and one of the major areas of focus now is meeting the challenges in implementation.

The forward movement in the completion of PRSPs by a number of countries is welcome, though some slippages with respect to the original schedule have been reported. A variety of factors enumerated in the PRSP preparation status reports explaining the delays in completing the full PRSPs provide some indication of the possible causes. In order to reduce the possibility of time–overruns, the experience gained so far may be analyzed with a view to reducing the demands on the countries and exploring the scope for streamlining the process and the content of the PRSPs without prescribing a standard format. Such an exercise should also capture the concerns of the countries arising from the fact that different milestones in the PRSP process are pre–conditions for access to a multitude of bilateral and multilateral sources of concessional aid and debt relief.

In this regard, we welcome the clarification that the Annual PRSP progress report should be an integral part of the annual budgetary or reporting framework of the governments. However, we share the staff's concern regarding the excessive time and resources that continue to be devoted to I–PRSPs despite the requirement only of a short and focused document as an interim measure. The staff have at the same time indicated several areas for greater or improved elaboration. These include more details about timetables and institutional arrangements for the planned participatory processes, and greater attention to gender and efficiency of service delivery issues etc. We encourage staff to consider keeping the requirements to be a met by the I–PRSP to the minimum, if it is to remain a road map and not become a near replication of the full PRSP.

The staff paper alludes to the possibility that a multiplicity of actions are being incorporated in the PRSPs without adequate attention to costing, prioritizing, and linking of policies to diagnostics. While the number of policy actions required and their sequencing, prioritizing etc. would not only necessarily vary from country to country but would also need to evolve continuously in response to a dynamic situation, it would be interesting to have an analysis in a future paper to determine if too many and diverse donor concerns are contributing to this trend.

The staff have rightly reiterated the well recognized principle that enhanced aid effectiveness, apart from increased aid flows and improved market access, has to be an important element of a comprehensive approach for reaching the MDGs. While welcoming the various related initiatives reported to be in the works, we look forward to tangible progress, by the next annual review, in improving donor alignment and harmonization of procedures and practices. These are critical to reducing transaction costs and enabling the authorities with weak and overstretched capacities to shift the focus from processes to actual implementation.

Adequate, timely and appropriate technical assistance in enabling the countries to design and implement the PRSP framework will also be critical, in addition to enhanced and assured aid flows from donors. In view of the varied initial conditions and institutional capabilities of PRSP countries, rigid standards and guidelines regarding preparation of PRSP may need to be avoided, and in fact where plan documents are available through consultative as well as democratic process, they could be adequate basis for PRSP.

The success of PRSP as a key global initiative to promote growth and poverty reduction is as important to the concerned countries as to the credibility of the global institutions. While organizing national dialogues and preparing comprehensive strategies was a challenging task for most of the PRSP countries, implementation would be even more demanding. The ultimate objective, namely poverty reduction, requires significantly higher growth and better distribution. This is contingent not only on the right policies and sound implementation on part of the countries but equally on the provision of enabling environment. Many of the PRSP countries are extremely vulnerable to exogenous shocks, due to their overwhelming dependence on export of single commodities. PRSPs could, therefore, devote greater attention to analysis of the possible sources of pro–poor growth and to fallback strategies to mitigate the adverse impact of exogenous shocks. Further, in devising review procedures and additional areas to be covered, we have to take care not to overwhelm the limited capacities of most of these countries. It is also important to fully take into consideration the authorities' need to calibrate the pace of policy changes so as to minimize the likely disruptions to the social fabric and facilitate a continuously reinforcing progress towards poverty reduction. Adequate maneuverability to the authorities enabling necessary changes, innovations and improvisations in policies as well as procedures as they go along implementing their strategies would be critical to success. Future reviews may include a reference to the flexibility of the PRSP frameworks from this perspective.

Mr. Callaghan submitted the following statement:

Key Points

The focus should increasingly shift from processes to the implementation of poverty–reducing strategies, as outlined in PRSPs.

If PRSPs are to be an effective instrument in poverty reduction, it is essential that they become closely integrated into a country's policy formulation and implementation processes.

A key concern is that nine of the PRSPs reviewed had difficulty in presenting a realistic and sequenced policy package to promote growth and reduce poverty.

Particular attention must be given to the institutional capacity limitations countries face. All donors should align their assistance with the priorities outlined by governments in their PRSPs.

We are perplexed over the concerns that I–PRSPs may be diverting resources from the development of full PRSPs. This seems to suggest that I–PRSPs are different documents than PRSPs.

The paper presents a useful overview of progress with the preparation and implementation of PRSPs.

Shifting the Focus from Preparation to Implementation

The coverage in the report on some of the key issues countries are facing as they implement their PRSPs is welcome, for the focus must increasingly shift from preparation to implementation. This was a key challenge identified in the joint staff review of the PRSP approach considered in March.

It is important that the preparation of PRSPs and I–PRSPs not be seen as ends in themselves, but as part of an ongoing process with the objective being the reduction of poverty. Similarly, the focus of these progress reports should be on how the PRSP process is actually contributing to the implementation of policies that are pro–growth and leading to a reduction in poverty, and what can be done to improve their effectiveness in this regard.

Unfortunately, there still appears to be many shortcomings. While some progress has been made in implementing PRSPs, they still seem to be largely developed in isolation rather than through a coordinated effort with the IFIs and donors. Furthermore, they still seem to be largely removed from the country's policy processes.

Integrating the PRSP into a Country's Policy–Making Process

The onus is on governments to develop and pursue the objectives outlined in their PRSP, by utilizing appropriate mechanisms and putting into practice their priorities for addressing poverty reduction. Yet a common theme across all status reports is overly–optimistic schedules in I–PRSPs and shortcomings when it comes to the costing and prioritization of public policy actions. However, the sequencing of reforms and the prioritization of limited administrative capacity and financial resources is essential. A telling assessment is that nine PRSPs had difficulty in presenting a realistic and sequenced policy package to tackle poverty (paragraph 21). This should go to the heart of the PRSP process.

We should be particularly concerned with the assessment that there is often a disconnection between the macroeconomic framework underpinning a country's PRSP and that upon which its annual budget is based. This appears symptomatic of the problem mentioned earlier that PRSPs are not integrated into a country's decision–making framework.

If the PRSP is to be an effective instrument in poverty reduction, it is important that it be integrated as far as possible into a country's policy formation and implementation processes. For example, incorporating a country's PRSP progress report into its budget process might help bring the PRSP increasingly into the decision–making framework. The approach taken by Uganda in this regard is a good example for others to follow.

Similarly, when the report notes that creating a framework for institutionalizing the participatory processes that PRSPs have stimulated is a key challenge, this is essentially saying that countries have to concentrate on consensus building and develop good governance and accountability procedures into their policy–making processes.

Related to the above point, we were somewhat surprised that concerns over weak participatory processes, which were key issues highlighted at the PRSP review last March, do not seem to be a concern in this progress report. Strong participatory processes are important.

Capacity Limitations and Donor Coordination

Particular attention must be given to the institutional capacity limitations countries face. Poor progress in implementing PRSPs is a result of over–optimistic objectives and capacity limitations. In particular, we would like to see continued Fund support in strengthening Public Expenditure Management systems and in providing assistance for data collection. It is essential to develop the capacity of governments to deliver reliable data to incorporate into realistic projections and objectives within the PRSP.

It would clearly be desirable for countries to incorporate alternative scenarios and contingency plans in a country's PRSP at the outset. However, given the extra demands this would place on the already limited institutional capacity of low–income countries, such scenario building and contingency planning may necessitate additional technical assistance. Related to this point, Mr. Mirakhor has raised the important point of helping countries overcome their vulnerabilities by exploiting other sources of growth. Nearly every JSA has referred to a failure to adequately identify sources of growth as a major weakness in PRSPs.

This highlights the importance of all donors (not just the Fund and Bank) aligning their assistance with the priorities outlined by governments within their PRSPs. Donors have their own lending/grant instruments with differing arrangements/conditionality. Administering all these arrangements places considerable burdens on limited institutional capacities in the recipient countries. Importantly, the Fund and Bank should ensure that technical assistance to low–income countries fully aligns with PRSP priorities.

I–PRSPs

We were perplexed by staff concerns that I–PRSPs are too large and may divert capacity from development of a full PRSP.

Given that I–PRSPs are intended to provide an outline of the priorities to be included in full PRSPs, a more comprehensive I–PRSP should be considered as assisting the completion of the full PRSP.

Concerns that comprehensive I–PRSPs are diverting resources from a full PRSP imply that the I–PRSPs are significantly different documents than the full PRSP. If this is the case, we would be interested in the reasons as to why I–PRSPs have differed from their original intention and what should be done to rectify this situation. For example, is there a need to specifically review the I–PRSP process?

However, we would be particularly concerned if the problem is that the preparation of lengthy and ambitious I–PRSPs and PRSPs, as well as requirements for progress reports, is in any way detracting from the task of policy implementation. As noted previously, the PRSP should not be seen as an end in itself.

Regional Issues

A number of countries in the Asia Pacific region will shortly be required to produce a full PRSP. As such, we would welcome more PRSP learning, capacity building and outreach activities in the Asia–Pacific region, along the lines of the Joint World Bank, ADB, IMF and UNDP "East Asia

Regional Conference on National Poverty Strategies" held in Hanoi in December 2001.

Mr. Chatah and Mr. Bakhache submitted the following statement:

It is not surprising that the experience gained in the past six months, since the Board last discussed at length the joint Review of the PRSP, does not add substantially to the findings of that review. Although a significant number of PRSPs have been finalized since the March review, six months is too short of a time period to expect the staff to derive meaningful new lessons, let alone for those finalized documents to benefit from the lessons learned from the review. The staff report states that the PRSP approach remains on track. This, in our view, is not unexpected given that countries have to follow a set of guidelines relating to the PRSP, albeit with built–in flexibility, in order to access concessional Fund resources and HIPC Initiative debt relief. A more important question here is whether this approach is yielding the desired results in terms of achievement of development goals and poverty reduction targets. While it is too early to make such an assessment, we feel that this review is still focused on the process. More attention should, however, be accorded to examining the effectiveness of the approach and its ability to generate positive results. In this connection, we wonder whether it would not be useful, at an appropriate time, to undertake an outside assessment of the PRSP approach that fundamentally examines the adequacy of all its elements.

The discussion of recent experience with regard to the preparation of poverty reduction strategies clearly shows that there is room for improvement. While we generally agree with the staff on ways to improve the preparation of PRSP and PRSP–related documents, it should be emphasized that this exercise has to remain country led and country owned. Any suggested good practices should be treated as such rather than becoming a set of new uniform guidelines. For instance, the Fund and Bank's effort to support country initiatives to institutionalize civil society dialogue in the PRSP context is worthy. However, the set of good practices that emerge and will be disseminated in this area should not be treated as a one size fits all outfit. With regard to I–PRSPs, countries ought to be given discretion on the length (which of course is not indicative of quality) and scope of the documents. Any effort that goes into the preparation of an I–PRSP can feed into the preparation of the full PRSP and hence facilitate it.

In what follows, we will focus our comments on those issues that have direct relevance to the Fund's involvement in the PRSP process. One such issue is what appears to be a disconnect between the macroeconomic framework underpinning a country's PRSP and that on which the annual budget is based. This problem, in our view, is symptomatic of the pre–occupation with the process leading to the preparation of PRSPs, and represents a serious challenge for the Fund.

Ideally, while unlikely to be the same, the macroeconomic frameworks that underlie the PRSP and the annual budget, which typically underpins the economy's adjustment program, should be broadly consistent. The gap that exists between the two is likely the result of the apparent tension between the tendency for ambitiousness and over–optimism in the PRSP and the necessity for realism in the annual budget. Country authorities along with civil society typically try to include the widest range of policies and measures in the PRSP that, if properly implemented and financed, can lead to high growth rates. When designing Fund supported programs and annual budgets, however, the availability of domestic and donor financing becomes a major constraint leading to a much different and more realistic macro framework. The task of bridging this gap is not a simple one and raises a number of important issues pertaining to the Fund and Bank's technical and advisory roles in the process, as well as the countries' institutional and technical capacity.

More realism in growth projections is critical for designing adequate policies and estimating the right level of foreign assistance needed to finance social programs and fill financing gaps. We are pleased that this issue is acknowledged in the staff paper and like Mr. Mirakhor we support the proposals to place more emphasis on helping countries identify measures to raise growth, while striving for more realism in growth projections.

Early involvement of the Fund in the PRSP process is necessary to ensure that realism is injected in the macro framework underpinning the PRSP. Given that the Fund is an important partner in the development effort, such involvement has in all likelihood been taking place to some degree. However, in light of the prevalent and sometimes wide gaps between the macro framework of PRSPs and the Fund supported programs, there seems to be room for more input, technical and advisory, from the staff in this area at the earliest stage.

This could usefully be done in the context of helping countries to develop alternative macro scenarios and contingency plans in PRSPs at an early stage. In this regard, we agree with the staff that it would be useful to have two scenarios that anchor policy–making and guide donors' contribution to the development effort. One based on policy and financing assumptions necessary to produce the most desirable development objectives, and another more realistic one, with contingency plans, based on available financing and practical expectations with regard to policy implementation.

Needless to say, enhanced involvement by the Fund in this area is not sufficient to bridge the gap between the PRSP and the Fund supported programs. Countries need a long time and lots of external support to enhance their institutional and technical capacity to deal with the complications of addressing this issue. Furthermore, the challenge of introducing realism to the PRSP transcends public authorities. All participants in the PRSP preparation effort should be mindful of the importance of aligning the PRSP with the reality of policy implementation and availability of resources. Of course, the donor community has also a role to play in terms of ensuring that those areas identified as essential for growth and poverty reduction be adequately financed.

Finally, the staff raises interesting issues pertaining to the flow of aid to poor countries. Here, two aspects of donor aid flows deserve a closer look. One is the trade–offs between macro and development objectives. This is particularly important for those countries that are making progress in their development efforts and therefore receive larger aid flows which in turn could raise questions about fiscal and external sustainability, macro stability and aid dependence. Another related issue is the manner in which aid monies can be best allocated to generate the highest return for recipient countries.

Mr. Zoccali and Mr. Maino submitted the following statement:

By focusing on the key issues of preparation and implementation, the progress report on Poverty Reduction Strategy Papers provides a thorough and balanced assessment of the advances made and the many challenges identified in this process. The Joint staff report corroborates that in going from design to implementation, the PRSP approach remains on track. We welcome, in particular, the recent sound and active response by countries across all regions in preparing poverty reduction strategies that presuppose not only support from the international community, but also institutional and political will and effective use of resources and development assistance. That said, we believe that much remains to be done by low–income countries themselves and by the international community in light of the Millennium Development Goals.

We concur with staff that the focus should now shift to transforming countries' commitments into practice by connecting assistance programs to PRSP priorities, by deriving policy conditionality from PRSP programs and by relating aid allocation to PRSP implementation. The PRSP process has, in our view, generally contributed to a strong sense of ownership and a high degree of participation, placing poverty reduction as a central subject in policy proposals. The process has also encouraged a more open dialogue between governments and civil societies, while recognizing the need for flexibility and the acceptance of country specific circumstances in the analysis of the content of national strategies. Notwithstanding the greater openness in government decision–making and the extent of participation, the desirability of engaging sectoral agencies and sector ministries in strategy formulation, raised by the staff in Section III of the report, should be emphasized in light of prevalent coordination risks.

We encourage all stakeholders to work towards the reduction of transaction costs for low–income countries. In this regard, the Guidelines for

Joint Staff Assessments should serve the purpose of more effective implementation. Notwithstanding the importance of monitoring and evaluation, the problem of measuring of the poverty impact of policy actions should be underscored to make poverty targeting meaningful. We welcome the preparation of the PSIA Toolkit by the World Bank to provide more systematic details and examples of country applications and facilitate the mainstreaming of PSIA in PRSPs.

For many countries lacking the necessary institutional capacity, the evaluation process could represent an excessive administrative and technical burden. Therefore, we would caution on the requirement that low–income countries prepare comprehensive annual PRSP progress reports. The emphasis should instead by on conciseness and focus and, where possible, involve the use of objective quantitative indicators or other perception–based measurements of welfare. In any event, we concur with Mr. Mirakhor on the need to avoid overtaxing limited institutional capacities by preparing brief and focused interim–PRSPs, to maintain flexibility on the timing of the annual report –taking into account the cycles of national development plans– and to provide the macroeconomic framework for the formulation and application of PRSs.

We welcome the candid assessment on Macroeconomic Choices and Pro–Poor Growth presented in Section III–B of the report and the recognition that improving our understanding of these issues is paramount. In this regard, an effective and efficient partnership with the World Bank, to establish clear priorities and realistic growth projections and targets is critical, so as to minimize the risks associated with unfulfilled expectations and backsliding due to lower growth. While it is important that countries identify the sources of growth to improve outcomes, the role of market access for low–income country exports, as a key driver of growth to better align development assistance with national priorities, should not be downplayed. Additionally, the effort of low–income countries should be accompanied by a policy of systematic data collection, analysis and results–oriented monitoring of outcomes.

A more pro–poor and pro–growth environment requires overcoming impediments for the efficient use of budgetary resources in low–income countries, including improvements in budget execution to enhance productivity and the growth prospects. This reaffirms, in our view, the importance not only of political will but also of adequate financial and technical assistance resources, to narrow the institutional and administrative gaps that breed insufficient accountability and inefficiency in budgetary management. Similarly, a pro–poor expenditure policy should be part of a broader framework that encompasses transparent and enforceable systems of taxation and improved tax administration.

Encouraging countries to develop more conservative scenarios and to present contingency plans should serve to address some of the perceived weaknesses of the macroeconomic frameworks in early PRSPs. This reformulation involves, however, not only the adoption of realistic assumptions but also greater predictability in the financing of a structural reform process and the timely provision of technical assistance, to help identify and implement needed policy measures to foster growth and institutional capacities, including in the area of data management. We concur with Mr. Mirakhor in stressing the importance of external financial assistance in addition to domestic adjustment to make exogenous shocks less painful.

Finally, we commend staff for their assistance in strengthening PEM systems. The progress made in tracking poverty reducing expenditure since the last report is noteworthy. However, in addition to improved reporting, combating poverty will require more intensive coordination and complementarities with other development partners and the donor community in general. Sharing experiences in poverty reduction and social related issues can serve to shorten the learning process to ensure a more effective allocation of PRGF assistance. We encourage completion of assessments of PEM systems being currently undertaken by some 14 additional low–income countries to help operationalize plans in this area.

Mr. Rustomjee submitted made the following statement:

Progress in Implementation

We thank staff for a detailed account and update of progress on PRSP implementation. We are encouraged that all the issues raised in the Joint PRSP Review as well as those that our chair raised in previous Board discussions are being taken into account. These include strengthening ownership; flexibility in using the PRSP as conditionality; aligning the PRGF to the PRSP; conducting Poverty and Social Impact Analysis; providing technical assistance to strengthen capacity in PEMs as well as the key issue of aligning donor assistance to PRSPs. The staff paper reveals that progress is being made. At this juncture, we concur with Mr. Callaghan that the focus should now shift towards consolidating implementation of these processes. In this regard, we should recognize that there remain key challenges that need to be addressed to achieve satisfactory progress in all these areas.

Strengthening Ownership

We acknowledge that strengthening ownership is not an event, but a process that evolves over time. All indications point to substantive efforts being made by all stakeholders to strengthen ownership. The involvement of parliamentarians is of particular importance in strengthening local ownership. However, there is a need to ensure that decision making is not necessarily protracted. The involvement of sectoral ministries and agencies should be strengthened as part of efforts to strengthen ownership in implementing PRSPs at the grassroots and properly targeting poverty alleviation efforts. Dissemination of the PRSPs in local languages should be strongly encouraged as a vehicle for catalyzing broader participation and strengthening ownership. Nevertheless, it should not be made a requirement given the likelihood of diverse languages in some countries and the limited institutional capacities in producing such documents.

Alleviating Capacity Constraints

Related to ownership is the continuing problem of limited administrative capacity in many countries. More technical assistance is needed to prepare I–PRSPs and full PRSPs that are focused but not unnecessarily long. We note Mr. Callaghan's observations on the merits of comprehensive I–PRSPs and PRSPs, while we also recognize that unnecessarily long documents and too ambitious timetables could be a serious strain to the limited capacity particularly in post–conflict countries. We have also urged both the Bank and the Fund to strengthen their collaboration and assign their most experienced staff on PRSPs issues to countries that are preparing PRSPs for the first time and those that are facing acute administrative capacity limitations. We hope that the paper for the forthcoming discussion on strengthening Bank–Fund collaboration is addressing this issue.

Macroeconomic Content of PRSPs

More effort is needed in aligning the PRGF to the PRSP, thereby enriching the macroeconomic content of PRSPs. This also ensures that there is broader participation in the design and implementation of PRGF-supported programs. In this regard, we have highlighted the need to provide ample room for countries to explore and present their own alternative policy scenarios and timetables. We share Mr. Mirakhor's observations that in Bank and Fund documents, and particularly in PRGF-supported programs, there has been an inherent problem of overly ambitious growth targets and lack of contingencies for exogenous shocks. More effort is needed on the part of Fund staff in understanding the potential sources of growth in low income countries, the causes of shocks and their macroeconomic and social impact, as well as providing for smooth adjustment to these shocks. We recognize, however, that an improved effort is being made.

Free Trade and Poverty Alleviation

The staff paper observes that poverty is mostly a rural phenomenon in many countries and investment in agriculture and rural development will play an important role in alleviating poverty. In this context, it is pertinent to continue stressing that agricultural subsidies in industrial countries are depressing world prices for agricultural exports of developing countries and the impact is disproportionately severe to low–income countries. The PRSP forum provides an opportunity for donors to appreciate this problem and to encourage them to take action in their respective countries. We hope that the forthcoming discussion on market access will help to raise the profile of this problem and the need for expeditious solutions.

Alignment of Donor Support

On donor support, it should be noted that it is not only the problem of alignment but also of timely disbursement of external assistance which has affected the implementation of both the PRSP and PRGF. We welcome that many donors are considering aligning their support to PRSPs and to shift more of their assistance towards general budgetary support. Associated with donor assistance are the multiplicity of conditionalities attached. We do not question the principle of conditionalities, however, we continue to urge that more meaningful progress is necessary for these to be streamlined and harmonized.

Technical Assistance

The paper observes that there is no acute shortage of technical assistance. We wonder whether this represents a completely accurate analysis. Nevertheless, what is clearly needed is to harmonize efforts and strengthen coordination. Efforts in this direction are encouraging, particularly in addressing capacity constraints on PRSP preparation and implementation, strengthening PEM systems and tracking poverty reducing expenditure. The learning events, including for Fund and Bank staff, building a network of regional technical assistance centers, Bank–Fund outreach programs and other initiatives aimed at alleviating capacity constraints in the preparation, dissemination and implementation of PRSPs are welcome and should be strengthened. We encourage donors to remain fully engaged and to lend their maximum support to the provision of more technical assistance.

Monitoring and Evaluation

Ultimately, PRSPs are the vehicle of achieving the millennium development goals (MDGs) as endorsed at the Monterrey Conference. In this regard it is important to monitor and evaluate whether PRSPs are helping to achieve the intended goals and whether the timeframe for the (MDGs) remain appropriate as well as to know what the international community could do to preserve the credibility of these goals. We fully support Mr. Mirakhor’s call for the Fund and the Bank to begin developing a framework to assess progress and eventual outcomes of PRSPs, beginning with those countries that have already completed one or more years of implementing full PRSPs. In addition, efforts to incorporate poverty and social impact analysis (PSIA) as a key element of PRSP and PRGF will go a long way in highlighting areas of effectiveness and deficiencies in PRSP implementation.

Mr. Lundsager and Mr. Dohlman submitted the following statement:

We welcome the focus of this review on what we view as key priority areas: better understanding of growth and links to poverty reduction, more realistic projections and assumptions, stronger governance/anti–corruption efforts, more effective monitoring, more transparent and accountable public expenditure management (PEM), broader participation, better costing and prioritization, and greater selectivity. This review also takes a step closer to focusing on outcomes of PRSPs, rather than just process. The end goal of these reviews must continue to be PRSPs that are of sufficiently high quality, and adequately connected to the policy process, to deliver on the key objectives of growth and poverty reduction. We have a few ongoing concerns we would like to highlight.

Growth/Projections

As we have noted previously, greater emphasis needs to be given in the PRSP process on credible, measurable growth strategies that emphasize productivity–enhancing opportunities, human capital formation, private sector investment, and revenue generation. We continue to have concerns about overly optimistic growth, export, and revenue projections. We welcome the initial thinking on these issues – and promises of future research – mentioned in the report. More needs to be done however. One helpful proposal is for development partners—including the Fund—to engage early in the participatory process to ensure the consistency of the macroeconomic framework. This will also help strengthen the links between PRSPs and PRGF-supported programs. We also find merit in the recommendation to include policy contingencies in PRSPs corresponding to low, medium and high growth scenarios. Niger (Box 5) is a good example of this. In generating such scenarios, it should be recognized that good policies will generate donor support, while poor policies will not. A poor macroeconomic outcome resulting from bad policies is likely to reduce support.

Discussion of sound debt management practices was largely absent in the report. New borrowing can be supportive of growth and poverty–reduction goals, but has implications for the short–term macroeconomic framework, the budget, and medium–term sustainability. An assessment of debt management should be included in draft JSA guidelines.

Monitoring, Evaluation, Prioritization

The report's emphasis on tracking—and Fund/Bank efforts to build country capacity in this area, such as Bank technical assistance for PSIAs—is also welcome. We join Mr. Padoan and Mr. Lombardi in highlighting the importance of improving PEM and welcoming inclusion of PEM issues in PRGF conditionality. We agree with the staff that plans for addressing data limitations should be better specified and that better costing and prioritization of goals is needed in PRSPs. Going forward, it will be important for PRSPs to have a credible set of indicators, with adequate baselines, that will allow evaluation of efforts. Without measurable results, and means to learn from successes and failures, the PRSP process will not fully succeed and steady donor engagement cannot be assured.

Donor Coordination

We agree that donors should better harmonize measurement and reporting of results with country systems and help build capacity within the country. Efforts to harmonize other donor procedures are also welcome. But these efforts must conform to high standards. "Coordination" using low standards is not in anyone's interests. All donors have something to contribute here.

We also agree that donor support is most effective when aligned to core content of strong PRSPs, but note that maintaining continued donor support requires retention of donor flexibility to focus support on areas they are convinced are high value added.

Further, while noting that the Fund/Bank collaboration paper is to be discussed separately, there is continued need for progress on coordinating conditionality and accountability, particularly with respect to poverty and social impact analyses and public expenditure management. As experience with the HIPC Initiative has demonstrated, there are far too many countries where weaknesses in public expenditure management preclude the effective use of domestic and external resources.

Broader Participation

We welcome the progress shown in recent PRSPs on broader consultations. Our experience has been that the stronger PRSPs are those that are fully participatory. Private sector involvement in particular is essential to making sound policy decisions related to prioritizing and sequencing reforms for sustainable growth. We also see merit in greater outreach to parliamentarians (Box 4) and look forward to a fuller assessment of the pilot projects now underway in this area.

We recognize some tension, however, between increasingly broad PRSP efforts and limits to the capacity of governments. The first best solution is to build capacity, but as this takes time, it should be accompanied by the realization that credible PRSPs take time to prepare and should not be rushed through to the detriment of critical day–to–day government operations. On a related point, we noted in Annex Table 1 (a very useful table overall) that several countries, such Guyana, Rwanda, and Senegal have what we view as overly ambitious schedules.

Governance/Anti–Corruption

We welcome the strong emphasis in the report on good governance/anti–corruption as a key pillar of successful policies (paragraph 20).

Selectivity

The official sector should direct its lending to those countries committed to strong reform programs with clearly identified growth and anti–poverty policy actions, and that demonstrate real achievements. We disagree with those who call for a lowering of standards in the name of ownership, regularizing aid flows, and reducing budget volatility. Diluting the link between disbursements and measurable results undercuts the paramount goal of ensuring the most effective use of resources.

Mr. Cippà submitted the following statement:

I would like to commend the staffs on their candid and comprehensive presentation of the progress in implementing the PRSP initiative over the last six months. While I agree with the conclusions of the paper, I feel, however, that it should have been given a more strategic and political thrust in view of its nature as a report to the forthcoming meetings of the IMFC and the Development Committee. Among the key questions at the political level are (a) how are we to ensure that the PRSP is not only considered in terms of conditionality for HIPC debt relief but becomes fully integrated in the core policy–making process of member countries; (b) how is implementation to be promoted in poorly performing countries; and (c) how are we to achieve a closer alignment with PRGF/PRSC and bilateral programs. Particularly on this last point some high–level endorsement might prove valuable.

The report confirms the findings of the recent joint review, namely that PRSP implementation is moving ahead steadily and in the right direction. Indeed, it has been a fruitful six months since the Boards' consideration of the joint review, with an additional nine countries submitting fully–fledged strategy papers. The report identifies some encouraging trends in certain countries, such as tightened links between the PRSP process and budgetary procedures, the inclusion of national parliaments in the process, an increasing participation at the local level, and a greater use of local languages in the dissemination of information. Also, there are signs of intensified collaboration between donors and multilateral institutions in PRSP countries.

However, in all these areas there is still considerable work to be done. As the staff document and our own experience show, the challenges faced by PRSP countries in finalizing and implementing their strategies are impressive indeed. On the more procedural side, the participation of all relevant stakeholders, the elaboration of rigorous poverty diagnostics, and the prioritization and costing of public policy action in line with national budgets are areas in which major weaknesses have been identified. On the implementation side, continuous work is required on poverty and social impact analyses, public expenditure management, and on the monitoring and evaluation of policy actions, including for annual progress reports.

One of our greatest concerns for the successful further implementation of the PRSP initiative is the still inappropriate capacity and political commitment in the area of budget and debt management. It is worrisome that there remain substantial deviations between the PRSP and the budget in most countries. Developing medium term expenditure frameworks in parallel to and in interrelation with the PRSP process is one way to address this problem. In decentralized countries, regions and districts should be provided with sufficient means to meet their priorities under the PRSP. Another major issue is the fact that increasing priority spending alone does not yet reduce poverty. To actually achieve this goal, the budgeted money has to be spent in the intended way. Once this is done we must then closely monitor whether the additional money has a true impact on the ground.

A further common problem is that of setting intermediate indicators at over–ambitious levels. This can be, and has been, particularly cumbersome if these indicators are part of completion point conditionality under the HIPC Initiative. Further, as staff clearly points out, contingency plans need to be developed in case the economic assumptions underpinning the PRSP turn out to be too optimistic, as has repeatedly been the case. In order to address the volatile external environment of many PRSP countries, alternative scenarios must be developed. As we stated in earlier discussions, the risks of exogenous shocks and their potential effects on PRSP implementation should be elaborated in more detail in Joint Staff Assessments.

Building the institutional capacity for monitoring and evaluation (M&E) also remains a major challenge. Indeed, sound statistical indicators are essential to enable PRSP countries to better monitor progress in terms of impact and poverty reduction. Staff mention the importance of building an adequate M&E framework early on in the PRSP process. We believe that M&E could be substantially enhanced by government–led, institutionalized review processes and calendars. These could serve as common assessment frameworks for donors as well as for civil society organizations. Countries could then secure political ownership by better demonstrating the results of the agreed reforms and, at the same time, contribute to the reduction of transaction costs of multiple donor reviews. The Fund and Bank staffs could for their part contribute to enhancing M&E by sharing data and assessments more closely with regional development banks and U.N. agencies. In this respect, we would be interested to hear whether staff has any intentions to undertake efforts similar to those within the International Development Evaluation Association (IDEAS) for developing monitoring indicators and expenditure tracking systems. Staff could also seek to contribute to efforts to reduce the transaction costs of aid more generally by encouraging PRSP countries to seek common donor funding for their prioritized expenditures.

Concerning donor alignment, my Swiss authorities fully support the staffs' call for closer coordination of donor practices with the PRSP process. In order to accelerate the alignment, it might be helpful to establish some common guidelines for the cooperation of bilateral donors and the IFIs. We would also be interested to learn more about how exactly the staffs see their role in the PRSP process based on their comparative advantages and how they envisage to intensify cooperation with their partners in the donor community. Finally, we agree with staff that increased attention to the Millennium Development Goal indicators would serve to better assess progress in implementation and would help to ensure that targets in the environmental and gender area would be included more consistently in future PRSPs.

Mr. Oyarzábal and Mr. Garner submitted the following statement:

We would like to thank the staffs of the Fund and the World Bank for an excellent document that allow us to have an update in the progress achieved in the implementation of the Poverty Reduction Strategy Papers (PRSP). Since our last review the Board has considered nine full PRSPs, six other are under way and four countries have completed their interim PRSP. Furthermore, the strategy has brought about important advances in improving ownership by increasing both the civil society's participation and the role of parliaments in the process, as well as in other areas that are essential for the success of the strategy, among them macroeconomic and policy dialogue, Public Expenditure Management (PEM), and donor alignment. We concur with the staff's perspective that there is room for further improvement in these areas. In addition, the Monterrey Consensus—by emphasizing the importance of the PRSP in the process of achieving the Millennium Development Goal (MGD)—is contributing to better donor alignment and collaboration among the stockholders of the PRSP.

With regard to the participatory process, the Civil Society Organization (CSO) plays an important role in the implementation of the PRSP and we welcome its increasing participation in PEM issues. However, it is important to channel such participation through the appropriate legal framework in order to allow an orderly involvement of these organizations in the budgetary decision process, while at the same time institutionalizing the civil society dialogue in the PRSP process. We welcome the Fund's and the Bank's involvement in support of such actions.

As we have stated in previous discussions, to better achieve ownership of the PRSP, it is important to engage all the country's democratic elected authorities in the process. Consequently, the increasing role of parliaments in the preparation and implementation of the poverty reduction strategy is welcome news. As this engagement in the process broadens, the consolidation of the strategy as the main device in the fight against poverty will be strengthen, given the fact that the economic policies envisaged in the PRSP will be more likely supported by the necessary legislation.

We concur with the staff's concerns with regard to the participation of sectoral agencies and ministries in the PRSP. These experiences should be followed more closely so they can be further evaluated in future reviews. Both the Fund and the Bank need to continue their actions to promote such participation in a jointly effort with the authorities that are directly engage in the process. To the extent that theses agencies understand the principle and goals of the strategy, it would become easier for them to plan their own strategies and to direct their resources in support of the country's PRSP.

The PRSP, as a dynamic and learning process, will present continuous challenges to the Fund, the Bank and other stockholders. These institutions need to work with the authorities to produce feasible scenarios, and to bring the attention of the governments to the constrains of their macroeconomic policies. This is of especial interest if we are to prevent a decline in public support to the country's PRSP, as unfulfilled expectations may arise. As the review points out, much remains to be done regarding the macroeconomic issues and the pro–poor growth policies. In this regard, we support the Fund research in aspects dealing with the analytical basis and the potential trade between macroeconomic and development objectives, among others. In any case, the vulnerabilities produced by external shocks and lack of access to market and subsidies in developed economies will continue to disturb any possible outcome.

The capacity constrain remains one of the key issues with regard to the PRSP for its direct implications in almost all aspects of the strategy development. The staff points out the need to develop local capacity not only at government level but also at the level of the CSO, parliaments and local government. Consequently, it is of the utmost importance that donor partners continue their support to learning and capacity building actions. It is essential that this effort take into consideration the specific challenges and needs that are emerging from the PRSP process. Training in these areas need to be envisaged to assure that these issues will be addressed—the Bank's "Attacking Poverty Course" is a good example of this. The IMF Institute can develop similar training programs but focusing on Fund's core activities. This assistance will produce a positive return, as it is clear that with a better technical capacity the country will be in a better position to produce and follow a more efficient strategy.

We coincide with staff on the importance of conducting Poverty and Social Impact Analysis (PSIA) as a tool to ensure that the net benefits of the reforms reach the envisaged target (the poor). However, the review points out that this task continues to be a difficult challenge, giving the fact that capacity constrains and inadequate methodology remain present in the PRSP countries. For that reason, we welcome the Bank's development of a User's Guide to PSIA and a "PSIA Toolkit" as these mechanisms will provide for the appropriate methodology; training in its use is also welcome. In this regard, we are pleased to see that the Board's concern for the need to support Poverty and Social Impact Analysis (PSIA) is being addressed as donor countries are providing more technical and financial support to this task.

We concur with Mr. Padoan and Mr. Lombardi in seeing PEM as one of the weak spots in the PRSP, thus we encourage staff to continue their efforts to strengthen countries' PEM as a way to achieve transparency, accountability and efficiency in the use of public resources and donors' contributions. Donors' support to this activity remains crucial to its success.

Finally, there is one aspect that, in our opinion, requires deeper assessment, namely the gender issue. Studies indicate that gender inequality is a major cause of poverty, thus the PRSP should address the disparity among women and men in their access to the benefits of the strategy. Staff comments in this matter would be appreciated.

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

General Remarks

We thank Fund and Bank staff for preparing a comprehensive progress report on PRSP. Since the Board meeting last March on the Joint Review, an additional nine countries have completed full PRSPs, while significant developments have also been made in other countries. It is welcome that the PRSP approach has been receiving wide support and remains on track.

Having said that, substantial challenges still remain for the PRSP approach, as staff rightly points out. Especially, this approach will inevitably be facing difficulties due to the capacity constraints of the counties concerned and, realistically, it is difficult for them to respond to all of the four main issues mentioned in the staff paper (Section III, A to D) all at once. Such a situation, however, is within the scope of expectation. It is essential that we do not seek quick results in the short–term, and that the Fund and Bank engage in the exercise effectively and flexibly with patience, putting particular emphasis on macroeconomic choices and public expenditure management.

Macroeconomic Framework

As was emphasized in the Joint Review and the previous Board meeting, the discussions and analyses in PRSP of macroeconomic framework and economic policy to achieve growth have often been insufficient. In order not to turn PRSP into mere wish lists and make them something that can be implemented, the economic projections in PRSP should be realistic and consistent with the framework used in the domestic policy–making processes, such as in budget formulation. It is also important that the Fund and Bank link their program designs to the discussion of macroeconomic framework in PRSP. In addition, it is critical to cost and prioritize public policy actions to formulate a well–focused PRSP, so that the strategy will not become too diffused and over–stretched.

That being said, it is also true that it will not be appropriate to demand too much at the outset from the countries concerned, as they often have only limited capacity. Needless to say, it would be more desirable if preparation of alternative scenarios, such as analysis of exogenous shocks as well as poverty and social impact analysis (PSIA) were carried out sufficiently. However, in many cases this would require dramatic improvement in the capacity of countries, and even when technical assistance and advice were provided to this end, it would take a substantial amount of time to build that capacity. As is stressed in the staff paper, expectations need to be tempered. In this respect, this chair highly values the efforts made by Fund staff to develop guidance on updating macroeconomic framework under the ownership of countries in the absence of alternative scenarios.

It is appropriate that development partners, including the Fund, engage early in the participatory process and advise countries, with a view to formulating realistic macroeconomic framework. It should be noted, however, that such engagement must be implemented in a manner that respects the ownership of countries. Particularly, Fund and Bank staff should avoid giving the impression that they dictate to the authorities. At the same time, it would be desirable that these institutions put more emphasis on the implementation of technical assistance toward capacity building.

Growth Strategy

Economic growth is a prerequisite for poverty reduction. It is essential that sufficient discussion takes place on likely sources of growth and that policy measures necessary to achieve growth be identified in the PRSP. In this respect, it is welcome that various policy measures have been examined in recent PRSP and that the Fund and Bank have placed greater emphasis on helping countries to identify the policy measures needed to raise growth.

Domestic and foreign private investment, and putting in place the infrastructure that stimulates economic activity of the private sector are essential to achieving sustainable development. From this viewpoint, some chairs, including this one, stated at the last Board meeting that the Fund and Bank should seek the views of business communities and their greater participation. Having read the present staff paper, however, this chair has the impression that few developments have been made for facilitating participation of the business sector, in comparison with civil society organizations and other donors. This chair would appreciate further efforts by member countries as well as by Fund and Bank staff.

Coordination with Other Donors

In order to implement assistance efficiently and effectively, it is critical that not only the Fund and Bank, but also regional development banks (RDBs) and other donors, provide assistance based on PRSPs that were completed in the spirit of country ownership. In this regard, this chair is somewhat concerned about the lack of accounting for the RDBs in the staff paper. Further efforts are needed that include encouraging broader participation by RDBs and other donors in the preparation of PRSPs.

The relationship with the MDGs

There is a degree of tension between PRSPs, which are compiled under the ownership of countries, and the Millennium Development Goals (MDGs), which are global targets. Although achieving the MDGs is important, we should allow room for each country to establish its own goals, as the degree of difficulty in achieving the MDGs differs from one country to another. This chair understands that Fund and Bank staff share this view, and believes that setting up realistic targets in PRSPs will be beneficial to countries in the long term.

Mr. Portugal and Mr. Rambarran submitted the following statement:

We thank Managements of the Fund and the World Bank for their continuous efforts to facilitate poverty reduction in developing countries, and staffs of both institutions for their dedication to the PRSP initiative and for the comprehensive report prepared for today’s discussion.

To date, member countries have completed 18 full PRSPs, prepared 45 interim PRSPs, and submitted 5 annual PRSP progress reports. We welcome this steady progress in the design and implementation of national strategies to reduce poverty, but we recognize that several challenges lie ahead in maintaining this momentum. Perhaps, the most relevant challenge lies in mitigating the inevitable tensions between speed and quality. We underscore the need for effective poverty reduction strategies to be focused on good design practice rather than speed, especially in the transition from interim PRSPs to full PRSPs.

We wonder, in this regard, if there might be a case to review the relationship between completion of a PRSP and access to concessional resources and/or interim debt relief under the HIPC Initiative. This linkage generates considerable pressure to speed up the movement to a full PRSP. We believe that HIPC Initiatives should be granted debt relief as soon as the floating point conditions are met, preferably within the year, rather than awaiting implementation of the PRSP for at least one year. The same consideration applies to the delivery of additional debt relief beyond that committed at the decision point.

We remain concerned about the poor quality of data and weak poverty diagnostics in many PRSPs. The perilous food security situation unfolding in Southern Africa is a clear illustration of this dynamic. While the causes of the food crisis are complex and country–specific, it stems partly from the failure of the region's early warning systems, based on flawed agricultural statistics, to signal a crisis, and partly from poverty that has weakened household's safety nets. This could provide a case for crafting, among other initiatives, a coherent rural agricultural policy and for giving it more weight in interim and full PRSPs in these countries, than presently obtains. This would help prevent a reoccurrence of extreme food shortages and the risk of starvation in the future. At the same time, we strongly encourage the international community to commit additional food and humanitarian aid to Southern Africa.

We welcome the efforts to broaden the participatory process by bringing a wide cross–section of views into the design of PRSPs, including the greater involvement of sectoral line ministries and Parliaments. This is contributing to a stronger sense of ownership, improved policy dialogue, and a more prominent place for poverty reduction in national macroeconomic frameworks. We look forward to the wider dissemination of essential poverty–related documents in local languages.

Among the development lessons of the last three decades is that a strong emphasis on education, primary healthcare, and income redistribution can have a tangible impact on reducing poverty. These lessons partly guide the policy context of PRSPs. We are pleased that the HIV/AIDS problem now features in several PRSPs. However, much remains to be done to improve our understanding of the policies that support growth and enhance productivity. We, therefore, look forward to the policy prescriptions arising from the extensive Bank/Fund research underway in this area. Broad dissemination and review of such policy–oriented research could help to narrow the prevailing and often vitriolic disagreements on economic policy, distribution and poverty. Equally hopeful, is that it could help stimulate conceptual advances in the analysis of poverty and inequality, including with respect to the measurement of poverty in the context of the HIV/AIDS pandemic.

We continue to emphasize the need for technical assistance, especially in the areas of public expenditure management and monitoring and evaluation, to help member countries better meet the challenges of participating in the PRSP process. In particular, we welcome the Fund's regional, country–based approach to technical assistance, reflected in the establishment of new regional technical assistance centers in Africa and in the Caribbean.

Over the last two years, several changes have been made to the design of PRGF-supported programs, though there is scope to further improve PRGF alignment with the goals set out for the facility. We remain concerned that interruptions of PRGF-supported programs that are not totally attributed to policy slippages can generate the need for a new track record of performance, thus delaying much needed HIPC debt relief and other forms of concessional financing. We look forward to the staff report on the suitability of the PRGF in helping to finance the development needs of low-income member countries. We support the view that consultations on a country's macroeconomic framework should be mainly based on its PRSP and not restricted to the conditionality surrounding the PRGF. This is more consistent with the spirit of country ownership.

Finally, we reiterate our call on the need for a more enabling global environment to better support reform efforts in developing countries. The international community can help poor countries to achieve the Millennium Development Goals (MDGs) by further raising market access for developing countries' exports and by expanding the volume of aid flows. We note the possible establishment of a new multinational fund aimed at development and poverty alleviation at the World Summit on Sustainable Development in Johannesburg. We hope that this would generate an increase in the overall level of financial assistance to developing countries.

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

Key Points:

Prioritization and specificity have thus far continued to be the Achilles' heel of PRSP programs

Balancing the speed and quality of PRSPs, as well as their closer coordination with PRGF-supported programs remains a key challenge

Development of alternative macroeconomic scenarios as well as contingency measures against the positive/negative effects of external shocks would greatly enhance the integration of PRSPs into the countries' economic policy frameworks

Achieving donor alignment and coordination is increasingly important in advancing the goals of the PRSP process

Recent steps to develop and disseminate good practices in PRSPs are welcome and should be further actively pursued

Introduction. We thank the staff for a comprehensive report on the progress in the implementation of PRSP programs. The report is encouraging in that it does point to advances made recently in developing stronger PRSPs that have contributed to superior economic policy (including in some cases greater transparency) and outcomes. But while there are some encouraging signs in the operation of the PRSPs so far, it is still too early to draw any general conclusions regarding the effects of the PRSP process on poverty outcomes and economic policies. As is noted in the concluding paragraph of the staff report, firmer conclusions may still have to wait for more evidence that is to be derived from the experience of the next several years. At the same time, already at this stage of the development of the PRSP framework some important lessons may be gleaned from recent experience. These concern the importance of tempering the pace of preparation of PRSPs with the quality of the countries' poverty–reduction frameworks; the need to complement current PRSPs with contingency measures and realistic macroeconomic scenarios and projections; the need to establish a workable framework for ex–post assessment of the implementation and adequacy of PRSPs.

Issues concerning the design of PRSPs. One of the issues that appears to be important in the design of PRSPs is the need to balance their comprehensiveness with their targeted character. In this respect there may be a need to sharpen the focus on normative issues in designing the PRSP programs. While retaining some of the analytical/positive assessments (for example poverty diagnostics) within individual PRSPs is clearly crucial, greater emphasis on clear and well–targeted normative guidelines would render the program more operational and easy to integrate into the decision-making process.

The viability of PRSP programs hinges to a considerable degree on their ability to take into account the changing dynamics of the country's economy as well as of the global environment. Accordingly, the inclusion of contingency plans to account for external shocks as well as realistic macroeconomic projections is of prime importance in further improving the PRSP process. The Fund could aid in this process by adapting the recent approach to assessing external and fiscal sustainability to the specific needs of low-income countries. Finally, with respect to the integration of macroeconomic and structural reform guidelines into individual PRSPs we note the need to accord greater attention to issues of proper sequencing of individual reform components.

Realistic projections are particularly important in the design of PRSPs, for therein lies the key to rendering these programs part and parcel of economic policy-making. In the extreme excessively optimistic projections render the PRSP program a mere wish list, whose rationale is that of a declaration rather than a credible action plan. Designating ex-post monitoring and evaluation procedures is indispensable to keeping the projections and general guidelines of PRSPs under close scrutiny with the aim of ensuring adequate accountability and credibility of the reform process.

Implementations issues. Poverty reduction, as well as structural reforms that aim to boost real growth have their respective regional and sectoral dimensions that need to be analyzed more rigorously within the context of PRSP programs. The inclusion of such issues as regional inequality, or addressing the development of depressed regions could contribute to greater ownership and comprehensiveness of poverty–reducing strategies. Vietnam's experience with localizing its PRSP framework is instructive in this respect, though there may be also room to complement the ex-post implementation of the PRSP localization process with ex-ante localization of the discussion and design of the poverty-reduction program. At the sectoral level, it is important that the PRSP guidelines on sectoral reforms are in conformity with the action plans of individual ministries and agencies responsible for structural reforms. The contribution of the PRSP framework in this regard could be in synthesizing all individual sectoral reform initiatives into a single coherent framework.

As we noted on several occasions in the past, closer integration of PRSPs and PRGF-supported programs is important in view of the scope for mutual reinforcement of PRGFs and PRSPs in the medium to longer term. In particular such closer alignment between PRSPs and PRGFs could be instrumental in using the latter as a complementary monitoring and review mechanism with respect to the former. At the same time, the higher the specificity of guidelines in individual PRSPs the easier will it be to incorporate them into the targets of PRGF programs.

The staff report makes a strong case for reinforcing the ex–post evaluation of PRSP programs, which in turn should set the stage for the next cycle of poverty-reduction measures. With respect to the process of monitoring of PRSP programs, the staff report is correct in pointing to the inevitability of some divergence in the indicators used in individual countries, given the peculiarity of their individual circumstances. At the same time the MDG goals may indeed be useful in guiding countries efforts to institute a workable monitoring mechanism within their PRSP framework. Furthermore, there may be a rationale for developing a more narrow set of core indicators for low-income countries that could serve as a reference point in monitoring PRSP programs.

We welcome the recent measures on the part of the Bank and the Fund to disseminate good practices for PRSPs as detailed in para 78, for in our view greater outreach to the global community is of prime importance for informing the ongoing debate on poverty reduction in the world economy. Also, harmonizing donor participation in support of PRSPs remains an important component in the strategy of strengthening donors' contribution to poverty reduction in low-income countries. In this regard, we note the need to regularize this process of harmonizing donor support at the expense of numerous ad hoc initiatives in this sphere. Finally, the alignment of donor support to the PRSP process needs to be explored and developed further, given the significant scope for improvement in this area. In the end the success of poverty reduction effort in general and the PRSP framework in particular will be a function of a common effort of the global community that brings together all participants and stakeholders in setting low-income countries on the path of sustainable development.

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

We would like to thank the staffs of the Fund and the World Bank for an excellent report.

We are in a broad agreement with the findings and recommendations that have been outlined in the document. As was concluded in the previous joint Review on PRSP, countries with full PRSPs perform significantly better than countries that were allowed to proceed on the basis of Interim–PRSPs. Thus, we welcome the additional nine countries that have completed their first full PRSP, and the progress that has been achieved in other countries. At the same time, staff rightly emphasize that substantial challenges remain.

We believe that broad-based ownership and participation in the PRSP process is essential, and we welcome the progress shown in recent PRSPs on broader consultations. The process should not only be vested in the government institutions, but it should also include civil society, donors and local authorities. We agree with staff that a poor flow of information between executive and legislative branches is a systematic issue that should be resolved. Parliaments should clearly be a part in the PRSP preparation framework, but even more importantly, they are well placed to ensure follow-up of commitments made to reduce poverty. It is encouraging that different capacity building activities to raise parliamentarians' awareness of the PRSP approach have been initiated, and we are pleased to note that countries in our constituency have been able to provide direct assistance to these initiatives.

Although we agree that it is important to have proper legal frameworks for civic engagement in the PRSP processes, this cannot be a substitute for the necessary political will from the authorities in charge to ensure the necessary broad participation. In that respect it is worrisome that in some countries the parliaments are involved only after the executive branch has already finished its work on PRSP.

We agree with staff that the PRSP preparation timetables should be realistic but also reasonable ambitious. Realism is also of essence when making the underlying macroeconomic assumptions. It is essential that the underlying macroeconomic framework is based on prudent and realistic assumptions about growth and exports, and supplemented by alternative scenarios and contingency plans. Too much optimism in the beginning may force substantial revisions and more difficult policy choices at a later stage. We believe that all countries should try to prepare alternative scenarios. Not only for growth and export forecasts but also for poverty and social impact analyses. We urge the Fund to continue its work to identify more effectively the sources of economic growth, to promote budgets that are pro-poor and pro-growth, and give greater consideration of alternative policy choices for authorities.

Although we understand staff's argument that developing alternative scenarios would further tax countries' already stretched institutional capacity, we do not believe it is appropriate to rely only on hope that the country may not need other scenarios. Several examples from the report indicate that many countries have been forced to work on alternative scenarios anyway after some external or internal shocks have occurred.

It is also essential that countries invest more resources into improvement of their statistical systems. It is not very encouraging that out of 21 countries, which PRSP-related documents have been discussed by the Board this year, only 6 are subscribing to the GDDS, and none of them to the SDDS.

We join Ms. Lundsager and Mr. Dohlman in welcoming the strong emphasis in the report on good governance and anti-corruption as key pillars of successful policies.

The mobilization of domestic resources in support of countries' poverty reducing strategies has not been at the forefront of the PRSP process so far, and consequently most PRSPs have not discussed revenue measures. However, the revenue side of the budget, along with the expenditure side, needs to be addressed in PRSPs. A strengthened focus on more transparent and accountable public expenditure management (PEM) is also essential for the success of the PRSP process. As the Fund-Bank study shows, there is an extensive need for enhancing the tracking of poverty reducing spending.

We fully agree with the report that better coordination among the donors is desired. While we will have the opportunity to come back to the issues of collaboration between the Fund and the Bank relatively soon, we would already at this stage emphasize that cross participation in one another's country missions, joint missions and common participation in PRSP-processes "on the ground" could be increased, including by use of local resident representatives. As the Fund and the Bank were the lead agencies launching the PRSP concept, they have a special responsibility of showing a collaborative spirit towards the governments as well as towards other donors.

Mr. Kiekens made the following statement:

This latest report confirms the findings of last March comprehensive review: The PRSP approach is now well–integrated into the development process.

We must be grateful to the civil society organizations and also the external evaluators who, three years ago, when they evaluated our ESAF process, pressed us and the World Bank and the whole development community to improve.

We must also recognize the very effective work of our staff in translating the useful suggestions we received at that time into operational policies and recommendation.

Last, but not least, we must recognize the tremendous efforts of the authorities in the developing countries that have adopted the PRSP approach.

The PRSP approach, indeed, is being implemented by a growing number of recipient countries, as well as donor countries—because it applies to them, too. I will come back to the donor countries.

Even so, Mr. Chairman, many challenges must still be overcome to make the PRSP approach fully effective, and I would like to comment briefly on five of these challenges.

First, poverty reduction strategies must be built on realistic growth assumptions and based on clearly-documented sources of growth. If not, these PRSPs will quickly lose their credibility.

There is some evidence that the growth assumptions in the PRSPs are more optimistic and less carefully documented than growth assumptions, for instance, in national budgets. This is not entirely surprising, since PRSP projections often assume full implementation of reforms and absence of external shocks. Sensitivity analyses around prudent base scenarios should help identify, more realistically, the potential benefits of reforms and avoid unrealistic expectations about poverty reduction. That is the first challenge that we have to deal with—ensuring realistic assumptions and avoiding unrealistic expectations and disappointments down the road.

Second, additional efforts are needed to bring all relevant stakeholders into the dialogue of the PRSP, including with regard to the macroeconomic chapter. Given the key role played by the private sector and entrepreneurs in achieving sustainable development, it is essential for business leaders to be closely involved. This can often be done by establishing advisory councils for improving the business environment, as suggested by you, Mr. Chairman, during your last trip to Africa. I think it is a very useful idea. The highly desirable involvement of the International Trade Union Movement, which emerged here in Washington from dialogues with the International Confederation of Free Trade Unions and the World Configuration of Labor, should be also replicated at the country level. This is a task in which Fund resident representatives can play a constructive role. So the interaction is not only with business leaders, but also with trade union representatives.

Resident representatives should also encourage country authorities to consult with the representatives of the poorest classes so as to have a firsthand understanding of the causes of poverty and the possible ways to overcome them.

Third, firsthand knowledge of the causes of poverty for the poorest segments in the society is an indispensable complement to the statistical information on poverty used when conducting poverty and social impact analyses. The insight of the poorest people will also assist in a better understanding of the poverty ethics of envisaged structural reforms. This is essential for anticipating and remedying the undesirable side effects of these policies on the poor.

Fourth, much more progress is needed in coordinating multilateral and bilateral support more closely with the poverty reduction strategies, to reduce the often very large administrative burden lumped with aid provisions for the recipient countries. The pursuit of the best practices by donor countries would also help to reduce these administrative burdens on both sides of the development cooperation.

Finally, there is a need for both patience and perseverance to implement PRSPs. Effective poverty reduction requires that recipient countries receive consistent support from donor countries from the IFIs and from the U.N. organizations to help them pursue the right policies for a very long period. We recommend that each recipient country produce an annual report on its progress in implementing its poverty reduction strategy. This will help maintain policy momentum, as well as the momentum of the commitment of its development partners. The development of such reports could be combined with the process of budget preparation as a matter of administrative efficiency and democratic procedure.

To conclude, it is now widely accepted that there are three pillars on which rests the success of the PRSP process: First, consistent and perseverant efforts to improve policies and government in the poorest countries; second, increased and better coordinated aid; and third, better access to advanced country markets for developing country exports. The Fund's policies should always promote progress on those three fronts.

Mr. Wei made the following statement:

At the outset, let me thank staff for the comprehensive and informative paper. The recent progress in the preparation and implementation of PRSP is remarkable. As indicated by staff, an additional nine countries have finished their fist full PRSP and a significant number of countries have made important advances in the design and implementation of their poverty reduction strategies. The strength of PRSP has also begun to emerge. We are encouraged by the achievements of PRSP in strengthening ownership, facilitating open dialogue and improving data collection and analysis. Nevertheless, important challenges remain ahead and continued efforts are needed to address the concerned issues.

The success of PRSP largely relies on the continued and well–focused efforts of the individual country in question and persistent support from the international community. We support the view that development partners need to align their assistance programs effectively with PRSPs and harmonize and simplify their systems for providing aid. With financial assistance becoming more result oriented, we have certain concerns on the predictability of its disbursement. In this connection, we encourage the recipient countries and donors to establish closer links on the basis of PRSP by better aligning assistance with PRSP priorities as suggested by the joint review.

The staff paper indicates the systemic weakness of setting unrealistic goals with regard to such indicators as economic growth. In our opinion, it reflects either weak analytical capacity or, as Mr. Mirakhor indicates in his buff, the inability to deliver required policies. Either case requires the understanding and help from the international community. We welcome the staff initiative to help identify the source of growth in these countries. Also, this has again underscored the need to strengthen capacity building in these countries. From another perspective, we also caution against donors and development partners to hold too ambitious expectations for the recipient countries. As indicated by staff, patience and perseverance are greatly needed and there remains a long way to go in combating poverty. In many cases, weak infrastructure and capacity just do not allow for high growth rate at the current stage. We appreciate the view of adding flexibility to allow for different country starting points.

We share the view that the Poverty and Social Impact Analysis (PSIA) is an important tool for identifying the benefits of reform to the poor and helping maximize the welfare. In this process, open dialogue can be helpful in generating support from the general public to the reforms and improving social coherence. We are pleased to learn that several countries have incorporated PSIA in their PRSP process and encourage more countries to do so since it is very important to ensure that the reforms are in line with the target of pro–poor growth. Given the resource constraints in PRSP countries, the international community should provide additional help in this area. We also support Mr. Mirakhor's and Mr. Rustomjee's view for the Fund and the Bank to develop a framework and assess the progress and eventual outcome of PRSP. On technical assistance, we share Mr. Rustomjee's view that the Fund and other IFIs should continue to provide adequate technical assistance to address the capacity constraints on PRSP preparation and implementation.

We also share the view that strengthening the public expenditure management system is essential to the implementation of PRSP. The strong commitment and prompt action by HIPC Initiative countries and some other low-income countries is encouraging. Their consensus on the need to improve PEM is appreciated.

We share the concern of Mr. Rustomjee about the impact of industrial countries' agricultural subsidy on the export of agricultural products by developing countries. As trade is an extremely important tool for the developing countries to combat poverty and agricultural products account for a large share of many poor countries' exports, the bulk of agricultural subsidy is particularly harmful. We call for expeditious attention and hopefully a solution to this issue.

In conclusion, we appreciate the great efforts by these countries that have adopted or are preparing to adopt the PRSP approach. The international community, including the Fund and the Bank, has also devoted considerable assistance. Nevertheless, we remain far away from the Millennium Development Goal. Greater efforts, patience and wisdom are continuously needed in our cause of combating poverty.

Mr. von Kleist made the following statement:

Since the joint review carried out in March of this year, some encouraging progress has occurred. The intensification of the participatory processes and of the policy dialogue as well as increased integration of the PRSP process into the corresponding budget process are especially noteworthy. The written information on "good practices" for creditor countries and their development partners should give additional support to the PRSP approach. Since we in general share staff's assessment and recommendations, I shall only offer a few specific remarks:

We especially welcome the stepped up efforts to improve donor alignment through a harmonization and simplification of the support being offered. Better alignment between donor support and PRSP priorities and alignment between conditionality and the PRSP program can significantly increase the efficiency of donor support and reduce transaction costs for recipients, especially if donors also coordinate their efforts and the conditionality of their support. Overall conditionality, however, may not be watered down through this process. The appropriate use of standardized indicators may play a role here, freeing capacities of both donors and recipients.

This is especially urgent because the most important problem which remains to be tackled is the increase of limited administrative capacities. These limitations have far too often led to disappointing delays of the PRSP process and also caused problems concerning the implementation of poverty reducing expenditures. We fully support staff's views that an increase of administrative capacities does not necessarily imply increased financing. We therefore support the approach suggested by staff that the World Bank and the Fund can, in addition to their catalytic financing function, also assume a catalytic role concerning donor coordination, especially also regarding technical assistance. Within their catalytic role, the Fund and the Bank would concentrate on four areas: Public expenditure management; stronger integration of the macroeconomic framework into the PRSP, including, if viable, alternative scenarios; integration of PRSP goals and PRGF/PRSC conditionality; monitoring.

The goal would be to empower recipient countries to take over the leadership role of coordinating and donor alignment. According to the document this has at least partially already been achieved in Ghana, Niger and Vietnam. In this context we feel that the content of PRSPs in many cases fails to recognize the importance of broader topics, for instance environment, HIV/AIDS or gender issues. Also, politically sensitive topics, like access to credit, property rights, distribution of wealth and income and minority issues too often are not picked up in PRSPs.

We regret that a PSIA has only been integrated in a very few cases. A detailed analysis of the poverty situation and the social implications of proposed measures, are, however, an important precondition to ensure outcome orientated policy actions and to enable monitoring and evaluation of poverty reducing expenditures. Mr. Kiekens made a similar point. If lacking data should be the reason for the absence of PSIAs, technical assistance in this area would need to be enhanced.

We strongly support the notion that the design of PRSPs should not follow a “one–size fits all” approach, but that the individual circumstances of each country have to be taken into account. This is not only important with regard to the specific poverty situation, but also in view of different mentalities, different trade structures and judicial systems and different governance environments. Notwithstanding this need for country specific designs, the improvement of public expenditure management systems and of governance in general remain the two most fundamental policy challenges for all countries concerned, to substantially reduce poverty inter alia by improving the efficient usage of donor support.

Mr. Vermaeten made the following statement:

Like others, we thank the staff for a well written and balanced paper; and like Mr. Kiekens, we are encouraged by the evidence that the PRSP remains a useful approach to enhance development.

I have little to add to the very good points already made by other Directors in their preliminary statements, so I will only make a few remarks.

The focus of PRSPs now has to shift from preparation to implementation. Given this change in emphasis, it would be useful if staff could give us a sense of their work program, what priorities they will have going forward over the next year or so on the macroeconomic framework.

I share the concerns of Ms. Lundsager and Mr. Bakhache, to name just a few, over the optimism of revenue projections in PRSPs. The Fund and others need to ensure much earlier that estimates are realistic and consistent with the PRGF framework. There is no point in having an unrealistically optimistic scenario. This will help the authorities to make more realistic and better prioritized expenditures decisions. A broad variety of economic outcomes and shocks should also be envisaged. When only one growth scenario is used, PRSPs quickly becomes out of sync with reality.

Another issue discussed in most preliminary statements, and by Mr. Von Kleist this morning, is that of capacity. We encourage countries to make PEM a priority, and we are pleased to see that the assessment of PEM is starting to be a part of PRGF conditionality. Related to this issue, we are pleased to see that PEM improved in seven of the recent nine full PRSPs, but I suspect that this issue should remain a key issue.

The lack of capacity to undertake sufficient poverty and social impact analyses was also discussed in many preliminary statements. PSIAs are crucial to make PRSP and PRGF policies more effective. PSIAs are undertaken to a large extent on a case–by–case basis and I am wondering whether we need a more systematic framework for PSIA. The World Bank can better mobilize and coordinate PSIA. I would appreciate it if Fund or Bank staff could comment on this.

As Messrs. Yagi and Miyoshi pointed out in their statement, and Mr. Kiekens this morning, greater participation by the business community in the development of the PRSP would be welcome. There is rarely discussion of foreign direct investment and private sector participation in the PRSP. Can the staff do anything more to encourage greater discussions of PSI in PRSPs? We strongly agree with Mr. Garner that this should be given more attention.

Similarly, environmental issues tend to be mentioned only in a few sectors rather than being dealt with in a cross-cutting way. Can staff comment on what further actions can be undertaken to ensure that these issues are examined in PRSPs in a cross-cutting manner?

Mr. Nijsse made the following statement:

I would like to thank staff for the comprehensive paper on current PRSP issues. From reading the document and from reports out of individual countries, I get the impression that the PRSP process is well on track. Of course there is still much to improve with regard to the implementation of the PRSP process, but the overall framework seems to be well in place. I therefore agree with Mr. Callaghan that the focus should increasingly shift from the design towards the implementation of economic programs. In that spirit, I will raise a few areas where some further improvements in the PRSP process seem to be possible and necessary.

First on the participation in the PRSP process. I am glad that the staff document pays special attention to the role of national parliaments. Parliaments are virtually the only institution representing society as a whole. Their opinions should therefore be carefully listened to and I strongly support the capacity building activities for Parliament described in Box 4. I would be somewhat less optimistic than the staff about the impact that civil society organizations have on the final PRSP documents. Experience of my authorities in PRSP countries suggests that it is still not unusual that civil society organizations are heard, but not really listened to. I believe that the Joint Staff Assessments could more systematically monitor the impact that different PRSP participants have on the final product. Non–governmental organizations should of course not only be heard, their views should also be reflected in the actual PRSP, so as to generate broad enough support in society for the PRSP.

With regard to the macro–economic program in PRSPs, I fully support incorporating alternative scenarios and contingency plans in the PRSP and in the national budget. Both in the budget and in the PRSP program, the same prudent projections should be presented to make both the PRSP and the PRGF credible. The Niger example in the staff document is indeed a good example of a thorough analysis, including a baseline scenario, and low and high growth scenarios. Such a multiple scenario–approach would also be appropriate for countries reaching the HIPC–decision point, so that it becomes already clear at the outset which extra policy measures would be necessary if external developments deal blows to the originally envisaged economic program. But we should come back to that in next week's HIPC Initiative discussion. It is of course highly desirable that PRGF-supported programs clearly reflect the macro–economic policy framework as agreed to in the PRSP process. Fund staff should therefore be involved in PRSP–discussions in an early stage. Furthermore, economic programs that deviate from the PRSP should be regarded with great caution, as there might be serious ownership deficiencies in these cases, which could easily lead to program failure.

I welcome the development of the Poverty and Social Impact Analysis "Toolkit" and I would be interested to hear from the World Bank representative when it is expected to be operational. Actually, my authorities are somewhat disappointed by the limited progress made in this area. The World Bank input necessary to include PSIAs in IMF–programs often seems to be lagging behind.

On donor coordination, I would like to repeat that this chair fully supports further coordination of donor flows and conditionalities. Mr. Rustomjee in his preliminary statement has a valid point that donor coordination not only means that conditions are coordinated and aligned with the PRSP. He is right that also the actual disbursements should be done in a predictable and transparent manner, so as to make adequate budgetary planning in the recipient country possible. In that context I very much welcome the staff analysis on Harmonization and Donor Coordination Efforts.

Finally, a crucial precondition to convince donors to align their programs with the PRSP and to harmonize their procedures will be if the PRSP process can show visible results. Much therefore depends on the continuous monitoring of the progress in implementing the poverty reduction strategy. I hope that all PRSP countries are adequately aware of the fact that preparing a PRSP is not a one time exercise, but a continuous process which requires continuous attention, investment and energy to monitor and evaluate the results, so as to be able to make the right policy changes to reach the desired outcomes.

Mr. Al–Azzaz made the following statement:

I thank staff for a comprehensive and well–written review of the progress in PRSP implementation. Additional countries have completed their full PRSPs. Others have also made substantial advances in design and implementation. The experience, since the last review, reaffirms many of the already known strengths and challenges of the PRSP approach. The record also underscores the complexity of the causes and remedies of poverty across countries and over time. The staff has rightly noted the need to further improve the Fund's understanding of the policies and approaches required to sustain growth and poverty reduction. That said, it is important to maintain the focus on implementation of agreed policies. I will add a few remarks in that context.

First, I share the review's stress on the need to ensure that the macroeconomic framework underlying PRSP is tied to realistic growth and financing estimates. Increased staff focus on helping countries produce realistic PRSPs is thus a priority. In that connection, I welcome the intention to place more emphasis on identifying measures to accelerate growth and to provide for alternative macroeconomic scenarios, including contingency plans to respond to external shocks.

Second, the review has made it evident that weak country capacity is a major constraint to effective preparation and implementation of poverty reduction strategies. A realistic assessment of individual country capacities and constraints is critical to fully address the technical and administrative challenges that the PRSPs present. The priority is to improve the productivity and effectiveness of the existing institutions. To help ease the burden, Interim PRSPs need to be short and well–focused and the preparation of progress reports should also be limited in length and extent. In addition, there is a need to enhance the analytical and organizational capacities with case–by–case focus on relevant local issues and priorities. As noted in the paper, the need for realistic expectations about the likely immediate improvement in capacity is important. At the same time, an appropriate sequencing of capacity building measures over a reasonable timeframe is crucial.

Third, further technical assistance is critical to help build capacity. Given the resource limitations, the basic challenge is to enhance efficiency and prioritize by concentrating on the Fund's core areas. While the need may vary with changing country circumstances, the priority should be on provision of practical training of the basic skills. In this connection, the Fund's new Africa Regional Technical Assistance Centers (AFRITACS) network for provision of locally based assistance and training is a step in the right direction. These centers should help ease the limitations of Fund technical assistance and speed delivery. Greater collaboration with other providers of technical assistance is also essential to reduce duplication, enhance efficiency, and avoid taxing the authorities' administrative capacity.

Finally, I endorse the staff's suggestions to achieve donor alignment and harmonization. To that end, it is important to ensure greater linkage of assistance programs with the countries' PRSP priorities. Relating aid allocations to policy implementation is also important. Progress in these areas should help increase the effectiveness of donor support, strengthen ownership, and enhance monitoring and evaluation of implementation.

Mr. Djojosubroto made the following statement:

At the outset, we would like to thank staff for a comprehensive report. We welcome the progress achieved so far in the design and implementation of the PRSP approach. The trend should be encouraged and strengthened in order to make the PRSP a realistic approach based upon the country's ownership.

As outlined in the staff report, the PRSP approach so far remains on track and is showing "vigor and significance" at country levels. We noted that altogether 68 low–income countries are presently engaging in different stages of developing PRSP. A more important process is that those who are following are learning from the good practices of others. This trend should be encouraged to make PRSP a more realistic and practicable approach.

Proper diagnosis of poverty is important for effectively implementing the poverty reducing measures. As mentioned by many Directors, problem of weak human, institutional, and information capacities may be gradually solved through the coordinated approach in the provision of technical assistance from the donors. However, as mentioned by Mr. Yagi and Mr. Miyoshi in their preliminary statement, it may be difficult for the countries to response simultaneously to all of the main issues mentioned in the staff report. In this context, the recent initiatives taken by the Fund in building capacity are noteworthy. We fully agree with the staff that capacity building is not merely a technical exercise but should also be extended beyond learning events. Since building capacity and addressing challenges to reduce poverty will take time and need huge resources, we agree with staff that both the countries and their development partners would need patience, realism, and perseverance in dealing with these constraints.

On PRSP preparation, a number of extensions indicated that initial and revised PRSP preparation timetables are too ambitious. We share the staff's view on the need of setting realistic PRSP preparation timetable by the countries, as well as the need of clearer indications on the delivery and coordination of technical assistance.

With regard to lack of macroeconomic policies that support pro–poor growth, and that the PRSPs tended to be optimistic in their growth assumptions and their related revenue, expenditure, and financing targets, indeed, it is not a surprising finding, as the poor countries' economic situation are always associated with weak macroeconomic policies and limited capacity. As stated by Mr. Mirakhor, the authorities are almost always depend on the assessment and the recommendations of the IFIs, and early engagement of development partner in this matter are welcome. It can be noted from the report that Fund and Bank staff will be expected to base their own projections on a more thorough analysis, and they are expected to place greater emphasis on helping countries to identify the policy measures needed to raise growth rates to desired levels.

It is encouraging to note that as countries are moving ahead to implement their strategies, we can see a more intensive participation by stakeholders in macroeconomic and policy dialogue that lead to greater transparency. We share the view of Mr. Rustomjee that this will strengthen country ownership. However, it is a delicate and sensitive issue and we have to be patient with the process. Also in designing appropriate targets and instruments of pro–poor growth, we cannot expect too much from the authorities, since in poor countries the authorities are very much constrained by their limited capacity.

We fully agree with staff that strengthening countries' public expenditure management (PEM) systems would be critical for PRSP implementation. Assessments of HIPC Initiatives' PEM systems had begun to influence the Fund's PRGF-supported programs; as such programs were increasingly drawing on countries' expenditure tracking plans. In this context, timely delivered and well-coordinated assistance can also help strengthen the PEM system. Local capacity building is also necessary for strengthening the PEM.

We agree with staff that monitoring and evaluation are critical for the effective implementation of PRSPs and further strengthening of data and institutional capacity is also required, as a good monitoring and evaluation requires a lot of inputs from the implementation units. As I have mentioned above, the authorities are facing a serious capacity constraints, not only in designing and implementing the proper policies, but also in monitoring and evaluation stage.

We can conclude, that at the end it is up to the IFIs and the donor countries, whether they are committed to make an all–out effort to help these poor countries to eradicate the poverty. They have to realize that they cannot expect too much from the authorities to meet unrealistic conditions and participation. We can make an analogy of a parent who raises a very young child, where it has to be done slowly, gradually, properly, through an educational process, but with much care.

Mrs. Boucher made the following statement:

We join other directors in thanking staff for a very interesting paper which provides valuable information on many areas of concerns that we raised during the previous review. I refer in particular to the need for building stronger ownership and improving the dialogue with and contributions from key national institutions and stakeholders' groups, enhancing collaboration with development partners, ensuring better alignment of IFIs program to the PRSPs, and developing monitoring and evaluation capacity that will enable to assess progress and help keep up the momentum.

Going through the review, we were encouraged by the progress to date and, moreover, by what we sensed as genuine and constant efforts by countries and development partners to refine and mainstream the PRSP process. We particularly appreciated the numerous references to specific country cases. They illustrate the variety of experiences and innovative solutions to cope with the many challenges of this ambitious process, the major question at stake for all partners being how to implement and operationalize the PRSP process so that it can be sustained over the long run and effectively help reach the Millennium Development Goals.

I share many of the valuable comments made by directors in their preliminary statements and previous speakers. I will just highlight a few key areas for emphasis

We continue to believe that realism and pragmatism should guide us during the PRSP finalization process : this means realism on the targets and objectives set within the PRSP as well as on the expected outcome, in light of the countries weak administrative capacity, limited poverty data base and emerging civil society ; we also share the views on the necessity to set up realistic timetables for the completion of the full PRSP

The second issue is relative to the growth targets set under the PRSP and which underpin the poverty reduction objectives and how to reconcile these objectives with the fund's program framework : this is a delicate matter since it can contradict stakeholders' expectations which have been raised under the participatory process, or even worse, give the impression that there is a disconnect between the Fund supported program and the PRSP. We certainly see merits in the approach proposing the inclusion of alternative scenarios and contingency plans. This would enable us to take into account the inherent vulnerabilities of countries to exogenous shocks and help safeguard priority spending programs during periods of difficulty.

On ownership, we would particularly stress the importance of involving Parliaments in the PRSP process. We believe it crucial to make sure that they fully endorse the PRSP. We find the initiatives described in section III aimed at strengthening capacity and improve information dissemination very interesting and valuable in this regard.

I share the comments made by directors on the need to address the issues of Public Expenditure Management and governance, as well as debt management, especially in the context of HIPC Initiative countries.

The link with sectoral/regional approaches is one area which might be interesting to cover under the upcoming review. We see merits in comparing the priorities set up in PRSPs with other sector work (Education for all and National plans for the Fight against HIV/AIDS) or regional initiatives such as the NEPAD.

Coordination is indeed essential to make sure that PRSPs actually serve as a common framework to design donor support. This implies strong coordination throughout the process, including as rightly stressed by some directors in setting up targets and objectives. Although there is a broad understanding of this objective among the partners, we sense that it is not always working well on the ground. It is indeed important, especially during this initial period, to ensure strong involvement of all Fund and World Bank mission chiefs and country directors during the PRSP preparation and review process. Both institutions should actively contribute, at the adequate level, to this active forum and direct exchange of views with donors, so as to avoid creating the impression of a gap between the living debate in the country and the decision making process on 19^{th} street.

Finally, we fully support the recommendations on strengthening monitoring and evaluation and the need for setting up indicators to assess progress as was also outlined by the OECD DAC. This is not an easy task, given the various state of administrative capacity and availability of reliable data among countries. Coordination with other multilateral and bilateral donors is equally important in this field. This also can help optimize the provision of technical assistance and learn from the experience of all partners.

We thank again staff for an excellent work and look forward for the follow up on the implementation of the PRSP approach which is central to all development partners.

Mr. Scholar made the following statement:

This is a very good paper which highlights key issues in PRS implementation. It includes key recommendations for Bank and Fund, including pointers to new research and policy analysis; rather than general descriptions as in some earlier papers.

The report is detailed and makes some clear recommendations about current priorities. We strongly agree with the priorities identified, including the importance of further work on participation macro–economic policies and pro–poor growth, PSIA and public expenditure management.

We note, particularly, the emphasis on contingency planning and the elaboration of linkages and trade–offs between policy choices and poverty reduction goals. It is very important that the Fund take an early lead here. This ties in well with our conclusions in board discussions on conditionality and ownership. Paragraph 39 makes specific recommendations on scenario planning in PRSs and this will have specific read across to scenario planning in the PRGF. Will the same guidance be used?

We wonder whether Fund staff need more guidance on appropriate processes for participation in the discussion of trade–offs? The PRGF Review highlighted this as an area of concern and talked about cultural constraints on open participation—what successes or lessons could management identify since the PRGF Review ?

We welcome the specific commitment by Fund and Bank staff to analyze growth (in para 36) and we look forward to seeing this in forthcoming PRSPs.

We agree that it is important for poor countries that the Fund deepen its analysis and research effort (para 37) in the area of macroeconomics but we also stress the importance of this for the Fund's own research agenda.

On PSIA, we welcome the way in which Fund staff have quickly embraced the need for PSIA but urge faster progress by Bank and Fund in ensuring that PSIA is undertaken on a more systematic basis. We remain concerned that at present too much responsibility for ensuring progress in this area has been allowed to rest with developing country partners. We look forward to a more proactive involvement by the Bank and Fund, where necessary Bank and Fund staff should work with other donor partners to ensure that sufficient assistance is available for partner governments. As we have said before, we would welcome the production of country based timetables of key reforms to be analyzed in the year ahead and elaboration of responsibility for the work.

The IMFC in April noted that using PSIA more systematically could enhance progress under PRGF-supported programs. We would have liked to see deeper staff discussion of staff plans to make PSIA more systematic, and we would hope to see a joint staff report on this following the workshop in October.

We agree that strengthened public expenditure management systems will be critical for PRSP implementation; it is also critical in ensuring donor assistance is used effectively. Welcome progress made on Public Expenditure Management Assessment and future worked planned in this area.

While there appears to be few apparent shortages of planned assistance, there are serious problems caused by the use of multiple diagnostics and tools, overburdening governments. The IMFC in April noted their desire to review progress on Bank/Fund collaboration in this area. In Malawi last year, the country authorities had to deal with a Country Financial Accountability Assessment (CFAA), a Public Expenditure Review, an exercise to follow–up the HIPC Initiative tracking exercise, a Fiscal Transparency ROSC exercise—all while developing the PRSP and associated Medium-Term Expenditure Framework.

We look forward to the joint staff report on Bank/Fund collaboration in this area of public expenditure management, tentatively planned for later this year/early next year, and would be keen to review staff proposals on measures necessary to harmonize and streamline the assessment process and number of assessments, and in particular to address overlaps between the CFAA and Fiscal ROSC. We should seek agreement on a common assessment procedure—not necessarily one diagnostic, but clarity on how various diagnostics mesh together.

We note, particularly, the emphasis on improved analysis of the sources of growth and more realistic growth forecasting (and related scenario planning).

Referring back to the New JSA Guidance is clear and helpful. We note that the commitments in the Spring Meetings Action Plan on Harmonization to amend the guidance to include monitoring of progress on harmonization have been included although we would have liked to see a much firmer commitment for staffs to comment independently on progress on harmonization by donors. This is very important—at the PRS Review countries stressed the importance of a "safe" place to air concerns about slow donor progress on harmonization

Similarly, we have repeatedly called for better guidance to staff on how to describe the political constraints and opportunities to implementation of the PRS. We understand that staffs should not be assessing this but there should be a middle ground—as there is with participation.

Finally, we repeat our calls for better guidance to staff on the JSA process, including how to work with donors.

Mr. Barro Chambrier made the following statement:

I welcome today's discussion on the PRSP and thank the staff for a well written report.

My views are very close to those expressed by Mr. Mirakhor and Mr. Callaghan, and I want to apologize if I do not succeed in being as brief as previous speakers. This is an important subject for my constituency.

The report provides a balanced update on the implementation of the PRSP approach. It is reassuring to note that the PRSP approach remains on track as emphasized by the quality of recent PRSPs and the momentum described in recent annual PRSP progress reports. However, a number of challenges remain for countries and development partners to strengthen the dynamics and the relevance of the PRSP approach. At the country level, these challenges include the policy dialogue, the public expenditure management framework, the poverty and social impact analysis of policy reforms, and strengthening institutional capacity and poverty outcomes. At the development partner level, key challenges include aligning their assistance with the PRSP and simplifying their systems for providing aid.

The recent experience with PRSPs demonstrates strong commitment and broad ownership. However, I share staff's view that these documents should be more focused and address key issues related to poverty reduction. Staff also rightly point out that the recent PRSP documents could have given more weight to key cross cutting issues that are crucial for assisting the state of poverty. In this regard, I see that shortcomings continue to be evident. There is a clear need to strengthen capacity building particularly in the area of statistics and here we should give more means to the Statistics department. With regard to full PRSPs, I am of the view that the quality of these documents should be the main priority. The objective should not be to complete a full PRSP at the cost of quality. These documents are not a final objective, per se. Indeed, progress reports should be used to maintain the dynamics of the PRSP approach.

I welcome the continued improvement in the design of recent PRSPs. In particular, the involvement of the private sector and the increasing role of parliaments in the preparation of PRSPs are commendable.

The focus on sustained economic growth as one of the main priorities in the PRSP is a key step towards enhancing the effectiveness of the PRSP approach. In that regard, I note that most of the recent PRSPs concentrate on identifying the source of growth, while putting emphasis on improved governance and improved access to basic health and education services as key priorities. However, I am of the view that identifying alternative policy options is a key issue that would benefit from more attention. In this regard, I think that more emphasis should be placed on analyzing the long-term perspective, which is presently quite limited. And I hope that this will be taken into consideration in the future studies.

I would also like to add that it would be helpful if we looked at cases that have actually worked and not focus on fairly identical models of economic progress. Sometimes policies are called adequate, but do not fully take into consideration the specific characteristics of the country. I think that successful cases should be the basis of our studies and I would like to see our staff look at the specificity of each country in making recommendations and not follow some standard approach.

Let me add that we are always told about the low saving and investment rates of developing countries, but to improve these rates it is important to look at each country individually and see how this can be improved. We do not need to stay with a first best solution. Let us see what can work and then apply it. These countries will need to improve their investment climate and many issues need to be addressed, not all of them are policy related. We also seem to neglect the importance of close dialogue between the government and private sector, which has worked well in many countries, at least in the beginning stage. And here, Mr. Chairman, I welcome your initiative to improve regional integration and create the right environment. It is not just selling public enterprises that can help these countries to improve gross prospects. These are the type of practical approaches that I would like to see in these studies with regard to growth prospects.

Staff point out that assumptions are generally overly optimistic. It seems to me that there is a contradiction between striving to meet the MDG objectives and calling on countries to assume more modest growth prospect in their PRSPs. I am not sure that I agree with staff recommendations to lower the growth assumptions, which in principle should be set at the level needed to effectively reduce poverty and help these countries to have sustainable external positions. If the growth objectives are lowered, then these objective will not be achieved and our strategy will have failed.

I understand the staff's preoccupation with the need for realism, but we are not trying to set a course that will perpetuate present conditions. Indeed, the objective is to raise the level of growth so far that the other objectives can be met. Therefore, I would have preferred for the staff to analyze the conditions for increasing the growth rate to what is needed and to make the necessary recommendations for overcoming shocks and other developments that might derail the achievement of ambitious targets. It is important that PRSPs take a more proactive approach through an early identification of a set of policy responses and trade offs to respond to such shocks. The preparation of alternative scenarios and contingency plans, as suggested by the staff, will also be helpful. However, I would like to note that very often in practice external shocks have been addressed more by the tightening of policies than by additional financing.

Again, we need to be serious about the objectives that we are aiming at. If we want to reduce poverty, external shocks that threaten growth objectives should be addressed also by additional financing. This also means that the facilities should have some leeway to increase financing for those cases. In the end, it is generally a question of available financing.

With regard to the poverty and social impact analysis, I think that this analysis should be generalized. I encourage countries to undertake PSIA on a more systematic basis. I know that some donors provide financial and technical assistance to support PSIA. However, for the purpose of generalizing these analyses, it is important to broaden the possibilities.

Public expenditure management is crucial to best direct expenditure toward areas with poverty reducing effects. However, the importance of expenditure management requires that countries' benefit from technical assistance when designing their PRSP.

Let me add that I share the concern expressed about deviation between the PRSP and the budget process. I think that the budget framework needs to take into consideration the objectives of the PRSP. It is also important to ensure that the spending programs are implemented as planned, and not to rely only on an increase in budgetary social spending to see that progress is being made in the social sector.

Governance issues are also very important in the implementation of the PRSP. More needs to be done in that regard, and there is a need for technical assistance to strengthen administrative capacities, including to carry out PSIA. I would highlight also the areas of institutional arrangements, the identification of targets and indicators, and collection of poverty data for the tracking of poverty related expenditure. Another area of major concern includes the costing and prioritization of public policy actions, and the strengthening of public expenditure management in the presence of limited administrative capacities and resources.

It is also important that countries set realistic timetables for the design of their PRSPs. Indeed, the number of extensions of PRSP preparation timetables reflects the overly optimistic schedule with regard to the technical assistance that the Fund and the Bank can provide. It is important that this assistance be organized to improve the effectiveness of the resources. Setting plans for technical assistance could be useful.

Finally, like Mr. Rustomjee, I wish to comment that the effectiveness of the implementation of the PRSP approach relies on the availability of resources. In a country depending heavily on foreign assistance, the best PRSP document will not be sufficient to tackle poverty issues. Timely delivery of financial assistance by donors is key for the effective implementation of the PRSP; and it is not always true that the better implementation is, the more timely the delivery of financial assistance will be.

In addition, it is crucial to improve the coordination of donor support. There is a clear need for donors to align their assistance with the priorities outlined by the government within the PRSP so as to strengthen the dynamic of the PRSP approach. In this context, I would like to note that when countries prepare their budget, they make assumptions about the assets that have been promised. Delays in the provision of this assistance can make the program go off track and be the cause for missing performance criteria. In the case of Niger, for example, which is highly dependent on extensive assistance, delays in the provision of assistance were very problematic. Greater predictability of assistance would improve significantly the implementation of the program, as well as helping to reach the objectives set. We need to make an effort to ensure that if a country is implementing its program well, it should be in a position to receive the assistance that is promised in a timely way.

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

I would like to start off by thanking Directors for their comments today. They have given us a lot to think about, not only in regard to the report, but also on the priorities for the period ahead, which we appreciate.

In responding to the specific questions raised, I will comment on three broad areas that have been covered in most of the interventions, and then turn to a few specific questions that do not fall in those areas.

First, one clear issue is how to better integrate and align the macroeconomic framework within the PRGF with that in the PRSP. In a sense, it is a welcome development that this issue is being raised because it means that the PRSP process is becoming more grounded in the reality of economic decision-making and expenditure planning on an annual and multi–year basis. The objective, as Mr. Barro Chambrier has said, is not to be less ambitious about what the growth rate should be in a country. Clearly, to achieve poverty reduction and the MDGs, it is crucial to raise and sustain higher rates of growth. The question is, how does one ensure that? That is where one gets into an analysis of the sources of growth and how best to address the obstacles to growth. Many Directors made comments about how we could focus more on identifying alternative sources of growth, or improving the investment climate and enabling environment that underpin those sources of growth. At the same time, however, there is still a question of how one can reconcile the objective of raising growth rates with the need for budget management that is based on realistic expectations of the availability of resources and of the impact of policy and reforms on outcomes.

Drawing up alternative scenarios would be one way to have both a base line that is realistic—based on expectations of resource flows—and another plan, should additional resources be mobilized for expenditures that have been identified as part of the PRSP process. That would provide a framework for day-to-day expenditure control in budget management, as well as an excellent and transparent discussion about how additional resources could be used. This also responds to questions that have been raised by a number of donors in terms of how additional resource availability is reflected in the evolution of Fund-supported programs. That is one area in the macroeconomic domain where we are endeavoring to develop stronger guidance to our own staff, and also in terms of working with our partners in countries.

Another question that we are working on in the macroeconomic area is how to take account of shocks, both in terms of a country's macroeconomic framework, but also in the way in which the Fund might support countries in responding to those shocks. You will recall that, at our previous discussion in March on the PRSP, this was one of the areas that had been identified by Mr. Rustomjee and others as requiring additional analysis and then some proposals. We hope to come back to you on that issue towards the end of the year. We are also working on trying to provide clearer guidance on how to help address concerns about the macroeconomic consequences of sudden or large increases in aid flows, both in terms of their impact on the exchange rate or competitiveness, as well as on inflation or domestic markets and crowding out.

Second, as many Directors have noted, a joint Fund–Bank paper is being prepared on public expenditure management issues. It should be ready in early 2003, and it will look at the evolution of the cooperation between the Fund and the Bank in this area, as well as issues of coordination with other donors. This topic systematically comes up in consultations with partners in low-income countries as one that is beginning to worry them because many agencies are now focusing on the strengthening of public expenditure management as a core dimension against which their assistance is being measured. While we all agree on the importance of this as a core area, the concern is that the multiplicity of efforts in technical assistance, in monitoring performance, and in establishing conditionality in the area of public expenditure management run the risk of creating overlapping or slightly disconnected conditionality; and that the costs of transactions for countries may become quite high. So this is a priority area for trying to rationalize and streamline donor assistance, so that each agency is not trying to define its own bilateral arrangement, but rather trying to integrate its requirements with the national PRSP and budget process. That common framework should serve as a guide for the assistance of all of the agencies that are engaged in this area.

Third, some have asked whether the multiplicity of donor requests or requirements was causing PRSPs to become diluted and unfocused in trying to cover lots of issues. That issue really predates the PRSP, and in some ways the PRSP has simply surfaced it. Hopefully, the fact that the PRSP now provides a common framework for a range of objectives and a diversity of demands will lead to rationalization and more common views on priorities. Beyond that, the question that we are now working on in terms of our involvement in the PRSP process, is both to work with the Bank and with some of the other key donors in trying to see how the program aid that is provided to countries and the monitoring of that program aid, the conditionality associated with that, can be better coordinated in ways that would have the same kinds of streamlining or harmonization as work that has been done in the context of project data. That can be done in part through better alignment of requirements with the PRSP process and with the timing of national budget cycles, in a way that from countries' point of view, reduces some of the costs of processing. But our work on this is still at an early stage.

Mr. Kiekens suggested that annual progress reports could provide such a common framework, and that is very much the intention of the existing annual progress reports on the implementation of the countries' PRSP. They would be the basis for a common report for all donors, as well as for the country itself, on implementation and for the donors to be able to take stock of their own annual assistance cycles. In many PRSP countries, the timing of that annual progress report is not yet aligned with the budget cycle or with the national expenditure management cycle. One of the priorities going forward is to align them better. The more one can bring them together, the more likely they can have an impact as a common framework that donors can use.

On more specific questions, Mr. Callaghan and Mr. Reddy raised the issue of whether time spent on preparing I-PRSPs could lead to a diversion of resources that should be directed at seeking civic participation. In that regard, the staff tried to make clear in the report that the guidelines for I-PRSPs are really quite modest in terms of their requirements. The I-PRSP essentially should only be a road map towards the full PRSP. However, many countries have chosen to do much more substantive, detailed I-PRSPs, which is helpful in producing a full PRSP. To the extent that that is the case, there is no diversion of resources. Nevertheless, we have stressed that countries should not feel compelled to do that and, in particular, that they should not feel compelled to spend a lot of resources on the drafting of a roadmap at the expense of advancing the substantive participatory work in which they are engaged.

On whether the requirement of having a PRSP finished and implemented for a year prior to reaching the HIPC completion point should be revisited, the issue was discussed at length during the HIPC Initiative review, and at that time it was concluded that it would be useful to maintain the basic framework. We also took note of the fact that, during this period, interim debt relief was available to countries to be able to help offset the cash flow consequences of that delay.

On whether it would be useful to have a fundamental outside assessment of the PRSP approach, we have been in touch with the IEO, and our understanding is that the PRSP/PRGF is indeed on their shortlist for their

> next round of studies, and we very much welcome that. Ideally, that review will focus not only on the Fund and the Bank, but also on the experience of the other agencies that are increasingly beginning to use the PRSP approach.
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> Finally, on whether we have any intentions to undertake to develop monitoring indicators and expenditure tracking systems, this is very much part of the work that is being done, particularly in the context of providing assistance to countries for monitoring outcomes and progress. The Bank in particular is actively involved in helping countries to do that.

Mr. Mirakhor noted that he was pleased that the staff agreed with Directors that growth projections in PRSPs should be more realistic. From a practical standpoint, however, he wondered how that could be achieved. The Fund could not really ask for PRSPs to be recalibrated, once they were completed, if the macroeconomic assumptions appeared to be unrealistic. The problem was that when programs succeeded, many were ready to claim ownership of that success, but when they failed, the Fund was usually the first to be blamed. The Fund had something to do with the elaboration of many of the projections, but not all, and his worry was that problems with the PRSP approach would end up being judged in the same way as problems with the HIPC Initiative. From the beginning of the HIPC Initiative, Directors had raised concerns about the over-optimistic export growth projections that tended to underpin the debt sustainability analysis; but focusing too much on this point early on could have affected the resources being made available. Now, indeed, it was becoming clear, that in many cases, debt would not be sustainable at the completion point. The Fund would most likely be blamed for that. It was important to make sure that that did not happen with the PRSP, by ensuring that overoptimistic growth rates did not create frustrated expectations.

The Chairman considered that Mr. Mirakhor had raised a very important point, which had to do with experience with democracy. Democracies—both advanced and developing—always tended to plan their budgets based on optimistic growth rates, and then when those did not materialize, to either find a way to manage or to find someone to blame. In that context, perhaps it would be important, in the context of the larger discussion on how to monitor progress with the Millennium Development Goals, to also consider how to identify accountability if efforts fell short, such as by documenting how growth assumptions had been determined, and whose views had prevailed in discussions. If they then proved to have been unrealistic, it would be easier to identify where mistakes had been made.

The Deputy Director of the Policy Development and Review Department (Mr. Ahmed) stated that there were two ways in which the Fund could have an impact on growth projections: one was to engage with countries early on in the PRSP process, including by providing cross-country analysis that showed what seemed like a feasible, reasonable set of assumptions about what could happen, compared with what seemed very unlikely; and another was to acknowledge that most PRSPs would still be based on expectations of resource availability that were higher than historical trends, including because of the hope of generating more donor support for an ambitious program, and then try to come up with a more baseline scenario for budget management purposes, which would be based on the resources that were much more certain to be available. One key place where the staff could signal that it thought that the macroeconomic assumptions that underpinned the PRSP were overly optimistic was in the joint staff assessment of the PRSP. That was one place where Directors would begin to see a more realistic set of assumptions about the short–term macroeconomic projections, based on a more certain estimate about the availability of resources. In terms of the accountability, it was clear that the country had to retain the primary responsibility for the assumptions in the PRSP. However, the Fund could be more accountable by being much more systematically explicit up front in its evaluation of the country strategy and in program documentation about its assessment of the projections and the risks associated with them.

Mr. Barro Chambrier said that it was important to be careful not to set back the PRSP approach by arguing about the realism of growth projections. The aim of the PRSP should be to create the conditions for alleviation of poverty. When a country performed poorly, instead of saying that the assumptions had not been realistic enough, the key question should be to analyze the reasons why it had not been possible to reach the intended growth rate. Making progress in securing higher growth rates was not a question of democracy, it was a question of economic and social sustainability. He himself had visited countries where it was clear that the potential of the country was not being used, and where both poverty and unemployment had been increasing. To solve those problems, it was necessary, for instance, to find ways to improve the environment for private investment, the justice system, or governance more generally. Therefore, he would tend to disagree with Mr. Mirakhor—and that was a rare occasion—that the staff should target more "realistic" levels of growth. The staff should target rates ambitious enough to improve the implementation of the program and raise countries' prospects. Otherwise, one could not explain why the ESAF had been renamed to become the PRGF, and why the PRSP approach had been created.

The Chairman replied that the issue was not that countries should not try to achieve as much growth as possible, but that experience showed that, in the past, there had been exaggerated growth projections, which had led to high expectations, and big disappointments and setbacks in the policy process when the expected growth rates had not materialized. Nevertheless, he certainly agreed that what was important was to analyze the reasons why the higher growth rates had not been achieved, so as to do better thereafter.

Mr. Mirakhor said that he agreed with the Chairman. To suggest that growth rates should be realistic was not the same as suggesting that a country's growth potential should be underestimated. If one looked at the growth projections for Africa over the last five years—as he was sure someone would do one day—it would almost certainly emerge that those projections had had an optimistic bias; and the natural follow-up question should be: why? It was important to analyze the potential sources of growth, not take them unquestionably. Overoptimistic growth projections tended to result in overoptimistic expenditure and budget plans, which would inevitably lead to frustrated expectations. The Fund had a responsibility to hone its advice to countries, so that if it projected a certain growth rate, it should be an achievable one.

The Deputy Director of the Policy Development and Review Department (Mr. Ahmed) remarked that focusing on more realistic growth projections was a way of confronting the concerns raised by Mr. Barro Chambrier, in that the focus should be on how to realistically raise growth rates, rather than on assuming away problems by simply assuming that growth rates would be high without dealing with the substantive issues of how to secure that higher growth.

The staff representative from the World Bank (Ms. Klugman) made the following statement:

> Thank you for inviting us to attend a very interesting discussion.
>
> On the questions raised on PSIA, the user's guide to social impact analysis, which sets out the principal issues to help guide policymakers about the sorts of techniques that might be appropriate in different circumstances, was published on the web in April. We have received good feedback on it, and the guide will be published in final form later this year. It will also be complemented by two further volumes, one which focuses on specific sectors— for example, agriculture—and another which we have been referring to as a "tool kit", which is a product of work by the Research Department, which is much more technical in nature, and which looks at different methods and types of analysis.
>
> On systematic application of PSIA, I would just like to respond to this by raising a couple of points. First, in terms of learning activities, there is an extensive program for Bank staff—which is also open to Fund staff—that is being undertaken to enable them to support countries much more effectively on the ground, including by helping countries to build capacity. Second, in the country assistance strategies coming forward, the need to incorporate PSIA more systematically is being highlighted. As Directors know, the poverty and social impact analysis is assessed by staff as part of the Joint Staff Assessment. Therefore, like other important elements, such as public expenditure management or growth estimates, it is being encouraged in a way which is consistent with country ownership. In practice, however, what we find is going to vary a lot depending on the country, and the view of the staff is that it is difficult to standardize PSIA in the same way that it is possible to standardize, for example, public expenditure management criteria. The support of various countries and the interest of civil society is helping to raise the momentum and interest in poverty and social impact analysis, which can play a part in the broader need to open up the policy dialogue to consider alternative options. As that process continues to gain momentum over time, I think that we will see a lot more poverty and social impact analysis.
>
> On the question raised on gender issues, a recent staff review updated the work presented in the March joint review, and its main conclusions were that there was a good focus at the Bank on gender issues, and generally a good understanding of the nature of gender problems in the particular countries. There has also been follow–up in specific sectors in terms of actions to

> address gender problems, particularly in the sectors of education and health, as well as less obvious areas like legal reform. A couple of countries have come out with appropriate public actions to address gender, while still lagging in areas such as infrastructure, for example. To provide support at the country level, the Bank has had, for instance, a recent event for all east Asian PRSP countries, aimed at helping each of them to develop action plans to address gender problems.
>
> On environmental issues, the Bank is closely monitoring the contents of PRSPs and staff have prepared review papers in this area. On this score, we have been especially encouraged by the much better treatment of environmental issues in four recent PRSPs, for instance with regard to water. As you would know from the discussions in Johannesburg, safe water is an essential component of a good environment, particularly for the poor.
>
> On the specific issues raised with regard to HIV/AIDS, there is a general recognition that, while these issues have often received some attention in PRSPs, they have not been as prominently covered as one would expect, given the severity of the problem in a number of countries. It seems that part of the reason might be that efforts to combat HIV/AIDS are often being supported through global funds and so-called vertical initiatives to provide support, and thus are not being fully integrated into country strategies.
>
> Finally, it is clear that the focus of recent PRSPs on growth, human development and governance is appropriate. We are very strongly encouraged by the increasing evidence of alignment of budget and decision-making processes with these priorities, and we look forward to maintaining that momentum.

The Chairman wondered how countries went about deciding what to include and what to leave out of PRSPs. He asked the staff to reply to that question after lunch.

After adjourning at 1:14 p.m., the meeting reconvened at 2:45 p.m.

The Deputy Director of the Policy Development and Review Department (Mr. Ahmed) noted that it was often difficult to determine priorities in the PRSP. In particular, the first few PRSPs had only made limited attempts to prioritize across proposals, as well as to consider their costs. That was why it was so important to align the PRSP with the budget process, so that the resource constraints, and the associated trade-offs between certain policies, would be clear. That meant that a much broader group of people needed to be involved in the setting of priorities which previously had been made only within the budget process and without the link to the PRSP; but it would result in a more conscious effort to identify a subset of the priority expenditures in the budget which would be protected if resources fell short. That process was made easier to the extent that donor-funded projects went through the national budget process. Having a lot of donor-funded projects outside the budget process made it more complicated to establish priorities, because individual projects came with their own funding, leaving the authorities without a choice as to whether those resources might be better used elsewhere.

The Chairman made the following concluding remarks:

Executive Directors welcomed the continued positive experience with the Poverty Reduction Strategy Paper (PRSP) approach, and noted that recent developments confirmed the broad findings of the joint staff review concluded earlier this year.

Directors highlighted the increased momentum over the past six months, with the completion of an additional nine PRSPs and advances by other countries in designing and implementing their poverty reduction strategies. The priority now, both for low-income countries and for their development partners—including the Fund and the Bank—is to focus on issues of implementation in domestic policies and the provision of financial and technical support. Effective implementation will entail strengthening national institutional capacity, focusing more sharply on policy priorities and choices, and closely monitoring poverty outcomes—in the setting of a broad effort to enhance transparency and governance. This would achieve a much closer coupling of the PRSP to policy implementation, but it will require perseverance and patience by countries and their development partners. The Interim PRSP process needs, also, to lead to a tightly-focused road map, linked to priority goals.

Directors welcomed the continued strengthening of participatory processes underlying PRSPs, and indications of increasing local engagement, including by line ministries and—in particular—by parliaments and other representative bodies. Further progress will also depend on increasingly open policy dialogue—including with business and labor leaders, and the poorest members of society—and institutionalizing participatory processes. Directors encouraged countries to build on these efforts, and they called on development partners to provide the technical support needed to sustain and deepen participatory processes.

Directors welcomed country efforts to better integrate macroeconomic management issues into their PRSPs, but recognized that this area needed further attention in many cases. They encouraged low-income countries to base the macroeconomic frameworks in PRSPs on robust and well-substantiated growth and financing projections, which are consistent with the policies of the PRSP, and to better integrate these frameworks with the macroeconomic frameworks upon which national budgets are based. It could be valuable to integrate annual PRSP progress reports by countries with their budget preparation process. In support of country efforts, the Fund and Bank staff should strengthen their own analysis of likely sources of growth, and direct increased attention to pro-poor growth and distributional implications.

Countries should be ambitious in their policy approach in order to accelerate the attainment of growth and development objectives.

Given the vulnerability of many low–income countries to external and internal shocks, Directors emphasized the need to incorporate better contingency planning in the macroeconomic frameworks in their PRSPs. Countries should work to incorporate contingency-based alternative macroeconomic scenarios in their PRSPs, with Fund support, as had already been done in at least one PRSP: this would allow countries to respond to exogenous shocks or other changes in country circumstances without having to recast the overall poverty reduction strategy. It would also facilitate the more effective analysis and use of additional aid inflows. In that vein, several Directors pointed to the need for adequate external financing to parallel adjustment in the event of shocks. Over the medium term, it was noted, the vulnerability of many countries to shocks should be addressed by policies to favor diversification in the sources of economic growth.

Directors noted that countries were likely to face capacity constraints in developing and discussing more consistent and well–substantiated macroeconomic projections, as well as contingency plans and alternative scenarios. They underscored the importance of analytical and technical support, including through regional technical assistance centers. They encouraged staff in their efforts to develop operational guidance, particularly with regard to effective absorption of higher levels of aid flows. Directors also called on Bank and Fund staff to discuss more explicitly with country authorities the policy choices that could help accelerate growth rates and underpin countries' contingency plans, including through sound debt management. It was emphasized that the possibility of additional financing would need to be incorporated in countries' poverty reduction strategies in order to ensure that fiscal sustainability and macroeconomic stability are maintained.

Directors encouraged donors to continue efforts to align their support with countries' PRSPs, by deriving program conditionality from PRSP policies and priorities as well as relating aid allocations to PRSP implementation. For the Fund's part, a good start has been made in ensuring the consistency of PRGF-supported programs with PRSPs, and in drawing PRGF conditionality from PRSP priorities and policies, but further efforts are needed to improve this alignment. In this regard, Directors noted the importance of the Fund and Bank closely coordinating their policy involvement and continuing to work with the EU and bilateral donors to improve the overall coordination of reporting requirements and performance assessments. This would reduce the transaction costs for countries receiving program assistance. At the same time, it was stressed that the link between the provision of assistance by donors and the achievement of measurable results by recipients should not be weakened.

Directors welcomed the efforts in the most recent PRSPs to strengthen governance and accountability. They noted that improved public expenditure management (PEM) and more systematic poverty and social impact analysis (PSIA), would be crucially important for effective design and implementation of poverty reduction programs. Stronger PEM and PSIA would also assist donors in aligning their financial assistance plans with the financial plans of recipient countries, which was seen as an important goal. Directors underscored the need for more coordinated and timely delivery of PEM assistance, and for a stronger focus of this assistance on making PEM reforms sustainable over the longer term, as well as enhancing the capacity to track poverty–reducing expenditure. Directors also urged further efforts by the Bank and other donors to help countries undertake PSIA on a more generalized and systematic basis. They reaffirmed that PRGF program design and documentation should continue to incorporate available PSIA. It will be important for governments to take fully into account cross-cutting issues, ranging from property rights to environment, HIV-AIDS, gender, and minority issues. Capacity and methodological constraints will limit the pace of progress in incorporating PSIA, and this underscores the crucial contribution that technical assistance can make.

Directors considered that monitoring and evaluation (M&E) frameworks, based on identified indicators, are important to assess progress in the implementation and eventual outcome of individual PRSPs, as well as to measure collective progress toward achieving the Millennium Development Goals. Directors pointed to two areas where M&E systems could be strengthened, while beginning to develop thinking on a full–fledged framework for assessing PRSP outcomes in due course. First, they could be more explicit in identifying intermediate indicators that are based on PRSP policies and linked to longer–term objectives. Second, they should give earlier attention to collecting baseline data and assessing institutional capacity.

Given the extent of the implementation challenges facing low–income countries and the range of capacity and other constraints, Directors underscored the importance of mutual responsibility in keeping with the two–pillar approach reflected in the Monterrey consensus. Progress in countries' PRSP implementation efforts needs to be complemented by donor efforts to provide more and better-delivered aid—on a well-coordinated and predictable basis. It would remain crucial to improve access for developing countries' exports to industrial countries' markets.

Directors agreed that the next progress report on the implementation of the PRSP approach should be prepared jointly by Fund and Bank staff in 12 months' time.

3. TWELFTH GENERAL REVIEW OF QUOTAS—FURTHER CONSIDERATIONS

Documents: Twelfth General Review of Quotas—Further Considerations (SM/02/253, 8/9/02; and Sup. 1, 8/27/02)

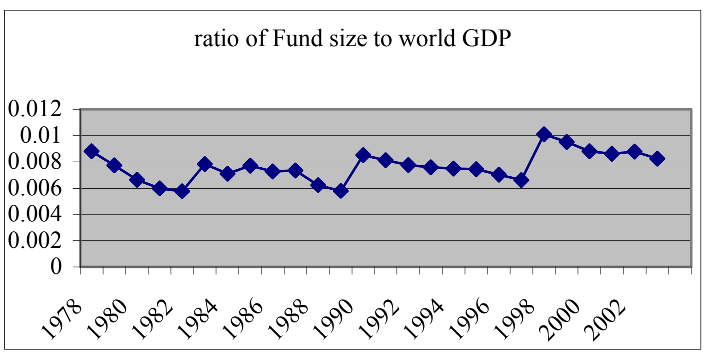
Staff: Brau, TRE; Ross, TRE

Length: 1 hour, 35 minutes

Mr. Wijnholds submitted the following statement:

I appreciate the staff's efforts to provide additional indicators to assess the appropriate size of the Fund. However, I remain unconvinced of the need for a general quota increase at the time of this review. At our previous Board meeting on the 12th Ggeneral Review of Quotas, there was clearly no 85 percent majority (or even a simple majority) in favor of a general quota increase and I do not think the staff's new paper (and supplement) will change that outcome. I refer to our previous discussion for most of my arguments for not supporting a quota increase. The paper does raise some additional issues that I would like to address.

The size of the Fund has not declined relative to world GDP:



The staff states that *"all the traditional indicators suggest that a quota increase would be needed to restore the Fund's relative size, particularly in relation to GDP*". Or in the penultimate edition of "Current Account": "*TRE says smaller IMF relative to world GDP may jeopardize the Fund's capacity to help*". It seems these rather dramatic statements are based mainly on Table 1 in the report. The actual data on the size of the Fund and world GDP do not show a declining ratio, however (see the figure above, which simply plots the ratio of the actual size of the Fund to the actual *WEO* figures on world GDP)[1].

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[1] The figure above takes data on the size of the Fund from table 1 of the report, and data on the size of the world GDP from the *WEO* database (most recent projections used for 2002 and 2003). The main reason for the

As a more general point, it is arguable whether it is necessarily the case that the Fund's size should keep even pace with the developments in world GDP or the other variables mentioned in Table 1. In particular, I note that in most cases the general increases of indicators (the denominators in the presented ratios) are primarily caused by developments in industrial countries, which are normally not relevant in the context of an assessment of the potential need for Fund resources. In addition, I strongly question the usefulness of the variability indicator, which is conceptually weak.

The forward capacity to make financial commitments should suffice

The current liquidity position of the Fund is comfortable and the current one-year forward capacity to make financial commitments (at SDR 56 billion) has been higher in only one single year (2000) over the past seven years. Although I realize that the comfortable liquidity position of the Fund will be negatively affected by the new package for Brazil (as noted in supplement 1), I think our resources should still be sufficient to meet possible further demands for Fund resources. In this respect, I would also point to the additional SDR 34 billion that is available under the GAB/NAB, and that could be drawn upon in times of excessive stress.

Furthermore, I feel that it would be undesirable to further expand the size of the Fund while the pressing issues of PSI and access policy have not been resolved. Indeed, it could be argued that a general quota increase under the current circumstances would run counter to the objective of a more limited financing role for the Fund and might fuel moral hazard, certainly in the absence of substantial progress with regard to PSI/SDRM.

The baseline-scenario is not my baseline

The illustrative demand scenarios presented by the staff seem to be overly pessimistic and do not in my view provide a realistic estimate of required Fund resources. I have two main reservations. First, all scenarios – including the first scenario that is presented as a 'favorable' scenario – extrapolate the experiences during both the Asian and Russian crises into the future, by taking the average level of commitments of either the period 1997/1998 or 1996/2001 as a basis for the estimates. Although I acknowledge that we must consider worst-case scenarios, the use of this particular reference period unduly results in a pessimistic bias in *every* scenario, as it constitutes

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difference with the figure in the staff report is that staff does not use the *WEO* figure for world GDP in the denominator, but rather the data used for the calculation of individual quota at general quota increases. As a result, their figure has only 6 data points for the 1978-2002 period (which are therefore quite sensitive to the phase in the business cycle), whereas the figure above plots annual data. Furthermore, the staff report does not use actual data on world GDP, but rather a backward-looking and asymmetric indicator of the sum of members' individual quotas (going back five years for the Ninth review, but going back only four years for the 11th review and only three years for the latest projection, in addition, membership changes over the period).

what is probably the most turbulent period in the history of the Fund, during which committed resources rose to unprecedented levels.

Second, it was precisely during this period that questions were raised with regard to the financing role of the Fund. The general unease with the large bailout packages provided in that period has spurred the current discussions on PSI and access policies, which aim at a more limited provision of Fund financing in future crises cases.

The incorporation of commitments under the CCL in the scenarios also raises eyebrows. Thus far the CCL has not been used and I am not aware of any indications that this is going to change in the foreseeable future. Indeed, the eligible candidate countries themselves seem to remain skeptical about the merits of this facility (as do—according to the latest edition of "Current Account"—the majority of Fund departments). Furthermore, possible CCL commitments would for the countries concerned, at least to some extent, offset alternative commitments under the Stand-By Arrangement or SRF further down the line. They would thus partly be a substitute for the commitments that are already incorporated in the baseline scenario, and should not be added on top of it.

Report to the IMFC

It seems we will have to report to the IMFC that at this stage there is not sufficient support for a general quota increase. The staff suggests that our report to the IMFC should also cover the distribution of quota, a possible reform of quota formulas and basic votes. This seems somewhat premature given the fact that there is no consensus on these issues in the Board. There just is nothing to report. At the very least, I would like to have an opportunity to discuss what exactly will be presented to the IMFC on formulas and basic votes. At this stage, this could at most be a discussion about the broad principles that will need to prevail in any proposal to change the formulas.

Mr. Padoan and Mr. Bossone submitted the following statement:

The staff paper makes a very clear case for thinking carefully and in a timely manner about the need for reassessing the size of the Fund vis–à–vis the rapidly changing world economy. We are grateful to the staff for their informative analysis and for presenting the Board with well–balanced arguments and yet with a strong warning message.

There is no question that the Fund needs to adapt over time to the evolving nature of the international monetary and financial system, as it has continuously done in the past. Its operations and resources obviously need to keep pace with the changes in the demand for assistance from membership. The adaptation of both has been clearly affected over the last two decades by the increasing freedom of capital movements around the world, the growing role of private financial markets in allocating capital, and their attendant risks.

The fundamental question now is whether the current size of the Fund is enough to match the prospective financing needs of its membership, assuming realistic future scenarios. Answering this question is complicated as it inevitably begs the more general question on what the Fund's role should be in a world with high and fast capital mobility and global markets. The endless issue of moral hazard is of course central to this question, so much so that whenever the size of the Fund is under assessment, the deep "existential doubt" keeps re–emerging as to whether a larger Fund is in fact a good or bad feature for the world.

We think, however, that associating the two questions is a misleading premise that risks leading to misconceived answers. Whether a larger or a smaller Fund generates the right incentives for crisis prevention or, more generally, for sound policymaking in countries running external imbalances relates to the way the Fund is designed to carry out its role. If, for example, we had a convincing case that there was a serious moral hazard issue as a consequence of Fund assistance to crisis countries, then the Fund should be redesigned in ways that would have to limit its role in crises, or that would constrain access to its resources by member countries: the optimal size of the Fund would automatically adjust as a result of the Fund's re–design, since its obligations would change in response to its different role and architecture.

If, however, the basic role and architecture of the Fund are not directly in question, then the only real issue at stake is a practical one, and that is whether the Fund is funded enough to be able to meet its potential obligations. Therefore, once the Fund's role and architecture are given (or if they are assumed to be given), what remains to be accomplished in a quota review context is to determine the Fund's short to medium-term obligations, using as much prudence as possible in the art of guessing.

Assuming the Fund's role and architecture as given seems to us to be a realistic assumption. In fact, in all those areas where adaptations are in order (such as PSI, surveillance, and access policy), improvements will be gradual and marginal. Even in the area of sovereign debt restructuring, where the adoption of an SDRM and a stronger private sector involvement could in principle allow for a decrease in the demand for Fund resources, changes will at best be slow. As a result, in trying to measure the Fund size adequacy against its potential obligations, the recent past can be used as a valid guide to the medium–term future, which is precisely what the staff have done in their exercise—correctly, in our view. In this context, to be sure, not all the arguments used by the staff are entirely convincing to us, but correcting them would, if anything, only reinforce their same conclusions.

In particular, we are not convinced that, in today's world, the size of the Fund relative to global GDP is a good measure for assessing the adequacy of Fund resources. In our opinion, in fact, the financial dimension of the world economy should be included as a key determinant in that assessment, and we trust that the staff would find the appropriate way to incorporate such a dimension.

Any insurance resource pool is determined by considering the risks to be covered, their probability of occurrence, and their degree of mutual correlation. In the case of the Fund, even if such a determination could only be done using historical values, it would still be more informative than one based on the historical Fund size–to–global GDP ratio, whose value neither posses a rational foundation nor does it reflect the world economy's structural change. Yet, observing the events of the last two decades indicates that the size of the financial crises, as well as their probability and cross probabilities of occurrence (i.e., contagion) have all increased, leading to growing Fund use commitments. In this respect, the evidence provided in the staff paper as regards capital flows and vulnerability assessments are quite compelling. And if there is any sense in looking at the Fund size–to–global GDP ratio, the fact that its value is declining should be considered against the judgment that in the new global world the desired ratio should be above the historical 1 percent.

In this context, therefore, this Chair does not have preclusions against the idea of arriving at a consensus on the need to augment the Fund resources, provided that individual quotas reflect primarily the members' contribution capacity.

We would not agree on using the special arrangements to borrow to resolve structural and permanent problems of Fund resource adequacy, both because this would alter the character of the institution and because these instruments should be seen only as temporary last resorts that provide the international financial community with extra degrees of flexibility when needed.

Finally, we support the next steps proposed by the staff.

Mr. Reddy submitted the following statement:

During the last discussion on quota formulas it had become apparent that work on the Twelfth Review could be accelerated only after a consensus on the issue of quota increase as well as the size of such an increase had emerged. We therefore compliment the staff for a well–focused and succinct paper, which clearly highlights these important issues. In particular, current events which have necessitated significant commitment of Fund resources coupled with recently observed consequences of the volatility of capital flows for emerging economies do impart a sense of urgency for serious consideration of this issue.

The optimum size of the Fund would depend upon a number of factors, which have been well articulated in the staff paper. In this regard, while the Fund has been placing increasing emphasis on contingent financing mechanisms as well as precautionary arrangements, this needs to be reflected in the number and nature of precautionary arrangements approved in the future. This will ensure that the 'insurance' role of the Fund is reinforced. In any case, as this chair has pointed out earlier, the costs of having a larger Fund are not significant compared to the costs of crises to national/ global economies, which may result from an inadequately equipped Fund. We therefore reiterate that Fund resources should be adequately buttressed in a timely and forward–looking manner so that it is enabled and empowered to effectively fulfill its mandate.

On the issue of moral hazard, we would like to emphasize two issues. First, moral hazard considerations are relevant while considering the utilization of the Fund's resources and not its availability. We do not agree that a larger Fund by itself will generate larger demand for its resources—resources which in any case have been fully paid back to the Fund along with charges in the past, barring a few exceptions. In fact, a larger Fund will strengthen the credibility of its 'insurance' role. Second, moral hazard considerations are ideally addressed by targeting them specifically and this is best done by focusing on the Fund's conditionality and access policies as well as the ongoing work on PSI/SDRM. With regard to the timing of the various decisions, one set of decisions need not necessarily precede the other. If the quota discussions are considered as an iterative process, with inputs feeding into it from the other policy discussions, a final view can be reached asymptotically.

Staff has clearly documented the decline of the Fund size relative to global economy using the traditional indicators. This must be seen in conjunction with the marked increase in volatility in exchange rates and capital flows during the last decade, which has resulted in the international environment becoming substantially more uncertain, unpredictable and unstable. Given these increasing uncertainties consequent to greater market integration, the larger share of the Fund in financing packages as well as lower bilateral funding available to countries in crises, we agree with the paper that the Fund should continue to have a prominent role in resolving liquidity crises, especially since there are no credible alternate mechanisms.

The three scenarios presented by the staff are quite illuminating and seem to point to the need for an enhanced Fund size to enable it to fulfill its mandate and 'give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards….' These scenarios reflect combinations of demand fluctuations of the size experienced in the past and do not account for any worst–case scenario, which may arise in future. Irrespective of the interpretation of the indicators and scenarios in the staff paper, it must be recognized that the crises in the capital account have completely changed the dynamics of demand for Fund resources. A small number of large arrangements can possibly take the Fund to the limit of exhaustion. We therefore agree that for reasons of prudence alone, an increase of quotas is necessary and a timely increase in quotas will be essential if the IMF's ability to assist members is to be sustained in such an environment. There are few avenues for the Fund to quickly raise necessary resources at short notice in times of crises and we cannot afford to wait for a large spurt in demand before considering a quota increase.

While this chair is broadly in support of the proposal for a larger Fund, we wish to reiterate a concern—which we share with many other Directors—that the quota share of developing countries should not fall during the present review. This issue is significant not merely for representational reasons but also because with the Fund access policy presently tied to quotas, the availability of support to these countries in times of crises remains constrained. These two policy proposals must therefore be seen in conjunction. This chair had earlier proposed that quotas be allocated only on the basis of a single variable PPP based GDP—which truly reflects the size of the economy with respect to the rest of the world. Any other formulation would not adequately reflect changes in the relative economic position of Fund membership in the global economy, which is also a purpose of the quota review. If agreement on such an issue is not possible, perhaps there is a strong case for a quota increase where the entire allocation is equiproportional.

Finally, I would like to emphasize that the quota increase must be seen against the background of the need for the Fund to optimally manage the risks in the global economy. If there are risks accompanying larger resources being placed at the disposal of the Fund, these need to be off set against the risks of inadequacy of resources. In the light of adverse consequences in terms of suffering as well as misery of many in the event of an insufficient response, wisdom lies in timely augmentation rather than postponing an increase in the Fund's resources.

Mr. Shaalan submitted the following statement:

This is an excellent staff paper. In addition to being well organized, the paper helps to move us forward in putting in place the necessary building blocks to examine the case for a quota increase. The paper addresses the relevant issues needed to reach an educated judgment on where we go from here. In this regard, we are in full agreement with the relevant considerations put forward. We very much condone the separation of the qualitative and quantitative considerations that go into an assessment of the adequacy of the

Fund resource base at a time when the global financial system and the unusual shocks it has witnessed will undoubtedly continue to emerge in the future.

The evolving developments in the world economy render the traditional approach of measuring the adequacy of Fund resources rather inadequate, particularly, but not only, in view of the volatile and sudden capital flows which are not always reflective of underlying fundamentals. This adds an important complicating dimension to projecting credit demand by the membership. Additionally, given our recent experience, the initially programmed duration of Fund credit on an increasing volume of Fund lending in excess of normal limits is proving to be unrealistic. Longer repayment schedules may well have to be factored into any calculation of the adequacy of the Fund's resource base. In this sense, we see much merit in the staff's proposal for building in a "premium of prudence" in assessing the Fund resource adequacy. Furthermore, while the CCL facility has not been used as of yet, there has been a discernible increase in the number and volume of precautionary arrangements which are viewed as a component of crises prevention. For these arrangements to represent credible commitments, they must be supported by the necessary funding, on the assumption that they will be activated. Accordingly, in determining the size of the Fund's resource base, they should be taken into account. Moreover, as will be indicated later, the Fund's resources by a number of key indicators have shrunk over the years.

It is not altogether surprising that the size of the global economy was singled out in recent Board discussions as the most comprehensive measure for assessing the adequacy of Fund resources. Quota reviews have, for nearly three decades served to maintain the size of the Fund at 1.25 percent of global output. The staff points out that at current levels, the size of the Fund now stands at less than 1 percent, and will decline further to about 0.75 percent of the projected global output in 2004 without a quota increase—i.e. slightly more than half of the longer term average level. Still on the size of the Fund, another disturbing development is evident. Since the collapse of the Bretton Woods' system in the mid seventies, actual quotas have increasingly diverged from calculated quotas and, without an increase in quotas, the former would reach the lowest relative level in the Fund's history.

The latter indicators of quota erosion are taking place at a time when the economic and financial risks associated with globalization and the increasing incidence of volatility in capital flows volatility are more than likely to increase the demand for Fund resources. Volatility has become a major contributor to financial crises, particularly, as the paper notes, since private capital flows, which are more volatile than those from official sources, are assuming an increasingly important role in the global financial system.

Given these developments, there is a compelling case for an increase in Fund resources if the institution is to play an effective and credible role in overseeing the international financial system. The arguments that such an increase would have to take into account a broader measure of variability that includes capital account volatility has considerable merit. Nevertheless, a major draw–back of this approach is that it is likely to depress the relative share of developing countries' quotas since, for one reason or another, most are not poised to be significant players in the capital markets. Of course, it can be argued that these very same countries are also less likely to be users of Fund resources in the high access ranges. This argument notwithstanding, we cannot ignore the undesirable side effect of reducing the participation of this group of countries in a cooperative institution. Accordingly, this consideration must be taken seriously.

We have some reservations on using the concept of Gross Financing Needs (GFN) in projections based on resource use by the membership in earlier years. The staff points to a number of relevant considerations that would, in our view, detract from the adequacy of this measure. In this regard, three factors stand out. First, to the extent that PSI in the resolution of crises would reduce the level of financial assistance from the Fund, GFN would still remain unknown, and in many cases will always be unknowable in view of the unpredictability of the behavior of certain forms of capital flows. Second, the fact that the availability of bilateral resources to support Fund arrangements appears to be dwindling and accordingly may result in the Fund assuming a larger role in financing packages. Finally, there is the issue of contagion which we still do not fully comprehend, but which has, for the most part, been more prevalent in the nineties than in earlier decades, and whose course is difficult to project. Given these uncertainties, the quantification of the GFN concept is likely to remain elusive, and best judgments will need to be resorted to.

As indicated earlier, evidence strongly suggests that the trend in the incidence of volatility in capital flows has increased in recent years. This has particularly been the case in private capital flows in the larger emerging market countries which have been major users of high access levels of Fund resources. Thus, there is merit to broadening the measures of vulnerability, to cover net capital flows in addition to current receipts. Applying this component to quota calculations would result in a sharp increase in quota calculations for the larger emerging market countries. However, it is not clear how the application of the broad coverage of variability would affect global quota calculations, including in particular developing countries generally. If the data is available, we would appreciate staff comments.

It is clear from the data and the convincing arguments presented in the paper that there is at best a need to stem if not reverse the decline in the size of the Fund relative to what is believed to be potential global financing needs. This decline, if left uncorrected, could seriously affect the Fund's effectiveness and the credibility of its commitments. We fully realize that the current report does not address the question of reviewing quota formulas, which is still pending. However, a resolution of that issue should not delay a conclusion of the Twelfth Review of Quotas.

We found the presentation of the three alternative scenarios representing three levels of potential demand for Fund resources quite plausible and reasonable in the sense that they avoid extreme eventualities. In fact, only one scenario, which assumes a degree of contagion, would exhaust the Fund's forward commitment capacity, and adversely affect its liquidity. The other two scenarios put forward do not seem to give rise to pressure on Fund resources.

Even so, we cannot, and should not, assume away the conditions under the scenarios leading to potential pressures on Fund resources. The Fund should stand ready to address the consequences of such a scenario, if it were to materialize. Finally, while we agree that the work program leading to the submission to the Board of Governors of a proposal on the Twelfth General Review of Quotas by end of January 2003, will benefit from the forthcoming discussions on access policy, as well as progress in the work on PSI/SDRM, we have serious reservations on the inclusion of the prospects of the world's economy and financial market conditions as an input in quota deliberations. As we know all too well, developments in financial markets are unpredictable and volatile. A period of stability should in no way lead us to a state of complacency regarding the size of Fund quotas.

Ms. Lundsager and Mr. Baukol submitted the following statement:

Key Points

- The Fund must have adequate resources at hand to fulfill its important responsibilities to the international monetary system, including the provision of support to member countries in need that commit to and implement a strong reform program.

- Currently, the Fund's financial position is very strong. Further, it will remain strong even after anticipated commitments to Brazil. The staff's preferred measure—the one-year forward commitment capacity—indicates that the Fund would have (after Brazil) over US$100 billion in available resources, including the overly conservative US$50 billion 'minimum' level of untouchable resources.

- Hence, our position on a quota increase has not changed since the Board discussion in February. There is no need for an increase at this time, and we are prepared to conclude the 12th review this fall with no increase.

- More broadly, the Fund should recognize that official resources will remain limited, and will not and should not keep pace with private sector capital flows. This does not mean that the role of the IMF in the world economy will be less influential. Indeed, the Fund is recognized globally as playing an essential role in the international monetary system.

- The Fund should further strengthen its central role by focusing on the quality, not quantity, of its assistance and thereby enhancing its catalytic role. Greater selectivity in the number of programs is an essential component of this process. Sound policy implementation will remain key for countries to attract desired funding from the private sector. An excessively large Fund can reduce incentives to strengthen crisis prevention.

The staff paper takes another look at changes in the world economy and Fund operations that could have a bearing on the demand for Fund financial resources. At the risk of repetition of the discussion in February, we find the arguments in the paper, which are clearly geared in favor of a quota increase, unconvincing.

The paper reiterates the argument that ‘all the traditional indicators’ suggest that the Fund needs a quota increase to retain its size relative to measures of the world economy—particularly GDP. In our view:

- The size of the Fund has declined over time relative to many measures of the world economy, such as capital flows, reflecting the welcome growth in the role of private financial markets.

- The growth of private capital flows has not led to a diminution in the Fund’s role in the international system. The Fund is widely regarded as more central to the international monetary system than ever before.

- That said, a gradual decline in the relative role of official support compared with private capital flows is to be expected and desired. Such an evolution, in the presence of a hard budget constraint on official resources, will lessen the chances of any abrupt change in investor expectations and thus allow for a smoother and gradual transition.

- Moreover, it is not clear that the size of the Fund relative to all key indicators has fallen significantly.

- IMF quotas relative to global GDP appear to be relatively constant, judging by the figures in Mr. Wijnholds’ preliminary statement.

- Other measures suggest that the Fund’s size remains large by historical standards. For example, the size of the Fund relative to the GDP of the most likely borrowers (those countries *not* in the financial transactions plan – FTP) is high, as shown in this table:

	1990		1998		2002
	Pre-quota increase	Post-quota decision	Pre-quota increase	Post-quota decision	Current
Total quotas/GDP of members not in FTP	3.6%	5.5%	3.4%	5.0%	8.6%

The paper argues that the increase in the volume and volatility of capital flows suggest that the Fund needs more resources to respond. In our view:

- Growth in private sector capital flows have been accompanied by larger flows of FDI. Many countries have also provisioned for greater volatility by bolstering reserves.

- Improved crisis prevention, greater ex-ante conditionality, and more focused and selective lending practices should diminish the demand for IMF resources. The Fund needs to strengthen and adapt its operations to take large capital flows into account, rather than simply increase the size of the Fund's resources.

- Consistent with the Fund's revolving and monetary character, the shortening of the Fund's maturities, the reduction in the number of EFFs, and the use of repurchase expectations should allow Fund resources to revolve more quickly. A more predictable framework for sovereign debt restructuring would also help.

These considerations lead us to disagree with the conclusion that it would be 'prudent' to increase Fund resources, even if at little financial cost to creditor members. Increasing the size of the Fund at a time when available resources are high and more than adequate could be viewed as a sign that we have not been effective in our work. Instead, our goal should not be a bigger Fund but a better Fund focused on quality programs that catalyze private sector flows.

The paper notes that IMF vulnerability assessments indicate that significant demand for IMF resources could materialize quickly.

- It is difficult to make a judgment that potential and unknown vulnerabilities justify a quota increase. Presumably, vulnerability assessments feed in to the three scenarios presented in the paper. We turn to those next.

The Scenarios

The paper considers three scenarios to assess whether the Fund's quota resources are sufficient. One scenario assumes continuation of recent commitment levels plus large CCL commitments. The other two scenarios are 'crisis' scenarios, also including large CCLs. We would note that:

- The first scenario is based on average commitments of 1996–2001, plus additional funds for CCLs. Like Mr. Wijnholds, we think this scenario should not be considered a favorable one given that 1996–2001 would not be described as a calm period for emerging markets. Nonetheless, under this scenario, the Fund's resources are robust.

- The second scenario makes very pessimistic assumptions about the level of demand for IMF resources and the phasing and amounts of disbursements. For example, new commitments of IMF resources, including CCLs, are larger than those in 1999, 2000, and 2001 combined.

- The third scenario provides a more realistic picture of a 'crisis scenario'. Under this scenario, the Fund's resources remain robust.

As noted in the staff supplement, the paper was written before the announcement that the IMF may commit extra resources to Brazil, and thus it is useful to look at the 'forward commitment capacity' assuming the Brazil program goes ahead. The figures presented in the supplement indicate that the Fund's one-year forward capacity would remain very comfortable at over US$50 billion, even allowing for the overly conservative assumption that the Fund must set aside over US$50 billion (SDR 40 billion)—an issue which the Board will discuss this fall. And, this amount excludes the NAB/GAB arrangements.

Publication

The staff proposes to publish the staff report and a PIN. We have no objection to publication, but suggest that the paper be modified to incorporate Directors' comments and perspectives regarding the need for a quota increase. For example, the comment that all traditional indicators suggest that a quota increase is needed to restore the Fund's relative size is overstated. In addition, the paper should make clear that the definition of the 'forward commitment capacity' indicator has not been agreed by the Board. Also, the PIN should make clear whether Board support for a quota increase comes close to the 85 percent requirement. We expect it will not. Finally, we share the concerns expressed by Mr. Wijnholds about a possible report to the IMFC.

Mr. Djojosubroto and Ms. Phang submitted the following statement:

We commend the staff for a concise and crisp note which provides a comprehensive assessment of the adequacy of the Fund's resource base. We are pleased to note that the staff have taken account of the points that were raised by a number of Directors, including our chair, on the need for a quota increase to ensure the Fund has adequate resources to fulfill its role in crisis prevention and resolution. We believe this need has become much more urgent given our recent commitment of additional financing of US$30 billion to Brazil and the uncertainties in the regional and global environment. The staff have presented clear justifications why a quota increase is urgently needed. We therefore agree with the staff's conclusion that it would be prudent for the Fund to decide on a quota increase before the Fund's capacity to assist members is called into question.

Developments since our last discussion on quota in February have clearly demonstrated that large and sudden reversals of capital flows arising from increased global financial integration could quickly lead to significant demands for Fund resources (even with significant policy adjustment) and place a strain on the Fund's forward capacity to commit resources. As the staff has highlighted, indicators of the size of the Fund relative to the world economy and potential financing needs point to a continued decline which could impair the credibility of the Fund as an "insurance" provider and weaken the institution's ability to fulfill its important responsibilities. The updated version of table 4 shows that the forward capacity to make financial commitments from own resources has dropped dramatically from SDR 55.6 billion in June to SDR 39.4 billion, lower than the estimated minimum prudential amount of SDR 40 billion.

We reiterate our stance that the cost of the Fund having too small a resource base far outweighs any potential moral hazard there is of too large a resource base because the credibility of the Fund in carrying out its mandate of maintaining stability of the international financial system would be at stake. In the present environment of significantly higher incidence and duration of contagion and where the bulk of the financing is related to the capital account, we agree with the staff that members' potential demand for Fund financing is likely to be substantial. The Fund will therefore need a significantly larger resource base to ensure that it has adequate financing for its precautionary facilities in the event of a drawdown, to provide credible support for its shift in emphasis to crisis prevention. Concerns on moral hazard should be addressed through conditionality imposed on access, not the overall size of Fund resources.

As we stated for the earlier discussion in February, the rationale for the PSI strategy and the CCL instrument are appealing in theory but in practice have been far from successful. Experience has shown that the Fund is increasingly being relied upon as the lender of last resort to provide emergency funds to restore confidence in order to catalyze the re–entry of the crisis countries to regain access to private capital markets. In this regard, the CCL has failed in practice because countries view its use as signaling an impending crisis. This underscores the importance of the Fund having sufficient resources to enable it to complement its efforts at crisis resolution through shifting its focus to a more forward–looking approach, namely, crisis prevention.

We concur with the staff that there are many difficulties in forecasting demand for Fund resources. Hence we support the staff's use of scenarios in lieu of forecasting demand. The basis for the three illustrative scenarios is generally good, but scenarios 2 and 3 appear to lack realism given that recent events have shown that the amounts involved are much higher than during the Asian or Russian crises. The proposed financing package for Brazil far exceeds that granted for any other country during the Asian or Russian crises. Therefore, it is not realistic to continue to use the experience of the last seven years as the basis for judging the demand for Fund resources in the future. Furthermore, we do not think it is prudent not to consider a worst–case scenario as the Fund should be prepared. Otherwise, the role of the Fund as a source of confidence for the global economy could be severely undermined.

The risk of contagion and of increased demand for Fund resources is exacerbated by the slower than expected recovery of the global economy as well as loss of investor confidence due to various factors, including issues of corporate governance. Given the fragile situation, particularly with respect to the confidence factor, we feel that the need to replenish and enlarge the Fund's resources has now taken on greater urgency. Hence we concur with the staff that the issue of quota increase should be brought to the forthcoming IMFC meeting for consideration by the Board of Governors of the Fund. We do not have the luxury of time to continue to debate about further considerations for a quota increase. It is clear that a quota increase is needed. In addition, it would be opportune to address the distribution of quotas and the "out–of–liners" to better reflect the changes in the relative position of countries in the world economy as well as for improved governance.

Mr. Bennett submitted the following statement:

Key Points

- I continue to believe that it is premature to consider an increase in quota allocation based on a potential inadequacy of Fund resources.

- IMF resources need not keep pace and backstop private capital flows. The credibility of the Fund in promoting international financial stability in the period ahead will come from effective surveillance, strengthened program design, and financial assistance on scale that promotes strong adjustment.

- There is scope to further refine the IMF's operations in these respects and generally strengthen ongoing initiatives to improve crisis prevention and resolution. In doing so, the potential demand on Fund resources will be greatly reduced. Priorities going forward include:

- Enhancing the role of transparency and better operationalizing prudent debt management policies in program design.

- Making concrete progress on the work program for private sector involvement. This involves moving forward with our work on the SDRM and clarifying access policy to reinforce the exceptional nature of extraordinary access to Fund resources.

- Overall, the Fund's financial position appears reasonably sound, especially when the generally prudent nature of the illustrative analysis is taken into account. It is important to bear in mind that the Fund can call upon its special borrowing arrangements to meet unexpectedly large financing spikes should they arise.

Assessing the adequacy of the Fund's resource base involves making informed judgments on the evolving character of the IMF and its operations in relation to ongoing developments in the world economy. This is an inherently difficult task and I generally welcome the forward-looking quantitative analysis put forth by the staff as further background. While the report does not provide any firm recommendations on the need for, or size of, an increase in the Fund's quota, it puts a heavy premium on prudence that is embedded in the analysis. I am concerned that this emphasis might too easily lead one to conclude that a quota increase is necessary. Overall, I am not convinced there is a clear need to further expand the Fund's resource base at this time in the review.

Conceptual Considerations

An underlying consideration of the quota issue is the financing role the Fund is to play in the international monetary system in the period ahead. The Fund's core responsibility is to promote international financial stability, but in recent years the IMF has embarked on a series of initiatives to better achieve this objective in the current international economic environment. As I noted at our last discussion, these initiatives are works in progress and any discussion of quotas must be consistent with the underlying objectives we are seeking to achieve.

In this respect, the report considers the case for additional Fund resources based on the greater size and volatility of capital flows and the potential for large financing spikes in financing commitments. It points to the decline in the size of the Fund in relation to traditional variables and financial aggregates, including private capital flows, and highlights the potential risk of weakening the credibility of the IMF's insurance function. But within a strengthened international financial architecture, the Fund's "insurance" to members will come increasingly from strong surveillance, sound policy advice, and financing on a scale that facilitates structural adjustment and policy implementation. This will enable countries to strengthen economic fundamentals and pave the way for relatively stable access to external and domestic financial markets. The notion that quotas and the Fund's resource base more generally need to reflect the potential financing needs of members should therefore not be overstated. This chair places a greater emphasis on making quotas more reflective of a country's position in the world economy, and I look forward to exploring this issue further in our quota formula discussion.

The evolution of the Fund's policies in recent years has a significant bearing on the quota discussion. On balance, expanded surveillance, increased transparency, and a stronger emphasis on prudent debt and reserve management, in conjunction with ongoing work to better manage international financial crises should help greatly reduce the demand on Fund resources. But there is considerable scope to refine IMF operations in these respects that will further offset the risk of potentially large spikes in financing commitments. The emphasis on crisis prevention should generally become better operationalized in program design, particularly as it relates to prudent debt management policies to insulate countries from volatility risks. Finally, transparency can play a greater role in strengthening crisis prevention and resolution, especially in precautionary or catalytic programs designed to restore market confidence. Success in this respect requires that market participants are up to date on the progress being made to strengthen economic fundamentals as well as being able to make informed judgments on the staff's analysis. Indeed, when the sustainability of a country's debt is at question, public disclosure of the IMF's debt sustainability analysis (DSA) at the outset might prevent a self-fulfilling prophecy.

In terms of the Fund's financing facilities and policies, the greater use of "exceptional circumstances clause" underscores the importance of developing robust arrangements for PSI and clarifying access criteria and procedures to reinforce the exceptional nature of extraordinary access to Fund resources. The former involves pressing forward with the work plan on the SDRM. On the latter, we would emphasize the importance of establishing a transparent set of procedures to determine exceptional access, which should include a rigorous DSA analysis based on a more standardized and robust analytical framework that holds up to public scrutiny.

Quantitative Considerations

New forward-looking measures are helpful in conceptualizing the potential liquidity risks, but caution should be exercised when interpreting results. Gross financing needs-based projections are relatively static in that they do not consider any change in policy, despite ongoing efforts to strengthen surveillance, improve conditionality, and enhance the role of the private sector in crisis prevention and resolution. Furthermore, as has been noted in previous discussions, the new forward capacity indicator is founded on prudential assumptions, including setting the minimum level of uncommitted resources at a relatively high SDR 40 billion. As this chair has argued in the past, a prudential floor of SDR 25 billion is likely to be sufficient and would paint a different picture in terms of the adequacy of the Fund's resource base within the context of the illustrative scenarios.

Finally, although illustrative demand scenarios provide a useful framework for assessing the impact of various developments on the Fund's liquidity, the analysis "builds in" a degree of prudence that introduces a pessimistic bias. Demand fluctuations are based on the experience of recent years, which overlooks the potential impact of the evolving crisis management paradigm and a more disciplined access policy. In this sense, the scenarios are only forward-looking in that they consider financing spikes associated with a potential increase in contingency arrangements. Furthermore, as Mr. Wijnholds notes in his statement, the reference periods chosen relate to among the most turbulent periods in IMF history, during which committed resources rose to unprecedented levels. Finally, the assumed scale of CCL commitments and drawings under these arrangements are relatively large based on experience to date.

In any event, the analysis illustrates that the Fund's resource base is generally adequate to accommodate a range of financing demands. This does not rule out the possibility that the demand for IMF resources may become acute in times of significant international financial turbulence. However, the IMF can call upon its special policies and borrowing arrangements, such as the NAB, to deal with unexpected financial crises as they arise.

Conclusion

To sum up, I agree on the importance of being forward-looking with regards the Fund's resource base, but it is necessary to make a realistic assessment of resource needs based on the financing role of the IMF going forward. On balance, the Fund's resource level appears strong—even when the recently announced large program for Brazil is taken into account, there is still considerable scope to make new financial commitments from the Fund's regular resources. With this in mind, and given the potential for ongoing IMF initiatives to greatly reduce the demand on resources, I remain of the view that it is premature to consider a quota increase at this juncture.

Mr. Rustomjee submitted the following statement:

Introduction and General Remarks

The staff have produced a series of very useful documents during the Twelfth Review of Quotas to facilitate discussions in this regard. This current, very focused paper is once again welcome. It takes this complex process further, this time to review whether the Fund's resource base is adequate to fulfill its mandated functions inter alia to contribute to international financial stability. The staff have provided many useful proposals in the paper, many of which we can support, which are aimed at ensuring that the Fund contributes to international financial stability.

As a consequence of successive financial and capital market crises in emerging economies in recent years, the Fund has in recent years expanded its surveillance of member countries and regions, including through FSAPs, in collaboration with the World Bank, the PSI Initiative, the ROSCs framework and the Capital Markets Consultative Group. The most recent initiative involves efforts to establish a Sovereign Debt Restructuring Mechanism.

All of these initiatives have been aimed at reducing the frequency and the extent of contagion associated with the financial and capital market crises in emerging market economies, in order to contribute to a more stable international financial environment. Notwithstanding these efforts, we note that financial and capital market crises in emerging economies continued to occur, and requests for access to Fund resources increased.

The critical question raised during the February 2002 discussion of the 12th Review on Quotas as to whether the Fund's resource base should be increased has not been resolved, and we welcome the further consideration of the issue today. Since the last Board discussion on the issue however, a positive growth outlook for major economies and emerging economies seem less certain, the financial environment in mature and emerging economies have generally deteriorated, and the Fund had to increase its efforts in supporting member countries in addressing financial crises or the contagion effects emanating from them. Furthermore, requests for increased access to Fund resources by member countries to forestall balance of payments problems over the medium term have increased. Our chair supported calls for further Fund financial support and in light of recent developments we continue to do so. The Fund's ability to fulfill its function, as promoter of global financial stability, will to a large extent be determined by the adequacy of its resource base, enabling the institution to provide members with legitimate requests for liquidity, in a timely manner.

Qualitative Considerations for an Expanded Resource Base

The Fund needs adequate resources to fulfill its mandate to promote global financial stability, by providing member countries facing balance of payments problems with financial resources. This responsibility has increased very significantly with increased globalization of capital markets, with many member countries having become more vulnerable and more exposed to financial crises as a result of the increased volatility of capital flows. The Fund's response to the more globalized financial environment, through enhanced financial sector surveillance, and increased emphasis on prudent debt and reserve management policies is appropriate. All of these efforts, which we have supported, have been helpful in contributing to the containment of financial and capital crises, without however eliminating them. Financial crises still prevail in a number of members, notwithstanding the Fund's engagement, and the risk of contagion cannot be excluded. Critical questions therefore arise as to whether the Fund's resource base is adequate to deal with these recurring crises.

Adequacy of the Fund's Resource Base vs. Moral Hazard

Many factors determine access to or the need for Fund resources, and influence the size of the Fund's resource base. These factors include: the level of the quota by member countries needing financing, the type of the facility to be used, the size of funding that the Board is prepared to provide to members, which can be in excess of 100 percent of quota, as well as provision for contingent financing for future balance of payments financing needs. As regards providing contingent financing, we support the bold and pro–active stance taken by the Fund Management in deciding to commit increased resources to Brazil under a new Stand-By Arrangement, subject to Board approval, to ensure balance of payments sustainability over the medium term. An environment of large and uncertain capital flows has increased the need for an expanded Fund resource base. We would continue to support the view that the Fund needs adequate resources to fulfill its obligations, and that the current mechanisms in projecting the size of the Fund's resource base, namely credit demand should be revisited in the context of the current environment of increased capital volatility.

On the issue of moral hazard we wonder whether moral hazard should be the overriding concern in the process of reviewing the adequacy of the Fund's resource base. Moral hazard can certainly pose a problem to Fund lending operations when funding is provided indiscriminately to member countries, or when resources are not used for the intended purposes. We are pleased to note that empirical research suggests little evidence of moral hazard since 1998. Moral hazard has also been reduced with the implementation of the Fund's safeguards policy and conditionality frameworks, and creditor moral hazard could be reduced by an early implementation of an SDRM, which we support. Finally, in view of the deterioration in the global financial environment, we concur with the staff's observation that the cost of providing additional resources to enhance the Fund's resource base would be less than the cost of failure to provide resources as a result of an inadequate resource base.

Quantitative Considerations for Increased Resources

(i) Traditional indicators. The staff paper contains compelling arguments, all of which we support, as to why the Fund's resource base should be increased during this review based on traditional indicators.

Firstly, the Fund's resource base traditionally stood at a level of 1.25 percent in relation to global GDP. This ratio has declined sharply since the 11th quota review to less than 1 percent of global GDP, and is projected to decline even further towards to 0.75 percent by 2004 in the absence of an increase of quota during this review. Secondly, the Fund's resource base in relation to the level of international transactions has declined to its lowest level during the Fund's history. Thirdly, despite the limitations highlighted by the staff regarding the concept of gross financing needs, gross financing needs have increased relative to the previous review period.

(ii) Capital flows. Capital flows to emerging economies increased since the 1970s. Nevertheless, these flows were also characterized by stops and reversals with recurring financial crises at various stages in various emerging economies. Such reversals have increased during the early 1990s and in 2000–01, and many large emerging economies have responded to these capital movements by increasing their gross reserve holdings significantly. In this regard, emerging economies have frequently sought IMF financing to bolster their reserves, a process that we envisage would continue, as long as financial crises continue to emerge.

(iii) Vulnerability Assessments. While the Fund's vulnerability indicators still need further development to improve their predictive value, we note that recent assessments indicate that a number of countries may face financial difficulty in the short term. Some countries may very well obtain the needed resources from private sector capital markets; others may have enough reserves, which could be used to avert the problem. In a few cases however, fresh resources from the Fund may well be sought. Expanding the Fund's resource base well ahead of such an occurrence may prove to be a prudent policy to be followed in the long run.

Next Steps

The proposed next steps of this paper, which constitute the preparation of the status report on the likely requirements for reforms of the quota formulas and basic votes for consideration by Governors at the Fall meeting, are appropriate and in order, and we propose that it should be strongly pursued.

Issues for Discussion

Implications of the evolving role of the Fund in Crises Prevention and Resolution and the Adequacy of the Fund's Resource Base

The Fund has clearly become increasingly involved in financial sector surveillance through various initiatives such as the FSAPs and ROSC modules. The Fund also initiated the PSI to enhance private sector involvement in the resolution of crises and is currently in the process of designing the SDRM framework with the cooperation of the private sector. The Fund is nevertheless mandated to enhance global financial stability, and the involvement of the private sector in the process is indeed appropriate. Recent experience in Turkey and Argentina suggest however that the private sector is less than willing to provide fresh resources to assist these member countries in crises. The Fund should as a cooperative institution be in a position to assist member countries in crises, provided that the countries involved are determined to make the necessary adjustments to correct the macroeconomic imbalances. Again, these cases underpin the need for an increase in the Fund's resource base.

Comments on Illustrative Scenarios

First Scenario

In our view, the first scenario is unlikely to prevail, since the condition of the world economy at present is not favorable, and the possibility of contagion cannot be excluded. The Fund's exposure is likely to increase within the next few years, as countries in crises seek additional resources. In our view, the inability of the Fund and the market to provide additional financing could lead to a further deepening as well as spreading of crises, as experience has shown.

Second Scenario

We concur with the view that demand for Fund financing, including demand for contingent resources under the CCL cannot be excluded within the next year. An activation of borrowing arrangements could also occur. Given the fact contagion could still take place, this scenario could emerge during the course of the next year.

Third Scenario

While a scenario of a spreading of crises is possible over the next two years, in our view this scenario seems less likely to emerge than the second scenario.

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

We thank the staff for a very helpful paper on the implications for the adequacy of the Fund's resource base of the current global environment, characterized by frequent financial crises in emerging market economies, large and volatile international capital flows, and a significant sensitivity of investor confidence to global, regional or local disturbances that may affect risk conditions in emerging markets. In the remainder of this statement we will elaborate on the issues for discussion proposed in section VI.C.

In response to the global conditions mentioned above, the Fund has further developed its surveillance operations and underscored the importance of macroeconomic stabilization and the implementation of prudential policies and regulations to strengthen financial markets, and of structural reforms to enhance growth potential. Most notably, as emphasized by the staff, the Fund must set out to ensure the availability of sufficient Fund financing for crisis prevention —including deterrence to speculative attacks through Contingent Credit Lines (CCLs); stand ready to provide resources for crisis resolution—particularly in view of the likelihood of contagion episodes in emerging markets; coordinate access to alternative sources of financing; and strengthen the revolving character of Fund resources. Given the nature of these objectives, which involve the need to anticipate demand for Fund credit before balance of payments crises actually occur, we agree that the traditional methods to calculate credit demand should be replaced by a forward–looking approach based on the current characteristics of the global environment. The exercise of forecasting financing requirements has become more difficult and uncertain, given the significant volatility prevailing in global capital markets. We agree with the staff that this has increased the "premium on prudence" in assessing the adequacy of the Fund's resource base given the asymmetry of costs. The costs from shortfalls of Fund resources have the potential to generate considerably greater costs for the world financial system than those that would arise from an "excessive" quota base.

In order to ensure the Fund's ability to provide contingent and precautionary arrangements, as well as financial assistance in the case of countries experiencing an external crisis, safeguarding the Fund's resources entails minimizing moral hazard. At the same time, we strongly agree that, given the conditions prevailing in international markets, the Fund is unlikely to fulfill its role of promoting growth and financial stability if it seeks to tackle moral hazard in its credit operations by limiting the overall size of its resources.

Program conditionality and the implied policy corrections are a significant counterbalance to moral hazard. Conditionality in Fund arrangements should be accurately defined; the use of sustainability assessments in Supplemental Reserve Facilities (SRFs) should be part of the framework; and there should be greater clarity in the specification of conditions for credit access in order to address moral hazard and ensure debt sustainability in member countries.

We can also associate ourselves with the view that Private Sector Involvement (PSI) should be considered as part of the overall strategy, including the design of the Sovereign Debt Restructuring Mechanism

(SDRM), to be used in the exceptional cases in which debt sustainability cannot be ensured through macroeconomic adjustment alone. We also support the promotion of the use of Collective Action Clauses (CACs) in sovereign debt arrangements, as an international standard of universal application to facilitate resolution in future cases of restructuring, while not acting as a stigma for those who incorporate them in their debt contracts. Additionally, in consideration of the impending risks stemming from the present financial instability, we concur with the staff's view that it would not be prudent—nor consistent with a forward–looking approach in the assessments of quota adequacy—to postpone decisions to enhance the Fund's resource base until all issues related with conditionality, access and PSI are settled.

The staff paper provides convincing arguments regarding the risks of not increasing the Fund's own resources sufficiently. The first one addresses the view that, since the Fund's contingent arrangements can be regarded as "insurance" against the spread of a financial crisis, they can be compared with the operations of insurance companies. While it can be argued that the insurance business is based on reliable probability assessments, Fund operations are faced with the intrinsic uncertainty and volatility of capital flows, for which there are no actuarial tables or well defined risks. It should be kept in mind that, in such a context, capital outflows and contagion could occur despite the emphasis on sound policies in contingent arrangements. Moreover, unlike an insurance company, the Fund does not have the ability to diversify risk or obtain additional resources on short notice. Additionally, preserving the Fund's cooperative character is intrinsically linked to its ability to maintain an adequate quota base in light of the changing demands and evolving circumstances of the world economy.

In addition to the above arguments, the quantifications in section III provide support to the need to come to a decision in connection with a quota increase in the context of the Twelfth General Review of Quotas. Even though an analysis in terms of traditional indicators would not be adequate to calculate the Fund's resources, we concur that useful conclusions can be drawn from the evolution of the size of the Fund relative to GDP, openness and reserves. Specifically, we see merit in underscoring that the size of the Fund has clearly decreased with respect to the main indicators of the world economy, and that in the absence of a quota adjustment such ratios would fall to historic lows, as shown in Table 1 of the staff report. It should be stressed that, due to the pace of globalization in the 1990s, international transactions—including trade, current payments and reserves—have become greater and more volatile, and consequently the size of the Fund relative to these measures declines more than in the case of GDP. Even though the usefulness of calculations based on traditional indicators is limited in the present context, the staff suggest nonetheless that the size of the Fund should be restored if it is to maintain its effectiveness in preventing and resolving financial crises. It is important to keep in mind the calculation presented in section III.C to illustrate the sensitivity of the demand of Fund resources to external crises: if a reduced group of countries with the highest probability of experiencing such problems were to obtain access to arrangements with 500 percent of their quotas, the result would be an additional SDR 20 billion in new commitments.

Following the forward–looking approach and taking into consideration the difficulty in forecasting the Fund's future commitments, staff provides illustrative future scenarios. Both the characteristics and assumptions used in the design of these scenarios seem plausible. Even though only scenario 2 results in a depletion of the Fund's Forward Commitment Capacity and the activation of the Fund's borrowing arrangements, the successive international crises that have occurred during the 1990s and the latest developments in the world financial markets lead to the conclusion that this possible outcome should also be provided for. At the same time, scenario 2 draws attention on the need to consider decisions regarding the arrangements to borrow. The fact that the borrowing capacity under such arrangements is limited to specific purposes and that the future demand for Fund resources is subject to substantial uncertainty, reinforce the main conclusion of the staff paper that reliance on owned resources in the form of quota subscriptions would be more consistent with the Fund's objectives. Finally, we support the staff's proposal to prepare a status report for the IMFC, which would include possible reforms of the quota formulas and basic votes.

Mr. Portugal and Mr. Tombini submitted the following statement:

Preserving the capacity of the Fund to fulfill its role depends on the ability to adapt its size to the new realities of the global economy, characterized by deepened economic integration in the areas of trade and finance, by greater volatility of international financial flows, and by increased synchronicity amongst member countries' economic cycles. Arriving at a consensus on a general increase of the aggregate quota is an important step to strengthen the new architecture of the international monetary system.

As pointed out by the staff, judgments regarding the resource adequacy of the Fund and a possible quota increase need to be made in a forward–looking manner. Likewise, we fully share the view that the costs associated with a possible shortfall or excess of Fund resources are sharply asymmetric as, on the one hand, "excessive resources" would imply only modest additional costs for creditor countries, whereas, on the other hand, the insufficiency of resources would likely have substantial detrimental repercussions on global prosperity.

The rapid growth of international transactions in goods and services and the increasing dependence on volatile international capital flows impose a progressively more important role for the Fund in providing financing to help prevent and overcome crises. Traditional indicators to assess adequacy of

Fund resources such as the liquidity ratio appear less useful today due to additional sources of demand. In this respect, the concept of Gross Financing Requirements (GFR) as a tool to gauge the necessity of adjusting Fund size may need to be complemented by other indicators. For instance, if we look at the recent sudden stop of capital flows to Brazil, we see the novelty of not only short–term flows being affected, but, more strikingly so, trade credit lines being significantly reduced. The use of the forward capacity in combination with the more traditional indicators seems more adequate as the former allows planning for the worse scenario even if it is not the most probable. The forward capacity concept makes a number of “prudent” assumptions; namely, that all scheduled purchases under already–approved arrangements are made, all repurchases are extended from the expectation to the obligation schedules, and that a minimum prudent level of uncommitted usable resources remains.

The more volatile financial environment and the need to respond to a sudden impairment of market access and meet financing requirements, all signal to a demand for additional resources. There is sufficient evidence in the report suggesting an increase in the size of the Fund, and of replenishing the resources of the institution in a forward–looking manner. In this respect, primary reliance should be given to Fund–owned resources and less to borrowed resources. The future demand for official support shall be increasingly met by Fund–owned resources to mitigate problems of governance and to preserve the cooperative nature of the Fund. Borrowed resources should remain as a back–up facility in case that cyclical circumstances require Fund resources beyond what is foreseeable with the new indicators.

We share the staff view that the analogy of Fund resource needs with those of insurance companies is overly simplistic and not applicable. The staff provides compelling arguments as to why our reality is more complex than that faced by insurers, including the Fund’s lack of flexibility to spread its risk (in the reinsurance market) and the limitations to borrow additional resources promptly. Thereby, as the staff underscore, the Fund’s resource base must be adequate to meet its contingent commitments in full to preserve its credibility.

Progress in defining a meaningful framework for private sector involvement and in the SDRM as well as on the discussion of access policy would not preclude the need for a larger Fund. The shrinking relative size of the Fund, and the under–representation of a number of fast–growing, emerging market economies, has required that financial support of the Fund become a large multiple of the member’s quota, and sometimes to be supported by bilateral official financing. Progress in designing a meaningful framework for private sector involvement would certainly be a useful complementary initiative to strengthen the crisis resolution tool kit, but not a substitute for a larger Fund. The significant lack of appetite of official bilateral creditors to participate in crisis resolution is a strong indication that the multilaterals will have to play a central role in members' financing, in spite of all the progress that can be achieved with PSI.

The empirical evidence on moral hazard stemming from large Fund packages is inconclusive, to say the least. The majority of the work done on this issue suggests that there is no statistically significant moral hazard related to Fund lending activities. For instance, the evidence of lower and more stable spreads of emerging market bonds after Fund financing (a commonly used indicator to suggest the presence of moral hazard) could be interpreted as Fund programs having reduced not only the likelihood of default events, but also reducing the probability and severity of sovereign crises themselves. We support the view that moral hazard should be mitigated by a series of initiatives including the proper design of Fund facilities, the streamlining of conditionality, and the improvement of crisis prevention tools, among others.

In case that the Twelfth General Review moves forward without agreement being reached on a new quota formula, this chair will insist on an essentially equiproportional increase in quotas. An eventual selective quota increase with the current quota formulas would aggravate the already existing distortions in the relative economic position of member countries.

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

Key Points

- The resource base of the Fund should be enlarged substantially in order for the Fund to respond to the expansion of the world economy and particularly the rapid increase in global capital flows.

- This chair agrees with the staff that it would not be prudent to delay the decisions on quotas until relevant issues such as PSI are resolved. A decision not to increase quotas at this time could result in impairing the credibility of the Fund. We must avoid any market disorder occurring on the assumption that the Fund would not be able to fulfil its responsibilities due to its inadequate resource base.

- The proposed new arrangement for Brazil will substantially reduce the forward commitment capacity of the Fund, and its liquidity position also could deteriorate as a result of further arrangements. We must proceed to more concrete discussion on a quota increase promptly.

- The next quota increase should be implemented so that the allocation of quotas would better reflect the reality of the current world economy.

We welcome the presentation by the staff of quantitative indicators that could be used to inform judgements regarding the adequacy of Fund resources, and possible scenarios of future demand for Fund resources.

As was pointed out at the previous Board meeting in February, this chair believes that the resource base of the Fund needs to be substantially larger in order for the Fund to respond appropriately to changing circumstances, i.e., the expansion of the world economy and particularly the rapid increase in global capital flows, and to fulfil its responsibilities to the international community.

According to the quantitative indicators presented by the staff this time, even traditional indicators, such as the ratios of actual quotas to global GDP and to calculated quotas, would fall to historically unprecedented levels in the absence of a quota increase. Moreover, we should take into account the significant changes in the world economy: that is, currency crises that developed during the 1990s have been capital account crises caused by large, sudden reversals of capital flows following financial globalization; and recent crises have tended to occur in more countries simultaneously because of contagion. In view of these facts, the need for a quota increase is obvious.

Recent examples of Fund financing arrangements—Turkey, Argentina, Uruguay, and Brazil—reflect the fact that the demand for Fund resources necessary for crisis resolution has become enormous and far exceeds past levels. The staff paper argues that access to Fund financing amounting to 500 percent of quota to only a few vulnerable countries could result in more than SDR 20 billion of new Fund commitments, but commitments that far exceed 500 percent have already been made to countries like Turkey and Uruguay. The Fund must be prepared for circumstances in which large scale financing becomes necessary, as shown in the second illustrative scenario in the staff paper.

Although the Fund has adapted its policies and practices to the changing world economy, its implications in assessing the adequacy of the Fund resource base are unclear and do not convince this chair that the need for a quota increase has been significantly reduced. First, Fund's facilities and policies have placed increased emphasis on crisis prevention and, as a result of sound economic management by members and the activation of precautionary arrangements by the Fund, the incidence of a crisis and contagion could be prevented effectively and the demand for Fund resources or the amount necessary could be reduced. However, it should also be noted that the strengthened contingent financing, in addition to the increase of the size and volatility of capital flows, has made it difficult to predict when and to what extent the demand for Fund resources could arise. Second, PSI is still under discussion and, as the staff rightly points out, it is difficult to make robust estimates of the likely impact of PSI on Fund financing.

At this stage there is an argument against a quota increase that the decision for an increase could have an adverse effect on the PSI discussion. However, this chair agrees with the staff that it would not be prudent to delay the decisions on quotas until relevant issues such as PSI are resolved. As mentioned above, the size of the Fund's resources has not kept up with the expansion of the world economy and the rapid increase in capital transactions. A decision not to increase quotas at this time could result in weakening the ability of the Fund to fulfil its important responsibilities, thereby impairing its credibility. The developments in the PSI initiative and reduced scale of Fund financing as a result are indeed desirable, but the cost that would arise if the Fund has an inadequate resource base while PSI is still being developed, would be far larger than that caused by moral hazard given a Fund with an excessive resource base. Moreover, we should note the fact that if the Fund has a sufficient resource base, that in itself would serve as a function of crisis prevention, and could bring about economic and financial stability at a low cost in the end. Put another way, we must avoid a situation in which, as stated in paragraph 15 of the staff paper, the markets move in a disorderly manner under the assumption that the Fund would not be able to fulfil its responsibilities due to its inadequate resource base.

This year, the Fund has already made additional commitments to Turkey and Uruguay. In addition, it is undertaking a new financial arrangement for Brazil in the amount of SDR 22.82 billion. As the staff argues in its supplement paper, this will be a large scale commitment, amounting to almost one third of uncommitted usable resources—SDR 79.9 billion as of June 2002. The financial position of the Fund could deteriorate rapidly if it committed further financial assistance to, say, Argentina, while the extension of repayments and augmentation could occur frequently if downside risks for the world and regional economy materialize, thereby impeding the progress of programs in crisis–hit countries.

Since the Mexican crisis in 1994, currency crises have occurred intermittently and the Fund has continued extending large–scale financial assistance both in terms of actual amount and in comparison with quotas. This is nothing less than clear evidence of the change in the global economy and of the inadequacy of the Fund's resource base. Lest the shortage of Fund resources should materialize, we need to proceed to a more concrete discussion for a quota increase promptly, together with that on policies for crisis prevention and resolution.

Finally, this chair should stress that it believes the next quota increase should be implemented so that the allocation of quotas will better reflect the reality of the current world economy.

Mr. Cippà submitted the following statement:

I thank the staff for providing us with a further paper on the Twelfth Review of Quotas. The staff, more or less, present the same factors that are considered to have an influence on the size of the Fund as they did in the last paper. Frankly, I was surprised by the staff's conclusion that there is a strong case for a quota increase. I do not consider such a conclusion compelling. As at the time of the seminar last February, I am still of the view that an increase in the Fund's resources is neither necessary nor desirable.

Declining values of the indicators that relate the size of the Fund to macroeconomic and financial measures have to be interpreted with caution. First, as shown by Mr. Wijnholds as well as by Ms. Lundsager and Mr. Baukol, outcomes can vary considerably depending on data presentation and aggregation. Second, such indicators simply reflect the continuously changing structure of the global economic and financial system. The capital account crises of the recent past have made it clear that an increasing provision of large credit packages by the Fund is not sustainable and can give the wrong incentives to both debtors and creditors. Countries that want to benefit from cross–border capital flows are well advised to ensure that conditions are in place that make them as resilient as possible to volatile financial markets. This has long been acknowledged both by management and the Board.

In my view, we should not aim at endowing the Fund with enough resources to deal with all the potential financing needs of its member countries. Instead, we should seek to address the causes of the increased demand for Fund credit and the increased volatility of capital flows. Indeed, the Fund is rightly investing considerable amount of work in crisis prevention and resolution. These efforts in areas such as surveillance, program and facilities design, PSI, and technical assistance are already slowly bearing fruit. While progress has not always been as fast as we would have hoped for, I remain convinced that these efforts will help to establish a more stable global financial system, with the corresponding dampening effect on the demand for Fund resources. I believe that we would do a disservice to our ongoing efforts to better involve the private sector in the prevention and resolution of financial crises if we endowed the Fund with additional resources at this time. This could reinforce the growing perception that the Fund is moving back to resolving financial crises with large provisions of public money, particularly in view of the proposals contained in the access paper, which impose only very soft constraints on access to Fund resources in cases of capital account crises.

The staff argue that the emphasis on contingent financing mechanisms will necessitate additional Fund resources. Based on the experience with the CCL, including the period after the adjustments made to increase its appeal, it is unclear if a demand for such a facility exists. Without pre–empting the upcoming CCL review, the future of this facility is not very certain, and I would not be unhappy if the existing sunset clause is not extended.

The staff stresses the asymmetry of costs associated with a potential shortfall or excess of Fund resources. This seems self-evident; but what one should reflect on carefully is for what and to what extent the Fund should mobilize its resources. I continue to see the Fund as a catalyst. I am convinced that the Fund can only credibly put across this message to other players in the global economic and financial system if its resource base is sufficient but not unnecessarily large.

Finally, I consider the current level of the Fund's forward commitment capacity to be sufficient. Instead of building up a larger commitment capacity based on the Fund's own resources, I think we should rely on the Fund's borrowing arrangement (GAB/NAB) for dealing with the possibility of a temporary lack of Fund resources. Notwithstanding the modalities of the borrowing arrangements, which restrict the use to cases involving threats to the international monetary system and include decision procedures, experience has shown that the arrangements are flexible and efficient.

Mr. Oyarzábal and Mr. Moreno submitted the following statement:

We thank staff for their insightful and balanced paper that provides a good basis for advancing our work on the 12th General Review of Quotas. The staff paper provides new information that in our view reinforces the position that we have held in the past in favor of strengthening the IMF resources through a general quota increase in the 12th review.

The staff paper provides an accurate overview of the major changes on the world economy and their implications to the Fund's operations and resources. The increasing uncertainties in the world economy call for a Fund's resource base replenished in a forward-looking manner in order to guarantee the institution's flexibility and capacity to react to unpredictable but latent crises. The larger frequency and magnitude of these crises since the mid-90s reveal the higher financial vulnerability and the need of higher financial resources to cope with them.

As established in our February meeting, other IMF policies such as PSI, SDRM, access limits, conditionality, surveillance or SRF are linked to the decision on the Fund's size. These policies condition from a qualitative point of view the need for Fund resources. Nevertheless, we understand that a decision on quota increase is meaningful in itself. Prudence recommends an increase in quotas without necessarily waiting for the outcome in these policies, particularly considering that it is still too soon to judge their effectiveness in rationalizing the use of Fund resources.

Furthermore, we do not view these policies as substitutes to fund financing, but rather as a complement that enrich the crises prevention financial facilities of the Fund. Regardless of the outcome of these policies, the Fund will have to play a leading role where official support is critical to restore market access. In this respect, recent experiences show that the magnitude of capital account crises requires combined efforts from private and official sectors.

From a quantitative point of view, the staff paper gives meaningful data on the loss of the IMF's relative weight, both according to the traditional indicators (GDP, trade, current payments, and reserves) and indicators on capital flows. Additionally, provided that the new package of Brazil is approved, the liquidity ratio of the Fund would fall below 70 percent. This ratio has usually been above 100 percent in the last decade, except in 97 and 98 when GAB-NAB were transitorily activated.

This weight loss undermines the Fund's ability to guarantee financial assistance to its member countries, and its flexibility and autonomy to respond to crises. Even though we recognize that GAB-NAB agreements provide a useful safeguard in case of liquidity needs, they are not designed to substitute the Fund's own resources and they should only be used in extraordinary circumstances and for a short period of time.

We do not think that an increase in the Fund's resources would entail moral hazard problems. We consider that, if anything, it is a risk more related to the rules and conditions of the Fund's lending facilities than to the availability of sufficient resources. Therefore, moral hazard is an issue that should rather be dealt with policies such as conditionality or PSI and SDRM initiatives. In this respect, we believe that by the refinement of conditionality the Fund has successfully reduced the margin for advantageous behavior of debtors and creditors. Furthermore, as the staff points out, there is little evidence of moral hazard related to Fund financing after 1998.

Regarding the three baseline scenarios proposed in the paper, we think that they are plausible and we would even not rule out more pessimistic situations given the current turmoil of the world economy and the uncertainties about a war.

Finally, we support the staff's proposed agenda to present a status report to the IMFC on quotas. Like other directors, we think that the report should be submitted to the Board before it is sent to the IMFC. We understand that a central issue regarding quotas is the question of out-of-lineness of a selective group of countries, which in our view undermine the legitimacy of the Institution. It is a long-standing position of this chair that this issue needs to be promptly addressed by starting a process of selective quota increase, irrespectively that out-of-line countries could also receive a specific treatment during the next general quota increase.

Mr. Al–Turki submitted the following statement:

I thank the staff for the concise and helpful sequel to the paper discussed last February regarding the Twelfth General Review of Quotas. During that presentation and again in the June discussion of Alternative Quota Formulas, I have already expressed my views on the key issues. I will therefore limit myself to a few brief remarks mainly focused on the issues for discussion.

First, the staff's quantified scenarios provide a useful reality check for the extensive discussions on whether a further rise in quotas is required after the large increase in 1998 under the Eleventh General Review. While judgments can differ, the evidence in the staff report lacks any convincing basis for any quota increase at present. Indeed, the Forward Commitment Capacity (FCC) under the Fund's General Resources Account (GRA) remains comfortable even after this year's record arrangements.

Second, notwithstanding the drop since June 2002, Fund liquidity remains hefty by past standards. Besides, the FCC is effectively underestimated in view of the conservative assumptions underlying the staff's nominal estimate. Specifically, the staff projections likely overstate the actual drawings on Fund resources. Moreover, the amount that is set aside as a prudential minimum requirement of uncommitted usable reserves is too conservative. I also share Mr. Wijnholds' reservations about incorporation of commitments under the still unused CCL.

Third, regarding the staff's claim that the Fund quotas have declined relative to the size of the world economy, I would be interested in the staff's response to the contrary view presented by Mr. Wijnholds, and by Ms. Lundsager and Mr. Baukol. That said, as I have stressed in the past, I see no necessary link between the Fund's resource base and the size of the world economy and financials flows. Indeed, any expectation of a rising use of GRA resources in line with GDP or financial flows is counterintuitive in view of the Fund's increased focus on crisis prevention and resolution as well as prudent management of debts and reserves. With increased global integration, countries also have a greatly increased access to the financial markets including through foreign direct investment. Moreover, as Ms. Lundsager and Mr. Baukol rightly note, the effective shortening of Fund maturities should allow Fund resources to revolve more quickly.

Fourth, a strong private sector involvement (PSI), including progress toward sovereign debt restructuring, should also reduce the need for Fund financing and help address moral hazard concerns. In addition, I share the view that prospects for large–scale Fund financing should be limited to truly exceptional circumstances. Such a limitation on availability of Fund financing is clearly critical to help promote timely and effective PSI.

> Finally, in cases of systemic importance, the Fund can trigger supplementary financing under the New Arrangements to Borrow (NAB) and the General Arrangements to Borrow (GAB). Here, while I agree that the Fund should continue as a quota–based institution, it is important to stress that the GAB and the NAB provide a cushion to the Fund's resource base in case of an unexpected need.
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> To conclude, I support keeping the Fund's size unchanged under the Twelfth General Review of Quotas. On reporting to the IMFC, I share the views expressed by Mr. Wijnholds.

Mr. Wijnholds stated that he had not gladly come to the conclusion that the case for increasing the size of the Fund at this moment had not been convincingly made. Further, his conclusion should not be associated with any doubt as to the central role the Fund had to play in the international monetary system. Having said that, it would not serve the integrity of the Fund to push for enlargement at a moment when the evidence to justify doing so was not clear, and when the Fund's liquidity situation remained comfortable. Numerous Directors, along with the staff, had made the point about the strain placed upon the Fund given the pending large credit to Brazil of US$30 billion. Yet it was important to note that on a net basis only 60 percent of that amount would obtain.

There were also a number of important issues touching on the role of the Fund that still remained unresolved, including PSI/SDRM and access policy, Mr. Wijnholds continued. As long as a modicum of progress was being made in those areas, pushing ahead with a quota increase in isolation was not a good idea. Further, it was important to keep in mind that the political climate in quite a few countries was not favorable to increasing financial commitments to the Fund at the present juncture.

On the discrepancy between what was shown in the graph included in his chair's statement and that of the staff's calculations on the size of the Fund in relation to world GDP, there was no need to engage in a methodological discussion, Mr. Wijnholds remarked. Nonetheless, it was important to note that different methods could lead to different outcomes, and that strong statements—especially to the outside world—that the size of the Fund was declining in relation to the size of the world economy should be avoided. The evidence supporting such a statement could be challenged on the basis of varying methodologies, and the risk that an unfavorable, or at least unpredictable, reaction might be received was high.

Mr. Portugal disagreed with Mr. Wijnholds, stating that the staff paper presented a convincing case that the size of the Fund had been shrinking in relation to several variables, including global output, trade, external payments, reserves, and capital flows. It was not clear that if different methodologies were used from that of the staff's that different conclusions would be arrived at with regard to all of those variables, and the shrinking of the size of the Fund in relation to all of those variables was worthy of notice. Further, the scenarios presented by the staff were within the realm of experience of the past few years, and gave credence to the possibility that a situation could arise where the forward commitment capacity of the Fund's resources could be jeopardized.

It was clear that the Board remained divided on the issue of an increase in quotas, and it was also true, as Mr. Wijnholds had stated, that there was not too much in the way of political appetite to address the issue at the present time, Mr. Portugal said. Given the situation, it should be considered that the issue be elevated for discussion during the Fall IMFC meetings. It seemed the staff had suggested the same in paragraph 39 of the paper, where it said that the paper should be considered by Ministers during the Fall meetings. The deadline to complete the review was January 30, 2003, and it would be fortunate—especially after all the discussion that had taken place on the issue—to have a discussion at the political level.

Mr. Cippà reiterated Mr. Wijnholds's point that although his chair was not ready at the present time to increase the size of the Fund's resources, it in no way meant that the Fund did not have a crucial role to play in the world economy.

The Chairman replied to Mr. Wijnholds that it might not be an appropriate time to ask for an increase in quota. What was of concern were statements that it was not a favorable time to discuss the issues involved. The world economy was in a fragile state, and the Fund needed to demonstrate that there were institutions, instruments, and commitment to promote cooperation and to be able to counteract adverse developments. The financial capacity of the Fund was not the crucial issue; what was critical was the debate about globalization. The world needed to be aware that further integration in world markets was good for growth, for less poverty, and for more peace in the world, and the Fund needed to take a position to promote that understanding.

It was important to look beyond the question of whether it was right or wrong to increase the Fund's quota, and important to have a medium to long-term perspective, the Chairman stated. The Fund should not shy away from having an open, forward-looking, and proactive discussion about the future role of the Fund. In that context, the size of the Fund as an item for discussion was a legitimate issue. Mr. Wijnholds was correct that there were pending issues such as PSI/SDRM, access policy, and voting rights. But the way forward on those issues was on a consensual basis based within a wider context of what the future role of the Fund should be.

The question to be asked was whether growth in the world economy should be based on further integration, the Chairman stated. If so, the Fund had to be open to a political discussion of what was needed to arrive at a consensus that would foster such an approach. Nothing should be presumed, and, in the short run, too much energy and ambition should not be spent on the question and its answer. Having said that, Directors should encourage their Governors to think in advance on the subject and to raise their voice at the Fall IMFC meetings.

Mr. Wijnholds agreed that it was crucial to discuss the role of the Fund, but that the role could be looked at from two sides. It was one thing to say that the size of the Fund should not be viewed in isolation apart from the role the Fund should play in the global economy. It was another thing to say that the size of the Fund should not be hampered by the current understanding that it was the lender of last resort. It the latter approach was chosen, that in itself had implications for the size of the Fund. It was not the case that those who see the present climate as unfavorable to an increase in the size of the Fund were only looking at the short term. The medium term had certainly been taken into consideration, but in the context of thinking of the Fund as not being the lender of last resort.

Ms. Lundsager assured the Chairman that her chair along with others had considered the wider role of the Fund within the global economy. Mr. Cippà had made the point of how central the Fund was to what had been started several years ago with regard to PSI/SDRM, transparency, standards and codes, and conditionality. The size of the Fund's quota was but one part of a much bigger picture.

The Fund had a power going far beyond its numerical size and far beyond its power to adequately lend to any country or every country that found itself in trouble, Ms. Lundsager continued. The Fund's role was to help countries put the right policies in place, while bringing together all other pieces necessary to achieve a combination of financing and policy adjustment. For example, the Fund's crisis prevention efforts in recent months had helped countries avoid the effects of contagion—countries which had distinguished themselves by taking those actions which actually protected them. The Fund should take credit for helping countries get to that point, even if that help occurred through instruments outside the context of programs.

The issue at hand was that of the size of the Fund's quota, Ms. Lundsager noted. Nonetheless, it was clear that the role and influence of the Fund went far beyond the size of its resources. The Fund would remain at the center of the international monetary system, regardless of its size. It was the primary institution that was looked to for help, not only financially, but also for policy guidance, surveillance, and research. The Fund sent a powerful message, and it was in that context in which her chair and that of others approached the issue of the size of the Fund, as opposed to approaching the issue in isolation.

Mr. Portugal agreed with Ms. Lundsager that the issue of the Fund's quota had to be seen in the context of many other issues. Since the Asian crisis in 1997, substantial progress had been achieved on a number of initiatives—initiatives for countries to implement on their own domestic national fronts—including standards and codes, and strengthening of the financial sector and the FSAP program, to name a few. Yet one initiative on which no progress had been made was that of quotas. It should be remembered that in 1997, the predecessor of the IMFC, the Interim Committee, included in its communiqué that formulas used to establish quotas should be revised promptly. Thus, there seemed to be a lag in progress on some aspects of the big picture. Perhaps it was now time to raise the profile of the issue.

The Chairman clarified to Mr. Portugal that the context in which the issue of quotas should be approached very much included the issue of the SDRM.

Mr. Chatah stated that the issue of the size of the Fund in terms of financial resources should not be viewed in terms of trade-offs with other aspects of the Fund's role in the global economy. Once the issue of quotas and other issues were thought of as trade-offs—meaning the Fund should either have more resources or the Fund should concentrate on other aspects—the issue of quotas became distorted. In our mind, all issues under consideration were critical elements of the Fund's role, and there was a place for discussion of the size of the financial resources of the Fund. In that sense, Ms. Lundsager and others were correct that the other elements of the Fund were very important—maybe even more important than the financial size of the Fund. Nonetheless, the size of the Fund was important too.

In the past, his chair had taken an open mind on the issue of quotas, in particular because of the multi-dimensional difficulty surrounding it, Mr. Chatah continued. As of late, his chair had become increasingly convinced that there was a powerful argument to be prudent with Fund resources. The burden of proof should be to show that, indeed, the indicators related by the staff were wrong and that the Fund could do without larger resources. The Fund was not like other institutions that had contributions, where being prudent meant retrenchment. For the Fund, prudence meant that given plausible assumptions, a problem could arise that needed to be addressed ahead of time. His chair needed to be convinced that the Fund could do without an increase in quota, meaning that problems might not arise, and that case had not been made by those who had argued against a quota increase.

The Chairman stated that what was important was the Fund's credibility in the context of the global economy, which meant that a number of items had to addressed step by step including quotas, access policy, voting shares, and the SDRM.

The Treasurer (Mr. Brau), in response to questions and comments from Executive Directors, made the following statement:

> The discussion at hand should not be about the status of current liquidity and whether it is adequate for the immediate future, but whether the Fund's liquidity position is adequate for the medium term. Nonetheless, to make sure all have the same numbers in mind concerning the status of current liquidity, I will give a brief summary. The forward commitment capacity on the assumptions that the staff has employed and which are outlined in the paper has dropped or will drop as a result of the pending arrangement for Brazil from SDR 56 billion to SDR 40 billion, or from US$75 billion to US$53 billion. Everyone agrees that use of the GAB and NAB is a temporary last resort for extreme situations in the amount of SDR 34 billion, equivalent to roughly US$45 billion.
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> The traditional liquidity ratio that has been used in the past (and that the staff would like to phase out) shows that as of September 10 the liquidity ratio will drop to roughly 80 percent from well over the 100 percent it has been since 1999 after the last quota increase. During the 1990s, there were only five calendar quarters when the liquidity ratio was below 80 percent. Thus, what is being said is that, in particular because of the pending arrangement for Brazil, there is a significant decline in liquidity, but this is not an immediately alarming situation.

As an aside, in her statement Ms. Lundsager mentions that the Fund has a current forward commitment capacity of US$100 billion. I would caution against using that number because it gives an exaggerated impression of what is available. In particular, if the number of US$100 billion is used, there is no allowance whatsoever for a prudential minimum liquidity balance, which would not be appropriate.

As regards the medium–term adequacy of existing quota resources, the staff has analyzed this from different angles. We have looked at the traditional indicators that have been used in past exercises, and which are based on the variables of the existing quota formulas. We have looked at the variability of capital flows and, in particular, the incidence of reversals of capital flows in relation to GDP; we have looked at what could reasonably be said in terms of the conclusions that can be drawn from the ongoing vulnerability assessments that the staff is conducting; and we have looked at illustrative scenarios of demand for Fund resources.

Mr. Wijnholds among others questioned the ratio of aggregate quotas to GDP, and whether the staff had not been overly pessimistic in designing the illustrative scenarios. On the ratio of total quotas to GDP, the staff does not disagree with Mr. Wijnholds's basic position. In paragraph 19 of the staff paper, the staff state that because of the last quota increase, the ratio of total quotas to the GDP of members of the Fund has been remarkably stable, but in the absence of a quota increase in this review there would be a significant drop in that ratio going forward. Mr. Wijnholds's chart makes the same point using different methodologies. The staff used the GDP of members, which at present amounts to world GDP for all intents and purposes. The second related concern is whether the staff used global GDP estimates at a point in time or for every single year. The staff were using the methodology that the Board has endorsed and that has been used in every quota review up until the present. The message remains: the ratio of total quotas to GDP has stayed remarkably constant through 1999 review, and would drop significantly if there were no quota increase in the present review.

On the illustrative scenarios of demand for Fund resources, Mr. Bennett and Mr. Wijnholds seem to think that one of the scenarios is too pessimistic because it is based on the total commitments made by the Fund during the Asian and Russian crises. A powerful counter–argument to that would be that, at the time, there were large parallel financing packages for Korea, Thailand, and Indonesia, which have not been replicated in subsequent capital account crisis cases where the Fund has provided a greater share of financing. If it is assumed that the past might is replicated, allowances should normally be made for that. The amount of commitments that were included in the scenario is SDR 66 billion; if the size of the parallel official packages had been taken into account, the commitment would be significantly higher than SDR 66 billion. The staff did not make an allowance for those packages because it would have entailed assumptions about policy reactions in the future which would be speculative. The key message from the scenarios is that if there were Fund commitments of the order that occurred during the Asian and Russian crises of SDR 66 billion, the key to the Fund's ability to provide adequate financing would come down to timing. If the demand were to be spread out over a two-year period, adequate financing would be available. If demand were to occur bunched together within a short period of time, adequate financing would not be available.

The other issue important for whether there is pessimism or optimism looking forward is related to the influence of the ongoing discussions and decisions yet to be made concerning PSI/SDRM, access, and other issues. The question has to be whether the scenarios would be significantly altered if decisions on these issues which are related to quotas were in place. There seem to be varying views in the statements from Directors on this question. The staff, or at least the Treasurer's Department, does not have a specific view because it is not our role to do so, except to hope that all good things will come from decisions taken on crisis prevention, PSI/SDRM, and so forth. But as a matter of financial planning, it is quite reasonable to assume a gradual—as opposed to a large and immediate—reduction in the frequency and size of the use of Fund resources resulting from decisions taken on those issues. In this manner, the staff is again attaching a premium to prudence.

With regard to the use of Fund resources in the last seven years, if anything stands out, it is the number of surprises as to which countries requested use of Fund resources and the size of the requests. It does not seem unreasonable to think that, looking ahead over a five–year period, one should be ready for more surprises. Thus, to sum up in our view, it would not be fair to say that the scenarios embody a particular bias of pessimism.

Mr. Wijnholds responded to Mr. Brau that the decline in the staff's graph on the ratio of the size of the Fund to global GDP was much sharper than that in his own graph, and so there was at least a difference of degree. In any case, it did not seem the staff was really using global GDP, and language to the effect that the size of the Fund was declining relative to global GDP should not be included in the summing up.

On pessimism in the scenarios, although it was important to look at the potential quantitative effect on the use of Fund resources of decisions taken on PSI/SDRM and access, there were also potential qualitative effects, Mr. Wijnholds continued. Although those effects were not appropriately within the purview of the Treasurer's Department, there were of concern to the Board.

Ms. Lundsager mentioned that in the graphics on page 9 of the staff report on the ratio of the size of the Fund to GDP, the last column was based on GDP going forward, whereas all the previous columns were related to the past. If the last column were done in the same fashion as the previous column (which could not be done as of yet) the ratio would not go down to 0.78 percent; it would be between 0.95 and 0.78 percent. There were many different ways of looking at the data, and Mr. Wijnholds way seemed more plausible.

On the most pessimistic scenario presented in the staff paper, the Fund might use up its forward capacity, but still would not arrive at the point where the GAB and the NAB would have to be drawn upon, Ms. Lundsager stated. Further, her chair had not agreed to what was an overly conservative US$50 billion of untouchable resources. A comfortable prudential position could be maintained in the US$30, 35 to 40 billion range.

Mr. Yagi remarked that the ratio of the size of the Fund to GDP was important, but that the size of capital flows were also important. Thus, too much emphasis should not be placed on what methodology was used to determine the size of the Fund to GDP. On the large official financing packages delivered to Korea, Thailand and Indonesia mentioned by Mr. Brau, at the time of the crisis, only Japan extended more than US$50 billion of funds to those countries in a short period of time. Given the present state of the Japanese economy, if something similar were to happen again, it was not clear where financing would come from. The Board needed to consider what the size of the Fund would in five years' time; it was important to maintain a medium-term perspective.

Mr. Andersen made the following statement:

> I thank the staff for a useful paper in our important work to assess the need for an overall increase of quotas considering developments in the world economy including increased globalization, which should be supported for many reasons to which you just referred, Mr. Chairman.
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> While agreeing that the Fund must be forward looking in its financial planning to help resolve financial crisis, we would prefer more emphasis on work in other areas with regard to the role of the Fund before making a conclusive assessment of the appropriate size of the Fund and, let me add, work that hopefully should effectively reduce the need for large financial packages.
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> I concur with Ms. Lundsager and Mr. Baukol that the Fund should further strengthen its central role by focusing on the quality of its assistance and thereby enhancing its catalytic role. In this respect, continued efforts focusing on improving the quality of our crisis prevention and crisis resolution framework, will be of essence. I emphasized the word "continued" as this will be an ongoing challenge, and although progress may occur gradually, I would think that that there is a significant potential, which should be explored. Sound macroeconomic policies and good governance in each member country, effective risk management and effective Fund surveillance should significantly reduce the risk of crises. In this regard, I look forward to strengthened sustainability analyses and vulnerability assessments, based on realistic and transparent assumptions, a sufficiently long time horizon, and including comprehensive stress tests. In crisis resolution, vigorous work on

PSI, including SDRM, should continue in order to give right incentives and limiting moral hazard. I would also like to emphasize the importance of targeted and transparent measures related to access to Fund resources and PSI, and Mr. Wijnholds just alluded to the importance of making progress in these areas. Last but not least, the responsibility of members for putting their own houses in order through sustained stability–oriented policies should not be forgotten.

At the same time we should take into account that the international community is increasingly looking to the Fund to take the lead in providing the official component in resolving balance of payments problems rather than providing bilateral assistance. The world economic outlook has deteriorated since last spring and there may be large financing packages on the horizon. The illustrative scenarios demonstrate that even if the Fund's liquidity position is adequate, substantial pressure could be put on the Fund's resources, in a situation of several severe and largely simultaneous financial crises. While the Fund's size has diminished relative to the most traditional indicators, I do, however, concur with Mr. Padoan and Mr. Bossone that the size of the Fund relative to global GDP may not be a particularly good measure for assessing the adequacy of Fund resources. Furthermore, it is not straightforward that the size of the Fund relative to GDP has fallen significantly. Quotas relative to global GDP appear to be relatively constant as shown by Mr. Wijnholds and the size of the Fund relative to the GDP of the most likely borrowers is indeed quite high as indicated by Ms. Lundsager and Mr. Baukol.

Moreover, although we should bear in mind that the direct financial costs to creditor members of an increase in quotas are small compared to the inconveniences and loss of confidence that would result from undue stress on Fund resources as referred to by a number of my colleagues, I concur with Mr. Cippà's emphasis on the importance of the Fund's catalytic role and that this should be underpinned by a resource base which is sufficient but not unnecessarily large, as this should help limiting the risk of moral hazard. Moreover, I want to reiterate our view that the Fund should not perform the role of a lender of last resort.

In sum, I think it is premature to conclude that a quota increase is warranted at this stage and would emphasize the need for more and vigorous work in various areas in relation to crisis prevention and the crisis resolution framework, including on PSI and access limits. Finally, I can support publication of the report and a PIN, after proper revisions are made to take into account the many important points made during the discussion.

Mr. Wei made the following statement:

We thank the staff for their clear and comprehensive report, which provides a sound foundation for our further discussions on the Twelfth General Review of Quotas.

We generally agree with the thrust of the report and would like to emphasize that both the current demand and supply of Fund resources fully justify a quota increase in this round of the review.

On the demand side, the increasing external vulnerability of member countries with expanding globalization and financial market integration, together with changes in the Fund's lending policies and instruments—SRF and CCL in particular—amplifies the potential demand for Fund resources. This was vividly reflected in the considerable borrowing requests during the Asian crisis and during the recent economic financial turmoil in some Latin American countries. The share of Fund resources in the gross financing needs of past users has surged in the past ten years (Table 2). In addition, the most recent agreement on the US$30 billion Stand–By Arrangement with Brazil registered a new record in the demand for exceptional resources from the Fund. The enormous financing provided to Brazil and the possible program for Argentina, which I hope will materialize soon, will substantially affect the Fund's financial position as pointed out in Mr. Yagi's and other's statements.

On the supply side, based on the staff's comprehensive calculation, it is clear that the Fund's current quota size in terms of traditional indicators has declined to its lowest level in nearly 30 years. At the same time, the unfavorable capital flow outlook for emerging market and developing economies and the increased vulnerability of a significant number of members in the near future call to the Fund to build up sufficient usable resources as a buffer to adverse developments. However, the Fund's liquidity has been falling since 2000, including the most recent Stand-By Arrangement to Brazil (Table 4 in Supplement 1) as I mentioned earlier. Moreover, one of the staff's illustrative scenarios on the Fund's forward Commitment Capacity cautions us on the one-year crisis scenario which is quite likely to exhaust the Fund's resources.

We agree with others that while we have witnessed the international community's many achievements and continuous efforts in crisis prevention and resolution—factors which help alleviate the demand for the Fund's resources—such as the Fund's strengthened bilateral and multilateral surveillance and better tailoring its programs to crisis countries, the implementation of international standards and codes in member countries and setting up framework for private sector involvement (including the SDRM under discussion), it is still very difficult to measure how much the above–mentioned positive elements can reduce the demand. What is more, from the point of view of the most recent crisis cases, the Fund's financial commitments have not decreased because of these favorable developments, but rather have been augmented because of the size of the economies involved or the degree of the contagion effect.

Therefore, after considering the supply and demand for Fund resources together with the above mentioned uncertainties and taking a more forward looking and prudent approach in reviewing the quota issue, we would like to stress that a quota increase in this round of review is well justified. As the staff clearly elaborates, given the asymmetric consequences in a possible shortfall and an excess of Fund resources, we need to make every effort to avoid a shortfall. In this regard, we share the views of Mr. Reddy and Mr. Portugal that the so-called excessive resources would imply only modest additional costs for creditor countries, while the insufficiency of resources would likely have substantial detrimental repercussions for global prosperity. Meanwhile, we would also like to draw attention to the inappropriate quota distribution across member countries—especially in the developing country and the Asian country groups—in the context of a rapidly changing world. Accordingly, we should solve this issue in the ongoing review through revising quota formula and appropriately increasing their quotas.

In conclusion, we agree on publication of this paper to encourage more discussion on this issue and on presenting a status report to the forthcoming IMFC on our discussions of the size and distribution of Fund quotas.

Mr. Boitreaud made the following statement:

We thank the staff for providing the Board with additional information to make a fair judgment on the optimal size of Fund. This chair has already expressed its openness to the argumentation in favor of a general increase of quota, and this interesting contribution has not dramatically changed our stance. In fact, the Board has been provided over the last month with a fair amount of information, indicators, reports, assessments, and other papers to help us reach a decision on what should be the optimal size of the Fund. No matter how well informed we are, this decision remains largely a matter of judgment on how to strike a fair balance between many convincing and robust arguments. Like previous reports, the very instructive document we are examining today presents pro and con arguments for a new quota increase.

Turning to these arguments, the growing interdependence between economies, coupled with the increasing volume and volatility of cross border capital transactions, remains a serious argument in favor of an increase. True, the point made by Mr. Wijnholds in his statement on the size of the Fund relative to world GDP is well-taken. But beyond GDP, we have to take into account the significant changes in the world economy, as recalled by Mr. Yagi, including the emergence in the 1990s of capital account crises gauged by a large and sudden reversal of capital flows following financial globalization.

In that regard, the lack of progress of our discussions on a possible new SDR allocation does not contribute to open alternative venues to quota. Furthermore, recent experience has taught us that we should remain cautious in assessing the positive effects of an effective implementation of our policy decisions, on the shortening of the Fund's maturities, and on the use of repurchase expectations. On the contrary, the recent transformation of the SRF into the Stand-By Arrangement does not bode well for the revolving nature of the Fund's resources. Like Mr. Shaalan, we believe that longer repayment schedules may have to be taken into account into any calculation of the Fund's base.

Finally, several chairs have rightly pointed to the overly pessimistic assumptions about the level of demand for Fund resources under the second scenario presented by the staff. However, we would like to express a word of caution. The financial crises in the second half of the 1990s happened in the context of robust global growth, and this positive context probably reduced the effects and the duration of these crises. Even if one can argue that contagion mechanisms have significantly decreased since the Asian and Russian crises, we should not underestimate the effects of several crises happening in the future in the context of sluggish growth in the global economy.

Therefore, we tend to look at the second scenario as rather relevant in a "worst–case" perspective. In fact, the publication of the staff's supplement paper demonstrates how rapidly the financial position of the Fund can deteriorate. A large scale intervention for a single country has reduced the one -year forward capacity to less than SDR 40 billion from 56 billion, as Mr. Brau recalled. As stated by Mr. Yagi and Mr. Miyoshi, the prospect of additional financial assistance in Latin America or elsewhere should certainly not be excluded at this stage and, therefore, the risk of substantial further deterioration of the Fund's financial position is high.

Having said that, against a general increase of quotas, one could underline that SDR 34 billion are available under the GAB/NAB and can be drawn upon very rapidly in the event of a major crisis. These arrangements have proven their usefulness and effectiveness in the past, and they should certainly not be discarded. Another argument against an increase relates to the assumed scale of CCL commitments and drawings under the three scenarios. The assumption of use of the CCL seems ambitious in light of recent experience with the CCL. But Mr. Shaalan's statement rightly reminds us that there has been a visible increase in the number and the volume of precautionary arrangements over the last years, and these arrangements should be sufficiently funded to be activated, if necessary.

A strong argument against a general quota increase deals with the lack of robust estimates of the likely impact of PSI/SDRM on Fund financing. It is indeed difficult to determine the optimal size of the Fund at the moment that we are working on major changes in the modalities of the Fund's interventions involving PSI/SDRM, surveillance, access policy, and transparency. However, as underlined by Mr. Padoan and Mr. Bossone in their statement, improvements in all these areas will probably be gradual and marginal even if, as we would hope for, an effective sovereign debt restructuring mechanism could be established over the next years.

On balance, the arguments in favor of an increase remain relatively more convincing. There is, however, one definitive argument against. Reading the statements and hearing Directors today, it appears that such an increase is not supported by the required 85 percent majority, or maybe by any majority. In this context, as stated by Mr. Andersen, we should concentrate on developing robust arrangements for PSI and pressing forward with a work plan on the SDRM so that we could elaborate as soon as possible a fair estimate of the impact of our new policies before revisiting the issue of the relevance of a general quota increase. If the outcome of this work confirms the need for a larger Fund, then we should not wait for the next general quota review, but call for an exceptional increase to maintain and improve our capacity to prevent crises and smoothen their effects. Meanwhile, any discussion on the role of the Fund, notably at the political level, should certainly cover the issue of quotas, among others.

Mr. Bischofberger made the following statement:

We thank the staff for a comprehensive and interesting paper. The additional information and the main underlying assumptions provided in the staff paper could, however, not convince me of the need for a general quota increase at this point in time. In this respect, my views are very similar to those expressed in some of the statements issued for today's discussion, including the statements of Mr. Wijnholds, Ms. Lundsager, Mr. Bennett, Mr. Cippà and Mr. Al–Turki.

Clearly, the Fund as the central monetary institution for the world economy must have adequate financial resources at hand to fulfill its important responsibilities to the international financial system. In our judgment, this is currently the case. For reasons, I will refer to in a minute, we think that the Fund's resources appear to be sufficient, even when the recently announced large program for Brazil is taken into account. Furthermore, there is still considerable scope to make new financial commitments from the Fund's regular resources. We, therefore, concur with those Directors who point out that we should not strive for a bigger Fund in the first place, but for a better Fund, focused on effective surveillance and high quality programs that catalyze private sector flows and promote strong adjustment with a limited amount of public money. This implies that the Fund should not become a lender of last resort. In this respect, I agree with Mr. Andersen.

As I already mentioned, we are not convinced by the staff's arguments in favor of a need for a general quota increase at this point in time. While we do not question the fact that the volume, variety and volatility of capital flows has grown, thereby—other things being equal—increasing some members' vulnerability, this must not necessarily lead to an increased demand for Fund resources. In our view, it is rather an argument for a stronger involvement of market participants, including through PSI. Moreover, we would like to reiterate that the obligation to react to increased vulnerabilities lies first and foremost with the member countries themselves.

Concerning the implications of a possible further decline in the Fund's resource base relative to the world economy and financial flows, I would like to echo Mr. Wijnholds' remarks in his statement. Increased capital flows do not per se warrant an augmentation of Fund resources since they mainly reflect the growth of capital flows between industrialized countries, which do not have a need for official financing.

Regarding the question of how best to address the moral hazard problem, we think the question is not whether moral hazard should be addressed through PSI and SDRM or by limiting the overall size of Fund resources. This chair has always argued that limiting the amount of Fund resources is an indispensable precondition for credible access limits and efficient PSI. In this context, a decision to increase the level of available Fund resources at this point in time would certainly send the wrong signal with regard to the ongoing discussions on PSI, SDRM and access limits.

Furthermore, we find it difficult to accept the staff's assumption that contingent financing instruments warrants an augmentation of Fund resources. The Fund has not made any CCL commitments as yet, and we are not convinced that this picture will change dramatically in the foreseeable future. And, as Mr. Wijnholds has pointed out in his statement, possible CCL commitments can be, at least in part, substitutes for alternative commitments under the Stand-By Arrangement or SFR.

Regarding the illustrative scenarios presented by the staff, we think, that they are not fully convincing, at least for three reasons. First, the scenarios do not take sufficiently into account the fact that most of the recent adaptations to Fund policies are supposed to—and de facto will—reduce the demand for Fund resources. Second, since no commitment under the CCL has yet been made, we do not see the rationale for the staff to provide for commitments of SDR 14 billion under all three scenarios. Third, it must be noted that even under the least favorable second scenario, the activation of the

NAB/GAB will generate a forward capacity of SDR 34 billion. In this context, we do not share the staff's concerns about a possible activation of the NAB/GAB. The consultation process, which is mandatory before the NAB/GAB can be activated, should be seen as a welcome system of checks and balances rather than as hindering the flexibility of the Funds' operations.

Finally, Mr. Chairman, with respect to the report to the IMFC, we share Mr. Wijnholds's concerns. Like Ms. Lundsager, we support the publication of the report on the assumption that it incorporate Director's comments and perspectives regarding the need for a quota increase.

Mr. Callaghan made the following statement:

I will start where Mr. Boitreaud concluded in his statement, and that is to say that the one thing that seems clear at this stage, and perhaps it is the only thing that is clear, is that there is not the necessary level of support for an increase in quotas. Furthermore, there are some very different views on this issue. So, I think the immediate concern is how are we going to move forward from here. It is not so much a debate about whether this item should be on the agenda for the IMFC that I would be worried about, because I think that would just confirm what Mr. Boitreaud concluded with, that is, to say that there is not the necessary level of support. I think that the issue we should be thinking about is how are we going to push forward with our continuing review of the adequacy of the Fund's resources. So, perhaps now is the time to focus on what is the most constructive way to advance the Twelfth Review and try to lay the basis for more common ground on this issue.

The fact that there is a difference of views on whether there should be an increase in quotas is no surprise, and I am sure it does not come as any surprise, because there is no overwhelming evidence that can be produced, no single indicator or group of indicators that can be referred to that will clearly demonstrate that the size of the Fund needs to be increased along with the magnitude of that increase. That is perhaps a good thing because, if that were the case, we would probably have real problems; we would probably be in the middle of a very large financial crisis. We are dealing with judgments, and the judgment of Directors as to whether there is a need for a quota increase varies. Some say yes; some say no. As I say, it is not surprising, because plausible arguments can be advanced in support of an increase in quotas and, conversely, plausible arguments can be made that there is no pressing need. It all comes down to judgments and the weight that different Directors are placing on different issues.

But I think it is important, too, to come back to the point that Mr. Wijnholds said at the very start and it is one point that we made in the seminar in February that, while it does come down to judgment, the reality is that a very convincing case has to be made to support an increase in Fund resources. This is because a number of national authorities would have a battle convincing their legislatures to support an increase in Fund resources or, to paraphrase Mr. Wijnholds, the political climate is not terribly conducive for the Fund. Now, I certainly share your concern, Mr. Chairman, that whenever people start talking about the time is not right, you could say the time is never right; we need to look forward. But, again, I think that this is the reality, that we do have to produce a convincing case, because many are not terribly endeared with the Fund.

A large part of the skepticism that exists when it comes to proposals to increase the size of the Fund results from the fact that the Fund's activities are heavily criticized. This is the issue, I think, that you were talking about this morning, and one that Mr. Padoan and Mr. Bossone raised in their statement when they said there are two issues that we confuse. There is this question of the basic role and architecture of the Fund and whether it is appropriate; and there is the second issue of does the Fund have sufficient resources to meet potential demands and effectively do its job. Clearly, if there is a concern about how Fund management and the Executive Board is exercising its discretion in terms of the use of Fund resources, then this should be addressed directly and not by limiting the size of the Fund if there is a justifiable case for an increase in quotas.

Again, to come back to the points that you raised this morning and earlier at the start of this discussion, there is this fundamental question of the role of the Fund, but the discussion does have to be sequenced. Many of the comments that have been made so far seem to be questioning what should be the role of the Fund rather than focusing on whether the Fund has sufficient resources to fulfill its role. It is obvious that we need to be clear on the role of the organization before we can determine its required resource base. If we are to make progress, then we have to be clear what issue we are debating.

As I said, plausible arguments can be made to support an increase in the size of the Fund, and these have been well stated. They include how events quickly change the Fund's liquidity position, that the size of Fund programs seemed to be increasing, that there is a need for prudence, that the unexpected will always come along, that the cost of the shortfall or excess in Fund resources are asymmetric, and that the size of the Fund on the basis of calculated quotas is significantly larger than its actual size.

But, as a number of Directors have already noted in considerable detail, a plausible case be made in support of the view that there is no pressing need to increase the size of the Fund. These arguments include whether the Fund needs resources to cover all its contingent claims, the plausibility of making allowances for large commitments under the CCL when it has never been used, the fact that while spikes in demand for Fund resources may arise there is still an SDR 40 billion prudential buffer, and there is always the capacity to borrow under the GAB and NAB. So, arguments can be made in support and arguments can be made against. It is all judgment and, in making that judgment, the weight that you give to different factors.

So, where does this leave us? As I said at the outset, recognizing the extent of the differences in view, the differences in judgments, perhaps now is the time to focus on how we can advance the consideration of the adequacy of the Fund's resources and, in particular, the 12th review. There is this fundamental issue about what should be the role of the Fund, that is the first question; but let me turn to some more specific issues. Firstly, it seems we need to specifically explore whether there is any relationship between the size of the Fund and various indicators such as GDP, reserves, current payments, variability and current receipts, to the likely demand for Fund resources. A number of comments have been made on whether the ratio of quotas to GDP is correctly measured. The real issue, and one that has been identified in some other statements is, is this relevant in assessing the demand for Fund resources. There is a difference of view here.

By way of another example, what is the implication of the decline in the size of the Fund relative to reserves? Is this the outcome of the active encouragement by the Fund for emerging markets to build up their reserves? Does the mere fact that this is happening reduce the likely need for Fund resources going forward, or should any judgment be tempered by the fact that we are looking at growth rather than net reserves? Perhaps we may come to the conclusion that none of these indicators are particularly helpful in assessing the likely demand for Fund resources, and we should perhaps put them aside from this debate.

Secondly, we need to address this issue of the appropriateness of the size of the prudential buffer, and this is something that Ms. Lundsager has raised earlier. We are not going to make progress if some keep saying it is too generous or others say an SDR 40 billion buffer is being cast in stone and should never be touched. Thirdly, we need to do more in terms of refining our scenario work on assessing plausible future demands on the Fund's resource base. Scenario–building is fraught with difficulty because there will always be arguments about the appropriateness of the underlying assumptions, but it does have the potential to be the most helpful indicator in making judgments about the likely demand for Fund resources.

While it is a sensitive issue, it would be very instructive to think more about whether there are specific large cases that could put the Fund's resources under pressure, and this is the issue of the vulnerability assessments in Part C of the paper. As I say, it is an issue of could some large demands be placed on the Fund's resources, because it is not a question of whether a particular scenario is likely or a particular case is likely to come along, but whether it is plausible; that is, could it happen, not whether it is likely to happen.

There is one aspect in this discussion of Fund quotas on which we would place considerable emphasis, and that is the priority that must be given to addressing the fact that some countries are particularly underrepresented in term of their quota share. It is essential that a country's quota share reflect its relative economic standing. This goes to the heart of the legitimacy of this organization. It will come as no surprise for me to say that we are concerned that Asia is underrepresented and, in particular, that Korea's quota share needs to be increased so as to align it more with its position in the world economy. It is particularly important to ensure that a member's actual quota is closer to its calculated quota if access were to be more tightly defined on the basis of quotas. Many people have talked about the importance of clarifying our role or our approach on access limits. Korea is a good case in point. The 1997 Korean program was generally regarded as exceptionally large, 949 percent of actual quota after the 11th review, but it falls to 434 percent of calculated quota on the basis of formulas used in the 11th review.

There is an urgent need to address existing quota inequities. The increasing calls for reform of international economic governance just has to be heeded. It would be preferable if this issue were addressed head–on; that is, to adjust the existing quota distribution and to directly address concerns over the governance of the Fund. Unfortunately, the reality is that this will probably not occur, and some may say I am naive to even suggest that. In addition, ad hoc quota adjustments seem rare, despite the fact that there is a pressing need to correct some particularly glaring cases of under–representation in terms of quotas.

However, history has shown that a general quota increase does offer the opportunity to address the concerns, to some extent at least, of those members who have quota shares significantly out of line with their relative standing in the world economy. This is an issue we would put considerable emphasis on in the 12th general quota review. In short, substantial weight has to be given to the selective element in any general quota increase. To conclude, it is unfortunate, but not surprising, that there is such a large difference of views on the 12th review. Let us start focusing on how we can constructively take the issue forward, because this is of fundamental importance to the Fund. Finally, we have to focus on the need to address the position of those members whose quota share is too low.

Mr. Rouai made the following statement:

When the Twelfth General Review of Quotas was discussed last February, this chair articulated two considerations: first, we expressed our preliminary support for a sizable quota increase and, second, we urged the Board to carefully consider all important factors affecting this increase.

The staff paper calls for an increase in quotas on the basis of traditional indicators of the adequacy of Fund resources, such as global GDP, current payments, and reserves, but also applying new indicators, namely capital flows and members' vulnerability to financial crises. The illustrative scenarios also put into perspective the impact of potential demand for Fund resources on the forward commitment capacity (FCC) from own resources. Like Mr. Wijnholds, however, we have some reservations concerning inclusion of the CCL demand in these scenarios when serious doubts still exist regarding its usefulness. We also point out that the FCC indicator of Fund's liquidity position includes a safety margin of SDR 40 billion.

While we support the importance of the "premium on prudence" when assessing the adequacy of Fund resources, we do not wish to rush to a decision on such an important matter, only to be confronted later with a lack of political support to push for the necessary ratification as is the present case with the special SDR allocation. We should also avoid any perception that an increase in quotas would be used to finance capital outflows. The Board needs to make further progress in the important areas of PSI/SDRM, access policy in capital account crisis, and quota formulas and the associated basic votes. Finally, we urge the staff, within the context of the quotas review, to look carefully into the issue of the financing of low-income countries since the increase in quotas has no bearing on such financing, which remains constrained by the availability of concessional resources.

Mr. Mozhin made the following statement:

Like others, I would like to thank the staff for a very informative report.

As this is not the first discussion on the subject of quotas, we have recently had an opportunity to address some of the issues raised in the staff paper. Therefore, I will be brief and will make only a couple of observations.

Firstly, we believe that it would be premature to make a judgment on the appropriate size of the Fund before we have more clarity on access policy, the role of the PSI/SDRM framework in crisis prevention and resolution, and the future role of the CCL. Achieving greater clarity on these three issues will remove many uncertainties surrounding projections on potential use of Fund resources by the membership and will greatly facilitate deliberations on the need for a quota increase.

Secondly, looking through various tables and graphs in the staff paper, one can see that the present financial position of the Fund is not nearly as dramatic as it was in 1997/98. Of course, the situation may change and one can not exclude the possibility of further augmentations and new arrangements with crisis affected countries. However, at the moment the Fund seems to have at its disposal sufficient resources to address such potential needs.

On balance, at this stage we are not ready yet to support the proposal for a quota increase. However, like others, we remain open minded and do not rule out the possibility of quickly reaching a consensus on the need to augment Fund's resources should its liquidity position continue to deteriorate.

Mr. Brooke made the following statement:

We continue to feel that the Fund's resources are adequate at present. Looking further ahead, however, we accept that there may be a case to be made for a quota increase. Before we can be convinced of this, we would want to see the outcome of the Board's discussion on access limits, since this could have a significant impact on both the demand for, and supply of, financing, as other Directors have said. In addition, the agenda on the SDRM, CACs, and other improvements in our surveillance techniques will clearly have an impact as well, and we would like to see further progress on those issues before we can form a full judgment. Beyond this, I just have a few other brief comments.

First, I would like to associate myself with those Directors who have mentioned that the Fund's financial resource base should not be expected to keep pace with the growth of private capital flows. On the contrary, I expect the size of the Fund to decline over time as countries adopt stronger macroeconomic policies and improve their regulatory and supervisory arrangements, and as the quality and impact of the Fund's surveillance advice increases. I would generally hope that those would all have an impact to reduce such a ratio.

Second, I found the information in the chart in Mr. Wijnholds's statement very interesting. If the paper is going to be published, Mr. Wijnholds makes a fair case that the information would need to be presented in a more balanced way than it is at the moment. It is slightly misleading in its present form, and it might be possible to either include Mr. Wijnholds' measure or at least clarify in more detail the staff's methodology.

Third, my authorities continue to believe that Fund members should make use of the CCL facility, given its function of providing insurance against contagion in international capital markets.

On Mr. Portugal's point on the format for discussing quotas at the IMFC meeting, we welcome the proposal for a progress report. Ministers could then address the issue if they so choose in their written statements, which might help to develop our discussions after the Annual Meetings.

Mr. Ondo Mañe made the following statement:

I would like to express our appreciation to the staff for their efforts to help the Board formulate agreement on a quota increase. As we indicated on several occasions concerning the important accomplishments of quotas, this chair could not agree to any system that would reduce the quota share of African countries. Moreover, it is also important to ensure that the cooperative nature of the institution would be fully reflected in the decision making process. In that context, we continue to note that African countries are underrepresented at the Board.

It has been previously mentioned that one of the objectives of quotas is to improve the governance of the Fund. For us, this would translate into an adequate representation of every geographic region. Another important role played by quotas is in terms of an increase in Fund resources. Here, also, because of the low quota of African countries, access to Fund resources have been limited even though the need has increased. At a time when we are all trying very hard to reduce poverty and improve growth prospects in Africa, we think that by improving these countries' access to Fund resources, we would be sending a clear and positive message to the world community on our determination and commitment to this objective.

On the issue of the evolving role of the Fund in crisis prevention and resolution and assessing the adequacy of Fund resources, our views are close to those expressed by Mr. Shaalan. Finally, on the report to the IMFC and publication, we would like to see a balanced report with the views and concerns of all the members fully reflected so that the Governors and other stakeholders could assess the situation and redefine political guideline principles for our ongoing discussion on a quota increase.

In sum, while we agree on the general increase of quotas, we would like to reiterate our disagreement on any method or system that could reduce further the relative share of African countries.

Mr. Kiekens made the following statement:

Asking the shareholders to increase the Fund's resources is a serious question. It is probably one of the most critical moments in a Managing Director's tenure, aside from when the Board must consider the renewal of his tenure. Indeed, on the occasion of a quota decision, the Managing Director is held accountable for his management, and for whether the abundant resources that the shareholders have provided have been used effectively and prudently. Moreover, in almost all countries in the world, the decision on quotas is left, in the end, to the parliaments. I see few if any other occasion when the evaluation of the performance of the Management of an international institution is so broadly based as when the Fund asks for an increase in its general resources.

Making sure that the Fund has sufficient resources at all times to fulfill its mandate is a critical duty of both the Managing Director and the Board of Governors. The Board of Governors has a large degree of judgment on how the Fund should be managed, and thus what amount of resources should be made available. Even so, membership in the Fund obliges any country to support, earnestly and fairly, the Fund's financial needs for carrying out its mandate. In other words, countries should not withhold the resources the Fund needs to pursue the policies they want the Fund to implement. Let me put this idea another way: shareholders, and particularly the major shareholders, must be consistent in their relations with the Fund. If they ask the Fund to support countries with large credits to avoid damage to the international monetary system, they must provide resources adequate to the task.

Therefore it is good for the staff to provide the Board with the helpful calculations and simulations that are needed for an informed discussion on the adequacy of the Fund's resources.

Today's discussion shows that Directors' are divided in the conclusion they draw from the staff's evaluation. Most developing country Directors conclude that there is a convincing case for a meaningful increase in quotas. At the same time, most Directors, appointed or elected by creditor countries conclude that the Fund's liquidity remains sufficient and that there is not a convincing case for asking the Board of Governors to consider an quota increase.

My constituency is the sixth largest participant in the Fund's transaction plan. At the same time, because of the strong financial support it has received, Turkey is today the largest debtor to the Fund. Hence, the way we come to a consensus view on quotas in our constituency might help the Fund as a whole to reconcile the differences of views that exist in the Board.

The support received by the Fund from the countries of my constituency is longstanding and solid. Their consideration of the possible need for more Fund resources is earnest and open-minded. Based on a careful analysis of the staff's paper, we conclude that the Fund's current size is adequate to cope even with testing circumstances, and that we can conclude the 12th review of quotas without an increase. That being said, I restate my confidence that all the countries in my constituency would act swiftly to support an increase if an urgent need should emerge. Moreover, Belgium, as a member of the GAB, and Belgium, Austria, and Luxembourg as members of the NAB, are committed to lend to the Fund to supplement its general resources. The Fund has also the additional option of borrowing, over and above its credit lines under the GAB/NAB, directly from member states or on the financial markets.

The scenarios used by the staff for stress-testing the Fund's liquidity are strenuous but not altogether implausible. The worst-case scenario--Scenario 2 in Table 5--would still leave the Fund with SDR 40 billion. This is the controversial prudential minimum used by the staff in calculating the newly conceived parameter of forward commitment capacity, which is an important yardstick for measuring the Fund's liquidity. To this cushion of SDR 40 billion in usable resources in the GRA, should be added the borrowing capacity under the NAB/GAB of SDR 34 billion. The only assumption that seems slightly farfetched is a sudden increase in the use of the CCL to a level of SDR 14 billion per year. Despite the staff's and the Management's sometimes quite active marketing of the CCL, and the softening of the conditions for activating it included in latest reform of Fund facilities, there have been no customers for it up to now. The staff's emphasis on contingent financing as a means of crisis prevention is unnecessary.

It is hardly surprising that the Fund's quotas are declining in terms of world GDP, although according to Mr. Wijnholds's calculations not as sharply as calculated by the staff. The Fund's quotas have been on a secular downward trend in terms of GDP since the very creation of the Fund, because private capital flows have been playing an ever increasing role in financing current account deficits. A more meaningful measure of the size of the Fund would be the ratio of Fund quotas to the GDP of countries not included in the Fund's financial transactions plan. This ratio has clearly been trending upwards for the last 10 years, according to the calculations of Ms. Lundsager and Mr. Baukol, because of the increasing number of countries whose balance of payments is sufficiently strong to qualify them for inclusion in the financial transaction plan, and because of the last quota increase three years ago.

What should be the operational conclusion of this in depth discussion? I believe the probability that we will complete the 12th review of quotas without increasing the overall size of the Fund is high. That being said, it would be good for the Managing Director to seek a strong and credible commitment form the membership that if a need for a quota increase should become clear, all countries will act swiftly to provide the Fund with the needed resources. Admittedly this would only be a political commitment. How can we make it credible? The answer is straightforward: we must constantly seek the broadest possible consensus about effective and prudent use of Fund resources. More resources will only be forthcoming if all countries agree that the more than $200 billion now effectively available to the Fund have been wisely used. This requires first and foremost effective surveillance to prevent, as much as possible, financial crises and the need for financial assistance from the Fund. Moreover, when the Fund is called to the rescue, its help must be effective. And lastly, we must find the right balance between public land private financing in times of crisis. This will require progress in the difficult areas of access limits, private sector involvement, and mechanisms for the orderly restructuring of sovereign debts. Many Directors have spoken on all these topics, and I need not expand on them any further.

But I must raise one additional point, connected with the effective and prudent use of Fund resources. The Fund should not lend for periods longer than justified. Since the reformation of the Fund's lending instruments in November 2000, we have a better understanding of the need for a more restrictive use of the Extended Fund Facility. But I have the sense that the Fund and borrowing countries do not always fully comply with the early repurchase policy under Article V, Section 7(b) of the Articles of Agreement. This policy requires countries to repurchase the Fund's holdings of their currencies as their balance of payments position improves, even before such repurchases are due under the arrangement. I suggest that Management and the Russian authorities discuss whether the considerable improvement in Russia's balance of payments during the last three years does not justify an early repurchase. I expect the Board to be informed about the conclusions of such a discussion. Russia now has the third largest current account surplus in the world. It also receives large capital inflows. Even so, with more than $7 billion owed, it remains the Fund's fifth largest debtor. Even if the advanced repayment expectation applicable to all Fund arrangements decided since November 2000 do not apply to Russia's Stand-By Arrangement and EFF arrangements, Russia should still comply with the repurchase expectations provided by the Articles of Agreement.

Obviously an agreement on a quota increase also requires a broad consensus on the distribution of quotas. I have said several times in the past that the most effective way of correcting anomalies in the existing distribution would be ad hoc quota increases for those emerging and developing countries whose actual quotas are significantly below their calculated quotas. As Mr. Callaghan has reminded us, Korea is such a country. Turkey is another.

Mr. Mozhin replied that the comments made by Mr. Kiekens were well taken. Nonetheless, he wanted to remind the Board that, without any request from the Fund, Russia had made quite significant prepayments in 2002, despite the fact that it faced its highest foreign debt repayments upcoming in the year 2003.

Mr. Kiekens responded that in the latest publication of the Fund the outstanding amount owed to the Fund by Russia was still SDR 5.457 billion, which made Russia still the fifth largest debtor to the Fund. At the same time, as it was documented in the latest financial stability report and elsewhere, it was the third largest surplus country in terms of its current account balance. One of the issues with which Russia was struggling was the quite unexpected large capital inflows. There might not be any firm conclusion from the data, but the issue needs to be addressed.

The Treasurer (Mr. Brau), commenting on the CCL, stated that there had been three recent communiqués from the IMFC that had encouraged the use of the facility. The staff had simply carried it forward given there was ministerial encouragement, and therefore it was not unreasonable to make some provision for it. Alternatively, as some Directors had mentioned, if a member country did not wish to make use of the CCL, they could request a precautionary Stand-By Arrangement, which was essentially the equivalent.

On quotas in general, it was clear that there was no consensus, Mr. Brau continued. Management, the staff, and the Board needed to think about how to go forward. Many Directors had stated a willingness to return to the issue when needed and, in particular, to return to it after the discussion on access policy in capital account crises cases and after the review of the CCL at a minimum. It would be premature to agree to a quota increase at the present juncture; it would also be premature to close the door on the discussion, given that the review of access policy was scheduled for the following week, and given that the review of the CCL was scheduled to take place before the end of the year.

Mr. Kiekens noted that at some time fairly soon the Twelfth General Review of Quotas would have to come to an end, but that nothing prevented the Board from reopening a general review. Nor was it the case that the Board could not proceed with an increase in quota shortly after the close of the Twelfth Review.

Mr. Andersen concurred with Mr. Kiekens on the importance of early repurchases, and suggested it be included in some form in the summing up.

Mr. Brooke joined Mr. Andersen on the importance of early repurchases. Further, he requested clarification from the Treasurer on whether the staff paper would be revised to reflect the Board's positions before publication.

The Treasurer (Mr. Brau) replied that there would be a PIN, and attached to the PIN would be the concluding remarks of the Chairman, which would relate the views of the Board. As for the staff report, Ms. Lundsager had made a point that the staff should be explicit that the minimum prudential amount of resources to be set aside in the forward commitment capacity indicator had not yet been agreed upon by the Board. The staff would make that explicit. On the question of the ratio of the Fund's quota to GDP and Mr. Wijnholds's comments, the staff welcomed a bilateral discussion on that matter, but the staff was confident that their ratio figures were correct.

Mr. Wijnholds replied that it was important to be careful in stating so forthrightly that one was right or wrong. Such matters could be looked at differently, and at least that should be conveyed in the staff paper.

The Chairman considered that it was important for the staff to remain the staff, and to present their methodology and conclusions. It was not possible to include all methodologies or analyses in a staff paper or for that matter in a PIN.

Mr. Wijnholds replied that he had no desire for the staff to come around to his view, but that he did want the staff to take into account other views than that of their own.

Ms. Lundsager repeated her suggestion of another objective indicator, which was to take all those countries not in the financial transaction plan and performing a straight calculation of quota to their GDP ratios. That would be another way of looking at the matter, and as Mr. Wijnholds said, there was nothing political about trying to approach the matter in different ways.

On the vulnerability assessments performed by the staff, it remained very much an internal process, Ms. Lundsager continued. The Board was at a disadvantage in not knowing exactly what the staff had in mind in terms of what might be the real worst case scenario. Her office had performed research to try and come up with all the possibilities of countries that might draw upon the Fund, and that was how her chair had come to its conclusions. The staff probably did something similar, but obviously the conclusions were not the same.

Mr. Portugal agreed with the Chairman that the staff paper should not be revised to reflect the Board's views. The Board's views should be reflected in the summing up. The case to be made for changing the staff paper would be if there was a factual error, or if there was sensitive information or information that countries had provided on a confidential basis to the Fund that they did not want released to the public.

The Chairman noted that nowhere in the staff paper had an increase in quota been asked for, nor had he himself asked for an increase in quota. In some fashion, that had come to be overlooked. On the point about the varying methodologies, Mr. Brau was asked if he could not somehow incorporate a reference to those methodologies suggested by Mr. Wijnholds and Ms. Lundsager.

The Treasurer (Mr. Brau) responded that he would try.

The Chairman made the following concluding remarks:

> Our discussion has provided a useful opportunity for a further exchange of views on the conceptual issues relating to the role and size of the Fund, and for consideration of quantitative approaches for assessing the adequacy of the Fund's resource base and the possible need for a quota increase. While Executive Directors are not close to coming to a consensus regarding an increase in quotas, progress has been made in clarifying issues and the considerations that could form the basis for a decision.
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> Directors had a further exchange of views on the implications for the size of the Fund of globalization, integration of financial markets, and the Fund's efforts to strengthen its capacity to prevent and resolve financial crises. There is broad recognition that greater reliance on private market financing by many countries has contributed to increased vulnerability to capital account shocks, and that such shocks could be quite large in absolute amounts and

relative to the size of an economy. There is also recognition that global economic and financial integration may entail the risk of financial contagion. Directors generally agreed that the Fund's crisis prevention efforts will contribute to a reduction in the frequency and severity of financial crises, through improved surveillance that promotes sound economic policies and strengthens the functioning of domestic and international capital markets. At the same time, Directors accepted that future crises would occur, and that the Fund will need to continue to play a central role in crisis resolution and therefore should have adequate resources at hand. However, views differed on the extent to which the Fund's response to these developments would or should result in large financing that could require additional Fund resources.

Directors noted that the Fund is continuing to adapt its financial policies to strengthen its catalytic role, including by improving the conditionality associated with Fund financing, encouraging use of the CCL, clarifying policies on access to Fund resources in capital account crises, and developing new approaches for involving the private sector in crisis resolution. While resolution of these issues will have implications for the Fund's financing role, Directors considered that, especially in view of the increased uncertainties and volatilities, decisions on the size of the Fund should be made in a forward-looking medium-term context.

Directors had a further discussion of the moral hazard implications of Fund financial support. A number of Directors argued that increasing the size of the Fund and of Fund financing could aggravate moral hazard concerns and reduce incentives to strengthen crisis prevention by creating undesirable incentives for excessive official and private financing, and would send a mixed signal about the Fund's effort to increase the role of the private sector in crisis resolution. However, other Directors felt that moral hazard concerns must be weighed against the potential cost of disorderly adjustment to the member and to the international community. These Directors considered that there is little evidence from past experience that moral hazard is a significant problem. They believed that Fund conditionality and the PSI and SDRM initiatives should remain the principal means of dealing with potential moral hazard and safeguarding Fund resources, and that seeking to deal with moral hazard by leaving the Fund with inadequate resources would be counterproductive, especially as the cost of a Fund that is too small to fulfill its responsibilities exceeds the cost of providing resources that may not need to be utilized. Several Directors remarked that effective and prudent use of Fund resources would place the Fund in a good position vis–à–vis its members to obtain a swift decision for an augmentation of Fund resources should the need arise. These Directors also encouraged countries in favorable economic positions to make early repurchases to further strengthen the Fund's liquidity position.

Directors welcomed the opportunity to consider several quantitative approaches for assessing the adequacy of Fund resources and the need for a quota increase. In the discussions, many Directors noted that the size of the Fund has declined relative to the traditional indicators of the global economy in which the Fund functions, and expressed concern that a further decline in the relative size of the Fund would send the wrong signals about the Fund's ability to continue to fulfill its important responsibilities. Many other Directors, however, suggested that, based on alternative measures, the relative size of the Fund has not declined and that, moreover, it is not necessarily the case that Fund size should keep pace with world output or other macroeconomic variables, including international capital flows, as this would tend to diminish the catalytic role of Fund resources. They noted that the historical decline of the Fund's quota base in relation to the traditional indicators has not impacted adversely on the IMF's central role, and that it needs to be considered in the context of ongoing changes in Fund polices and the evolving situation in the world economy and financial markets.

Directors also considered projections of future Fund financing based on the Fund's share of the gross financing needs (GFN) of members that have recently used Fund resources. The discussion suggested that it is difficult to draw conclusions from the GFN variable, because in the last few years several countries have experienced particularly large reversals in capital flows that might not be repeated in the future. Moreover, projections based on recent GFN did not take account of possible changes in policies, both by the borrower and the Fund, and any conclusions for the size of the Fund would have to be interpreted with caution. Directors, therefore, concluded that this variable would need to be complemented by other indicators.

In response to an earlier request by Directors, the staff provided several measures of variability of capital flows, which confirm that capital flows have increased significantly and become more volatile, with large reversals occurring in recent cases of financial crises. Many Directors saw the size of these reversals and measures of capital variability in the second half of the 1990s as useful additional indicators that should be taken into account when assessing the adequacy of Fund resources. Other Directors were more skeptical that definitive conclusions could be reached due to the difficulty of interpreting the significance of recent experience as a predictor of future trends, particularly given the ongoing efforts to reduce market volatility and country vulnerability.

Directors also discussed the implications of several illustrative scenarios presented by the staff for the assessment of the adequacy of the Fund's resources. They noted that the Fund's ability to meet the substantial demand for financing in recent cases was attributable in part to the rapid turnaround of some of the larger cases which facilitated early repayments; the ability to utilize the GAB and NAB to supplement the Fund's quota resources;

and the increase in quotas that became effective in 1999. In considering possible scenarios of future demand for Fund financing, it was agreed that it is very difficult to foresee either the size or timing of future crises and therefore the scenarios presented by the staff should be considered purely illustrative. In this connection, a range of views was expressed on the plausibility of the scenarios. On the one hand, the scenarios were considered plausible or even too optimistic with regard to possible future demands on Fund resources. Recent developments were viewed as consistent with the worst case scenario described by the staff, with Fund credit outstanding reaching a historically high level and the proposed arrangement for Brazil representing the largest single commitment of Fund resources. As a result, Fund liquidity has fallen sharply, at a time when bilateral official financing has diminished, which points to the need for an early quota increase to enable the Fund to support members' adjustment efforts and to avert renewed contagion. Conversely, the scenarios were also viewed as overly pessimistic, as the projected use of the CCL seemed large in the absence of current interest in the facility, and that the base period of 1996–2001 reflected an unusually high demand for IMF financing. Moreover, even the most pessimistic scenario did not indicate a clear need for a quota increase, as uncommitted usable resources would remain substantial even with the latest commitments, while the estimates of forward lending capacity were based on conservative assumptions regarding the required prudential minimum (for which the appropriate level has not yet been decided), and the Fund's borrowing arrangements remain fully available at the present stage.

In conclusion, I believe that we are continuing to make progress on the conceptual and quantitative issues that need to be addressed to inform judgments regarding the adequacy of Fund resources. Although differences of view on the need for a quota increase remain, there is also broad recognition of the importance of the Fund having adequate resources to fulfill its critical responsibilities. Many Directors viewed progress on a number of related issues as important to reaching a decision on a quota increase. On steps forward, I realize that the Board is not close to the 85 percent majority vote required for a quota increase, and that some of you would not wish to pursue this issue further. Nonetheless, I believe the continued discussion of the size of the Fund is integral to a broader consideration of the role of the Fund in an integrated global economy and that financial prudence requires that we should attempt to make further progress on these issues in the period ahead. Therefore, I would propose that the staff prepare a status report to the IMFC on the Twelfth General Review of Quotas, based on today's discussion as well as the earlier discussion on the distribution of quotas. We could return to these issues for further discussion following the IMFC meeting and to prepare a report to the Board of Governors on the Twelfth General Review of Quotas by January 2003.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/02/89 (8/28/02) and EBM/02/90 (8/30/02).

4. BOTSWANA—ARTICLE IV CONSULTATION—POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance Over Exchange Rate Policies," attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board decides that the period for completing the next Article IV consultation with Botswana shall be until the dates indicated in EBD/02/123, Supplement 1 for such country. (EBD/02/123, Sup. 1, 8/21/02)

Decision No. 12836-(02/90), adopted
August 28, 2002

5. MALI—ENHANCED INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—ADDITIONAL INTERIM ASSISTANCE

The Fund as Trustee (the "Trustee") of the Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations (the "Trust") decides that:

(a) satisfactory assurances regarding the exceptional assistance to be provided under the enhanced HIPC Initiative by Mali's other creditors continue to be in place;

(b) the Trustee shall disburse to Mali as additional interim assistance the equivalent of SDR 2.646 million, which shall be made available by the Trustee to Mali in the form of a grant that shall be paid no later than three business days after the adoption of this decision to the account for the benefit of Mali established and administered by the Trustee in accordance with Section III, paragraph 5 of the Trust Instrument; the proceeds of the grant shall be used by the Trustee to meet Mali's debt service payments on its existing debt to the Fund as they fall due, in accordance with the following schedule: 24.0 percent of each of Mali's principal repayment obligations falling due between September 1, 2002 and December 31, 2002; and

c) for the purposes of Section III, paragraph 3(d) of the Trust Instrument, the conditions for the disbursement under (b) above are that Mali has met (i) all of the performance criteria applicable to the fourth and fifth disbursements under the three-year Poverty Reduction and Growth Facility ("PRGF") arrangement for Mali (EBS/99/129, Sup. 1, 8/16/99), as amended, that, based on the information provided by Mali, have been found to have been met, and (ii) all of the conditions specified in the decisions completing the third and fourth reviews under the PRGF arrangement. (EBD/02/160, 8/22/02)

Decision No. 12837-(02/90), adopted
August 29, 2002

6. ANNUAL REPORT, 2002—OUTLINE

The draft outline set forth in EBD/99/125 (8/21/02) is approved.

Adopted August 28, 2002

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAM/02/107 (8/27/02) is approved.

APPROVAL: January 23, 2003

SHAILENDRA J. ANJARIA
Secretary