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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 98/99

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Executive Board Attendance

S. Fischer, Acting Chairman
A.D. Ouattara, Acting Chairman

Executive Directors	Alternate Executive Directors
	S.M. Al-Turki
	M. Askari-Ranhouhi, Temporary
	J. Chelsky, Temporary
	W. Szczuka
	F. Zurbrügg, Temporary
B. Esdar	O. Schmalzreidt, Temporary
	W. Merz, Temporary
	J. Spraos
	F. Mercusa, Temporary
	J.N. Santos, Temporary
	J.P. de Morais
	O.-P. Lehmussaari
	H.F. O'Brien
	O.L. Bernal, Temporary
	J. Prader
	S. Zádor, Temporary
	B.S. Newman
	M. Sobel, Temporary
	M. Budington, Temporary
J.-C. Milleron	R. Fernandez
	M. Daïri
	S. Rouai, Temporary
	A. Lushin
	I. Zakharchenkov, Temporary
	J. Shields
	H. Hagan, Temporary
A.S. Shaalan	M.H. Elhage
	W.F. Abdelati, Temporary
M.R. Sivaraman	A.G. Karunasena
	N. Jadhav, Temporary
G.F. Taylor	O. Kwon
J.J. Toribio	J. Guzmán-Calafell
	E. Rodriguez, Temporary
J. de Beaufort Wijnholds	Y.G. Yakusha
	T. Presečan, Temporary
K. Yao	A. Barro Chambrier
	D. Fujii, Temporary
	K. Gobe, Temporary
	C. Harinowo
	Qi J., Temporary
	J.A. Costa, Temporary

A. Mountford, Acting Secretary
S.W. Tenney, Assistant
N.M. Hairfield, Assistant

Also Present

IBRD: J.A. Katz, D. Mane, M.T. Stephens, Africa Regional Office; D. Kim, Development Committee; S. Mehra, Europe and Central Asia Regional Office. African Department: E.A. Calamitsis, Director; G.E. Gondwe, Deputy Director; A. Basu, K.J. Cady, M.W.E. Desclercs, S.N. Kimaro, E.G. Kpodar, P.D. Peroz, A. Tahari, J.C. Williams. Asia and Pacific Department: C.J. McDermott. European I Department: M.C. Deppler, Director; Y. Horiguchi, Deputy Director; M. Annunziata, J. Canales-Kriljenko, S. Desai, H.B. Le, P.M. Thomsen. Fiscal Affairs Department: V. Tanzi, Director; P.S. Heller, Deputy Director; E. Ahmad, Ke-young Chu, R. Hemming, M.S. Kell, B.H. Potter. Legal Department: B.D. Dimitrachkov. Monetary and Exchange Affairs Department: C.J. Siegman. Policy Development and Review Department: M. Allen, Deputy Director; A.R. Boote, L.Y.M. Leigh, A.T. MacArthur, A.A. Selassie, R. Weber. Secretary's Department: B.A. Sarr. Statistics Department: P.R. Cotterell. Treasurer's Department: P.R. Menon. Office of the Managing Director: E. Brau, F.J. Gaitan. Advisors to Executive Directors: T. Brizuela, C.M. Gonzalez, J.M. Jones, E. Jourcin, M.F. Melhem, S. N'guiamba, H. Ogushi, L. Palei, O. Sein. Assistants to Executive Directors: S.A. Bakhache, R. Burgess, M. Carlens, H.W. Cocker, J.C. Estrella, N.K. Gueorguiev, O.A. Hendrick, J.K. Honeyfield, K. Kask, B. Killen, K. Kpetigo, T.-M. Kudiwu, S. Le Gal, J. Mafararikwa, D. Merino, E.T. Rădulescu, V. Rigász, D. Saha, J. Schaad, C.P. Schollmeier, Wang X., R.P. Watal, Zubir bin Abdullah.

1. DRAFT MANUAL ON FISCAL TRANSPARENCY

The Executive Directors considered the draft manual on fiscal transparency (SM/98/199, 7/31/98). They also had before them annexes to the draft manual (SM/98/199, Sup. 1, 7/31/98) as well as a supplementary note on related issues (SM/98/199, Sup. 2, 8/5/98).

Mr. Sivaraman submitted the following statement:

I have read with interest the Draft Manual on Fiscal Transparency. With all due respects to the authors, I would hesitate to call it a manual. According to definition, a manual should prescribe methods and procedures of handling a particular subject. The Draft Manual, in its present form, is more like a working paper not entirely focussed on fiscal transparency and loosely structured. At the outset, I have to regrettably say that even though I strongly recommended the issue of the Code, I cannot support the Manual in its existing form.

I. Organizational structure and its relevance to fiscal transparency

In my view, the Manual should have first dealt with the organizational structure of a government in terms of fiscal rights and responsibilities. In other words, if the manual is to address a federal government structure, it should have started with the need for codifying the sharing of powers at different levels of government in regard to the ability to raise resources, both revenue and capital, and expenditure responsibilities. The blurring of the lines of distinction in this regard have been observed in many countries and particularly so in countries like Russia and China, needlessly jeopardizing fiscal transparency. The Manual should have clearly brought out the significance of and the pre-requisites for a clear division of powers and responsibilities in federal governments. Having laid down the basic pre-requisites of a codified structure of powers and responsibilities at different levels of government, the draft should then have proceeded to identify the budget as a main fiscal policy document and the ways it could be made transparent. This does not in any way imply how governments are to be organized, but suggests how it would increase fiscal transparency and efficiencies in federal governments if fiscal powers and expenditure responsibilities are properly delineated.

I am not able to understand the merit of the sentence "it is important that the legislative and judicial branches play an active role in ensuring the availability and integrity of fiscal information". The judiciary does not play any role in the management of fiscal policy of a country. They come in only when the legitimacy of a tax law or any particular act of government - be it related to fiscal or any other matter - is questioned. I had earlier pointed out that we should not mix up issues in such a reference document. In spite of it, the staff seems to be pressing on with the role of judiciary in fiscal issues. I would like to have a clarification as to why this is being done.

Fiscal transparency should be apparent from the laws, regulations and rules that a country lays down for the preparation of its budget, its presentation to the Parliament, its approval by the Parliament, the maintenance of accounts of the expenditure for different purposes approved by the Parliament, auditing of the expenditure by an independent agency and its final review by the Parliament. This would complete what can be called a budget cycle. All issues relating to transparency could have been considered within this framework of the budget cycle. There is no harm in referring to matters connected with but closely associated with fiscal policy.

As regards clarity of rules and responsibilities of the government, no uniform definition of government is possible given the wide range of governmental structures, constitutions, cultures and traditions which have gone into the building up of a hierarchy of units which together can be called a governmental system. In many countries, there may not even be a hierarchical system where one can expect to generate figures for the total operations of the general government sector. Even in federal structures, apart from the Central Government, provincial or state governments, there could be lower formations of governments like municipalities for small towns, corporations of large towns, counties or other small bodies which could be functioning on an elected basis. It is also possible that monies may be flowing from one level to another either directly or percolating through the different levels to the lower most level. It would be extremely difficult, if not impractical, to build up a system of accounts or transactions which would encompass the activities of all these levels. For example, in the case of India, In spite of the existence of a proper institutional and legal framework, the data on general government does not cover operations of the innumerable committees, corporations, municipalities, panchayats (i.e., village level bodies) and so on. Even in the case of United States, the data coverage of local government is based on annual random stratified sample survey of a small percentage of local governments. As such, the Manual could have recommended that member countries should present full data coverage of the central and provincial governments in a federal structure and in the case of a unitary structure, data on any other subordinate formations of the central government which act independently on the basis of a budget. Some of these issues have been loosely covered in paragraph 2.1.1. In paragraphs 16 to 24, related issues have been covered. These should have been brought together under Chapter I - Clarity of Roles and Responsibilities and certain matters relating to investment etc., being matters of detail should have been covered elsewhere.

II. Budget cycle and data coverage

Para 32 talks about the relationship between domestic budget and aid-funded expenditure, the distinction between the two being somewhat invidious. If aid is flowing from bilateral or multilateral sources, it should find a place in the budget on the receipts side and correspondingly provisions to utilize this aid for the purposes intended must find a place on the expenditure side. Aid could also be in the form of kind in which case, there should be a procedure to reflect it in cash form in the budget with an explanatory note about it being received in kind and a suitable appropriation for expenditure for proper accounting.

The legal and administrative framework concerning the budget have been dealt with reasonably well. However, the paragraphs should be rearranged to make explicit the legal requirements under separate headings as follows:

(a) Budget - Constitutional provisions relating to the budget

(b) Tax laws

(c) Appropriation laws giving authority for expenditure out of the budget

(d) Administrative framework:

- Relating to expenditure, accounts and internal audit

- relating to collection of taxes

(e) Customs: Administration of customs duties is only one of the many subjects they deal with; they should not be mixed up.

III. Government budget and its relationship with other government owned institutions

Para 24 talks about direct equity investment by government. If any such new investment takes place, then it should find a proper place in the budget. In most cases, institutions in which such equity investment takes place are governed by separate laws - by Company Law if they are commercial undertakings or by separate laws for other agencies. One would expect these laws and regulations to provide for the preparation of annual balance sheets and accounts so as to present a clear picture of their state of health. While the details of government holdings in the form of equity or loan cannot find a place in an annual budget, it should certainly be explained and presented to the public in the form of other annexes to the budget separately so as to ensure transparency in government operations. The Code was not intended to propagate any philosophy of what a public or private sector should do in a country. It is designed to promote fiscal transparency. Many of these issues are getting mixed up. I suggest that they be reorganized in a manner suitable for the Manual rather than an article.

The draft Manual talks about the general government and public financial institutions set up to develop industry or agriculture which may have quasi-fiscal activities. It is not clear whether the Manual prescribes that these quasi-fiscal activities of the public financial institutions should get reflected in the budget. If an institution is set up, it is expected that it will have appropriate rules and regulations governing its activities and therefore would be expected to make available to the public its transactions periodically. The position in regard to non-financial public enterprises is also vague. Non-financial enterprises also get set up under laws or rules and regulations and are expected to publish their accounts and balance sheets. Being independent of the government, even if non-commercial services are carried out, they would become a part of the balance sheet and would get reflected in the profit and loss account. If the losses of these enterprises get financed through the budget, they should get appropriately reflected under the relevant appropriation account of the budget. It would, therefore, seem more practical and less intractable to present such figures as a part of the balance sheet of the company rather than mixing it with the general government budget.

The relationship of the government with the central bank should normally be in accordance with the law setting up the central bank. The access of the general government to the central bank for financing of the deficit should automatically find a place in the budget. The manner in which it should get reflected should be a part of the budget rules. These rules should also lay down how quasi-fiscal operations of the central bank should be dealt with. I am afraid these issues have not been adequately dealt with in the draft Manual.

IV. Public Availability of Information

Under the chapter "Public Availability of Information", the draft Manual deals with certain presentational aspects of the budget, whereas in paras 43 to 45 which deal with the legal framework, subjects closely linked have also been dealt with. There is a need for consolidating these segments and presenting them under appropriate headings so as to avoid confusion.

Para 2.1.1 (p.12) prescribes that "the annual budget should cover all central government operations in detail, and should also provide information on central government extra-budgetary operations. It is not clear how and why "extra budgetary operations" could be covered in the budget. If they are covered in the budget, they are no longer extra budgetary. The same provision also stipulates that the annual budget of the central government should also provide information on the revenue and expenditure of lower levels of government. This is one example of avoidable confusion as it is obvious that a central government cannot exhibit in its budget revenues of lower levels of government which by law may be required to present their own separate budgets. In this context, the intent of para 65 is also not clear. If the Constitution of a government provides for a presentation of budget separately by the central government, provincial governments and other elected local bodies, the question of the general government budget out-turn for the previous year being included in the central government budget just does not arise. However, it has been recommended as the best practice. This seem to exhibit lack of adequate knowledge of constitutional practices and positions in different countries. For statistical purposes, such figures could be compiled by the national statistical body and the total budget out-turn of the different levels of government could be presented as soon as the audited accounts are available. I would like to know which country's general government budget incorporates the budgets of its subordinate formations even when they have to be independently presented and approved by the elected bodies.

QFAs have been dealt with in paragraphs 35-39, and paragraphs 76-79 and 134 and 135. If QFA's appropriate presentation is an element of the Code, then it is all the more necessary to deal with it more substantially. These paragraphs require to be consolidated and a clearer presentation of how to deal with QFAs is called for.

The draft Manual also deals with open budget preparation, execution and reporting. Many countries still do not prepare their budget openly and it is considered a secret till such time it is presented to the Parliament. Chapter heading should therefore be changed by deleting the word "Open". I do not consider it necessary that because this word has been mentioned in the Code, it should also be used here. A mistake can always be gracefully corrected instead of being defended by its repetition.

There is a sub-paragraph 3.14 which deals with "Existing commitments from new policies". It hangs loosely and should have been a part of the prescriptions relating to how expenditure proposals should be prepared for the budget.

V. Classification of Accounts and Audit

The budget and accounts classification should be clearly more elaborate than what is found in the GFS. The GFS is a summary presentation of the general government budget and for the purposes of Parliamentary Appropriation, a classification of receipts and expenditure have to be more elaborate based on the functions of the government. A five tier classification, as indicated below, seems to be more appropriate:

(I) Organs of government: Legislative, executive and judicial

(II) Functional Classification of expenditure: Classification of receipts by sources and expenditure by functions of government

(III) Programs: Expenditure under functions being further sub-divided into programs.

(IV) Activities: As a program is likely to contain a number of activities, they could be further sub-divided into activities.

(V) Objects: Expenditure is incurred by objects such as salaries, allowances, rents, rates and taxes, purchases, grants, subsidies and so on.

This five tier classification would also normally correspond with the System of National Accounts (SNA). If proper code numbers are assigned to these in a logical manner, it should be possible to establish a correspondence with the System of National Accounts. These do not clearly emerge in the draft Manual. Recent changes that have been brought about in the Budget classification in Sri Lanka and Bangladesh on the advice of experts follow this system. India has been following this for over two decades.

The draft Manual also is somewhat anomalous in dealing with the accounting system. Budget provides only an estimate of revenue by source. It would be difficult to present an accrual based receipts budget. As far as expenditure is concerned, the budget should normally provide for all the liabilities of the government that are expected to arise during the course of the budget period - may it be an year or any other period that the Constitution of the country has laid down for the budget. If any major public works project is taken up for execution in a particular year, expenditure on which may be incurred over a period of several years, in the first year of its inclusion in the budget, a total picture relating to the whole project, its cost and benefits should be stated and annual requirement of funds for efficient execution of the project should be provided. Government accounting therefore would always remain partly on cash basis and partly on accrual basis. I wonder whether it would be possible to switch over entirely to an accrual based accounting system by the government on account of the complexities involved both in regard to receipts and expenditure. This aspect should be clearly brought out in the Manual. It is not wise to blindly replicate a system that some developed country might be following for its own reasons.

Reference have been made to IFAC and INTOSAI guidelines. While these guidelines have greater relevance to those countries which have statutorily independent audit mechanism, those that do not have could certainly follow them to their advantage.

Assessment of arrears of government revenue poses a difficult problem, particularly with regard to taxes. Assessment of taxes payable by individual and corporate entities could very well be challenged in courts of law or before appellate authorities. Some countries have been able to streamline these procedures to an extent and as such there are very few cases pending in the courts. But there could be many other countries like India, where litigation could be severe and it may be difficult to present a clear picture of arrears without knowing the outcome of the disputes in the courts of law or before appellate bodies. Nevertheless, it would be necessary for purposes of transparency to present every year a clear picture of government arrears both in regard to tax and non-tax revenue with suitable caveats being added in regard to the realizability of the arrears.

The subject of auditing should be dealt with along with accounts. Auditing of government accounts is in two dimensions: internal audit for purposes of internal control and audit by an independent agency. Internal audit is designed to ensure that expenditure is incurred according to appropriations and as per rules and regulations laid down by the government in this regard whereas external audit is intended to present an independent picture to the Parliament as to whether the government and its agencies have adhered to the budget appropriations focused on accountability of civil servants who had been given the responsibility to incur the expenditure for a public purpose. More often, performance audit is also conducted by external agencies in order to judge the performance of government departments, agencies or officials who have been entrusted with the responsibility of executing projects or running government departments. It is usually the reports of the external audit agency which are made available to the public as soon as they are presented to the Parliament or the legislative body of the country concerned. The Manual should lay equal emphasis on internal audit and external audit and point out their respective significance in public accountability.

VI. Procurement and Employment

The Manual deals with procurement and employment together. Government should have proper procurement procedures. Tendering is a part of procurement procedure. As far as employment is concerned, it is generally governed by different statutes and laws. It is a separate subject altogether which encompasses recruitment, assessment, promotions, disciplinary action, appeals and conduct and behavior of public servants. Privileges and immunities of government servants vary under different circumstances. There are Manuals and a whole library of case laws on this subject alone. It would be meaningless to deal with this complex subject in a simplistic way in a Manual on fiscal transparency. If at all, it would be sufficient to mention that government should draw up proper Manuals and codes in regard to government employees. In certain cases, there could also be provision in the Constitution in regard to the recruitment of civil servants. It is necessary to segregate procurement and tendering from employment. Rules and regulations relating to government employment is part of general governance and must be properly laid down. It is not necessarily a part of only fiscal transparency.

I object to the ethical standard of behavior for public servants being a part of fiscal transparency. It is imperative to have a code of behavior for public servants for good governance of a country and therefore, it is not exclusive to fiscal transparency. The fiscal accountability of officials should form part of the administrative framework within which rules and regulations should be framed for expenditure and use of public money.

VII. Structure of the Manual

The Manual has followed the Chapter headings of the Code and in this effort, several issues have got mixed up. In my view, the Manual requires to be re-written, clearly segregating subjects rather than cluttering them at different places. Examples of different governments that have been given such as that of the United Kingdom, Latvia or South Africa should be removed from the text of the draft Manual and presented only in annexes.

In the interest of conceptual clarity and consistency, I would like to propose the following structure for the Manual:

Chapter I Concepts and definition

- Government /Quasi-government organizations - their relevance to fiscal policies and transparency

- Legal administrative framework.

Chapter II Budget: Explanation of the Budget cycle

- Definitions, budget law, fiscal rules, preparation, procedures, coverage

- Classification of revenue and expenditure

- Extra budgetary funds - their treatment, importance of accountability and transparency

- Treatment of QFAs in the budget

- Treatment of aid funds

Chapter III Government relationship with central bank

- Financial institutions, both government and private

- Government owned non-financial enterprises, other government equity investment, their significance for fiscal policy and budget

Chapter IV - Accounts, their compilation, timeliness of presentation for public information, their consolidation at the end of the Budget period and presentation.

Chapter V - Audit

- Importance of internal audit controls

- External audit by independent agency

Chapter VI - Parliamentary checks - official accountability

- Budget approvals - reference to Budget law / fiscal rules referred in Chapter II.
- Public Accounts Committee

- Supplementary Budgets

Chapter VII - Macroeconomic projections of fiscal outlook in a medium term context and relationship with annual budgets

Chapter VIII - Transparency, Publication of Advance Release Dates, Availability of Information, Publications, Availability of Audited Accounts of the Government

In sum, I am sorry to say that I will not be able to recommend the Manual, in its present form, to my authorities and therefore, I cannot support its being on a web site.

Mr. Shaalan and Mrs. Farid submitted the following statement:

We thank the staff for the preparation of this important Manual. I hope that my comments on it will be seen as an effort to make the Manual more useful in its application to the membership and thus impart the transparency that is useful to the functioning of today's global economic system. In this spirit, we note that, given the short time between the issuance of the paper and the Board discussion, and particularly since August is a time when many officials are on vacation, authorities in a number of countries in the constituency I represent have not been able to provide us with detailed comments on the content of the draft Manual. We believe it is extremely important that members' fiscal agencies have the opportunity to present their input on the proposed draft Manual and questionnaire in order to enhance the Manual's acceptability and adaptability to the differing budgetary procedures applied in member countries. This is an important issue and we need to get it right. While we understand from staff that following this Board discussion a series of regional seminars will be conducted during which the views of the public, including participants from member countries, will be sought, we believe the appropriate course of action would have been to give member countries ample time to review the draft prior to publicizing it to the public at large. Accordingly, we would like our objections to the procedure adopted to be placed on record and request that the summing up of this meeting clearly state that the content of the proposed Manual will remain in draft form until a further substantive Board discussion takes place that takes account of the views of all member countries.

On the question of whether the Draft Manual meets the purpose of providing guidance to member countries on implementing the Code of Good Practices on Fiscal Transparency, our main comment has to do with presentation. We agree with many of the remarks made by Mr. Sivaraman on this issue and we think that staff was unduly concerned with following the format of the Code. Thus we do not follow the logic of staff's answer to Mr.Sivaraman that since the Manual is to provide guidelines on how the Code should be implemented the structure of the Code must be the starting point for the structure of the Manual, presumably even if that renders the Manual confusing! In fact contrary to staff's assertion, we would maintain that by mirroring precisely the structure of the code, the Manual has become far from user-friendly. In our view, a more concise presentation, particularly of the proposed minimum standards under a few main headings would be more effective in focusing the reader's attention. Good practices for countries with more sophisticated financial management systems should be separated from the proposed minimum standards.

Virtually by definition, the minimum standards should only include those standards that are regarded as crucial to effective fiscal management. It must also be clearly understood and noted that meeting even what are called minimum requirements may take time and require the provision of considerable technical assistance. Additionally, before formulating our views on the suitability of these standards as benchmarks to guide the Fund's surveillance, we would like staff to provide further elaboration on how they would expect to proceed in monitoring each of these benchmarks. Clearly some benchmarks will be more difficult to monitor than others. For example, how does staff propose to monitor progress in the identification of outstanding quasi-fiscal activities of Public Financial Institutions and Non-Financial Public Enterprises and the quantification of their actual and potential significance? Will staff be able to monitor these in all member countries, or will they have to be selective? If they will be selective, on what basis will the selection take place? How does staff propose to evaluate members' classification systems to determine if there is a clear tracing of responsibility for the collection and use of public funds? Will this be done for all member countries? It is issues like these, and surely many more, that we are not aware of that, in our mind, cast serious doubts on the implementation of the Manual.

We agree that the Fund should encourage voluntary implementation of the Code of Good Practices. The approach presented by staff in paragraphs 6,7, and 8 of the Supplementary Note, however, is not consistent with the voluntary aspect of this exercise. We note in particular that the paper proposes that staff could initiate a thorough assessment of fiscal transparency if a country does not carry out its own self-assessment. Also, staff would be authorized to second guess the answers to the questionnaires and summary assessments prepared by the authorities. First, we have serious reservations on the competence of Fund staff to evaluate these assessments. Second, and more importantly, we do not think staff should be in the business of checking the veracity of authorities' answers to the questionnaire.

In view of the voluntary aspect of this exercise, and until we see what Fund monitoring will involve in terms of required expertise and human resources, the implementation of the Manual by members should only be informally monitored and the confidentiality of the information provided by members should be preserved at all times. Until we are assured of a consistent quality of monitoring in all member countries, which we doubt can be achieved with the resources at hand, we do not agree to routine reporting to the Board on fiscal transparency in the context of Article IV consultations. Nor should completed questionnaires and summary reports be posted on the Internet by the Fund. We also do not think that the Fund should develop a quantitative index on fiscal transparency based on the questionnaire responses. Such indexes are misleading and too subjective and doing so would encourage officials to seek to embellish their responses rather than use them for a serious self-assessment.

A major shortcoming of the paper before us is the absence of a quantification of the resource costs of supporting the implementation of the Code. We are frankly surprised that we are still being told that the costs cannot be easily assessed, even though they could be significant. Clearly, the above questions pertaining to the role of the Fund in monitoring implementation, and the provision of technical assistance that will flow from this monitoring, cannot be properly addressed without an estimate of the costs involved. We, therefore, believe that a Board decision on these matters should await a clear presentation of the resource implications and staffing needs involved.

Finally, a question to the staff on paragraph 12 of the introduction to the draft Manual. Staff notes the need for cooperation between various organizations to ensure that resources aimed at promoting fiscal transparency be used efficiently. A possible role for the World Bank, the OECD, and regional development banks is referred to. Would the staff elaborate further on the extent of consultation that has been undertaken with the relevant organizations and on how the functions will be divided? Frankly, we cannot quite understand what is meant by "the World Bank could emphasize the developmental and more microeconomic aspects of the Code; and the regional development banks, with their geographical perspective, could play a role in tailoring the Code to different circumstances of their membership." Presumably, the Manual represents "the microeconomic aspects of the Code"; has the World Bank participated in its preparation? Have regional development banks provided their geographic perspective? In our view, these steps should be undertaken before this Board is asked to approve the draft Manual.

Mr. Spraos submitted the following statement:

I will answer all the questions posed by staff in the "issues for discussion" section of Supplement 2. Some I will answer in one sentence, or just one word. But I will address at some length the question whether the proposed minimum standards are set at an appropriate level. And I will also address at length a question not in staff's list: what is or should be the domain of the Manual?

As a preamble I repeat the general sentiment which I expressed when we discussed the Code: transparency is a good thing. There are areas which should be confidential to the government, especially in exceptional circumstances or in a transitional period. But, in general, transparency is a good thing and not just because it promotes honesty, trust and informed debate. It enables government to function more efficiently. It is an illusion to believe that fiscal affairs can be transparent within government while they are opaque vis-à-vis the public. At the core, transparency is indivisible. Coordination and consistency between various parts of government is hard at the best of times; it is much more difficult if opacity prevails.

The boundaries of a transparency manual

The Draft Manual by promoting transparency is also promoting efficiency in government. But a manual which is confined to transparency would be a different animal from one which addresses efficiency in the wider sense. Which animal do we want?

In paragraph 6 of the Draft Manual the distinction is enunciated clearly:fiscal transparency is only one aspect of good fiscal management, and care is needed to distinguish transparency from two other key aspects, namely the efficiency of government activity and the soundness of public finances. As the Code notes, attention has to be paid to all three aspects, which are clearly interrelated. But the Code does not advocate institutional changes that would promote efficiency or the maintenance of sound public finances.

This is in keeping with views expressed in the Board when the Code for transparency was discussed. But the practical difficulties of making the separation between transparency and efficiency are great. Because of this and perhaps because staff, with their natural enthusiasm for efficiency and good governance in general, tilted the benefit of the doubt towards inclusiveness we have ended up with an animal which goes extensively beyond transparency. At the same time, for the reasons given in the passage I quoted, it does not deal systematically with efficiency.

So, this is a hybrid animal. Recognizing the demarcation difficulties between transparency and efficiency, should we accept a hybrid as the best we can get? The Draft Manual has so much to recommend it that it is tempting to go for this option. But there is a pragmatic question that needs to be asked. Would the Manual be less acceptable if it extends beyond transparency and therefore have less impact? I am inclined to think that it would be less acceptable.

The Draft Manual makes a distinction between best practice and minimum standards but that is a different division from that between transparency and efficiency. And I am aware that the transparency Code which we have approved is not pure transparency either. But I believe the Draft Manual goes beyond the Code in that respect. Let me give just a couple of illustrations taken from the early pages of the Draft Manual. Box 2 on page 20 lists five of what it terms "Characteristics of Transparent Regulations." The second relates almost wholly to efficiency and good governance and not at all to transparency:

> New regulations should be introduced only after consideration of public costs, benefits, and distributional effects, and after comparison with alternative forms of intervention. Public consultation will often be desirable.

The third does not draw a line between transparency and non-discrimination:

> Procedures for applying regulations should be open and non-discriminatory. They should apply equally to the public and private sectors, and should contain an appeals process.

I agree with the principle. But it is not about transparency. Procedures can discriminate between the public and the private sectors while they can be perfectly transparent, if the rules that apply to the respective sectors are unambiguous and public.

Going through the text with a toothcomb—it need not be a very fine one—would yield many instances of this kind. If we decide we want to go for a purer transparency manual, I could communicate to the staff such instances as I have spotted.

I would favor going in that direction. A more specifically targeted manual would have a better chance of acceptance and therefore of application.

I did consider the alternative of going all the way to a manual on good fiscal practice, which would of course include efficiency. I find such an alternative intellectually very appealing but practically it would come up against formidable obstacles, not least that we do not have a mandate for going there. This is decisive, but it also means that we should be careful not to move in that direction through a back door.

Let me acknowledge again that the demarcation line between transparency and efficiency is a blurred one; not all of us would draw it at the same place. This hardly needs illustrating. But let me illustrate it, just the same, because the example I will use also has wider implications. The Manual advocates, as best practice, the publication of a complete balance sheet of government. This is a very radical proposal—it acknowledges that the practice of focusing on gross debt for assessing fiscal sustainability is flawed—and has everything to commend it on other grounds. But is it about transparency? Yes, since it furnishes fiscally relevant information. But no, since it cannot be considered failure of transparency not to reveal something that the government itself does not know. Even at the level of best practice, it could be argued that governments cannot be required to generate information on every thing that is deemed relevant. Where, then, do you draw the line about the information that the government must be required to provide, if initially it does not have it, in order to satisfy best transparency practice? I do not believe that there is a general answer to that. So inevitably there will be some arbitrariness. But we should make an effort to keep out of the Manual matters which clearly go well beyond transparency.

Minimum standards

I turn to the appropriateness of the proposed minimum standards. None of the authorities represented by this chair have flagged any difficulties and in one case, where we had an explicit reaction, the authorities are not uncomfortable with the proposed minimum standards. But I think it is incumbent upon us to check for problems.

I focus, first, on QFAs. (Paras. 36-39. Also paras. 76-79 and Box 9.) There are QFAs that need to be flushed out. But the number of QFAs in the wide sense of the term employed in the Manual can stretch, if not to infinity, to a very large number. How far down the list do you have to go to be deemed to have satisfied the minimum standard? Would you include the postal service in QFAs? It represents one of the most pronounced instances of cross-subsidization. You will have to include it if you go by the Draft Manual's example of less than cost recovery prices for electricity for rural areas. And why stop at public enterprises, as the Manual does. If it is a requirement that senior citizens be carried at a concessionary rate in urban transport, it does not matter whether it is a public enterprise which is instructed by the government to do it or private operators who are licensed subject to this condition. And what about the obligation often imposed on companies beyond a certain size, regardless of whether public or private, to employ a certain proportion of disabled people, war veterans, etc.? Or about costs of compliance with government regulations? They are costs of government; should they not therefore be counted as QFAs? Note that it does not matter whether there is believed to be a net benefit from the regulations (say, concerning the environment). By the logic of the QFAs, in the wide sense of the Manual, a cost is a cost is a cost. Step by step I could extend the argument to labor regulations, affirmative action laws, etc. etc.

There is no way, to my mind, that a very long list, or a shorter list (cut off at some arbitrary point) but with, at best, a fuzzy indication of what is to be included, can be required as a minimum standard. It will be too demanding and/or there will be no test by which it can be assessed whether what is included satisfies the standard

Regrettably, because it could let some abuses stay in the dark, I conclude that reporting of QFAs should not be in the minimum standards. I would keep them under best practice but would remove implications that QFAs are necessarily reprehensible. Theoretically there may be a better way of achieving the same result. But if the first best is infeasible, the second best is the best that is available.

Second, I turn to the medium-term macroeconomic framework (para. 105). This paragraph sets a minimum standard about two things, one appropriate and the other of little value. It is appropriate to demand that the forecasts and assumptions of the budget be made explicit. It is of little value to demand as a minimum standard a medium-term macroeconomic framework. It can be easily complied with: anybody can engage in numerology. But, in four cases out of five, it will be just numerology and will do more harm than good. What would be useful and could be set as a minimum standard (if not done elsewhere in the Manual) is to present the budgetary implications of new measures for one or two years beyond the budget year.

My third and last point under minimum standards relates to the operational balance (para. 116). The estimation and presentation of the operational balance and the structural balance are not included in the minimum standards. It is understandable about the structural balance: it is not straightforward to compute. But the operational balance is easy and is more essential the higher the rate of inflation. Its estimation when inflation is above a threshold rate (say 5 percent) could be included in the minimum standards.

The questions posed by staff

Will the Draft Manual help member countries in implementing the transparency Code?

Yes. But, for reasons given above, I believe the Manual is freer in its interpretation of what constitutes transparency than the Code. This should receive careful attention, notwithstanding that the Code itself is not entirely blameless in that respect.

Are the proposed minimum standards set at the appropriate level?

Broadly yes, subject to the points raised above. But I would like to hear the views of those with experience of budgetary mechanisms at the weakest end of the spectrum.

Does the Draft Manual's approach encourage voluntary implementation of the Code?

If I understand the question, it does not seem very different from the previous one.

Should the implementation of the Code be reported to the Board in the context of Article IV consultations? Yes.

Should information on implementation be made public?

I am ambivalent on this one. It would be a form of pressure and "voluntary" must mean voluntary. In any event, the questionnaire which will elicit this information needs some redesigning. It is meant to be a self-assessment exercise. But no self-respecting government is going to check the first box under most headings.

Should the Fund develop a quantitative index on fiscal transparency?

Let the subject of appropriate weights for such an index be researched and if, contrary to my expectations, a respectable quantification emerges, we can consider it later.

Do the resource implications for the Fund need to be considered? Yes.

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

As the four general principles of the Code on Fiscal Transparency have been endorsed by the Interim Committee in its April Meeting what remains by way of introduction is merely to highlight that in our view fiscal transparency can serve to enhance the efficiency and soundness of the public finances. In this connection, the efforts to prepare a Manual to improve existing practices in this area is commendable and timely.

It should, however, be noted that while the distinction between good and best practices reflects the diversity in country backgrounds and capacity constraints, the characterization of minimum standards to be implemented could be seen as conflicting with the intended voluntary nature of the Code. Perhaps a better expression could be found to avoid giving the impression that countries are being compelled to adhere to the minimum standards.

Notwithstanding this general observation, we consider the Code and the Manual as providing suitable benchmarks to guide the Fund's surveillance and technical assistance activities. Paragraph 6 of SM/98/199, Supplement 2, strikes in our view the right balance between the encouragement to be provided to members to adopt different aspects of the Code on occasion of the respective Article IV Consultations and the restraint that staff will have to exercise to exert avoid including in their appraisals detailed reference to the degree of compliance with the Code. This restraint should in particular apply to some of the external communications modalities suggested under number 4 of the issues for discussion section, such as posting the completed questionnaires on the web or developing quantitative indexes on fiscal transparency.

Supporting implementation of the Code is crucial for its success. In this regard, the papers convey somewhat conflicting messages concerning the likely budgetary costs for the Fund. While paragraph 13 of the main paper states that although some increase in the demand for technical assistance is inevitable, the assistance being provided in the areas of fiscal management and budgetary processes already addresses many of the issues raised by the Code. On the other hand, the fifth issue for discussion states that the costs could be significant. A realistic and detailed assessment of the likely resource requirements to help members effectively usher in the suggested technical improvements is deemed not only desirable but necessary.

Having addressed the issues raised for discussion, we will make some comments on specific paragraphs of the Draft Manual which could benefit from greater clarity. A general comment first, the repetition of concepts or guidelines throughout the paper confirmed by the numerous cross-references in the text which, for example, touch on the issue of QFA in three separate paragraphs: 23, 38 and 76, as well as in footnotes and Boxes, would suggest the desirability of some editorial simplification to enhance consistency.

A few specific suggestions are offered below:

Paragraph 12: While agreeing fully that other organizations such as the World Bank and the OECD should cooperate with the efforts to promote fiscal transparency, including through the provision of technical assistance, the closing sentences of this paragraph starting with "Thus the OECD could focus on those aspects of the Code more relevant to its advanced economy membership, ..." denote compartmentalized application rather than universal principles on transparency to which all countries should aim, without distinctions.

Paragraph 18: To the extent that the definition of government activities in the System of National Accounts does not cover the commercial activities of the non-financial public enterprises (NFPEs) and their losses and profits may have a clear fiscal impact, there would seem to be a case for bringing in this aspect more specifically into the proposed Manual, perhaps in the context of paragraph 39 and not only under the concept of QFAs as is done in the bottom of paragraph 77.

Paragraph 26: Regarding the relationship between national and subnational governments, the paper states that it should not be subject to ad hoc annual negotiations, but determined according to stable principles and/or agreed formulae". Notwithstanding stable principles or agreed upon formulae, the arrangement may not be optimal. Thus, greater elaboration of the recommended principles that should guide that relationship could be helpful.

Paragraph 39: When discussing the relationship between the general government and NFPEs, the often recurrent situation of arrears among NFPEs and between them and the central government and even individual states, suggests the need for a specific reference to facilitate the assessment of the fiscal stance, and of the efficacy of corrective measures.

Paragraphs 47-50: Weaknesses in the legal framework, including administration of the judiciary system may constitute a serious impediment for the accomplishment of fiscal objectives. We consider these paragraphs on the legal basis for taxes and their administrative application properly highlighted in the Manual.

Paragraphs 63/65: "Where independent borrowing by subnational governments is effectively controlled by regulation", it is suggested that reporting by central government would be sufficient. In paragraph 65, however, it is stated that "all governments should provide ex post data on the general government". On balance, the extent of the reporting obligation, which is central to bringing some form of market discipline to bear, seems somewhat ambiguous.

Paragraph 67: The Manual on Transparency recommends ambiguity regarding the possibility that the government might bail out a private sector bank to minimize potential for moral hazard. At the same time, paragraph 69 underscores the importance of reporting contingent liabilities of the type that paragraph 67 advises against.

Paragraph 68: It highlights the limitations of the cash basis accounting regime to account for contingent liabilities. We wonder, however, if an accrual basis regime would take care of the problem, as it seems implied by the paragraph. Staff comments would be appreciated.

Paragraph 70: In order to better assess the risks involved in loan guarantees or indemnities or to prevent abuses from preferential treatment, the names of the beneficiaries as a minimum or their main functional economic activity, should be included among the items to be reported.

Box 9: The listing of QFAs of several contingent liabilities, such as loan guarantees and exchange rate guarantees tends to confuse the two concepts. The confusion between contingent liabilities and QFAs becomes fully apparent in the example given in the second part of paragraph 77. In addition, some elaboration which specifically incorporates the inflation tax as a QFA might be desirable.

Paragraph 76: Footnote 53 merits clarification as it gives the impression that a central bank does not have any type of constraint. An assertion which does not stand if the set of policy objectives, including price stability is to remain unchanged. Seigniorage may not always be present or be of sufficient size to cover losses in which case the only alternative is inflation, which should not be confused with seigniorage.

Footnote 54: Since a central bank could influence market interest rates through several instruments, including through the discount rate, its inclusion as QFA would warrant some caveat particularly when used as a monetary policy tool.

Paragraph 85: "financial assets are defined as nonfinancial assets available to the government..."

Paragraph 86: Where central banks have issued their own debt and particularly in those cases where the financial relations between the central government and the central bank are not clearly demarcated, there would seem to be a case for a broader reporting of liabilities.

Paragraph 97: The expressions "a clear statement about the fiscal intentions of the government" and "statement of government fiscal policy objectives and priorities" could be confused with those in paragraphs 113-114, which refer to the objectives of government activities measured in terms of outputs and outcomes, as defined in the Annexes. It is important, therefore, to make clear in paragraph 97 that these refer to the expected fiscal balance in the following and subsequent years.

Paragraph 103: It would be helpful if the different approaches for assessing public debt sustainability were presented as complementary rather than, as it seems to be the case now, alternative ways to deal with this issue.

Paragraph 107: It includes again the suggestion that transparency cannot go as far as accounting for potential liabilities derived from possible bail outs. We find some inconsistency between what is stated in the Code in point 3.1.5 and what is in the Manual.

Box 14: Its purpose or message seems ambiguous, and might well be deleted or substantially rewritten..

Paragraph 118: The expression "regular net lending" in the fourth line seems in fact to refer to "regular net borrowing".

Box 15: It fails to address fully one of the most important recurrent issues in recent Asian crisis cases, i.e., the amount of resources involved in recapitalization activities, which was or will be several times the recorded overall fiscal balance. Given its economic impact looking forward the "augmented balance" concept covering the issuance of massive new government debt to recapitalize PFIs deserves more specific consideration.

Finally, the association in paragraph 135 between recapitalization and accumulation of past quasi-fiscal operations is not fully convincing. The example of the Asian crisis cases, points to inadequate cover for exchange rate risk feeding critically on the intensity of the crisis through the soundness of the banking and corporate sectors. The extent of the overshooting of the exchange rate, however, was hardly predictable and as such makes the economic impact difficult to characterize as a QFA. In any event, our preference would be to refrain from resorting in this important initiative to backward looking concepts as a means of enhancing inter-temporal fiscal solvency.

Mr. Zamani and Mrs. Vongthieres submitted the following statement:

We appreciate staff efforts to prepare a comprehensive manual on fiscal transparency in conformity with the agreed principles and guidelines outlined in the Code of Good Practices on Fiscal Transparency--Declaration on Principles. The draft manual is extremely detailed and covers a wide range of technical aspects that need to be examined more thoroughly and further refined if it were to provide a useful and practical guidance for member countries in their attempt to enhance transparency and discipline in fiscal practices.

While the work towards increased fiscal transparency is welcome, one should be mindful of the potential danger of imposing discreet judgments and abuse of the concept for particular purposes. Adequate safeguards should be properly spelled out and enough flexibility given to member countries. Apart from the differing status, procedures and practices currently followed by countries, there are also constraints on technical and institutional capacities of member countries to improve further on. In this respect, we fully endorse the guiding principle of voluntary implementation as emphasized by staff and wish to stress that this principle be strictly observed at all times.

This being said, we would like to comment briefly on specific issues:

We consider the proposed set of minimum standards broadly appropriate and fundamental to effective fiscal management and reporting system. However, a clear boundary needs to be identified between public and private sector activities. Specifically, the manual should provide more detailed definitions and examples in order to distinguish clearly the operations of extra-budgetary funds (EBFs) and quasi-fiscal activities (QFAs), which may be classified differently among countries.

On the transparency of behavioral aspects of fiscal agents, the call for behavioral changes involves evolutionary changes to the political and market systems that pose significant institutional limitations. These requirements include rational procedures for setting regulations, clearly defined goals of government regulations of the private sector (1.1.2), rational procedure for procurement and employment (3.3.2), standardization of external auditing (4.1.1). Its inclusion in the minimum standard requirements bounds to discourage voluntary participation of member countries. The manual should thus primarily emphasize the aspects of data reporting and openness.

The improvement to data reporting and openness of the fiscal accounts are agreeable and can be considered part of the minimum requirement. However, we do not support the inclusion of the requirement to publicize multi-year macroeconomic and budget forecasts, particularly statements on macroeconomic assumptions in which budget estimation has been made. Although this may help enhance the credibility of the budget in theory, it could at the same time undermine the existing credibility of many developing countries which lack sufficient data base and technology and thus find it difficult to commit to announcing macroeconomic forecasts on a bi-annual basis under a well-controlled margin of error. This would also discourage willingness for compliance.

In this light, the Fund is expected to stand ready to provide technical assistance in order to facilitate an early implementation of the manual by members. However, given the constraints in terms of both financial and staff resources, as well as the current situations in the international financial system that are more pressing and of more concern, technical assistance in this area is definitely considered low priority. This argument is valid not only for the Fund but also for its member countries which have more urgent issues to attend to. Therefore, it can be expected that the majority of member countries will not be able to show significant progress on improving their fiscal management and reporting in the near future. It is not the case that we backtrack on the agreed commitments as set out in the Code but we simply lack the means and time to achieve them. The markets may take this negatively; putting the whole exercise into jeopardy.

One way to avoid this is to keep it low profile. For these reasons, we do not find it reasonable, or practical, to pose a questionnaire and summary report on the Fund external web site. What is its objective, what is the expected end result, and how are the operational procedures? We do not see any benefit from having the general public respond to these questions. If the objective is to have each country assess its own current system, a status report can be easily obtained from consultation with the authorities themselves. It is not clear how staff intends to do with the responses, but would caution against the temptation to compare and rate countries on fiscal transparency standards.

Also, as the manual will certainly have implications on future Fund's surveillance, it needs to be clarified at this point how the manual will be used in Fund surveillance and reporting procedures--whether the status report on fiscal transparency will become part of the country's staff report as in the case of data availability and dissemination. Experiences with GDDS and SDDS are the case in point where statistical data availability and dissemination turn out to be one of the main debatable issues and countries are most likely pushed to accept the most stringent standards. In this regard, we would like to reiterate our stance that the implementation of the manual on fiscal transparency must be voluntary and at the pace that country authorities are comfortable with. Moreover, there should be no attempt by Fund staff to evaluate their performance, even through Article IV consultation.

Mr. Daïri made the following statement:

Fiscal transparency is a key element in achieving fiscal sustainability, enhancing tax compliance, improving effectiveness and rationalization of public expenditure, thereby mobilizing support for sound macroeconomic policies and structural reform. We welcome this preliminary discussion of the draft manual on fiscal transparency.

The exchange of views will be a useful input for our authorities to comment on the draft manual. We believe that the manual should be exclusively of a technical nature, indicating various modalities and country practices to implement the principles on fiscal transparency adopted by the Board and endorsed by the Interim Committee. In this context, we believe that the draft manual should not be submitted for formal approval by the Board or endorsement by the Interim Committee. This would preserve its technical character and will allow further suggestions and amendments.

We view this manual not as a checklist against which formal assessments of fiscal transparency would be made, but rather as a set of principles and practices to help member countries and their public evaluate their progress in this respect. In line with the view expressed in the paper that implementation of the

Code should be on a voluntary basis, we cannot, at this time, support the view expressed in para 4 that the Code or the draft manual should represent a standard that most countries should seek to meet.

We support the four points highlighted by the staff regarding the way the draft manual is prepared, namely that: (i) the Code is to be implemented on a voluntary basis; (ii) it does not (and should not) address issues of efficiency of government activity and soundness of public finances; (iii) implementation by member countries would vary, depending on diversity of their background and capacity constraints; and (iv) the Code and the manual are intended to be supportive of other areas where international standards have been developed.

It does not seem appropriate to set standards for fiscal transparency that put difficult constraints on less-developed countries and very little, or none on the most-developed. A more evenhanded approach should set high standards for advanced economies, and low or intermediate ones for other countries. During the earlier discussions of the issue, this chair suggested that the standards should cover areas particularly relevant to the most advanced economies, such as long-term viability of social security and pension funds and generational accounting. We would appreciate an indication as to why no proposals on these issues were included in the draft manual.

We can support the opening of a web site for access to the Code and the manual. However, more clarification is needed on the purposes of the proposed questionnaire. Many of the questions cannot be answered easily since they include a significant judgmental component and there are no straightforward benchmarks to rely on. For example, how could officials indicate that their government involvement in the private sector is pervasive and not well-defined? Unless an interactive process is carried out with the authorities to clarify the situation of their country with respect to the various components of the questionnaire, one cannot expect that clear and relevant answers will be provided. It is also important to ensure that any interactive communication between the staff and Internet users should be limited to explaining the Code or the manual; the staff should refrain from making any assessment on member countries practices or adherence to the standards. The surveillance process involving concerned members and culminating with the Board discussion must remain the only recognized channel for conveying Fund's views.

We generally agree with the guidelines of the draft manual with respect to clarity of roles and responsibility. However, some assessments have no place in the manual and should be deleted since they go beyond the issue of transparency. For example, para. 22 starts: "Direct regulation by government has a pervasive influence on the private sector." The same can be said about para 23, which blames directed lending and requirement of banks to hold government bonds at below market rates for undermining the profitability of banks.

We support the integration of extrabudgetary funds into the budgetary process as well as transparency with regard to quasi-fiscal operations. Regarding the implicit subsidies in differentiated pricing for provision of public services to different groups of consumers referred to in para 39, we agree with the principle that such differentiation, when needed, is best financed through implicit budgetary transfers. However, the implementation of this principle may at times be difficult since it would lead to a large number of channels for subsidization and increase administrative costs as well as opportunities for misuse of funds.

We agree with the principles regarding the legal basis for all taxes, including its accessibility, clear criteria for its implementation, and protection of the rights of taxpayers. On the ethical standards of behavior of public officials, while we concur with the underlying principles, in our view the manual could suggest that disclosure of personal assets and liabilities of public officials should be made mandatory.

Regarding the presentation of budgetary outturns and forecasts, difficulties may arise in countries where economic activity, and the conformity of outcomes to projections, may fluctuate significantly due to weather or other exogenous factors. In such cases a budgetary presentation based on structural balance is appropriate. It will take time however to draw the necessary framework and build up an expertise for such presentation.

We agree on the need to provide a full description of contingent liabilities and tax expenditure. The public should also have access to information on tax arrears, with a clear delineation between small and large levels of liabilities, and on governments arrears with respect to tax reimbursements, including outstanding VAT credits, where applicable.

The range of quasi-fiscal activities described in the paper is very wide. We wonder whether some activities, such as unremunerated reserve requirements, or credit ceilings should be included. Such operations are conducted for monetary purposes only, particularly in countries that do not have a well-functioning money market. It is better to limit the coverage of quasi-fiscal activities to those that have similarities with fiscal operations. Otherwise quasi-fiscal activities would be seen in most regulations.

Turning more specifically to the issues for discussion, we broadly agree that the draft manual meets the purpose of providing guidance to member countries on implementing the Code. However, we share some of the concerns expressed by Mr. Sivaraman regarding its presentation. While we commend the staff for mirroring the structure of the Code, which would help the Board focus on the essential elements of transparency already agreed upon, we believe that it may be possible after Board discussion to redraft the manual in a more user-friendly manner.

We do not see the minimum standards as suitable benchmarks to guide Fund's surveillance and technical assistance activities. If implementation of the Code is voluntary, it should not be a surveillance issue. Surveillance derives from members' obligations under the Articles of Agreement and not from voluntary endeavors. We also see some contradiction between the voluntary nature of the implementation of the Code and the proposal for the Fund to encourage such implementation.

Like Mr. Shaalan and Mrs. Farid, we do not see a role for a formal or open monitoring of the implementation of the Code. Fund assistance to members in implementation of the Code should remain confidential unless members agree to publish their assessment and progress in this regard. Moreover, in view of the variety of situations and regulatory arrangements, it is not possible, nor advisable, for Fund staff to classify countries by degree of fiscal transparency.

Finally, we feel uncomfortable with the Fund embarking on a major initiative without a clear assessment of its resource implications. Moreover, it is very likely that any significant progress in fiscal transparency would be extremely costly for the large majority of the membership in terms of budgetary resources and expertise, but also on the institutional front. Many of the proposed changes have also political implications and may challenge the limited legislative and administrative capacity of member countries. Any assessment by members of their situation with regard to the Code should include an assessment of what is needed to push ahead with its implementation.

Mr. Palei made the following statement:

I welcome the discussion of the first draft of the Manual on Fiscal Transparency. It was my understanding all along that the proposed manual is likely to be revised and updated frequently. Therefore, although I share the concerns of many Directors about the depth and comprehensiveness of the first version of the manual, its publication should not be delayed for too long. In my view, it is more important to attract the attention of the policy makers and other interested parties to the ideas reflected in the Code of Good Practices on Fiscal Transparency--Declaration of Principles and to the practical implementation of these ideas. As experience is accumulated and good practices are analyzed and refined, this progress should be continuously incorporated into the manual envisaged by the staff.

In my view, in the future, the manual should include a set of rather detailed case studies on fiscal transparency. Each case study should specify the fiscal challenges a particular country was facing, why transparency was considered to be an essential part of the fiscal reform, what were the main steps taken by the authorities, and what are the preliminary results of their efforts. The Fund's Fiscal Affairs Department already has experience in preparing similar studies. I refer to two books published by the IMF in 1992 and 1993. The first volume, Fiscal Policies in Economies in Transition, dealt with the general framework; and the second volume, Transition to Market, contained applications of this general framework to specific country cases. I believe, the manual on fiscal transparency should have the same structure.

In the proposed draft I did not find a clear description of the universal benchmarks to assess and compare fiscal transparency across Fund members. I remain skeptical about the possibility of identifying such universal criteria. I would rather emphasize a case by case approach with assessment of the progress toward fiscal transparency in comparison with the initial situation in a particular country. In light of the above, I do not see a persuasive case in favor of having an index of fiscal transparency or any other quantitative indicator designed for ranking the countries according to the achieved degree of fiscal transparency. At the same time, I see merit in trying to distill minimum standards along the lines proposed by the staff and to make this presentation more concise, as proposed by Mr. Shaalan.

The manual will be a good guide for the staff to carry out surveillance of its members. However, it is important for the staff to be open-minded and flexible in the application of the manual. The staff should aim at reaching consensus with the authorities on the need for the enhancement of fiscal transparency. While the staff should be frank in their assessment of fiscal transparency in the Article IV reports, confidentiality considerations should always be respected.

The Fund should evaluate resource implications and staffing needs before it makes any public commitments to the provision of large scale technical assistance on fiscal transparency. More generally, I would prefer to see a special note prepared by the staff on the availability of technical assistance in the fiscal area, including fiscal transparency. Information on current activities of the other international organizations, including the World Bank and regional development banks; on the technical assistance provided on a bilateral basis; and on the range of the services currently provided by the private sector, would be very helpful.

Mr. Shields made the following statement:

Transparency is a crucial element in ensuring that fiscal policy is credible, prudent, and sustainable. Earlier this year, we agreed the broad principles underpinning fiscal transparency. This draft Manual takes us a stage further by setting out, in a very clear and practical way, guidance on how to follow those broad principles. I liked, in particular, the links to existing international standards. This will help us to include a measure of consistency in the way we report and monitor our own fiscal developments.

The Code and the Manual will, of course, need to be updated and improved over time. But I think they already provide us with good frameworks for action, which will enhance openness and transparency across the full range of fiscal operations.

The checklist of principles set out in the Code has already been very useful in helping us to make UK fiscal policy more transparent. Earlier this year, we prepared a summary comparison of our compliance with the Code, following a format very similar to that suggested in Annex II of the staff paper. A revised version of this comparison is attached to this statement. Without prejudice to other countries' actions, my authorities would be happy for this to be placed on the proposed fiscal transparency home page on IMF's external website.

Implementation and Monitoring

Subject to agreement on the broad structure of the Manual, our first priority should be to determine ways in which the messages of the Code can be best promoted. We see a good case for staff encouraging self-assessment or undertaking their own reviews of transparency as part of the Article IV process. A summary comparing current practices with the Code and noting particular areas of concern could then be included in the Staff Report, but there would be no need for detailed exposition. This informational exercise would be of considerable benefit to the country concerned and could form the basis for further discussion or technical assistance.

I am also attracted by staff's idea that countries would contribute to a fiscal transparency home page. This would add to the ways in which governments are able to publicly commit to fiscal transparency, in the same way that the Dissemination Standards Bulletin Board has allowed members to commit to improved data standards.

I appreciate that all of this will involve costs. Some countries will want additional technical assistance to help them in drawing up a plan of action to enhance fiscal transparency. Resource implications will, of course, need to be discussed within the context of the IMF's overall budget and priorities. But I would emphasize the importance of seeking the support of other institutions, such as the OECD and the World Bank, and cooperating with them to help reduce the resource costs, as well as to ensure effective implementation of the Code.

Graduated Standards

We talked, during our discussion of standards a couple of months ago, about the desirability of uniformity in standards on the one hand, against recognition that countries at different stages of development may have different priorities on the other. I think the staff have come up with a very useful compromise between these two ideals, in identifying:

a core of crucial minimum standards, which all countries should be able to achieve relatively quickly;

a number of second-stage improvements or "very best practice" which those who have met the minimum standards can then aspire to.

Detail

While the Manual will need to evolve over time in response to changing circumstances, I was generally happy with detailed practices which have been outlined at this stage.

In one or two areas, however, I have some sympathy with Mr. Spraos' concerns that staff may have strayed beyond transparency to begin to advocate specific policy decisions:

- in paragraph 24, which deals with government holdings of private equity, it is probably beyond the scope of the Manual to press for a level playing field in terms of the way in which taxes, duties, and regulations are applied;

- similarly, in paragraph 137, the Manual should stress the need to establish clear guidelines and an accountable tender process for government procurement. But there are a number of different ways of achieving this outcome and the Manual should not rule out on option in favor of another (i.e. establishment of independent tender agency.)

My other specific comments are less easy to group but, following the order of the draft Manual, they are:

- paragraph 55--the reference to sharing information between revenue departments should note that this must be subject to confidentiality provisions and country specific legal restrictions;

- paragraph 57--the reference to advance tax rulings is at odds with the other taxpayers' rights which are listed. Rather than a principle it is one of a number of administrative procedures that can be used to provide information on the interpretation of a tax law. I would either add the qualification 'as appropriate' or drop this point from the Manual;

- paragraph 66--the requirement of publishing historical forecasts and outcomes for the past 2 years should be a basic requirement. A more advanced standard might include publishing information on forecast errors over a longer period;

- paragraph 80--the reference to government solvency should be changed to fiscal strength or sustainability. These terms are more relevant in discussing the public finances and will reduce confusion given the meaning of solvency for private sector organisations.

The Director of the Fiscal Affairs Department thanked Directors for their statements, and remarked that the staff would answer some of the more technical questions on a bilateral basis. On the perceived haste to consider the Manual before the Annual Meetings, it had been distributed at the end of July 1998, which should have provided a reasonable amount of time, given the usual workload of the Board. The staff had preferred reactions prior to the Annual Meetings, as the document included a proposed plan of action. Also, it had to be stressed that the Manual was a continuing work in progress—every month, items would be added and removed. As such, it was not a document that had to be approved or not approved, so there was no reason to wait until after the Annual Meetings when the Board's agenda tended to become more onerous.

Some Directors had questioned whether it had been necessary for the Manual follow the structure of the Code of Good Practices, the Director continued. That had seemed to be a logical approach, as the Manual was designed to explain the Code in detail. Without a similar structure, the Manual would have become a document in itself, and readers would have had more difficulty relating one to the other.

On the resource implications of the document, it should be noted that the staff were already engaged in much of the activity described in the Manual, the Director remarked. The Fund had always been concerned with the issue of fiscal transparency, and much work had already been done. The Manual simply highlighted particularly important areas. However, it would be extremely difficult to estimate what resources would be needed, as it was difficult to judge how seriously different countries would take the recommendations, how aggressively they would ask for assistance, and how helpful the Manual would be in reducing the number of subsequent requests. There was also the question of coordination with other institutions. The staff had engaged in extensive coordination with the OECD and the World Bank during the preparation of the Code and the Manual. But until the Manual was endorsed, it would be difficult to predict the extent to which those institutions would be able to help.

On the issue of efficiency versus transparency, the Director agreed that the Code and the Manual should be strictly concerned with transparency. Directors' comments in this regard had been entirely appropriate, and, to the extent that they had unnecessarily emphasized other issues, the documents would be amended.

There had also been a question on the extent to which regulation by members was a fiscal activity, the Director commented. Almost any regulation had a fiscal dimension, so it was important to focus only on those regulations which had more obvious fiscal consequences—for example, regulations that forced banks to lend money at non-market rates should be within the scope of the Code.

On the question of monitoring, the Interim Committee had asked the Fund to monitor progress in implementing the Code, the Director remarked. However, the real issue was not the monitoring of implementation, but was instead the monitoring of members' progress in introducing fiscal transparency. The Fund had always been concerned with that issue, and had always been interested in comparing data across different countries. The main channel for monitoring had been assumed to be the Article IV consultations. However, that did not mean that every Article IV staff mission would report on each country's fiscal transparency. Instead it would mean that, when staff were aware that a country was experiencing transparency problems, the Article IV staff mission would pay special attention to the issue.

On the confidentiality of the Fund's findings, given that the Code was already public, there would be little harm in publishing the blank questionnaire on fiscal transparency, the Director suggested. However, just as technical assistance reports were confidential, the results of those questionnaires should also be kept confidential, as they would generally be included within those reports. On the question of whether the Fund should publish an index based on questionnaire results, such an index would not be feasible for at least a few years. However, nothing would stop a member from publishing their own results.

Responding to a question from Mr. Daïri, on the role of the Board in approving or endorsing the Manual, the Director responded that the Board could not approve the document, as it was simply a draft that would require continuing amendment over time. However, given that the Manual might open a new activity for the Fund, and given that the recommendations might require considerable attention by member countries, the staff considered that it would be useful to have a sense of the Board's reaction. Perhaps a distinction could be made between the Board's approval and its endorsement.

Mr. Shaalan remarked that the coverage of the Manual appeared to be very broad, extending to items such as the quantification of quasi-fiscal operations that could be beyond the scope of even the most advanced member economies. Perhaps a more tightly-focussed Manual, with minimum standards, would be preferable.

The Director of the Fiscal Affairs Department replied that, although the task was often difficult, many countries had been able to quantify their quasi-fiscal operations. Furthermore, as the Manual was intended as an instructional tool, the staff had thought that it should be complete as possible. The Manual did not suggest that countries would have to implement every item precisely and quickly. Instead, countries could identify their own priorities, perhaps with Fund assistance.

The Acting Chairman remarked that the inclusion of a comprehensive list was not always costless, as many members might tend to be daunted if confronted with an overwhelming mass of detail. He wondered if that problem might be lessened through an alternative form of presentation.

The staff representative from the Fiscal Affairs Department remarked that the term "minimum standards" might be inappropriate, as it suggested an element of compulsion. Perhaps the term "high priority requirements" would be preferable. Box 1 of the draft Manual outlined a summary of fiscal management requirements, with certain high priority items highlighted. That format had been somewhat confusing, so the staff had prepared an alternative table that separated those items from the other requirements—it should be stressed, however, that although those other requirements were of lower priority, they were still important. The staff had also separated those standards based on the best practices of more developed economies. So the new table would have three separate levels of requirements, with different priorities and applying to different countries.

Mr. Sivaraman thanked the Director of the Fiscal Affairs Department for his remarks, but questioned the distinction between the Board's approval and its endorsement. Also, the document did not appear, as yet, to be an adequate working guide for budgetary planners and fiscal policy managers. A considerable amount of work remained, and Directors would probably put forward a number of detailed suggestions. Once it incorporated those comments, a revised document might then be ready for the Board's approval.

The staff representative from the Fiscal Affairs Department appreciated the comments of Mr. Sivaraman and other Directors who had remarked that the Manual was not user-friendly. However, the Manual was aimed at a wide variety of different users. The staff's preferred approach, therefore, had been to take into account Directors' current comments, and then to place the revised version into the public domain as quickly as possible, so that a wider audience would be able to contribute on its content and structure. Once those contributions had been collected, a major rewrite would be considered. However, although Directors' suggestions would involve significant revisions, a substantial restructuring of the Manual at this stage might not be the best way forward, particularly one that did not follow the structure of the Code. The Manual and the Code had been designed with the Internet in mind, as the staff had judged that the World Wide Web was an ideal medium to allow users to easily cross-reference between the Code, the Manual, the questionnaire, and the summary report. Having the structure of the Manual changed would make such comparison more difficult.

The Acting Chairman suggested that the Internet version of the Manual might include proposals for alternative structures, such as the one proposed by Mr. Sivaraman.

Mr. Sivaraman remarked that he had simply considered that a number of items in the Manual required further clarification. For example, page 12 of the draft stated that "the annual budget should cover all central government operations in detail, and should also provide information on central government extrabudgetary operations." That statement seemed somewhat puzzling—in countries where the budget was a statutory document, approved by parliament, if it contained details of extrabudgetary operations, they would then, by definition, become part of that budget. Further, the Manual required that "...sufficient information should be provided on the revenue and expenditure of lower levels of government." It was unclear how that information would appear in a federal government budget, as that might not be consistent with a federal constitution.

The Director of the Fiscal Affairs Department pointed out that such procedures had been followed routinely in Brazil, which had a federal constitution. The annual budget outlined the budget of the central government, but an appendix contained details on the planned activities of state and local authorities. The procedure was not unconstitutional, as the central government was simply reporting information, rather than dictating the expenditures of lower levels of government. Further, that information had been extremely useful in assessing the overall position of fiscal policy.

Mr. Sivaraman explained that, in federal countries where there was a constitutional provision that local governments present their own budgets, those budgets could not be subject to the approval of the national parliament. So although they might be presented as informational documents, they could not be included in the formal budget itself. The language of the Manual suggested that the central budget would have to include those details. That was a technical point, but was indicative of the confusion that might arise from the current language, and was one of the items that would have to be clarified before any endorsement.

The Acting Chairman remarked that such issues could be clarified easily on a bilateral basis.

Another staff representative from the Fiscal Affairs Department commented that it was important to confine the Manual to transparency, rather than allowing it to cover broader questions of budgetary management. Previous attempts to provide a universal budget manual had foundered on basic structural, institutional and cultural differences between countries. The World Bank had published a budgetary handbook with a structure similar to that outlined in Mr. Sivaraman's statement. However, that handbook covered in detail the organization, delivery, structure, and presentation of the budget, and so extended beyond simple issues of transparency.

Mr. Daïri remarked that it was important to separate the work on the Manual from the Interim Committee meeting. The Director of the Fiscal Affairs Department's wish for endorsement was understandable, but the Board was not endorsing a document; it was instead endorsing a process and reviewing the staff's progress so far. As such, neither the Board, nor the Interim Committee, needed to formally endorse or approve the document.

Further, the concept of surveillance and the voluntary nature of the process were mutually exclusive, Mr. Daïri continued. Surveillance by the Fund was based on members' obligations under the Articles of Agreement, not from their voluntary efforts. The two issues should not be confused. Similarly, on the language of the documents, while the Fund should stand ready to "assist" members who wish to implement the Code, it should not be in the position of "encouraging" them to do so, as encouragement from the Fund was often tantamount to an injunction.

Mr. Shaalan stated that he supported Mr. Daïri's sentiments on endorsement and approval of the Manual.

The Acting Chairman pointed out that the Fund's surveillance did not just cover members' obligations under the Articles. Acceptance of the Basle Committee standards was voluntary, but was nonetheless subject to Fund surveillance.

Mr. Shields remarked that, although technical assistance reports should remain confidential, if members wished to publish information about their practices, the Fund should provide a facility for them to do so. His statement had included a comparison of U.K. practices and the requirements of the Code, and the U.K. authorities wished that information to be placed on the Fund website, as that was an inexpensive and simple means of distribution. Other authorities might wish to do something similar.

On the question of whether voluntary efforts could be subject to surveillance, the Fund did not demand that members implement particular policies under the Article IV process, Mr. Shields continued. Rather, it simply offered an objective assessment of members' own policies. Transparency would appear to fit within that surveillance framework. The Fund would not be forcing transparency on members, but it would be in a position to offer a helpful service.

Mr. Szczuka remarked that Mr. Sivaraman's suggested structure appeared somewhat directive. Instead, the Manual could be made more accessible by simply improving the structure, while keeping the order of the Code. First, there should be a clear separation between minimum standards and current best practices. Although the staff had indicated their efforts to address that concern, it might be helpful to structure the Manual so that it first presented each problem, then presented the minimum standard that should be applied, and then outlined the current best practice, with country examples if necessary. Second, further work was needed on separating the issues of efficiency and transparency. Third, some parts of the paper appeared to be a somewhat academic review of the literature, rather than a practical guide for policy makers.

Mr. Daïri, commenting on Mr. Shields' proposal that members be allowed to publish information on the Fund website, questioned whether additional links—to government regulations, publications, and others—would be necessary, to allow readers to verify the authorities' statements. Also, there was the issue of whether the Fund would endorse the information placed on its website

Mr. Spraos, commenting on the potentially wide coverage of quasi-fiscal activities, questioned whether there was an objective basis for determining which reporting requirements would be set as minimum standards.

The Director of the Fiscal Affairs Department replied that the determination would be made on the basis of whether particular activities were quantitatively important. Furthermore, the list of important activities would vary from country to country. In Indonesia, the most important issue probably would be the implicit subsidy given to various products. In Chile in 1985, the important issue was the extent to which quasi-fiscal activities had been transferred to the central bank. In Mexico in the 1980's, the important issue was quasi-fiscal activity in the financial system. It was difficult to produce an ex ante list of important activities that would be appropriate for each country.

Mr. Prader made the following statement:

> We support all efforts toward more fiscal transparency. Both the Code of Good Practices on Fiscal Transparency and the Draft Manual provide useful guidance, though some of the principles they contain seem a bit too ambitious and others rather vague. Let me make the following comments.
>
> We certainly share the staff's approach of making compliance with the Code and the Manual voluntary. There are several reasons why it is too early to impose mandatory compliance. First, both Code and Manual are likely to change somewhat to accommodate the lessons of experience. Second, many countries are as yet far from being able to meet the standards, and it may require costly technical assistance to bring them up to speed. Expertise in this area is limited, and technical assistance is in short supply. And finally, mandatory compliance only makes sense if the Fund intends to enforce it, which it lacks the ability to do at present.
>
> But while we can agree with voluntary compliance, we cannot agree that pure self-monitoring of that compliance is sufficient. How can we expect countries to be sufficiently self-critical to admit, for example, that they are violating taxpayers' rights? The Fund should be involved, however minimally, to ensure that countries make a serious, candid self-assessment. It should also be known that the Fund's initial involvement would increase at the first sign that a country's self-assessment is unreliable. We could therefore go so far as to support the idea of making a candid and accurate self-assessment of compliance (but not compliance itself) with the Code and Manual a part of conditionality, as is done in connection with countries' provision of accurate, reliable economic data to the Fund.
>
> Given the seriousness of some of these difficulties, it seems reasonable to be modest in our expectations at this early stage. It thus appears that such ideas as publishing completed questionnaires and summary reports of compliance on the Fund's website, or maintaining a quantitative index on fiscal transparency are probably overambitious. Here, the experience with the Data Dissemination Standards is revealing: there is little point in publishing country's claims of compliance with a standard, if one has no control over the true extent of compliance.
>
> Realism and modesty are also called for because information on government activities is only meaningful under certain conditions. For instance,

the Maastricht Treaty is also based on the notion of transparency, and the hope that the financial markets will punish deviant behavior; but even more important is the non-bailout clause. With regard to future data requirements of the Fund, one therefore has to be mindful of the marginal utility of any new initiative and of the costs to the supplier of the data. Even a government which is as clear as a glass of water could have problems that cannot be foreseen or mended by a policy of transparency.

The Manual cites the SNA as the reference for good accounting practice. But the national accounts of EU countries are based on the European ESA classification, which differs slightly from the SNA but is, in our view, an equally reliable set of accounting rules. Perhaps the Manual should leave the door open to other internationally accepted accounting standards.

The Manual could explicitly suggest that information on public debt and assets should ideally include all derivatives, since the existence of derivatives would indicate that the breakdown of public debt does not give an accurate picture of the financial risks. But due to the strategic nature of this information, it is often confidential.

We do not think any explicit statement of fiscal risks (connected with interest rates, GDP growth, etc.) should be included in or accompany the budget. Budgets have to be approved by legislatures, and adding estimates concerning the main fiscal uncertainties is a recipe for slowing this process and making it more tedious or tendentious. It would seem sufficient to expect a government to provide an explicit comparison of its own hypotheses and those of national and international institutions.

The Manual discusses transparency about fiscal relations between different subsectors of the general government, but does not deal explicitly with the problem of fiscal commitments made by a multilevel government. For example: the EMU member states have agreed to comply with the Stability and Growth Pact (SGP), which puts constraints on public finances. But most of these countries have various levels of government which enjoy some fiscal independence, and fiscal transparency implies that it is clear to what extent every one of these subsectors is bound by this commitment to the SGP. In Belgium, this problem is taken care of by the High Council of Finance, an independent body of fiscal experts which sets annual objectives for all Regions and Communities (the subsectors).

The Manual is not altogether clear as to whether a government is required to produce complete budgets on a national accounts basis. We feel that this is unnecessary: the budget has its own administrative classification, which differs significantly from the methodology of the national accounts, and it would seem sufficient for the government to restate only the fiscal balance, revenue, primary expenditures, and interest charges in terms of the national accounts methodology.

Notwithstanding these comments, we don't think a major rewriting of the draft manual will be required before the Board can approve it.

Mr. Fernandez made the following statement:

Like other Directors, I welcome today's discussion and reiterate our support to the process we have embarked on late last year when discussing fiscal transparency issues. Without any doubt, fiscal transparency is a worthwhile objective, and the Fund can play a useful role in developing, disseminating and monitoring standards in this area, as Mr. Shields has confirmed. Nevertheless, we must also remain pragmatic and avoid being too ambitious if we want to be effective and user friendly, a point we made with others in previous discussions and that Mr. Shaalan emphasized this morning. This is evidently somewhat difficult given staff's commendable sense of perfection. I will now turn to issues for discussion.

On the first question, I would agree that this draft manual provides adequate guidance to member countries on implementing the code of Good Practices, even if, as several Executive Directors have pointed out, caution will be necessary in this exercise. Mr. Tanzi also confirmed that this was a working document, which would be updated on an ongoing basis. In spite of some shortcomings signaled in the Grays, this Manual should provide a useful tool in helping member countries, all member countries, to progress in the direction of transparency. Less advanced countries may need some time before being able to fully apply the minimum standards: but this is not a reason for failing to progress in the right direction.

Second, I broadly agree with the minimum standards proposed in the Manual, but share Mr. Spraos concerns regarding the issue of quasi fiscal activities and medium-term macroeconomic framework. To stick with the example of my own country, it may be worth noting that the second request will be only fully met in 1998 with the presentation of the first stability program in the context of EMU. On QFA, there was already an extensive discussion this morning on which I will not come back.

Third, on implementation, I fully agree with the voluntary approach proposed by the staff. Nevertheless, as several Directors have emphasized in their Grays, there is some room for ambiguity in staff proposals. I would not go as far as Mr. Shaalan, when he states that the approach presented in paragraphs 6 to 8 of the supplementary note is not consistent with the voluntary aspect of the exercise. Rather, I would tend to agree with Mr. Zoccali, who considers that the staff has here struck a right balance between encouraging members to adopt different aspects of the Code and the necessary restraint that staff will need to exert in Article IV missions.

I can therefore support routing reporting to the Board on fiscal transparency in the context of Article IV consultations, but, I would like to recall that our discussion in April had shed some interesting light on the difficulties of such an exercise. Resource constraints cannot be underestimated, to say the least, and we should keep this in mind. Like Mr. Shaalan, we call for progress in achieving a quantification of extra staff costs needed to support this whole process. This may not be doable immediately, but will have to be done.

Moreover, the extent to which the OECD and regional development banks will be critical.

Finally, I think the staff is right not to propose for the time being the posting on the Web site of completed questionnaires and summary reports: with other Directors, I doubt we are totally ready for this exercise. I also fully share Mr. Spraos' s answer to the question of developing a quantitative index on fiscal transparency shared by Mr. Tanzi, i.e., wait and see.

Mr. Askari-Rankouhi made the following statement:

The staff should be commended. I imagine that a lot of work went into the draft manual, and it is a very good job. Although the document is not yet perfect and can be presented in many different ways, if we wait for the perfect product, we will never finish. Therefore, I agree with the staff's suggested approach—i.e., to maintain the current structure, incorporate the technical comments, and then publish the document on the Fund website. We should treat the document as one that will be corrected over time, and improved upon as experts examine it carefully.

Transparency is a necessary for sound and effective fiscal management. To establish credibility with the public and financial markets, governments need to set out clear fiscal objectives, use transparent and widely accepted accounting standards, and provide timely and reliable information. The Code of Good Practices and the Manual will help members achieve those objectives.

I have no substantive disagreements with the draft manual, and support the staff's approach on the questionnaire and the summary report.

However, I was somewhat surprised that the minimum standards identified in Box 1 do not include anything on the accessibility or transparency of tax laws. That is an important aspect of fiscal management and should be a priority for developing and transition economies. Second, I agree with Mr. Spraos that providing medium-term forecasts should not be a minimum standard. I am not convinced that medium-term forecasts promote transparency.

On the issues raised in the supplementary note, the preferred approach should be based on self-assessment, at least in the short run. However, the Fund should make use of the Article IV process to monitor members' progress and help them achieve their goals. Otherwise, the staff's efforts in putting together the Code and the Manual might have been in vain. Following completion of the questionnaires, Article IV missions should discuss with the authorities the steps they have taken to improve their practices. The outcome of that discussion could then be reported in the Article IV report to the Board, but I agree with Mr. Shields that there is no need for a detailed exposition.

The implementation of the code will remain voluntary, but that does not mean that members should not be urged and encouraged by the Fund, through the Article IV process. Also, completed questionnaires and summary reports should be Published on the Web site on a voluntary basis.

On the resource costs, I support calls for detailed cost estimates, but I appreciate the staff's position that such an estimate would be difficult to compile. I do not expect the cost to be significant in the short run, as we currently have the resources to deal with those members that fall short of the minimum standards.

We should bear in mind that transparency, and its consequent benefits, are at the core of the effective exercise of the Fund's mandate. If we accept that fiscal transparency is a priority, then the Fund and staff should reconsider their priorities and redirect resources to help members achieve it. Some lower priority tasks may not be completed, but that may be inevitable given present budget constraints. Perhaps over time, as the staff becomes more involved in monitoring and implementing the Code, more resources will be needed. That should be discussed in the Fund budget. But I do not agree with those Directors who suggest that nothing should be done until we have a clear estimate of the cost involved. Fiscal transparency is an integral part of efficient fiscal management, and delays could be costly in terms of the effectiveness of Fund programs.

Mr. Bernal made the following statement:

We are grateful to the staff for their very useful set of documents. We found the Draft Manual on Fiscal transparency consistent with Fund surveillance principles well as a useful tool to promote fiscal transparency. The proposed Manual gives guidance to meet the adoption of the Code of Good practices on Fiscal transparency.

We want to emphasize the importance of the approach being proposed to encourage voluntary implementation of the Code. The notable differences among countries -- not only in their degree of development but also the wide range of governmental structures, constitutions, cultures and traditions-- are a heavy burden in the implementation of fiscal standards. Consequently, we are of the opinion that an index on fiscal transparency is at least premature if not counterproductive.

The Manual identifies clearly the most important issues. We believe that the main area in which the Fund should encourage greater transparency is the production of fiscal accounts. Fund staff should be more active in promoting transparency in government operations with a strong emphasis on the production of fiscal accounts, including coverage, proper timing, and publication of information. Adequate fiscal information means adequate coverage --including quasi-fiscal activities-- to produce data and to use the proper methodologies which would permit suitable comparison among countries. The externalities of good information are many. It improves the understanding of the economy, it permits the development of accurate projections, and, additionally, it provides the basic input for designing better and sounder economic programs.

Perhaps to attach more importance to fiscal data and avoid overlapping work, it would be necessary to revisit the issues of fiscal data on the SDDS. Is the frequency of requests for fiscal data appropriate? Is the time of release of fiscal data adequate? Similarly, it would be advisable if the staff could accelerate their efforts to finalize and publish the revised version of the Public Finance Statistics Manual and simultaneously encourage the use of that Manual by all the member countries.

Finally, staff might wish to comment on the effect that a more active involvement in the activities being discussed today would have on staff resources. We found that most relevant issues in the Manual are similar to questions included in most of the technical assistance missions and Fund program implementation. Would additional staff be really needed, or is it a matter of reorientation of activities?

Mr. Yakusha made the following statement:

The Manual is a useful addition to the Code. The minimum standards are well defined and would be a major improvement for many countries, with particular respect to their quasi-fiscal operations and activities. We commend the staff for its emphasis on those activities. The staff has also highlighted the special importance of enabling the authorities themselves to discern whether their fiscal activities correspond to their priorities.

We support the requirement asking for publication of the macroeconomic assumptions, methods, and framework on which the budget is based. That would reveal to the public the authorities' resolve in disclosing their fiscal intentions. Furthermore, it would provide a basis for public monitoring of the budget's execution. If there are deviations from the announced targets, outside experts would be more able to estimate the extent to which those deviations can be attributed to unforeseen shocks versus policy effects. Finally, knowledge that their methods will be subject to public scrutiny would serve to promote high professional standards for government experts.

The minimum standards have to be sufficient to ensure transparency in those areas where it is most important. The staff considered all of Box 1 to be very important for implementing the Code, with the minimum standards to serve as a starting point. However, there is a danger that outside observers may view only the minimum standards as sufficient, and the rest as relatively unimportant. In that context, we would like to make some specific suggestions.

On page 11 of the draft manual, section 1.2.2 requires taxation to be under the authority of the law. We would like to add a clause stating that opportunities for discretionary action by officials should be subject to procedural safeguards. That is clearly a basic element of transparency, and in many countries it is already standard.

On page 12, section 2.1.1, we suggest that ex post information should be provided on general government. We understand that might be demanding for many countries, but it is crucial for assessing a country's overall fiscal situation.

On section 2.1.2, which asks that original and revised budget aggregates for the two years preceding the budget should be presented with the budget, we would also like to emphasize that only historical data should be include, rather than past forecasts.

Although the code must be implemented voluntarily, effective guidance is important. The staff has an key role in informing the authorities about the Code and the Manual, and explaining how their implementation would be beneficial for the government and the economy.

Effective and well-structured monitoring is also necessary. However, that requires a well-defined division of labor between the staff area departments and the Fiscal Affairs Department. In the area departments, the staff could inform the authorities about the content of the Code and the Manual, and encourage them to complete and forward the self-assessment questionnaires. If a lack of transparency hampers program design, that should also be discussed with the authorities. However, I am reluctant to burden the area department staff with additional routine reporting on fiscal transparency. The Fiscal Affairs Department should be responsible for developing the quantitative index of fiscal transparency, which is a good idea, both for monitoring overall progress and for analytical purposes—such as evaluation of the impact of transparency on different aspects of the economy. Still, we would not want that task to consume too much of the staff's time. We appreciate that implementation of the Code will lead to additional costs, and we would like to emphasize that the crowding out of other important staff activities should be prevented.

Finally, we would appreciate the staff's comments on the links between the fiscal component of Special Data Dissemination Standard (SDDS), the Code, and the Manual. Page 45 mentions that the SDDS represents current best practice on fiscal transparency.

Mr. Morais made the following statement:

The Draft Manual is a natural outgrowth of the broad acceptance of the Code of Good Practices on Fiscal Transparency. There is something in it for everybody; but it does not lend itself to uniform application. It would, therefore, be difficult as recognized by Mr. Tanzi, to establish an index of fiscal transparency to be used as a basis for ranking countries. The value of the manual lies in being a reference for improving economic management and for creating procedures aimed at the early detection of fiscal problems. A manual of this nature offers guidance for self assessment.

My understanding is that the Manual is being put forward on the basis of four major premises: (1) the Code is to be implemented on a voluntary basis; (2) the road map for enhancing fiscal transparency has to be developed in the context of individual country experiences; (3) there will be technical and financial support for the efforts of the poorer countries; and (4) that the process of implementing the Code is expected to take time.

A key aspect of the Manual is the proposal for a list of minimum standards to be given priority by those countries that are a long way from meeting the overall standard embodied in the Code. This can be seen as a pragmatic approach to reduce the strain on the majority of countries. The fact that only a small number of countries now follows any one specific set of practices argues for such a less ambitious approach. In this connection, a concise list of minimum standards would be helpful in focusing attention of the authorities, as opposed to the present format in which references to these standards are dispersed through out the paper.

It should be noted, however, that the list of minimum requirements being suggested does not totally eliminate the difficulty of fitting all countries under one umbrella. The minimum standards could add up to a tall order for the poorer countries. In fact, some countries in my constituency have noted that they will need long-term assistance to comply even with the minimum requirements. Hence, it is important to place emphasis on only those key elements that are considered important to improving fiscal management.

The other point to make about the minimum standards is that they should not be used as a roundabout way to introduce a new conditionality for the poorer countries. As we have mentioned, it has already been agreed that countries are expected to work with the Manual on a voluntary basis. Formal monitoring procedures, for instance, in the context of Article IV consultations, could run counter to the voluntary nature of the exercise. In fact, we consider it important that provision be made for the continuous assessment of the benefit at the margin from the time and resources spent on making the budget process more elegant and transparent. Without doubting its potential for improving fiscal performance, transparency should not become the tail that wags the dog.

Like Mr. Daïri, I also do not see the necessity of including in the manual that government involvement in the rest of the economy, for example, through regulation and equity ownership, should be on the basis of rules and procedures which are neutral (see p. 19). This seems to restrict a government's ability to take discretionary actions in specific sectors as might be deemed necessary for the national interest. This is another example where the manual goes beyond transparency to advocating policy.

Mr. Guzmán-Calafell made the following statement:

I commend the staff for the speed with which they have moved to prepare the draft Manual of Fiscal Transparency, which represents an essential element in setting in motion the principles embodied in our Code of Good Practices on Fiscal Transparency. The challenges linked to the implementation of this initiative are huge, and especially so for developing countries and economies in transition, since, as explained in the report, a number of advanced economies have largely attained and in some respects exceeded many of the standards incorporated in the Manual.

I agree in general with the broad principles on the basis of which the staff has proceeded in drafting the Manual. Among these, I wish to note in particular its voluntary character, the consideration of different country backgrounds and capacity constraints to implement the Manual's recommendations, the importance of technical assistance in striving to adopt the Manual's practices, the search for consistency between the Manual and other international initiatives in the area of public finances, the respect for each country's priorities, and the provision of mechanisms to allow countries themselves to assess the status of their fiscal practices.

One of the first questions that comes to mind after reading the staff paper is if the Manual's recommendations are set at a level that can be deemed at the same time ambitious and realistic. To an important degree, the feasibility of achieving this goal is increased with the approach followed by the staff, consisting on attempting to identify simultaneously both best practices in this area and minimum standards to which countries can reasonably aspire. Since the level of development of fiscal practices varies widely from one country to another, and since as the staff explains in the paper the majority of countries would need to undertake a significant effort to put in practice the Manual's recommendations, the realism of the minimum standards will most likely be the most relevant issue for the majority of the Fund's member countries.

However, this is not an easy process and I am not surprised to see divergent views on the extent to which the staff's recommendations are considered as reasonable. With wide variations among the Fund membership on legal and institutional frameworks, and with large discrepancies in the level of development of statistical systems, the adequacy of the level set for the minimum standards will need to be evaluated on the basis of more concrete country experience. Therefore, we must be aware that this is a learning process and that we will need to continuously evaluate the minimum standards as we gain experience with the implementation of the Code. Mr. Spraos makes some interesting remarks in this regard, and I believe he has a point regarding the possible shortcomings of including QFA's among the minimum standards.

Let me turn now to some of the other issues for discussion raised in the staff paper.

I can go along with the approach proposed by the staff to encourage the voluntary implementation of the Code. It is very clear that giving the Code a compulsory nature would not be a feasible option at this stage. With this in mind, and taking into account that individual countries are the main beneficiaries of an improvement in fiscal transparency and that the Fund does not have the resources to evaluate in detail the extent to which member countries' practices deviate from those prescribed in the Manual, it makes sense to provide guidance on self-assessing compliance. Against this background, the questionnaire and summary reports on fiscal transparency made available by the staff are likely to be of great help.

If we are convinced of the merits of the Code in enhancing fiscal transparency, we should encourage its adoption among member countries. But how far must we go on this? Like Mr. Zoccali and Mr. Costa, I do not think we should expect detailed appraisals of compliance with the Code in the context of Article IV consultation discussions, but rather assessments of a general nature with especial emphasis on any problems of significance. Mr. Shaalan, Mr. Daïri, and other Directors note that there is an inconsistency between the voluntary nature of the Code and staff's assessments of fiscal transparency. In my view, this problem is likely to be more important for those countries using the Fund's resources. In these cases, conditionality may turn the implementation of the code an involuntary issue. I would appreciate staff's comments on this.

Like many other Directors, I have serious doubts on the merits of setting up a bulletin board where completed questionnaires and summary reports could be made available to the public. On the one hand, since this would be a Fund's bulletin board, the staff would need to be in a position to endorse the accuracy of the responses to the questionnaires and of the information included in the summary reports. It is far from clear that accomplishing this objective would be an easy task. On the other hand, as I said before, we should see this as a learning process where we need to move cautiously to avoid misinforming markets or giving rise to mistaken perceptions. For the same reasons, I do not favor the development of a quantitative index on fiscal transparency based on posted questionnaire responses.

The staff is absolutely right to point out that the resource costs of supporting the implementation of the Code will be higher the more seriously this activity is taken. We need to be aware that we have to find the proper consistency between our objectives and the resources we are willing to devote to meet them. Helping the less developed countries of this institution to meet the Code's principles and practices can only be feasible with strong technical assistance support. Our willingness to face these resource implications will represent, to a large extent, an indicator of the true importance which we attach to this issue.

Mr. Al-Turki made the following statement:

The staff is engaged in an ambitious undertaking to help members enhance fiscal transparency. Like other Directors, however, I found the proposed draft Manual overly expansive. Indeed, I share some of the concerns raised by Mr. Sivaraman, Mr. Spraos and others. While it is clear that this is a first draft that will be revised extensively in light of today's discussion in one way or another, it should be equally clear that regardless of what is finally agreed on, the following points should be kept in mind:

1) The best practice for a single country in particular circumstances cannot be transposed as the best practice to other countries and circumstances. Developmental, social, political, economic, and financial structures need to be taken into account. Therefore, one cannot over emphasize the importance of addressing fiscal transparency issues on a case by case basis and taking into account each country's specific circumstances and implementation capacity. Here, I welcome the paper's cognizance of the diversity of countries and the time and technical assistance needed to enhance fiscal transparency.

2) Implantation of the code is totally voluntary. In this regard, I welcome the remarks made by Mr. Tanzi at the beginning of today's discussion. Here, staff efforts should focus on explaining the benefits of those standards and encouraging countries to adopt them through discussion, technical assistance, and training. This should be seen by all as a cooperative undertaking aimed mainly at

benefitting the country concerned. In this regard, the voluntary and cooperative nature of this initiative should weigh heavily when deciding on how it should be monitored. Mr. Shaalan and Ms. Farid have made some very useful suggestions regarding this issue.

3) The manual is a set of guidelines to help members enhance efficiency by improving fiscal transparency. In a cooperative environment it is to be expected that members will try to implement the guidelines to the extent feasible. Therefore, I have some concerns regarding the proposed designation of a minimum standard. Such a designation could discourage members from taking a more ambitious effort. In the meantime, I still believe that such a minimum standard would at least negatively impact on the voluntary nature of the exercise. If staff feels that there are some areas that need to be prioritized, those could be noted as such in the manual and in discussions with the authorities without a reference to minimum or maximum standards.

4) There is a cost, and a substantial one, of implementing this initiative for both the Fund and the countries. Here, it is important that in the push for transparency and standards we do not reach a point where the costs of implementing such standards outweigh the benefits. We also have to consider the competing demands on resources of both the countries and the Fund. In this regard, establishing a bulletin Board and developing a quantitative index of fiscal transparency is clearly not a priority.

Mr. Merz made the following statement:

Fiscal transparency is a crucial precondition for informed fiscal policy, good governance, fiscal rectitude, strengthened international cooperation, macroeconomic stability, and economic growth. Transparency, however, is only one aspect of fiscal management, which also includes efficient government and sound public finances. Fiscal transparency is also only one of the necessary conditions for fiscal sustainability. Eventually, it is the overall quality of fiscal policy that matters.

On question 1, the Manual is a useful tool to help members implement the Code of Good Practices agreed upon at the last spring Board meeting. We therefore endorse it in principle, while acknowledging that some aspects seem too detailed and are not primarily focused on transparency. In that context, I appreciate the clarifications made by the Director of the Fiscal Affairs Department.

On question 2, the proposed minimum standards are suitable benchmarks to guide the Fund's surveillance and technical assistance activities. However, the proposed standards established for the third general principle—open budget preparation, execution and reporting—are somewhat ambitious, particularly for member states with less developed fiscal systems. Those countries would be well advised to start by building a transparent legal framework for the budget process, before embarking on the process of reporting more analytical data.

On question 3, we agree that the Code should be implemented voluntarily. However, given its clear advantages, we expect broad participation.

On question 4, the best way to promote the Code in member states is to address transparency issues during regular Article IV consultations. We have no reservations in making complete questionnaires and summary reports available to the public. However, we have serious doubts on the development of a quantitative fiscal transparency index based on posted questionnaire responses. Such a mechanistic approach would risk misleading markets, as it would exclude qualitative aspects.

On question 5, I fully share the remarks made by Mr. Askari concerning costs.

We endorse the various recommended measures for the first general principle, the clarification of roles and responsibilities, and the fourth general principle, independent assurances of integrity. On the second and third general principles, we wonder whether full implementation of all the recommendations might be too ambitious even for member states with well-developed fiscal systems. We have to be realistic. Too ambitious an approach may overburden member countries, and add to bureaucratic costs.

Finally, the manual focuses on countries with a more hierarchical system of government, as opposed to countries with different independent levels of government. In such countries, the main recommendations should primarily focus on the federal budget. Lower levels of government may have different schedules for the presentation of their budgets, and there may be coordination requirements and other issues which have to be taken into account. That takes time, and should be reflected in the draft manual.

Mr. Lehmussaari made the following statement:

Staff should be commended for their work on the draft Manual. They have produced a comprehensive and very ambitious draft, much more extensive than the lean 20 page paper initially planned. Although the draft Manual has some shortcomings, as pointed out in some of the GRAYS, I am sure that the Manual will, after some redrafting, prove to be useful in many member countries and will help the international community to further promote the importance of fiscal transparency.

I am in broad agreement with the contents of the Manual, and none of the authorities represented by this chair have reacted negatively to the proposed Manual. It is also fair to say that perhaps the best experts on this area have not yet had the opportunity to reflect on the Manual in detail. Moreover, I agree with the staff that the Code is to be implemented on a voluntary basis, and it is clear that there will be a need for technical assistance to support some of the member countries in implementing the Manual. In addition, I would like to reiterate the position of this chair that, in its work on fiscal transparency, the Fund should complement and not duplicate the work of other international organizations. Despite some clarifying remarks by Mr. Tanzi in his opening statement, I would like to hear staff's view on some sort of ideal arrangement for cooperation in this area.

I welcome the way that staff has highlighted a set of requirements that could be viewed as a minimum standard for countries to give the highest priority. On this point, I wonder why the staff was not able or willing to determine minimum standards for Box 1.2 regarding the legal and administrative framework for fiscal management. Staff's comments are welcome.

Another technical point I wish to make regards box 3.2.3. It would be useful if the analysis of the government's fiscal position would also include a report of "once for all measures," since these measures can have a significant effect on the overall balance of the general government, but which are also difficult for outsiders to catch.

On the specific issues in the supplementary note; yes, I think the Manual meets the purpose of providing guidance to member countries on implementing the Code. I don't have any problems with the level of minimum standards, although I have some concerns along the lines presented by Mr Spraos in his GRAY on the treatment of quasi-fiscal activities. I also think that the implementation of the Code should be reported to the Board in the context of Article IV consultations. On a quantitative index on fiscal transparency, and on the question of the bulletin board in the web site, I don't have any definitive answers at this stage. On a last point; yes, I think that the resource implications of this whole exercise have to be discussed in the broader context of the Fund's staffing needs.

Mr. Barro Chambrier made the following statement:

The "Draft Manual on Fiscal Transparency", prepared by the staff represents a follow-up to a recognition in previous Board's discussions that fiscal transparency is critically important in the process of improving governance, which in turn is fundamental in member countries' efforts to achieve high-quality growth in a stable macroeconomic environment. Transparent fiscal operations are likely to discourage the misuse of public funds, thus improve the soundness of public finances. Therefore, my authorities see merit in developing a Manual on Fiscal Transparency. This support is given with the understanding that the implementation of the "Code of Good Practices on Fiscal Transparency", adopted by the Interim Committee in April 1998, will be on voluntary basis, depending on the situation and the capacity constraints prevailing in individual countries.

In that context, we note staff's recognition that some countries may need considerable time to achieve the level of fiscal transparency that is expected after the implementation of the proposed code. This is particularly true for countries in my constituency, whose institutions and administration capacities, including the ability to compile reliable fiscal data are still characterized by some weaknesses.

To address these weaknesses, the provision of foreign technical assistance will be needed. Such foreign technical assistance may also be needed to achieve the minimum standards required by countries to undertake a detailed assessment of their fiscal management systems with a view to identifying specific weaknesses and preparing plans to improve fiscal transparency. While we note from the staff paper that the Fund is likely to increase its technical assistance to developing countries in their efforts to improve fiscal transparency, it is not clear whether resources will be made available for that purpose.

On the proposed Manual, it is our view that a clear separation should be made between good practices for countries with more sophisticated budgetary systems and the proposed minimum standards. Such a separation will introduce two stages in the adoption of good practices by member countries.

As regards specific steps towards more transparency in fiscal operations, we certainly share the view that the identification and the analysis of the consequences quasi-fiscal activities , extra budgetary funds and tax expenditures will be required. However, we wonder why the staff believes that transparency in quasi-fiscal activities will automatically lead to their replacement by more traditional practices of fiscal management? In our view, the existence of quasi-fiscal activities, for example, in the form of contingent liabilities is not necessarily the result of non-transparent practices. Staff comments would be appreciated.

Concerning the involvement of the government sector in the economies of member countries, we share the view that it should be conducted in an open and transparent manner on the basis of clear rules and procedures, which are applied uniformly. In the particular case of the banking sector, we fully agree that government involvement should be based on clearly defined policy goals. There should also be greater transparency in reporting government involvement in the banking system and an appropriate framework for bank regulation. This reporting, like that of other fiscal operations should be timely, comprehensive and reliable.

While recognizing the importance of providing reliable information on fiscal operations to the public, we note that the code proposes an external audit, the scrutiny of macroeconomic forecasts and the integrity of fiscal statistics to ensure the integrity of fiscal information. We welcome the idea of a national audit body to provide timely reports to the legislature and public on the financial integrity of government accounts. As correctly stated in the staff paper, such bodies already exist in many countries with varying degrees of independence. We believe however, that efforts should be made to strengthen their functions through the provision of adequate instruments. At this juncture, it is our view that national audit bodies require technical expertise is not often available in many developing countries.

On the integrity of fiscal statistics, we agree that it should be enhanced through the provision of institutional independence to the national statistics. At this point, however, many national statistics offices are not adequately equipped in many developing countries, underscoring the need for the provision of foreign technical assistance.

Despite its shortcomings, this Draft Manual is a welcome start in our efforts to improve fiscal transparency in member countries. However, the final document will have to reflect the views of member countries in order to become user-friendly.

Mr. Sobel made the following statement:

We greatly appreciate staff's effort to put forward the draft manual on fiscal transparency as a complement to the useful code, and we welcome the staff's recognition that this document will evolve over time. Many experts in my government have looked over the draft, and I will forward to staff their technical comments on the manual. Let me confine myself to several broad comments and questions raised in the supplementary note.

- The manual itself is a welcome effort to provide greater detail to the meaning of the broad principles in the code of good practices. In this respect, end-users will no doubt find it more operationally useful than the code. We believe it is preferable to improve the text, but to work within its current structure.

- The most important issues raised by the manual relate to its use by staff. Like Mr. Askari, Mr. Shields, and others, we think staff should use the manual as a basis for assessing whether countries are putting in place transparent and sound frameworks for the conduct of fiscal policy. In this regard, it would be useful for surveillance missions to note in staff reports how a country's fiscal practices compare with the points enumerated in the manual.

- In paragraph 6 of the supplementary note, staff observes it would not likely provide a detailed appraisal of compliance with the Code. Perhaps a relevant question is what staff means by "detailed." But one observation is that at the present time, staff reports generally include annexes noting the adequacy of a country's statistical data. Should there be an analogue regarding the manual? In general, this line of thought leads me to support an activist approach by staff to the considerations raised in paragraph 7 of the supplemental note.

- Regarding question two in the issues for discussion, we believe that this institution should only put forth high standards. At the same time, we recognize that countries have differing implementation capacities and that many developing countries and transition economies must significantly improve their fiscal management systems and transparency. Hence, rather than having a minimum standard, we would strongly prefer that countries meet a minimum "requirement," or a "high priority requirement" as Mr. Hemming suggested.

- My authorities already provide technical assistance on fiscal issues in many transition and developing countries. We would be prepared to have our TA providers in the field work with their host government on issues pertaining to the manual, if their host governments and the IMF felt such work would be helpful.

- Regarding the questionnaire and summary report, if there is a consensus to move forward with these instruments, we would certainly be prepared to join it. In these circumstances, we would of course support publication of country responses on the website. I take note of Mr. Tanzi's remarks on the preparation of an index.

- Since the Manual's emphasis is on transparency at an aggregate level with a framework conducive to the provision of information on the impact of budget decisions, we would appreciate more explicit reference to the impact of unproductive expenditure. The manual rightly highlights quasi-fiscal activities, but we would also underline unproductive military spending. In this regard, we believe that Article IV missions should look more closely into the fiscal transparency of military budgets and explore the implications of possible changes in overall military spending for economic performance, without getting into the question of what constitutes an "appropriate" level of military spending. Further we believe it is important that countries have in place, as a matter of transparency, a functioning system for reporting to civilian authorities audits of receipts and expenditures that fund defense activities and provide information to the IMF about their audit processes. We would urge the staff to include questions with these broad aims in mind in its questionnaire.

o Finally, the staff appears to think it will need a substantial beefing up of its resources to address issues arising from the manual. We would take a much more hesitant posture on this question. Let us begin to integrate the manual into the work of the institution and see what the resource implications are before we take a view on this matter. We can then revisit the resource implications in the context of the annual budget process and our existing resource limits and constraints.

Mr. Daïri commented that there might be a problem in making a simple distinction between high priority and low priority requirements. High priority items would have to be met only by countries with less developed fiscal systems, leaving more advanced members with nothing other than low priority items. It would be preferable to outline high priority requirements for less developed members, while stressing that the remaining requirements are priorities for all other members.

The staff representative from the Fiscal Affairs Department questioned whether Directors were satisfied with the term "minimum standards," or whether emphasis should instead be placed on "high priority" requirements. The classification of some items as minimum standards had arisen from a wish to identify those requirements of the greatest priority for members with less developed fiscal management systems. The staff had been careful to explain clearly in the Manual what was meant by "minimum standards" or "high priority," and had stressed that the intent was not to set different standards for different countries.

Mr. Qi made the following statement:

I thank staff for preparing a very comprehensive and detailed draft Manual on Fiscal Transparency, which can, and should serve as a complimentary and integral part of the Code of Good Practices. It seems to me that the Manual could be of great use for member countries, particularly those that are in the process of legalizing and standardizing fiscal management. However I am of the view that the present documents are still preliminary ones, and require more input and amendments from member countries before taking on a formal form and going public.

As we argued in the discussion on the Code, the objectives, tools, and safeguards of fiscal transparency as put forward in these documents should be seen as the high standards that countries should pursue or maintain. I agree with the view that the implementation of the Code and the Manual should be on a voluntary basis. Different countries at different stages of development and with different political structures and different capacities to implement the standards suggested in the Manual, will naturally have different views on the degree of speed and strength needed to carry out the various themes contained in the Manual. For instance, from China's perspective, although many standards stipulated in the Manual have been met, we still find in some cases that we have to treat them as intermediate objectives and some even as long-term goals. I, therefore along with other speakers, would like to emphasize the importance of Fund technical assistance in this regard.

The following are some specific comments:

I suggest we use financial sector instead of banking sector in paragraph 23, since in many countries, particularly developing countries, governments are involved in the activities of banks as well as non-bank financial institutions. So here, transparency is not only relevant to banks but to the financial sector as a whole.

in paragraph 36 line 4, it seems better if we use the phrase of exchange management instead of exchange system, because here we are discussing operations related only to exchange management rather than the whole exchange system.

in paragraph 37, the first sentence should be amended as "Most central banks transfer to the government part of the profits and losses resulting from their operations". Because central banks may also have losses while conducting monetary policies.

It is our impression from previous Board discussions that we should not privatize for the sake of privatization. Rather, our aim is to make NFPEs more efficient, regardless of their form, be it in private or public hands. So I prefer to also use "reform of NFPEs " in place of "privatization" wherever appropriate in paragraph 41 in order to cover the realities across all membership.

- on the issue of contingent liabilities raised from paragraph 67 through 71, specific liabilities have been mentioned, such as loan guarantees, exchange rate guarantees, deposit insurance and indemnities. If we put all those specific liabilities on the fiscal report, it is highly likely that this procedure will give rise to more unrealistic expectations by the insured and subsidized. So I would like to suggest that we, in principle, advocate transparency on contingent liabilities without mentioning the specific items.

Mr. Szczuka made the following statement:

I welcome and appreciate the staff's efforts in preparing the manual on fiscal transparency. Transparent and comprehensive fiscal management are crucial for financial and macroeconomic stability, both at the country level and on a broader global level. Additionally, fiscal transparency is a basic condition for the credibility of economic policy. Therefore, we support the idea of a Code of Good Practices, and we also support the preparation of the Manual.

On the staff report's first issue for discussion, I agree that the proposed structure is appropriate, but the language of the manual still needs significant redrafting along the lines indicated by many Directors. There are some instances of repetition, particularly on quasi-fiscal activities. Also the Manual needs to be more precise on issues relating to the structure of government, and the extent to which the recommendations apply to the lower levels of the government.

On the second issue, we welcome the proposed separation of minimum standards from best practices. As for the division of recommendations into high priority and low priority items, it should be emphasized that the standards are all high priority and should be a target for all countries—with due concern for the diversity and institutional capacities of particular members.

On the third question, I support the voluntary approach to implementation of the Manual and the Code. I do not see any conflict with proposing minimum standards, as a country willing to accept the Code is implicitly volunteering to accept those standards. Surveillance, however, cannot be on a completely voluntarily basis. So we should focus on supporting members' efforts to improve fiscal transparency. When there are problems in implementing the Code, only then should the issue be brought to the attention of the Board within the Article IV process.

On the fourth question, I welcome the clarification given by the staff at the beginning of the discussion, as I initially had the impression from the manual that we would be creating a vast bureaucracy. We should avoid a bureaucratic approach to the Code's implementation.

I am not convinced of the feasibility of a quantitative index at this stage, and publishing the responses to the questionnaire on the website might be problematic, as that would give those responses an implicit endorsement by the Fund. We may need to clarify how and whether we should check the correctness of the responses, and the consequences should there be differences of opinion between the authorities and the staff.

On the fifth issue, I share the concerns expressed by many Directors that the cost issue has not been presented clearly. Given the topic under discussion, we should try to be transparent ourselves on the cost consequences for the Fund of moving in the direction suggested by the staff.

I was also concerned with the question of coordination with other institutions. I am not convinced that coordination through the website is the best approach. Further, on quasi-fiscal activities, the manual is not completely clear on the treatment of quasi-fiscal activities and other contingent liabilities. Even though we know that blanket guarantees, banking sector bailouts, and unfunded Social Security liabilities are significant potential problems in many countries, the manual did not provide a clear answer on how they should be treated when evaluating the fiscal position of a country. In addition, I share Mr. Daïri's reservations on having unremunerated reserve requirements, or credit ceilings, included in the list of quasi-fiscal activities. They are monetary policy instruments.

I would like to stress the need to incorporate fully the external financing of fiscal activities into budgetary accounting, particularly aid financing. That is a problem in many countries—particularly developing and transition economies—and has not always been dealt with properly or transparently.

On the central bank, I share the views of some Directors that profit and loss accounting for the central bank is a complex issue, and that it is sometimes difficult to separate the losses resulting from monetary policy from quasi-fiscal activities. That issue should be given further consideration. Also, I share the view that in countries where there is insufficient central bank independence, the liabilities of the central bank should be included in any presentation of the liabilities of the general public sector.

A small point on the national statistics offices. The Code was not entirely correct in stating that increased independence of the statistical office would help improve the integrity of fiscal statistics. There are many countries where the statistical office does not play any role in compiling the fiscal statistics; it may publish the statistics, but it does not actually contribute to the integrity of the data. So we might not want to stress the issue in the Manual. At minimum, there should be an indication that the statement may not be relevant for all countries, depending on their particular circumstances.

Mr. Daïri, commenting on the issue of self-assessment and the questionnaire, suggested that questions without a straight-forward and verifiable answer should be avoided. For example, the question of whether government involvement in the private sector was pervasive and not well defined could have several possible responses, and would be based on subjective judgement.

Ms. Honeyfield made the following statement:

I thank the staff for what must have been a massive effort. Trying to prepare a manual that simultaneously suits the needs of over 180 members is quite a task, and the staff have largely succeeded. I appreciate the staff's comments that the Manual is work in progress, which will need to be updated and changed over time. But I have had positive feedback from all the authorities in my constituency that have responded. They all think the Manual is basically appropriate.

There have been a number of comments during this meeting about both the structure and the content of the Manual. I must say we sympathize with Mr. Sivaraman's position that a budget manual would be useful. But, having said that, there is not a perfect overlap between the issue of transparency and the preparation of a budget. So, although there is a place for a budget manual—the staff has referred to a World Bank project which should be useful—we should keep the two items separate, and allow the fiscal transparency Manual to stay as it is.

We agree with Mr. Spraos's comments that there is a need to clearly distinguish efficiency and transparency, and the staff appears to have taken those comments on board. We also agree with Mr. Spraos that an efficiency manual itself might be useful. While that is not within the Fund's field of expertise, perhaps the World Bank might consider the issue.

Of our constituency members, those that provided feedback considered that the minimum standards were basically appropriate. The Philippine authorities have said that they could meet those standards, but that they would need assistance. Such comments highlight the need for technical assistance in combination with the transparency initiative.

However, there is one item that should be added to the minimum standards—the inclusion of two-year forward estimates. My understanding from the Manual is that this item is a more advanced requirement. We consider that it is fundamental. We like the staff's idea of changing the presentation of the minimum standards, and we look forward to seeing the new structure. We also think that the Manual could benefit from a few more practical examples, and some of our constituency members have provided some of those examples, which I will forward bilaterally.

On some technical points, we agree with Mr. Spraos that it is difficult to know where to draw the line on quasi-fiscal activities. The staff appears to be suggesting implicitly that a kind of materiality test be applied. If that is the suggestion, it would be useful if it were some how included in the Manual.

On the question of whether the Manual and the questionnaire should be used in the Fund's work, we think they will be essential. The questionnaire will contribute to the consistency of the Fund's analysis across countries, and is essential to the Manual's adoption. We appreciate that this might add to the resource burden of Article IV missions, but there should be significant scope for filling in the questionnaire between missions, so that when the staff is not busy it can work on the questionnaire as part of its overall research on the country.

On the cost, we agree with others that it is not satisfactory to have no idea of how much this initiative will cost. We think the Fund should have some sense of how much it is willing to spend on the initiative relative to its current activities. That would provide some sense of the Fund's priorities.

On the index, we agree that there are problems that regrettably appear to be insurmountable. On the website bulletin board, we agree that such a facility would be useful on a voluntary basis.

The Acting Chairman remarked that the spending activities and priorities of the Fund were matters for the Board to decide.

Mr. Ogushi made the following statement:

We appreciate the staff's efforts in drafting the Manual. We would also like to stress the voluntary nature of the initiative.

Promoting fiscal transparency is one of the core activities of the Fund. As such, the Fund should play an active role in facilitating fiscal transparency through Article IV consultations and other occasions, but I think it should be recognized that there will be difficulties assessing members' adherence to the Code and Manual, owing to significant differences in the fiscal systems of different countries. Therefore, it may not be advisable for the Fund to adopt too rigid an approach in assessing compliance.

In that context, I am not convinced that publishing self-assessments on the website would be appropriate, before we gain further practical experience. For the time being, the Fund should concentrate its efforts on disseminating the Code and Manual through its regular contact with the authorities, and should encourage them to improve their fiscal transparency.

Third, on the resource implications of the initiative, I understand it may be difficult to present a clear picture of how much it is going to cost. But we need to have some sense of what we are committing ourselves to, before we can effectively proceed.

Mr. Palei asked how the Fund might publish each country's transparency experience. One option would be to include the staff's analysis within the Article IV staff report, but if a country decided that it wanted to release that information, it might face added restrictions. Another alternative might be to prepare a detailed case study as a separate paper, which might be included as part of the Manual. A further option might be for each country to take the initiative and publish their own report on their fiscal transparency. In that case, there would be a question as to the role of the Fund. He asked the staff for comments on those issues.

The Director of the Fiscal Affairs Department thanked Directors for their remarks, and pointed out that there was no established literature in the area of fiscal transparency, so the staff was still learning. For that reason, the Manual would likely remain in draft form for some time, and would depend on the comments and reactions of the Board.

On the issue of self-assessment, the staff had considered that the Manual would primarily have an educational function—highlighting issues and solutions of which policy makers might not have been aware the Director continued. In response to the comments of some Directors, it was important to stress that the staff did not believe countries' quasi-fiscal activities had been created to intentionally obfuscate their fiscal positions. For the most part, quasi-fiscal measures had been adopted because of a lack of viable alternatives. However, sooner or later, such measures became increasingly costly and distortionary. If the Fund conveyed that message successfully, then members would want to adopt voluntarily the provisions of the Code and Manual.

In the process of implementing the Code, it was hoped that members would seek the help of the Fund, either through Article IV consultations or technical assistance, the Director continued. The cost to the Fund was uncertain, but if every member decided to make a serious effort to address their transparency problems, then the cost could be considerable. At present, the best that could be done would be to allocate a minimum budget, and then attempt to optimize the staff's efforts subject to that constraint. As the Fund gained experience, and had an opportunity to gauge members' enthusiasm, then a more realistic costing might be provided. But it was not fruitful to attempt such an exercise prematurely.

On the issue of conditionality, Fund-supported programs had always included the consideration of transparency, the Director remarked. Without transparent accounts, a program that included indicators and limits was unlikely to be successful. The more the Fund was involved with a program country, the greater the need to pay attention to transparency issues.

On quasi-fiscal activities, case studies would be useful in helping determine the areas in which such measures were quantitatively important, the Director commented. Those areas had changed over time—multiple exchange rates were less prevalent, whereas financial repression and control of public enterprises had become more significant. A study of Italy in the early 1980's had shown that repressed interest rates had reduced the fiscal deficit by about 3 percentage points. Also gaining in importance were government guarantees and unfunded liabilities.

Responding to an observation by Mr. Sobel, on the question of whether military spending should be classified as such a measure, the Director emphasized that the issue was not whether the activity was productive or unproductive, but instead whether it was measured and recorded correctly. It was true, however, that in the military area, there were many forms of financing that were nontransparent.

Mr. Costa remarked that the potentially nontransparent nature of military spending should be reflected in the Manual.

Mr. Daïri questioned the need to single out military spending, as it would be covered by the part of the Manual dealing with extrabudgetary accounts. On the issue of which quasi-fiscal activities should be deemed important, the appropriate criteria for making that decision might be the subject of one of the Manual's boxes. One possible criteria would be whether the activity in question was distortionary and could be better dealt with through the regular budgetary process.

The Acting Chairman commented that the staff had been aware that many nontransparent extrabudgetary practices had involved military spending, but it had been decided to focus the Manual on the issue of nontransparency, rather than the particular nature of various spending items.

On the issue of the costs of added requests for technical assistance, although it might be difficult, a costing exercise would nevertheless be necessary, the Acting Chairman continued—if only to emphasize that the Fiscal Affairs Department was already stretched and that further assistance efforts would require either added resources, or cutbacks elsewhere.

Mr. Szczuka remarked that transparency was not the only focus of the Fund's technical assistance resources. Other objectives, such as the efficiency and sustainability of fiscal policy, and the quality of statistics, were equally important.

Mr. Shields, commenting on the Fund publication of members' self-assessments, expressed concern that the Fund would be implicitly guaranteeing their credibility. It appeared that the majority of the Board wished such information to be published, as long as the readership was clear on the quality control exercised by the Fund. He asked the staff for suggestions.

The staff representative from the Fiscal Affairs Department replied that Mr. Shields had raised a difficult issue. Providing a Fund website for the posting of voluntary contributions was relatively simple, but that was subject to the concerns that some Directors had raised. If such contributions were to be given a Fund seal of approval, there would be the need for the Fund to ensure that they were fair and accurate. The associated procedures and requirements were matters for the Board.

Mr. Shields commented that it would be useful if the Board could be presented with alternative suggestions and procedures for consideration.

Mr. Szczuka commended the U.K. authorities for publishing their own self-assessment. He also remarked that the Fund should either leave members to publish such self-assessments on their own behalf, or it would have to implement an internal mechanism of evaluating those assessments and providing a commentary. Many Directors had expressed strong reservations against including such a procedure within the Article IV process.

Responding to a further question by Mr. Szczuka—on whether the long list of requirements on, inter alia, medium-term scenarios and quasi-fiscal activities, would result in an somewhat long and complex budget paper—the Director of the Fiscal Affairs Department remarked that each country would have to consider its own specific circumstances. In most cases, there would be one or two particularly difficult areas. Once those had been dealt with, the authorities would move on. It was not envisaged that, following adoption of the Code, every budget from that point on would follow every page of the Manual.

Mr. Spraos remarked that it appeared that efficiency and transparency were still being confused, especially concerning assessments of whether a particular quasi-fiscal activity was deemed important. Given that assessments of efficiency were often subjective, it might be preferable to exclude such areas from the Manual's minimum standards, as the standard in question would not be clear.

The staff representative from the Fiscal Affairs Department commented that the staff would review the full range of minimum standards in light of Directors' comments and suggestions. The original minimum requirements had been based on the need for proper reporting of fiscal information. Directors had suggested other aspects, such as the needs for a legal and administrative framework, and had argued for the removal of others, such as the need for a medium-term framework. On the latter point, the staff were in favor of retaining that requirement, and the Board discussion of the Code had made clear that a medium-term framework was important, as it ensured that the recurrent cost implications of major projects would be accurately reflected.

The Director of the Fiscal Affairs Department commented that the Manual would be revised on the basis of the discussion, and on any bilateral suggestions that Directors might wish to send. An updated version of the Manual would then be circulated to get a sense of whether the Board considered that a further meeting was necessary. It was hoped that the Manual would be available on the Web by the end of October 1998, where it would be subject to continual revision. The Board might then consider discussing a snapshot of the Web version sometime in February or March 1999.

Responding to a query from the Acting Chairman, the staff representative from the Fiscal Affairs Department remarked that instructions from the Interim Committee were somewhat unspecific, so it would probably be sufficient to report on the initiative's progress at an appropriate time.

Responding to a query from Mr. Askari-Rankouhi, on whether members were expected to fill out the questionnaire before the finalization of the Manual, the staff representative from the Fiscal Affairs Department pointed out that the questionnaires were voluntary, so there was no requirement for authorities to respond before a new version of the Manual was published. The Acting Chairman made the following concluding remarks:

Most Executive Directors welcomed the opportunity to discuss the Draft Manual on Fiscal Transparency, but emphasized the very preliminary nature of the current draft, which would serve as a basis for a dialogue with country authorities and others about the usefulness of the Manual in guiding the implementation of the *Code of Good Practices on Fiscal Transparency*. Some Directors were of the view that the current draft was not user-friendly, in part because of the complexity of the issues addressed, but also because the presentation followed too rigidly the structure of the *Code*. In view of the many issues involved, Directors felt that the Manual would benefit from some clarification and revision to improve its usefulness, including by drawing a clearer distinction between transparency and efficiency. It was understood that the Manual would not be formally approved or endorsed at the present stage, and that Directors would have an opportunity to review a revised version, after they and the staff had had sufficient time to seek the views of fiscal agencies and other outside experts. Views were divided on whether the Manual should eventually be endorsed or approved by the Board, and this will be decided later.

> Directors discussed the proposed minimum standards of fiscal transparency suggested in the Manual. Some Directors considered that setting unduly high minimum standards would discourage some members from seeking to meet them, and said that the minimum standards should be limited to those deemed critical to effective fiscal management. Some Directors were concerned about the concept of "minimum standards," which may be inconsistent with the idea that compliance with such standards should be voluntary; alternatives, such as "basic requirements of fiscal transparency" or "high-priority requirements of fiscal transparency" were discussed, but Directors agreed to revisit this subject when reviewing the revised Manual.
>
> While there was broad agreement among Directors that implementation of the *Code* should be voluntary, it was emphasized by several speakers that that should not preclude the Fund staff from raising specific fiscal transparency issues with country authorities and from drawing the attention of the Board to shortcomings that might hamper surveillance and effective program design. Where the Fund had concerns on that count, there was support for encouraging the authorities to make a self-assessment of fiscal transparency that could form the basis for an evaluation of technical assistance needs and other plans for improvement.
>
> Directors noted that the Fund was expected to monitor improvements in fiscal transparency based on the *Code*, but there were divergent views as to how such monitoring should be conducted. Directors generally agreed that monitoring should be relatively informal, with reporting to the Board on a case-by-case basis and with due respect to the confidentiality of information provided by country authorities. While accepting that such an approach was appropriate in the early stages of the exercise, some Directors argued that there should be a gradual shift to more formal monitoring of fiscal transparency, with regular reporting to the Board. While some Directors supported the posting of country information on fiscal transparency on an Internet bulletin board, others felt that this would be premature, and a number of Directors were opposed to publishing countries'

responses to the questionnaire. Most Directors cautioned against development of a quantitative index of fiscal transparency.

Directors were concerned about the potential resource implications of future work on fiscal transparency. It was noted that even the minimum standards recommended in the Manual were demanding and that many countries would require technical assistance should they seek to meet them. Directors agreed that there was scope to seek support from other international institutions to help meet the resource costs of such requests for technical assistance and to help avoid any duplication of efforts. In any case, most Directors requested the staff to provide a detailed estimate of the resource implications before a decision is taken for the Fund to further extend its involvement in monitoring implementation of the *Code*.

Directors concluded that a revised draft, which would take account of Executive Directors' comments at the current discussion and feedback from country authorities and others, would be prepared for further consideration by the Board. As part of the process of carrying forward the work on fiscal transparency, Directors agreed to make the Manual and the blank questionnaire available on the Fund's external website. It will be clearly indicated that the Manual is a draft that has not been approved or endorsed by the Fund's Executive Board, and that it is being made available at an early stage to seek feedback on its usefulness as a guide to the implementation of the *Code*.

After adjourning at 1:05 p.m, the meeting reconvened at 2:30 p.m.

2. MALI—INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—FINAL ASSESSMENT OF ELIGIBILITY

The Executive Directors considered the final paper, prepared jointly by the staffs of the Fund and the International Development Association, presenting a final assessment of Mali's eligibility for assistance under the Initiative for Heavily Indebted Poor Countries (HIPC) (EBS/98/150, 8/24/98; and Sup. 1, 8/24/98).

The staff representative from the African Department informed Directors that on September 10, 1998 the Executive Board of the World Bank had approved Mali's final HIPC document, including the staff's recommendations.

Mr. Barro Chambrier made the following statement:

I would like to thank management and the staff for their hard work on the preparation of the final decision point Document for Mali on the initiative for HIPCs. My Malian authorities are in broad agreement with the staff assessment. They intend to maintain their strong track record of policy implementation through a high level of commitment to sound macro-economic policies and bold structural reforms over the years ahead. Board approval of the proposed dates of the decision and completion points, and the target of 200 percent of the NPV of debt-to-exports ratio, will allow them to free up additional resources under the HIPC Initiative to develop human capital and address vigorously the pressing issue of poverty in Mali.

I would like to focus my statement on the main recent economic developments and the economic policies my authorities are implementing or intend to pursue.

As Directors would recall, over the last 10 years, the authorities have implemented credible economic policies under programs supported by the Fund and other donors. These policies were critical in shifting the economy from a centrally-planned economy into a market-driven system. This was achieved through the implementation of a wide range of policy measures including price and trade deregulation, privatization of enterprises and civil service reform. In addition, Mali's medium-term adjustment strategy was strengthened in 1994 with a significant devaluation of the CFA franc and the integration of Mali into the newly-created West African Economic and Monetary Union (WAEMU). Furthermore, despite the difficulties encountered, a solid basis for political pluralism was established. Reflecting these efforts, investor confidence has increased significantly. Real GDP growth rate has recovered, averaging 5 percent annually during the last three years, while inflation has been kept at moderate levels. Steady progress has also been registered in reducing the external imbalances, although Mali's balance of payments needs are expected to remain large for several years.

Fiscal policy has remained a key element in the authorities' effort to stabilize the economy and mobilize the needed domestic savings to reduce the government's reliance on the banking system and foreign assistance. Consistent with these objectives, a series of reform measures were introduced to streamline tax and customs services, broaden the tax base and improve the quality of the public expenditures. These measures were instrumental in the continued improvement in the fiscal indicators recorded over the recent years. Tax revenue-to-GDP ratio is now projected to reach 13.6 percent of GDP in 1998, and the primarily balance has shifted from sizable deficits to significant surpluses since 1995, allowing Mali to normalize relations with its external creditors.

On the revenue side, the full benefits of the key measures implemented in the recent past will only materialize over the medium term, namely the reorganization of tax and customs administration, training of the customs duty personnel; the reduction of exemptions, the reinforcement of tax compliance; the withholdings of tax on salaries and rent and the simplification of cash and accounting operations of the treasury. For the remainder of 1998 and beyond, the authorities intend to extend the use of taxpayer identification numbers for better tax assessment, intensify efforts to recover tax arrears and limit tax evasion on petroleum products. The VAT rates are being unified at a single rate of 18 percent, in anticipation of potential revenue shortfall associated with the forthcoming harmonization of the Common External Tariff in the WAEMU. The authorities also intend, with assistance provided by the World Bank under the current economic management credit, to streamline the corporate, small business and personal income tax and to strengthen customs and tax administration further.

On the expenditure side, the preparation and the execution of the budget were, and will continue to be, strictly in line with the requirements of the Fund-supported programs. Thus, all extra-budgetary accounts were eliminated and transparent budgetary procedures were adopted. In addition, subsidies to public entities were eliminated and a scheme to clear domestic arrears was implemented. The authorities will also continue to contain the wage bill and other low priority expenditures, so as to allocate more resources to the primary education and health sectors. Toward this end, they will improve significantly the efficiency of the public expenditure with World Bank assistance. In this context, the authorities will follow a prudent wage policy, while strictly controlling the size of the civil service and enhancing the merit-based promotion of the civil servants for achieving further productivity gains.

Within the BCEAO monetary area, the authorities will continue to support a monetary policy aimed at containing inflation and strengthening the country's external position. To this end, the authorities will strictly adhere to a prudent credit policy and continue to improve the government's net position with the banking system. They will also rely on indirect instruments initiated by the BCEAO and support prudent policies that are critical for financial crisis preventions.

On structural reforms, the authorities would like to stress that the main objectives of maintaining a sound banking system, diversifying the economy base, creating an enabling environment for the private sector and integrating Mali into the global economy, are in their best interests. Therefore, they will do their utmost to deepen and accelerate the structural reforms, as agreed under the third annual ESAF arrangement. In sum, it is the authorities' intention to restructure the Banque Internationale pour le Mali (BIM-SA) and to privatize the Banque Malienne de Crédits et de Dépôts (BMCD) before the end of this year. With regard to the reform of the public enterprise sector, progress was lower-than-expected in the election year 1997. Cognizant of the need to intensify its structural efforts, the government will endeavor to sell the tobacco company (SONATAM) and its minority shares in five other enterprises, and to privatize the Abattoir Frigorifique de Bamako and two hotels. Moreover, with World Bank assistance, the privatization program was expanded to the major public enterprises and action plans were adopted to restructure and privatize the power and water utility (EDM) and the telecommunications company (SOTELMA), for which initial measures were taken to improve their financial viability. In the rural sector, the ongoing technical audit of the cotton production and marketing agency (CMDT) will provide, by October 1998, a basis for a new performance contract in the cotton sector. The authorities will continue, in close collaboration with donor community, to find special mechanisms to attract private investors in the areas of textiles and to develop new activities beyond subsistence farming to reduce poverty. Meanwhile, measures were taken to streamline the institutional framework of the private sector in general, mainly through the simplification of commercial and investment procedures and the adoption of a flexible labor code. A comprehensive reform of the judiciary system is also under preparation and the law on guarantees was adopted, with a view to providing the basis to reinforcing the property rights.

On the external sector, Mali's external position is highly sensitive to droughts and fluctuations of prices of its main export commodities. This heightens the critical importance of diversifying the economy and export base, through the promotion of other export products, such as fruits and meat.

As regards the external debt situation, the authorities will continue with a prudent debt accumulation and management, that has enabled them to normalize relations with their external creditors. However, as indicated in the staff paper, Mali's external debt situation is unsustainable, despite the debt relief granted by Paris Club creditors and other donors on traditional concessional terms. With the projected 221 percent of NPV of debt-to export ratio in 1998, and about 20 percent of debt service-to-government revenue ratio in 1998-2005, Mali's debt servicing puts a serious burden on the budget and limits the resources available to improve the social services and provide the social safety net to the most vulnerable populations. In this respect, the authorities hope that Mali, with its strong track record of adjustment and unwavering commitment to sound economic policies, will benefit soon from the HIPC Initiative, so as to address these pressing issues.

In conclusion, the Malian authorities would like to reiterate their high level of commitment to sound financial policies and to an appropriately ambitious program of structural reforms, that are critical to increase economic efficiency and to sustain high growth rates for poverty alleviation. The HIPC Initiative will help to free up part of the resources required to achieve these objectives.

Mr. Milleron made the following statement:

Based on the debt analysis prepared by the staff and on Mali's track record in structural adjustment, I can once again endorse eligibility under the HIPC Initiative being granted to Mali, one of the poorest countries in the world. This eligibility rewards the efforts made by Mali in the area of structural adjustment over many years. It should notably allow the authorities to strengthen their efforts in the health and social sectors, in collaboration with international financial institutions.

By adopting a target of 200 percent and a completion point fixed at the end of 1999, the international financial community will take into account the heightened vulnerability of Malian exports and the climatic risks endemic to this country, rightly referred to by staff. I note furthermore that the assumption on growth for Malian exports (7 percent annually until the year 2001, then 4.5 percent annually), even if they were revised downward as compared with the previous sustainability analysis achieved last March (10 percent annually from 1997 to 1999, then 3 percent annually as of 2000), remain ambitious and optimistic. The realization of this assumption will depend first of all on the developments of the international cotton market, at the present time greatly affected by the Asian crisis, as well as on eventual vagaries of the gold market. Besides, livestock exports could suffer from climatic conditions.

I would like to underscore that the shortening of the interim period will not constitute in any way an easing up on conditionality, given that the major structural reforms that Mali must implement, notably in the area of privatization, will have been achieved before the completion point.

Along with other creditors of the Paris Club, France will contribute to the agreed upon initiative, by handling Mali's debt stock in accordance with Lyon Terms.

As regards the non-member creditors of the Paris Club, I note the existing difficulties surrounding the financing of their proportional contribution. This being said, all concerned countries being members of the IMF and the World Bank, and having pledged their support to the success of the HIPC Initiative, I am convinced that they will know how to proceed to bring about a comparable effort as that realized by Paris Club creditors.

Finally, as for the ODA credit cancellation measures mentioned in the report, one must be clear: these measures are not part of the framework of the HIPC Initiative. They will remain exceptional decisions, taken on a case-by-case basis by each creditor. In the case of Mali and as regards Paris Club creditors, it is obvious that such measures are not necessary for this creditor group to contribute proportionally to the effort allowing for the 200 percent target to be reached.

Mr. Morais made the following statement:

I welcome this opportunity to discuss and make a final decision on alleviating Mali's high debt burden. I commend staff and the authorities for progress made in ensuring that all the preparatory work is on track. I am encouraged that 96 percent of the debt has been reconciled and that work is proceeding on the remainder. Looking at debt servicing in relation to both exports and Government revenue, it is clear that Mali's debt burden is unsustainable and remains the biggest stumbling block to stronger performance of the economy and the reduction of poverty, notwithstanding debt relief already provided by the Paris Club and other donors. In this regard, timely assistance under the HIPC Initiative will be of great assistance for the authorities to further strengthen their economic performance. I therefore support the decision point of September 1998.

The authorities have established a strong track record in policy implementation over a prolonged period of time, which is evident in previous staff reports and Mr. Chambrier's detailed preliminary statement. This effort contributed to a major turnaround in the fiscal and external accounts. Structural reforms have been deepened, including in the crucial areas of the banking and legal systems, privatization of public enterprises and civil service reform. Consequently, the supply response of the economy has been overwhelming and real output growth rate has been sustained at high levels with very low inflation. The commitment of the authorities to persevere with reforms remains strong. They have further strengthened their macroeconomic policies and deepened structural reforms in 1998 and set ambitious targets for the medium-term. Against this background, I believe the authorities deserve a substantial shortening of the completion point to allow early release of budgetary resources for human capital development and poverty alleviation. I therefore support a completion point of December 1999.

The amount of debt relief to be provided is also critical given Mali's external vulnerability and very weak social indicators. Mali is currently facing low prices for its key exports particularly cotton and gold. In this connection debt sustainability ratios at the lower end of the scale are the most appropriate and I support staff suggestion.

Looking ahead, I am confident that the authorities are well positioned to tackle the challenges that lay ahead. Measures are being taken to accelerate civil service reform and strengthen the revenue effort. This will contribute to raising public savings, facilitating low inflation and accelerating economic growth. The authorities also need to review the burden of taxation as well as harmonize their legal and tax systems with those of the region with a view to promoting private sector investment into the country, particularly in nontraditional exports, which are key to enhancing external viability in the long-run. Modernization of the banking system and the planned acceleration of privatization is welcome, most of which is expected to be done before the completion point. This provides the authorities with no room for complacency.

As the reforms deepen, there is need to continue fostering public support for the program. In this connection, it is important that VAT is introduced at a moderate rate and that cost recovery measures in education do not weigh heavily on the rural poor.

With these comments, I support the proposed decision and wish the authorities well in their endeavors.

Mr. O'Brien made the following statement:

The Malian authorities are indeed to be commended for the policy implementation track record which they have established. They have made substantial progress in putting in place an appropriate macroeconomic framework but undoubtedly the way ahead is longer than that which they have already traveled. I believe that they do meet the eligibility requirement for assistance under the HIPC Initiative and are at the point where a decision can be taken. They deserve the best possible support that the Fund and the rest of the international community can provide. In this regard, I agree that bilateral creditors should be strongly encouraged to provide the necessary debt relieve for Mali to reach its NPV targets.

The program outlined by the staff is both ambitious and credible and, if implemented fully, should provide a framework conducive to growth and development, with active private sector participation. I am particularly pleased to note the proposed measures for strengthening the judicial system and to provide an enabling legal framework for private sector activity. We can often under estimate the value of an adequate, well functioning judicial system as an incentive to both domestic and foreign private sector investment. I am pleased to note also that due emphasis is being placed on education and health as well as public utility reform and privatization.

However, the risks involved in implementing the program shouldn't be under estimated. The authorities would need not only to maintain but to strengthen the commendable resolve they have displayed over the past few years. The authorities need also to be careful not to create the impression to their people that relief under the HIPC Initiative would be a panacea for all their economic problems, nor should they themselves over estimate the value of the assistance and slacken their resolve. It is quite clear that even with the proposed debt relief and other international assistance, the Malian people will be called upon to make greater efforts and sacrifices if their economy is to be placed on a path of sustainable growth within a reasonable time frame.

It is within this context that I support the proposed decisions and the completion point in December 1999. I do not believe that being given more time to achieve the targets will necessarily be to the advantage of Mali. They have shown good resolve and sufficient capacity to undertake reforms on a sustained basis, and I believe that the momentum should be maintained. Staff, however, may need to closely monitor the situation and provide technical assistance in a timely fashion.

I take this opportunity to wish the authorities and people of Mali every success in their efforts to develop their country.

Mr. Al-Turki made the following statement:

Mali has been well served by the past decade's commitment to economic adjustment and reform. Last year's program expectations on growth and inflation were exceeded. Output picked up by well over twice the population growth rate, prices were virtually stable, and there were further improvement in the fiscal and external payments areas. The authorities have also outlined a credible policy framework for a sustained rise in per capita income. Reduction of the debt burden is, however, critical for a sustained recovery. I therefore broadly endorse the staff's recommendation concerning the final decision point assessment of the proposed assistance to Mali under the HIPC Initiative.

It is important that the momentum be maintained for early completion of this process. In that connection, I welcome the authorities' priority for improved debt monitoring and effective integration of the debt management function into macroeconomic policy formulation.

Successful implementation of the privatization objectives is crucial for Mali. In that regard, the slippage in 1997 is unfortunate. However, I am reassured by the renewed commitment of the authorities as noted in Mr. Barro Chambrier's statement. Judicial reforms, simplification of the regulatory framework for business, and the adoption of a more flexible labor code are vital for an environment conducive to market-led growth.

I agree with Mr. Milleron on the need for clarity. The decision on ODA credit is not a part of the HIPC Initiative framework. In what circumstances ODA decisions become relevant is, indeed, a matter for each concerned creditor to take up as needed on an exceptional basis.

I wish the authorities success.

Mr. Shields made the following statement:

I agree that Mali is ready for a decision point under the HIPC Initiative, and, indeed, was ready when the latest ESAF was approved. Given that Mali has had a long and effective track record, which will be further advanced by the end of next year, the completion point seems appropriate. Moreover, the NPV of debt-to-exports target seems appropriate. This is a tight limit, but given the vulnerability of the economy and their weak social indicators, that target seems correct. However, that target leaves some financing to be determined. We are confident that Mali's current policies and objectives will attract additional donor financing, and that the financing gap will be filled, as has been done in the recent past. I therefore agree with all the staff's recommendations.

Mrs. Zador made the following statement:

Mali is indeed eligible for the HIPC Initiative. Mali's projected net present value of debt-to-exports ratio for December 1998 is 221 percent, and although this is lower than the figure given in the preliminary document, we still consider Mali a fair case for assistance under the HIPC Initiative. Even with the revisions, Mali's debt burden is heavy, especially given that its social indicators are among the weakest in sub-Saharan Africa. The Malian economy is most vulnerable to fluctuations in the prices of its main export commodities, and the Malian agriculture is hostage to a climate of extremes. Among sub-Saharan countries, Mali was the second worst hit by the drought. Even though Mali's external debt burden is near borderline in HIPC terms, the other factors make it extremely vulnerable to external shocks.

As an ESAF-eligible country, Mali has pursued two ESAF programs since 1992, and has built up a track record of strong performance. Its creditors support its adjustment effort. Mali was one of the first countries to qualify for a Naples terms stock of debt operation in 1996 and the authorities have by now concluded bilateral agreements with all Paris Club creditors. More recently, Paris Club creditors have agreed in principle to step up the 1996 operation under Lyon terms.

In light of Mali's strong track record of performance, including the recent positive conclusion of the third annual ESAF arrangement, we agree that Mali has met the conditions for reaching a decision point. Regarding the completion point, we will stick to our earlier position that the completion point should not be earlier than end 1999 (15 months after the decision point). This is a good compromise compared to the transition period of other HIPC countries.

Despite Mali's good track record, much remains to be done. Mali must complete the policy agenda and strengthen their structural reform agenda under the present ESAF and IDA arrangement, and must secure approval for the successor ESAF. We think that Mali has a good chance of satisfying these requirements. However, we would like to see faster progress with privatizing loss-making state enterprises and parastatals. In addition, the financial sector reform should be accelerated to attract broad-based private sector involvement. We are pleased to see that the medium-term policy framework under the HIPC Initiative intends to establish a clearer linkage between the resources freed up by the Initiative's debt relief and the need for social spending. The social performance criteria and specific targets in the health and education sectors shown in Table 13 of the report are most welcome.

Regarding the debt sustainability targets, we are pleased that the staff has maintained its proposals for the debt-to-exports target and debt service ratio target to 200 percent and 20 percent, respectively. These are the same ratios we agreed to in the preliminary HIPC document. So far, debt relief financing has been secured for 204 percent. We applaud the staff's effort to secure the remaining additional debt relief from non-Paris Club creditors, but, if the authorities cannot obtain additional relief in time for the completion point, we would not consider this a reason to increase Mali's debt sustainability target to 204 percent.

Ms. Abdelati made the following statement:

We fully support the new decision point in August/September 1998. We also support an early completion date to take place in December 1999, with a net present value of debt-to-exports ratio of around 200 percent, contingent on the completion of most reform measures under the third annual ESAF arrangement, as well as under the first annual arrangement under a successor ESAF.

We believe that this would allow Mali with sufficient time to implement key reforms measures currently under preparation. In view of the shortening of the second stage, it is essential that for the authorities make definite strides in the next 18 months in critical structural reform areas which will place Mali on the path of sustainable growth; namely, reform of cotton, utility, and other key public enterprises; widening the scope of privatization; improving the environment for private sector involvement; deepening financial intermediation; strengthening the competitiveness of the rural sector; and modernizing the civil service to support the reform effort. The measures outlined in Table 5 are a good starting point for this reform effort, and we hope to see this more fully elaborated and resolutely implemented in successive PFPs.

In order for debt reduction under the HIPC Initiative to be effectively directed toward poverty alleviation, concerted efforts are needed to raise health and education indicators. We welcome the completion of the ten-year health sector development program and we look forward to the assessment of the education sector, as part of the public expenditure review to be completed in mid-1999. We note that even with the targets elaborated in paragraph 29 and 30 for end-1999, Mali's social and health indicators will remain weak, with only 55 percent of children enrolled in primary schools, 45 percent of the population covered by primary health services, and 70 percent of infants immunized. We would therefore underscore the importance of continuing efforts by the staff of the Fund and World Bank at developing detailed and sufficiently ambitious sector strategies for these two sectors, aimed at ensuring continued progress beyond end-1999.

Mr. Fujii made the following statement:

We agree with Mali's eligibility under the HIPC Initiative, and support the staff's proposal regarding the timing of the decision point. Although we would prefer to set a completion point in spring 2000 in order to give the authorities sufficient time to complete crucial structural reforms, we are prepared to go along with the Board consensus on this issue.

On the debt sustainability target, the staff proposes a target for Mali's net present value of debt-to-exports ratio of 200 percent. However, we have several concerns on setting the target at this level. First, the debt-to-exports ratio is much lower than those for others countries that have reached the decision point.

Second, in the case of Uganda, we determined a 220 percent target for Uganda, which is more vulnerable to external shocks compared to Mali. Against this background, I wonder if the target needs to be set at 210 percent, lower than the one for Uganda. Moreover, as the staff paper itself points out, financing assurance have only been obtained for a NPV of debt-to-exports ratio of 204 percent, assuming a strictly proportional burden sharing approach and debt relief of bilateral creditors on Lyon terms. I wonder if we should set the target at this ambitious level without ensuring sufficient financing assurances.

I join Mr. Milleron in noting that the ODA credit cancellation measures are exceptional—not within the HIPC framework— and should be taken into account on a case-by-case basis by each creditor.

Finally, I hope the Malian authorities will continue to strengthen their efforts toward the completion point, and I wish the authorities further success in their future challenges.

Ms. Mercusa made the following statement:

During the discussion on the preliminary document for Mali in April, we reminded the Board of the definition of borderline cases. There was no doubt that Mali belonged to that category, notwithstanding the ample data revision that had occurred at the time. Based on the rules stated in the selected decisions, we also argued that, in light of its good track record of adjustment, we could consider Mali exceptionally eligible. We maintain this stance of eligibility today, especially after the approval of the third-year ESAF arrangement in August 1998 and the authorities' commitment to proceed with structural reforms. We also maintain the stance that Mali is an exceptional case.

As for the decision point, we agree that Mali has reached it today. We notice, however, a delay of about six months with respect to the original timing of the decision point. This is not reflected in a similar delay in the completion point, which according to the staff proposal has been shortened to 15 months. We would have preferred to have the completion point in early 2000 as soon as data on the 1999 debt were available.

Finally, the Board had agreed on a net present value of debt-to exports target in the lower half of the 200 to 220 range. The current proposal of a 200 ratio falls short of financing. Should this be chosen, Mali's creditors would be asked to make an additional effort above the 80 percent of relief already granted. As in other cases, we think that, in the absence of a specific commitment by donors to finance the difference, the target of 204 percent appears to be the most feasible solution.

Ms. Budington made the following statement:

Given our recent discussion in context of the decision on Mali's third-year ESAF program, I would like to focus my comments on the HIPC decision. In light of Mali's debt position and its commendable record of market-oriented reforms over this decade and particularly since 1994, we certainly concur with staff's recommendation on the decision point. And, given Mali's commitment to ongoing macroeconomic prudence and structural reforms under the current program and a follow-on ESAF, we continue to believe an end-1999 completion point is warranted.

We appreciated the detail in the staff report regarding key elements of the reform agenda under the HIPC initiative -- including the explanation of plans in the education and health sector. We also appreciate the update in paragraph 26 and Box 6 regarding plans for the rural sector, and note in particular the clear statement of the government's overall objective to open the cotton sector to increased private sector participation, according to modalities to be discussed with the World Bank and IMF.

In terms of the debt target, given the vulnerability of Mali's external position, we believe an NPV of debt to exports target at the lower end of the range is justified. We are, however, concerned that commitments to reach the 200% target recommended by staff have not yet been achieved. In this light, we think that a more prudent decision at this point would be for a target range of 200% to 204% -- the latter figure representing the level of relief for which we have clear commitments at this point. We would certainly encourage staff to seek commitments to achieve the 200% target under their ongoing discussions with bilateral creditors and in particular we would encourage countries that have not already done so to forgive aid-related debt or take comparable action.

Mr. Jadhav made the following statement:

This chair has always supported Mali's case on account of its steadfast adherence to implementation of its programs. It is clear from the staff document that the Malian authorities deserve compliments for the way in which they have managed their economy. It is also heartening to note that Mali has been able to reconcile the discrepancies in debt figures. We support the position that Mali has reached a decision point and early completion point.

In Box 1, the staff projection on the debt sustainability analysis is based on assumptions which may not materialize, particularly with regard to export growth projections during the period 1998 to 2001. Unless new gold mines are discovered, the prospects for increasing exports are only minimal, particularly at a time when gold prices are falling. Similarly, the increase would also be contingent upon the increase in production of cotton, as well as its international production and prices, both of which tend to fluctuate. There is also the presumption that there will be growth in nontraditional exports. We do not know what the basis is for this assumption. Box 2, which elaborates on the cotton industry in Mali, does not mention diversification of this industry into the manufacture of textiles. This point had been made earlier when a group of Executive Directors visited Mali and had noticed the glaring fact that no attempt was made to develop any textile industry. It would indeed be sad for a country which produces enormous quantities of cotton to lose out because no institution has taken the interest to develop a textile industry in Mali. In spite of drawing attention to this omission, neither the Fund nor the Bank has reported on action taken in this area.

We are impressed by the targets that have been set for developing the areas of education and health. While allocation for these sectors would continue to improve, there should be an effort to increase capacity to take on additional responsibilities in both areas. The assistance required by Mali as reported by the staff is only US$128 million. If such assistance could give a big lift to a country like Mali, it deserves to be supported.

We wish the Malian authorities all the success.

Mr. Lehmussaari made the following statement:

I agree with the staff's analysis and recommendations in the final HIPC document for Mali. As a result of many years of hard struggle, the Malian authorities have managed to place the economy on a more sustainable and solid ground for development. This has been achieved through implementation of sound macroeconomic policies and by the determination of the authorities to carry out necessary reforms. We see merit in being able to advance with the case of debt relief for Mali.

This chair has not changed its position on the issues related to Mali's eligibility, and we agree that Mali meets the eligibility requirements.

We also agree that Mali has reached the decision point.

With regard to the completion point, this chair would have preferred a somewhat later completion point, but can also accept the proposed December 1999 completion point, provided that policy implementation remains strong.

Finally, we can also go along with the staff's proposal that the target for the NPV of debt-to-export ratio be set at 200 percent, and debt-service ratio at 20 percent.

Mr. Chelsky made the following statement:

For the reasons that have been well articulated, we support the staff's recommendation on eligibility, the decision point, the completion point, and the debt-to exports target of 200 percent.

We agree with Mr. O'Brien, as well as other speakers, on the importance of a continued strong effort at reform. In terms of the debt sustainability analysis and the export projection, like Messrs. Jadhav and Milleron, we have concerns that there may have been some overoptimism at the last discussion on Mali's HIPC Initiative eligibility, For instance, we had expressed particular concern with the gold price assumption, which was around $300 per ounce. A price around $290 per ounce or lower might be more prudent. I note on page 6, footnote 6, that there has been no change to the gold price assumption. I wonder how sensitive are the calculations to any change in the gold price.

With respect to the 200 percent debt-to-exports target which we endorse, while acknowledging that there is still a financing gap between 204 percent and 200 percent, we also believe that the country should not be penalized for problems which creditors face in coming to an appropriate accommodation on burden sharing, a point we have made on a number of occasions. We encourage bilateral creditors to show leadership in this regard, and we welcome the staff's reference to the G-8 Birmingham summit communiqué with respect to ODA debt relief.

We have some concern that the Fund is articulating a completion point as a point in time, because as is made clear throughout the document—albeit not consistently—the completion point is effectively tied to the completion of the mid-term review under the first annual ESAF arrangement. Instead we focus on the point in time, and indeed in some cases there has been confusion with other institutions and with the public with regard to a possible shift of the completion point because of changes in the time table for completing reviews. My understanding is that the World Bank is less precise in terms of what the prior conditions for reaching the completion point are, and focus more on the point in time. In the case of Mali, we are tying debt relief to the completion of the review: if that review slips, so does the completion point. We need to make sure that that is well understood by all participants, particularly since this document itself will be made public. In some places the document says contingent on in other places it just says that management and staff recommend that the completion point take place in December of 1999. We need to ensure consistency and clarity on that point.

Mr. Zakharchenkov made the following statement:

Mali is eligible for assistance under the HIPC Initiative in light of the strong track record of successful implementation of the Fund-supported programs, and we consider that this country has reached the decision point. We can accept a completion point of end-1999, provided that macroeconomic policies and structural reforms remain strong. With respect to the level of assistance, we are in favor of the lower end of the proposed target, that is, a 200 percent debt-to-exports target. We have no objections to the proposed macroeconomic policies and the structural reform agenda in the period ahead. In particular, we welcome the enhancement of social policies and increased attention to health and education programs. We would urge the authorities to use the debt relief granted under the HIPC Initiative to strengthen their efforts in improving social indicators.

I would like to support and enhance the point made by Mr. Chelsky on the gold prices. In the preliminary HIPC document, the staff investigated alternative scenarios, and concluded that the debt-to-exports ratio in Mali is highly sensitive to changes in cotton and gold prices. In the case of gold, the staff indicated that a price remaining below $300 per ounce would likely dissuade new investors and result in the closure of all but the most efficient operating mines, thereby eliminating some 60 percent of gold exports from the baseline scenario. In this regard, it would be interesting to hear from the staff the recent update on the viability of Malian gold exports and its budgetary implications.

Mr. Rouai made the following statement:

I reiterate this chair's view that Mali meets the requirement of assistance under the HIPC Initiative, and hope that early debt relief will help the country improve its social indicators, which are alarmingly weak even by sub-Saharan African standards. Over the past nine years, Mali has accumulated a satisfactory track record of adjustment and policy implementation, and I therefore agree that the country has reached a decision point, effectively shortening the completion point to December of 1999. In view of the vulnerability of the country, both to climatic conditions and to a limited number of export commodities, I support the adoption of a target of 200 percent for the NPV of debt-to-exports ratio, and I join the staff in encouraging bilateral creditors, including non-Paris Club members, to provide additional debt relief in order for Mali to achieve this target.

The privatization program detailed in Mr. Barro Chambrier's statement is comprehensive and includes such sectors as banking, utilities, and telecommunications. Traditionally, such companies—notwithstanding their indebtedness—hold sizeable assets. However, the privatization receipts projected for the year 1998/99 (as shown in Table 12) are negligible. Could the staff could elaborate on this point.

With these comments, I wish the authorities every success.

Mr. Qi made the following statement:

This chair still holds the view that Mali meets the eligibility requirements for assistance under the Initiative and agrees that Mali has reached its decision point. I support the completion point of December 1999 and the target for the NPV of debt-to-exports ratio be set at 200 percent.

Regarding China's claims on HIPCs including those on Mali, I would like to reiterate that the Chinese government is willing to make its own efforts to help the hips relieve their debts, mainly through bilateral negotiations, which will by no means burden the HIPCs' overall debt relief process and their economic development.

Mr. Schmalzriedt made the following statement:

This chair continues to have doubts about Mali's qualification under the HIPC Initiative. As already expressed during our discussion on the preliminary HIPC document in April of this year, Mali should be considered as a borderline case, not least because, even under alternative balance of payments scenarios, Mali's debt service ratio remains well below the target range of 20 to 25 percent. Mr. Barro Chambrier in his statement seems to introduce a new indicator when referring to debt service as a percentage of government revenue. If I remember well, we have agreed in this context to refer to debt service as a percentage of exports of goods and services, and here the figures are closer to 15 percent than to the 20 percent mentioned by Mr. Barro Chambrier. Furthermore, to give one example, already in 2000, Mali's net present value of debt-to-exports ratio without det relief under the HIPC Initiative will be below Uganda's ratio with debt relief under the HIPC Initiative.

Mr. Presecan made the following statement:

We agree that Mali is eligible for assistance under the HIPC Initiative. On the decision point, we agree that Mali has reached this point by now, and we can also support that the completion point take place in December 1999, given the strong performance by the Malian authorities, provided that implementation of macroeconomic policies and structural reforms under the third annual ESAF arrangement, successor ESAF arrangement, and IDA lending operations remain strong.

Since the decision point document has reasserted the previous DSA conclusions and the recommendations thereafter, we could agree that the target for the NPV of debt-to-exports ratio be set at 200 percent, and that the target for the debt service ratio be set at 20 percent. However, we need to emphasize the point that we have been consistently raising throughout the HIPC Initiative discussions, and which was raised by Mr. Chelsky today, that proportional burden sharing should be followed by all participants in the HIPC Initiative. In this case, it would be bad for the credibility of the HIPC Initiative if the financing gap of around $6.5 million could not be secured by the participants. It is our hope that it will not be necessary to raise the final debt target beyond 200 percent to ensure application of the principle of proportional burden sharing. In that respect, we have taken note of the staff's response during the discussion on the same topic in the World Bank Board; namely, that the decisions that are to be taken by both Boards were only decisions in principle, and that the process of seeking final confirmation on multilateral and bilateral creditors will start after both Boards agree to the final decision point document. We hope that the subsequent actions by the HIPC contributors will justify the confidence expressed by the staff of both the World Bank and the Fund on this course of action.

Mr. Schaad made the following statement:

I would like to thank the staffs of the Fund and the Bank for this document. As we already noted in the discussion in April, Mali has no doubt achieved significant progress in stabilizing its economy and reinforcing growth by implementing structural reforms in key areas.

Based on traditional debt indicators, Mali's debt situation is less adverse than that of other HIPC countries. On the other hand, we must bear in mind that Mali is one of the poorest countries in the world and that its debt will remain unsustainable in the near future, especially given the vulnerability of Mali's external economy. We therefore consider Mali eligible for assistance under the HIPC Initiative and accept the decision point to be today.

However, Mali's track record of uninterrupted policy reform is relatively young, given the fact that Mali's policy implementation was interrupted as recently as in 1994. For this reason and because of Mali's heavy reform agenda, I, like Mr. Fuji and Ms. Mercusa, would have preferred a somewhat later completion point than the proposed one, as this Chair already stated in our discussion in April. Since the decision point is now later as previously envisioned, this holds even more and I would like to ask the staff if the remaining interim period will suffice for implementing Mali's ambitious reform program. We could go along with this proposal, however, if the other members decided on a completion point at the end of 1999.

In the case of Mali, the vulnerability analysis deserves particular attention. Mali may be considered as one of the most vulnerable economies compared to other HIPC countries, especially if the likelihood of drought and its impact on cotton production is taken into account. We can therefore support the proposed debt sustainability threshold of 200 percent of the NPV of debt-to-exports ratio and 20 percent of the debt service ratio. In order to achieve this goal, non-Paris Club members should be encouraged to provide additional debt relief.

The staff representative from the African Department stressed that it would be necessary to ensure that Mali's record of structural policy implementation was strong, in light of the shorter interim period. Moreover, the staff would assist the authorities by delivering technical assistance on time, and by effectively monitoring the implementation of policies and reforms.

Concerning the balance of payments projections, specifically those pertaining to the price of gold, the staff representative stated that their projections were reasonable. The World Bank had calculated a break-even price for gold of around $250 per ounce. As long as the price remained above that level, gold production in Mali would not be jeopardized. Although it was true that the price of gold had declined by 9 percent at the time that the projections had been made, they had recently rebounded by about 6 percent.

With regard to the cotton sector, there was considerable scope for increasing productivity in that sector, the staff representative remarked. Arable land was still available and farmers seemed agreeable to the idea of expanding cotton production. That potential increase in cotton production had been built into the projection for exports, even though it was recognized that it would take time for cotton production to increase to 660,000 tons per year from 560,000 tons.

The sensitivity analysis in the preliminary HIPC document had attempted to capture the impact on the debt burden of not meeting the cotton production target, as well as fluctuations in the prices of cotton and gold, the staff representative said. Although it was not possible to incorporate the impact of the recent price changes on Mali's debt situation, when Mali reached the completion point any needed changes could be built into the DSA. At that point, one could also determine whether the NPV of debt-to-exports target would move out of the 190 to 210 percent range.

The impact of the gold sector on the budget was minimal, the staff representative stated. That was partly due to the way the investment code had been designed. In that context, the code for the mining sector was under review.

Projected privatization receipts were low because it was difficult to determine with any certainty what the level would be, the staff representative explained. The staff had an understanding with the authorities that privatization receipts would be used for one-off outlays, preferably in the social sectors.

On whether the authorities would be able to implement the structural reform agenda, given that the interim period had been shortened by three months—to 15 months—the staff representative acknowledged that the shorter interim period had not been a factor during the discussions on the third annual ESAF arrangement, which had been discussed by the Board in August 1998. The delays which had resulted in a shorter interim period had been due to a delay on the part of the staff in determining the recommendations for the final HIPC document. Therefore, the staff was convinced that the structural reform agenda would be implemented by end-1999.

The staff representative from the Policy Development and Review Department agreed with Mr. Chelsky that the completion point was conditional on the implementation of the program. The draft decision was unambiguous on that point: it stated that the timing of the decision point was December 1999, provided that the authorities maintained a strong adjustment and reform effort. If the authorities were unable to meet the reform agenda, then the completion point would be delayed. Moreover, it was up to the Board to assess whether the conditions in the draft decision had been met, and the World Bank understood that. He assured Mr. Chelsky that any public references on Mali's HIPC eligibility would be clear that the timing of the completion point was conditional.

The staff had not assumed cancellation of ODA debt under the HIPC Initiative framework, the staff representative continued. A strictly proportional burden sharing approach—by multilateral and bilateral creditors each as a group—had been followed. However, if debt were broken down by Paris Club and non-Paris Club official creditors, the Paris Club, which was providing an 80 percent reduction on eligible debt, was contributing more than its proportional burden sharing. That, however, had reflected the categories of debt held by the Paris Club; more specifically, the breakdown between commercial and ODA claims. For non-Paris Club creditors, an 80 percent reduction on eligible debt had been assumed. For ODA debt the comparable treatment was a rescheduling over 40 years, including 16 years grace at the original concessional interest rate. That, however, had not generated much debt reduction compared to Naples terms, which had the same requirement on ODA debt. One way to achieve a 200 percent debt-to-exports target was with additional debt relief by non-Paris Club creditors beyond what had been granted. However, that debt relief did not involve cancellation of debt. Debt relief could be discussed with non-Paris Club creditors on a bilateral basis. The Fund and the World Bank were optimistic that such a dialogue would produce additional debt relief, consistent with proportional burden sharing and a 200 percent debt-to-exports target.

In response to questions about how one could justify a 200 percent debt-to-exports target for Mali, for instance, compared to the Ugandan target of 202 percent, the staff representative explained that the setting of targets was based on the recommendations of the staff and management, which, in many cases, involved some judgement. Clearly, Mali's vulnerability, particularly to drought, was an important consideration. Moreover, during the Board discussion on the preliminary HIPC document, most Directors had favored a 200 percent target.

Ms. Budington asked whether, in the case of Uganda, the achievement of the 202 percent debt-to-exports target had required any additional effort beyond Lyon terms. Had the commitments to meet those additional efforts, if any, been achieved before the decision point had been taken?

The staff representative from the Policy Development and Review Department said that, in the case of Uganda, the commitments had not been achieved prior to the decision point discussion. A similar situation had occurred in the case of Bolivia. At the time of the decision point, Bolivia had not had full assurances for the recommended target owing to a large holding of ODA debt by a Paris Club creditor, which had not been subject to any reduction under Lyon terms because the interest rate had been close to the market interest rate. Since then, that creditor had decided to provide a large debt reduction on those claims. Therefore, in the case of Bolivia, the decision point target had been financeable, and the staff was optimistic that Mali would achieve similar results.

Mr. Chelsky noted that a few Directors had supported a particular target if bilateral financing could be obtained and another target if it could not. With regard to the sequencing of the various agreements from creditors, if there were more support for that approach, would it be possible to come up with a conditional target?

The staff representative from the Policy Development and Review Department said that, given that the Bank's Board had agreed to a 200 percent debt-to-exports target for Mali, it seemed that a majority of Directors were in favor of a similar target. However, the draft decision was subject to the receipt of financing assurances from other creditors. The staff would inform the Board whether there was a willingness by non-Paris club bilateral creditors to provide additional debt relief on their ODA claims. Thereafter, it would be up to the Board to review that decision.

Ms. Budington pointed out that the HIPC Initiative framework for Mali depended on whether the financing assurances could be obtained. In the case of Bolivia, the Paris Club creditors had an opportunity to discuss the situation prior to the Board discussions, whereas in the case of Mali, it was not certain whether the financing assurances could be obtained. Therefore, it would be more prudent to set a range for the debt-to-exports target. That way, if the Fund had been too optimistic, the target would not have to be replaced.

The Acting Chairman stressed that receipt for debt relief had to be linked to the completion point and to the implementation of the program in order to create an incentive for the Malian authorities. To ensure that the amount of financing could be mobilized, the managements of the Fund and the Bank would do whatever was necessary to close that financing gap.

Mr. Barro Chambrier made the following concluding remarks:

I would like to thank Directors for their constructive comments and recommendations. I was pleased to see that it was clearly recognized that Mali meets the eligibility requirement for assistance under the HIPC Initiative. Since the staff has given comprehensive answers to the questions raised, I will limit myself to a few remarks.

On the social indicators, as it has been stressed during the discussion, there is no doubt that Mali's social indicators are weak and that poverty is a pressing issue in Mali.

When we adopted the framework for the HIPC Initiative, there was a clear understanding that one should not rely on one indicator only, and that there should be some flexibility. It is difficult to set a target without making any judgments. It is important to look at other indicators. Moreover, after the group travel to Mali, the participants were convinced that Mali was a good candidate. With regard to the debt service ratio, the report says, "In view of Mali's external vulnerability, the staff and management recommend that the target of net present value of debt-to-exports ratio be set at 200 percent and that the target for the debt service ratio be set at 20 percent." I referred to the debt service as a ratio to revenue to indicate the burden the authorities would face in the absence of assistance under the HIPC Initiative.

On social issues, I wish to reassure Directors that the authorities are making concerted efforts with the donor community, including in the round table conference starting today in Geneva, to define a strategy to accelerate human capital development and to integrate the most vulnerable populations into the economy's activities.

Concerning the cotton sector, my authorities take seriously the remark made by the Indian chair with regard to the need to go further on the industrialization of this sector. It is obvious that there is a need to raise efficiency in this sector, to improve producer prices, and to diversify the economy's base away from cotton. To this end, in consultation with the World Bank, the government will consider the best alternative to achieve these objectives in an orderly manner when the audit of the CMDT is completed.

On Mali's vulnerability to external shocks, it is clear that the assumption may appear optimistic. In any event, I wish to reassure my colleagues that my authorities are prepared to take corrective measures that are within their reach to protect their external position, and to continue to make progress toward external viability.

Finally, I want to reiterate that my Malian authorities intend to maintain their strong track record of policy implementation through a high level of commitment to sound macroeconomic policies and bold structural reforms. My authorities are sure that the HIPC Initiative will help them to free up parts of the resources that are required to achieve their social objectives. I am sure that my authorities will do their best so we could benefit fully as soon as possible from assistance under the HIPC Initiative.

The Executive Board took the following decision:

Based upon the external debt sustainability analysis for Mali (EBS/98/28, 2/19/98; and EBS/98/150, 8/24/98), the Fund, as Trustee of the Trust for Special ESAF Operations for the Heavily Indebted Poor Countries and Interim ESAF Subsidy Operations (ESAF/HIPC Trust) adopted by Decision No. 11436-(97/10), February 4, 1997, decides:

(i) that in accordance with Section III, paragraphs 1 and 2 of the ESAF/HIPC Trust Instrument (Instrument), Mali is eligible and qualifies for assistance under the HIPC Initiative as defined in the Instrument;

(ii) that the completion point for Mali will be in December 1999, provided that by then the Fund as Trustee of the ESAF/HIPC Trust shall have completed the midterm review under the third annual arrangement under the current three-year ESAF arrangement, and shall have approved a new three-year ESAF arrangement for Mali and the first annual arrangement thereunder and shall have completed the midterm review under that arrangement;

(iii) that the external debt sustainability target for the net present value of debt-to- exports ratio for Mali at the completion point will be 200 percent; the target for the debt-service-to-exports ratio will be 20 percent; and the target range for the present value of debt-to-exports ratio will be 190-210 percent; and

(iv) that, in accordance with Section III, paragraphs 3(a) and 3(b) of the Instrument, the SDR equivalent of $14 million would be made available by the Trustee to Mali at the completion point in the form of a grant to permit a reduction in the net present value of the debt owed by Mali to the Fund, subject to satisfactory assurances regarding the exceptional assistance to be provided under the initiative by Mali's other creditors. This amount shall be committed by the Trustee once these assurances have been received, and the schedule for using the proceeds of the Trust grant by Mali shall be established, in accordance with

Section III, paragraph 4 of the Instrument. At the completion point, in accordance with Section III, paragraph 3(c) of the Instrument, the Trustee may adjust the amount of assistance committed.

Decision No. 11796-(98/99), adopted
September 15, 1998

3. ROMANIA—1998 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1998 Article IV consultation with Romania (SM/98/220, 8/31/98; and Sup. 1, 9/14/98). They also had before them a statistical appendix (SM/98/222, 9/1/98).

Mr. Wijnholds made the following statement:

Economic performance has remained weak in Romania since the last Article IV consultation, and the SBA, which expired in May 1998, had a limited success only. This situation proves indeed that deep rooted disequilibria and hesitant reforms at an early stage in the transition process keep imposing a high toll, in terms of economic recovery and proper utilization of the country's potential.

I want to thank the staff for its dedication in working together with the Romanian authorities in designing the reform program, in the aftermath of the 1996 election, and the continuous support extended thereafter. A recent staff visit to Bucharest, to discuss a revision of the budget, prior to its approval in the Government, is a good sign that the cooperation with the Romanian authorities is indeed frank and continuous, with or without a formal program. I also appreciate the candid paper submitted by the staff for this Article IV Consultation, which clearly underscores problems in a number of policy areas, but does not overlook the positive developments in some others. The authorities' agenda has been heavily loaded, and sometimes the targets were perhaps too ambitious compared to the available means to achieve them. Therefore, in addition to the staff's perspective, I will try to focus on major changes in the Romanian landscape, in the last couple of years. It is not a way to present "the full half of the glass" only, but also a set of facts showing that the country is fundamentally moving in the right direction, albeit not always at the desired pace.

Hidden subsidies have been removed

For years, the signaling role of prices was distorted. Initially, through outright price controls, which had been removed in a lengthy process, then by hidden subsidies granted to several industries, mainly via directed credits. All directed credits were discontinued early in 1997, and the new banking legislation, in force since June 1998, strengthens the central bank's independence and abolishes the mechanisms that had allowed directed credits. Above and beyond that, practically all prices have been fully liberalized, and the Government took unpopular measures, such as raising excises on gasoline, and increasing all energy prices, largely to international levels.

Another significant price distortion had been induced by the foreign exchange policy. The market has been fully liberalized since February 1997, and I am pleased to note that Romania was able to accept the provisions of Article VIII--which represents, in itself, a break with the past. There is no longer a "parallel market", and private exchange bureaux rates do not differ from banks'. Coupled with significantly lower custom duties, that development increases the openness of the Romanian economy, and its exposure to external flows. Indeed, imports have grown by 36 percent, and exports by 27 percent during 1996-1998. Those numbers are difficult to reconcile with the recorded abrupt contraction in GDP of the last two years. Assuming that output data are accurate, a rapid expansion in external flows suggests that the decline is connected to unrestructured industries, while a sound part of the economy is growing fast. Unfortunately, statistical data are rather weak and cannot support or dismiss that assumption.

It is encouraging that the removal of hidden subsidies and the transfer of some expenditures to the budget did not lead to a higher government deficit. In fact, due to higher than expected revenues, the general government budget recorded a lower deficit in 1997-- i.e., 3.6 percent of GDP, from 4 percent in 1996, and against a targeted level of 4.5 percent.

Privatization advances

Enterprise restructuring and privatization were less successful than assumed under the SBA. Inconsistencies in legislation, bureaucracy and vested interest, together with an adverse external environment, all contributed to this development. However, the process advances, albeit slower than desired by the authorities. More than 1,300 enterprises were privatized in 1997 only. The private sector contributed with 58 percent to 1997 GDP, six percentage points more than in 1996. In industry--which is the hard core of the economic structure designed by the former regime--the private sector share grew from less than 25 percent in 1996, to more than 33 percent in 1997.

Those numbers are not impressive, but they signal a continuing process. Two more recent examples appear relevant to me; one of the big heavy machines builders, located in Bucharest was sold to an important foreign investor for a mere 500 thousand dollars (the new owner assumes also arrears accumulated by that company); a big refinery was sold to another foreign investor, which assumed past arrears, as well. Those companies stopped bleeding, and they now bring revenue into the budget. Above and beyond that, each of them gives a strong signal: the former, that the authorities are prepared to accept the market value of an enterprise; the latter, that the once sacrosanct oil industry is being privatized.

Recent developments

Some recent developments are encouraging. Inflation in August recorded its lowest monthly level in 9 years, i.e., 0.6 percent; the annual target was revised downward, from 45 percent, to 40-42 percent. Admittedly, this is still too high, but it constitutes considerable progress compared to more than 150 percent in

1997. The central bank regained some credibility with its money-based program, validated by exchange rate developments. Thus, both velocity and interest rates are on a downward trend, while domestic credit picks up gradually. Two major state-owned "régies autonomes" (the electricity company and the railways) were reorganized, corporatized and will be subject to privatization. Two large state-owned banks are completing the final stage before being privatized.

Those developments notwithstanding, the revised budget is not that reassuring. Expenditures are traditionally higher in the last part of the year, and sometimes further adjustments are required, in order to keep the deficit at the projected level. Unfortunately, this year the decline in revenues appears to be higher, while there is little room for a further reduction of expenditures. However, the Romanian authorities expressed their firm commitment to keep the overall deficit within the revised target. Among the measures adopted in this respect, a temporary surcharge on imports is envisaged. Obviously, this is a second best option, and it partially reverses a welcome reduction in tariffs. It should not be forgotten, however, that such measures were imposed in other countries facing similar budgetary and balance of payments problems, and were included in Fund-supported programs. Therefore, I find the language used by staff in the supplementary information rather strong. Still, it would be preferable for the authorities to explore other means to deal with the existing problems.

In the current international environment, special attention should be given to the external position. It is encouraging that the turmoil in the financial markets has had a limited impact on Romania. The foreign exchange market is liquid and functions smoothly, and central bank intervention has remained quite limited, although it has grown somewhat in recent weeks. In August the National Bank of Romania's (NBR) interventions were in balance, and in September net intervention has been US$70 million, by far less than in other countries in the region. While the overall picture remains favorable (the NBR's net foreign assets grew by US$1.7 billion in 1997 and have basically remained unchanged in 1998), the authorities are prepared to adopt additional policy measures, should the recent pressures continue. For the time being, the authorities are confident that the exchange rate is not far from its equilibrium level, since in terms of unit labor cost there is little, if any, appreciation of the leu, while the CPI-based measurement can be considered as less appropriate, especially in view of the increases in administered prices.

The Romanian authorities are fully aware that much remains to be done, and that the restructuring process should be considerably accelerated. They also know that 1999 will be a difficult year, at least as far as external debt service is concerned. While results are less impressive than expected, the authorities presently are focused again on the need for further, far-reaching, adjustment, and I hope that negotiations for a new Fund program will be concluded in the near future.

Mr. Lushin made the following statement:

The recent economic performance of Romania has been bleak. Another Fund-supported program has gone off track, the current economic situation is precarious and the immediate prospects look discouraging. However, it would be unfair only to blame the authorities for a lack of political will and for the stop-and-go pattern of their policies. Compared to other transition economies of Central and Eastern Europe, Romania is heavily burdened with Soviet-type loss-making industry. Aggressive labor unions as well as vested interests have put up fierce resistance to reforms. Also, a significant momentum exists within the coalition parties and the government that runs counter to a sound reform strategy. Under these political and economic realities, due respect should be given to the already significant advances in the market transition achieved by the authorities. The staff, as well as Mr. Wijnholds in his preliminary statement, are absolutely right to acknowledge the important progress made in eliminating price controls, the liberalization of the foreign exchange market, price and trade liberalization in the agricultural sector, and the removal of hidden subsidies. This notwithstanding, objective impediments to reforms will not serve as an excuse should the Romanian economy deteriorate further. To this end, the staff report gives a clear and candid analysis of the current situation and provides recommendations with which it is difficult to disagree. Therefore, I will limit my remarks to several important issues.

I agree that monetary and exchange rate policies are overburdened by a lax fiscal stance and a sizeable imbalance in the external current account. The price of bringing down inflation by means of an exchange rate anchor may appear to be too high in terms of a further economic slump. Two-digit rates of dollar returns on short-term treasury bills are clearly not sustainable. The authorities had a belief that low inflation and the stabilization of the real exchange rate would encourage a reduction in interest rates and an early recovery in exports. Even if true, these expectations have been undermined by the recent financial turmoil. As a result, foreign exchange market pressures have intensified and there has been a considerable loss of reserves. Under such circumstances, the authorities had no other option but to ease monetary policy, and the staff's update paper signals that they have already started to investigate the possibility of some real depreciation.

This forced adjustment of the monetary stance brings fiscal policy to the forefront. Unless a considerable fiscal consolidation is achieved, the current policy mix may be disastrous for the economy. It is, therefore, highly regrettable that the authorities' fiscal policy is fundamentally inconsistent. On the one hand, there was a net cut in taxes. On the other hand, against a backdrop of a severe compression of basic expenditures, the authorities are involved in expensive military procurement and the launching of a new lunch ticket program, which alone stands for 2 percent of GDP. In passing, I would like to ask the staff: What does this lunch ticket program stand for? And why is it so costly? All in all, the authorities should take immediate measures to prevent a major increase in the budget deficit in 1998 and to secure a sustained reduction in the deficit in 1999.

Structural reforms, especially privatization and liquidation of loss making enterprises, are a key priority for the Romanian economy. In this area significant setbacks took place in the course of 1998. The initial plan for the restructuring of RENE has been withdrawn, nonviable refineries that were closed last year have been reopened, and the policy of cutting energy supplies to delinquent customers was suspended. According to the staff, privatization of large enterprises has almost come to a standstill, with 85 percent of such enterprises remaining state-owned. The staff is right in urging the authorities to undertake up-front measures in enterprise restructuring and privatization. However, with regard to large-scale privatization, I feel somewhat uncomfortable about blaming the authorities for its slow pace. I must confess that I don't know how to achieve sound up-front privatization of large industrial enterprises. Mr. Wijnholds gives some examples in his BUFF, but I have strong doubts that ½ million dollars is fair market value for a big machine-building enterprise in Bucharest, even if burdened with arrears. It well may be that the land alone occupied by this enterprise is worth many multiples of ½ million dollars.

With these remarks I wish the Romanian authorities success in their challenging reform tasks, so that a new Fund program can be concluded in the near future.

Ms. Abdelati made the following statement:

It is rather discouraging that the third Stand-By Arrangement has had the same ill-fate as previous arrangements following a short-lived effort at launching bold structural reforms. Despite some important achievements in 1997 including liberalizing the exchange market, shifting quasi-fiscal subsidies onto the budget, and maintaining a much lower than programmed general government deficit, the stop-and-go pattern of policy implementation continued in Romania, particularly with respect to tackling the large losses of the state banks and public enterprises. The counterpart of these losses was reflected in a widening current account deficit to nearly double its level in 1996. The fiscal and external deficits appear to be headed to a somewhat larger level in 1998, although the exact magnitude of the deterioration appears uncertain at this time.

Before turning to 1998, we would like to point to one aspect of the 1997 program that deserves to be highlighted. Our calculations of the fiscal adjustment of the consolidated general government balance, including the central bank quasi-fiscal subsidies, show that the adjustment in the primary fiscal balance was 8.7 percent of GDP as compared to 6.1 percent under the program for 1997 (EBS/97/69 page 14). Staff confirmation would be appreciated as well as their views on the impact this large adjustment may have had on the large GDP contraction.

For the remainder of 1998 and 1999, staff and the authorities disagree on the relative emphasis regarding the appropriate policy mix. Staff argue for a sharply tighter fiscal stance, as well as some leu depreciation, in order to ease the burden on monetary policy and to correct the large external imbalance. Staff point to recent export stagnation and some loss of reserves, and favor a faster rate of depreciation than hitherto pursued by the authorities. However, exports in 1997 were at the level assumed under the original program and the ULC based real exchange rate does not indicate loss of competitiveness over the past 6 years. We would therefore welcome additional information staff could provide on export performance since April 1998, and on whether there are other reasons for slow export growth and the recent loss of reserves, such as for example the effects of the Asian and Russian crises? More compelling evidence would be needed to indicate that the exchange rate is significantly misaligned before supporting a change in the current exchange rate policy.

We would place somewhat less weight on a large fiscal contraction and emphasize instead the quality of the adjustment and the composition of fiscal expenditures. By the staff's account, the Ministry of Finance has had to compress current expenditures to a level that threatens the provision of basic services and capital expenditures were reduced by nearly one third in 1997-98; so it may not be feasible to sharply tighten the fiscal stance. We would however concur with the staff regarding the need to continue to resist allocations to new low-priority programs and additional tax cuts at this time while considering measures to limit tax exemptions and improve tax collections over the medium-term.

More generally, it would be prudent to formulate the annual budget within a medium term budgetary strategy and exercise restraint in formulating the 1999 budget in order to allow for the cost of bank restructuring while easing the pressure for higher interest payments. Persistently high interest rates not only jeopardizes the chances of output revival, but they have also weakened the loan portfolio of an already troubled banking system.

On structural reforms, we take note of the modest but important progress made in the area of privatization as outlined in Mr. Wijnholds's candid and balanced preliminary statement. In particular, we welcome the recent sale to foreign investors of two large firms, a refinery and a heavy machine manufacturer, both of which were illiquid and in need of restructuring. In addition to accelerating the pace of privatization, we would underscore the importance of closing nonviable enterprises without further delay. In particular, the authorities need to be vigilant in requiring utilities to cut supplies to delinquent enterprises. Furthermore, it is important for the authorities to revive the bank restructuring program and resolve the non-performing loans of the large ailing banks.

Before concluding, we note with some concern the wide range of statistical problems that are described in Box 1 and the risk to program design and implementation resulting therefrom. Intensive technical assistance is appropriate in view of Romania's earlier isolation which has rendered it deficient in modern methodological standards. Nevertheless, we note that Romania has received about 50 technical assistance missions since 1990 from the Fund in addition to substantial assistance from multilateral and bilateral institutions. The persistence of statistical problems could be attributable to failure of the authorities to follow through with recommendations, rudimentary initial conditions and/or the quality of assistance. Unless comprehensive and detailed operational recommendations are provided, it may be difficult for the authorities to overcome all of the important deficiencies in a timely manner. We would be interested in staff views on the efficacy of the Fund's technical assistance missions in addressing some of the long-standing statistical problems and whether an evaluation may be called for to identify possible shortcomings in the quality of TA provided.

With these remarks we wish the Romanian authorities success in their attempts to mobilize the necessary domestic support to revitalize the structural reform program. Here, we fully appreciate the point Mr. Wijnholds makes regarding striking the right balance between sufficiently ambitious targets and adequate account of Romania's constrained implementation capacity.

Mr. Santos made the following statement:

The report presents a candid view of the substantial policy slippages observed over the past year, as well as the main challenges that lie ahead if the Romanian economy is to be put once and for all on a track of economic stabilization and sustained growth. It is clear that efforts to move Romania from a centrally planned economy to a market-based economy are still tentative, as government intervention in the economy is prevalent and price and other controls do not allow an efficient allocation of resources.

Although the magnitude might be different, the Romanian economy is affected by the same problems that have plagued the Russian economy which led it to the current financial crisis: a lack of institutional capacity or political willingness to raise taxes. As a result, public expenditure is compressed to an unsustainable level. The exchange rate is maintained at an artificial level, which implies a substantial appreciation in real terms, thus reducing competitiveness. Enterprise and financial sector reforms are still in a preliminary stage, and bankruptcies are a rarity. In addition, payment arrears have persisted in the economy, despite several bail-out interventions. In sum, like Russia, Romania presents all the features of what some have defined as a virtual economy, as it is based on illusion about almost every important parameter of the economy: prices, wages, taxes, and budgets. Romania seems to stall in a situation of neither market nor plan.There is an urgent need for the Romanian authorities to steer the economy decisively toward a market-oriented system, so as to avoid the risk of being isolated from the world economy.

Under these circumstances, we believe that Romania needs the support of the Fund. Consequently, the Fund should stand ready to help Romania in this endeavor. However, given the poor track record and the significant deviations from the previous unfinished program, before starting a Fund-supported program, there is the need for a meaningful interim period during which the Romanian authorities-under close monitoring by the staff-may show to the international community their firm commitment to economic reforms. We agree with the thrust of the staff's advice and would like to raise a few specific points.

First, in view of the authorities' intention to adopt an exchange rate anchor, an improvement in the competitive position and the growth outlook of the economy will depend on progress achieved in structural reforms; namely, in the public enterprise and banking sectors. Therefore, it is important that those reforms are accelerated as there is no margin for fiscal and monetary policies to promote economic growth.

Second, we would have preferred that anti-inflationary policies were based on the adoption of a monetary anchor, while allowing the exchange rate to be driven by a reserve target, even if that leads to a depreciation in real effective terms. Such a strategy will be more effective in strengthening the external position, where the margin for maneuver is limited and risks are higher, in view of the current international financial crisis. In these circumstances, if monetary policy is to accommodate adequate financing of economic activity, a further reduction in inflation will depend on a substantial fiscal tightening. That is a challenge faced by the authorities and a test of their will to pursue economic stabilization policies. In sum, we feel that exchange rate action cannot substitute for the pursuance of the right set of fiscal and monetary policies. On a more technical note, we would like to ask the staff why velocity is projected to be constant in 1998 when inflation is declining. Should not velocity decline in response to a reduction in the opportunity cost of money holdings? We would appreciate staff comments on this issue.

Third, we welcome the improvement in fiscal transparency brought by the inclusion in the budget of quasi-fiscal operations. It is important to deal with the problem of payments arrears, which prevent full understanding of financial transactions among public enterprises and between them and the central government. We believe that a sound financial environment will be key to improved policy design and implementation.

Mr. Sobel made the following statement:

One of the basic lessons from the transition economies is that for sustained growth, both stabilization and structural reforms must be pursued vigorously and hand-in-hand. Many of Romania's neighbors have done so and achieved good results.

This institution had an unsatisfactory programmatic relationship with Romania in the first half of this decade as Romania was unable to put in place the structural reforms to back stabilization efforts, resulting in stop-and-go policies, a dysfunctional exchange system, currency overvaluation, and bouts of monetization which resulted in spikes in inflation.

Last year's Fund program, which this chair endorsed, was designed to strike at the heart of these recurrent problems by promoting fiscal transparency and wholesale structural reform. Much was achieved. The exchange rate system is now liberalized, Romania accepted the obligations of Article VIII, quasi-fiscal activities have been put on-budget, and the agricultural system has become significantly more market-oriented. We welcome this important progress.

But regrettably, Romania has been unable to fully take advantage of last year's political window of opportunity and its policy course remains unsustainable. Fiscal discipline has given way to political pressures and unrealistic budgetary plans. The authorities' stabilization aims for the out years do not appear to be ambitious, especially when one considers that recent global developments suggest that countries that do not put in place sound policy frameworks heighten their vulnerability to turbulence. Regrettably, insufficient progress has been made on the much needed liquidation of loss-making firms; bank restructuring has lagged; and privatization is being pursued with insufficient force. Thus, the economy is not being subjected to a much needed hard-budget constraint. We agree with staff that recourse to the temporary import surcharge is highly regrettable.

The large and widening current account deficit should be an obvious source of concern for the authorities. The real exchange rate has appreciated sharply both as fiscal policy is burdening monetary policy and high real interest rates have been used to contain inflation. The impression one is left with is that the current account deficit should be seen as having its clear roots in large fiscal dissavings and insufficient enterprise discipline.

In this regard, I would appreciate it if staff could clarify its views on the leu's competitiveness. Export growth is flat, while imports are surging notwithstanding the economy's contraction. One might conclude from this story that the exchange rate is overvalued. But, on the other hand, real exchange rate appreciation is a common transition phenomena especially after a devaluation, average dollar wages do not appear all that high, and the unit labor adjusted real exchange rate doesn't appear out of line. In this regard, one might expect a country such as Romania to witness considerable capital flight, yet errors and omissions are positive. Could part of the answer to this conundrum be that capital flight is reflected in under invoicing exports and over invoicing imports?

A key issue going forward is the Fund's relationship with Romania. We do not believe that a debate about whether staff properly took into account Romania's political will or implementation capacity last year would be a productive starting point for examining this issue. Rather, we take the view that the design of the staff's program was sound in its underlying recognition that broad-based structural reforms, especially regarding the banking sector and loss-making enterprises, were a requisite foundation for putting Romania onto a sustained growth path. We strongly encourage the authorities to resume programmatic relations with the Fund and we hope that Romania -- Central Europe's second most populous country -- will join its northern and many southern neighbors in pursuing the path of reform. But we also believe that any resumption of programmatic relations should be based on a sound foundation, which will undoubtedly require many prior actions on the structural side and much bolder fiscal efforts.

We had one final question. Under the collaborative procedures for strengthening financial sectors, bank restructuring is seen as much more in the domain of the Bank than the Fund. In paragraph 40, staff note that restructuring of a key state bank is essential for stabilization. Now that Fund staff has identified this problem in the context of its surveillance mission, we would presume that the Bank is following up to underscore this point to the authorities and is working on the restructuring plans. Could staff of the Fund and Bank comment on whether this observation is consistent with their operations and views?

The staff representative from the European I Department, in response to comments on the sustainability of the exchange rate, stressed that even if an ambitious restructuring program were ready to be launched, the present exchange rate anchor should be preserved. Clearly, the staff had concerns about competitiveness. The most recent figures confirmed that exports were stagnating. Given the cost of surrendering the exchange rate anchor, the staff would recommend preserving the anchor, provided that a strong set of policies was in place. However, the authorities were clearly not in that situation at the moment; they might have even lost the anchor. The exchange rate had appreciated by 4 percent over the past three weeks. Including the interventions made today, the authorities had lost almost US$200 million in the foreign exchange market.

Monetary policy would eventually become unsustainable if the present course-no fiscal tightening-was continued, the staff representative continued. He believed that if the rectified budget was implemented as planned, the point at which monetary policy would become unsustainable would come sooner. At that point, the exchange rate would have to be let go. It was crucial that the NBR not lose reserves in defending an unrealistic exchange rate target; it was difficult to determine whether Romania was at that point. However, given the lack of a comprehensive program in the pipeline, and given the events of the past two weeks, the staff believed that the authorities would find it difficult to maintain the anchor in the period ahead. Certainly, if a comprehensive program were in the pipeline, the feasibility of the exchange rate anchor would have to be assessed carefully.

In response to Ms. Abdelati's suggestion that there had been a large fiscal adjustment in 1997, the staff representative clarified that the deficit had declined by 4 percent in 1997 on an accrual basis and 2 percent on a cash basis, reflecting a large buildup in arrears prior to the 1996 elections. Although a 4 percent reduction was indeed a major adjustment, the authorities should not have reduced taxes. In fact, additional tax revenues were needed to pay for the quasi-fiscal subsidies that previously had been covered through implicit, nontransparent taxes, such as the inflation tax. The main issue concerning the fiscal adjustment was that it was not being followed up. The staff was concerned that the deficit was expected to increase, especially given that monetary policy needed to be unburdened. Pressures were mounting again for reverting some of the quasi-fiscal subsidies to the NBR.

The lunch ticket program would allow all employees to receive lunch ticket vouchers, the staff representative explained. Employers would be allowed to deduct the amount of those vouchers from their profit taxes. In addition, the budget would provide for the cost of the lunch tickets. Although the cost of the program had been revised downward from 2 percent of GDP to 1.5 percent of GDP, the Ministry of Finance was strongly opposed to it.

On the rehabilitation of banks, the staff had suggested that the World Bank should take the lead, with Fund participation, the staff representative remarked. However, the bank in question had resisted that proposal, preferring to develop its own program. More recently, that bank has said that, once it has developed its own program, it would look into the World Bank's proposals. The World Bank had offered to assist that bank; however, it had not accepted their offer for help.

On statistical issues, the priorities were mainly the large errors and omissions in the balance of payments and the problems with the reporting of fiscal data, the staff representative stated. The authorities were working on that, and the Fund has offered to provide technical assistance in that area.

In response to a question on velocity, the staff representative explained that as of mid-1998, velocity had not changed. Therefore, the staff had assumed that it would remain unchanged for the remainder of the year.

The Deputy Director of the Policy Development and Review Department agreed with Mr. Wijnholds that import surcharges have been part of programs in the region, and that surcharges could be justified on balance of payments grounds. However, in the case of Romania, the import surcharge was not part of a comprehensive effort to tackle either their fiscal or the balance of payments problems. In addition, the surcharge probably made export growth more difficult, while only making a minor contribution to filling the budget gap. It was also considered a step backward from the trade liberalization that Romania had been undertaking.

Mr. Wijnholds was pleased that the Deputy Director of the Policy Development and Review Department acknowledged that such measures had been accepted in other Fund programs.

The staff representative from the European I Department, in response to a question by Mr. Hendrick, believed that if the rectified budget did not lead to a significant tightening of the fiscal stance, the authorities might be forced to let go of the exchange rate anchor. Although the anchor had served the authorities well, they might not be able to sustain it.

Mr. Esdar made the following statement:

I share the concerns expressed by many speakers, given that the program in Romania has run off track and that the reform process again has come to a halt. Indeed, the deviations are significant, as they include monetary policy, fiscal policy, as well as a renewed buildup of arrears. Also, the structural shortcomings are disappointing. While I acknowledge that there is progress in some areas, I endorse the finding of the staff that a broad revitalization of reform policy is necessary to overcome the deep recession, but also as a precondition for renewed Fund support. Prior actions in this area will be important indicators.

Mr. Gobe made the following statement:

It is very disappointing that the previous SBA went off-track. Although some progress was made, such as liberalization, both in the foreign exchange market and in the agricultural sector, it is a serious problem that there was little progress made in the very important reforms of privatization of public enterprises, restructuring of a large ailing Public Bank, and reduction of the fiscal deficit. I cannot help but wonder that, in Romania, insufficient formation of a political consensus, or lack of gain in national support for reform produced such instability. In this sense, it will be necessary for the authorities to make sure their country recognizes sufficiently the need for reform and to gain sufficient national support for its implementation.

Now, I would like to comment on a few important points.

On fiscal policy, as the staff indicates, it is a serious concern that the fiscal deficit would expand to more than the current level. The Ministry of Finance did not provide estimates for the cost of each reform, many of which were still being developed by the responsible line ministries. Considering this reality, I think an insufficient expenditure administration system is one of the major reasons for the increasing fiscal deficit. Allowing that for now, the authorities decide their expenditure without strict administration under this system, they need to introduce immediately an appropriate expenditure administration system based on a long- and medium- term fiscal program.

It is also a grave concern that the effects of the turmoil in the international financial markets have emerged, in particular, in Romania. Considering that structural reform there has not progressed sufficiently, there is a fear that a large capital outflow could occur. In order to defend the more serious contagion effect on the Romanian exchange market and to maintain foreign reserves, I hope that the authorities will make a strong commitment to the implementation of reform.

On the structural side, I think privatization of the non-viable public enterprises will be the main issue. The authorities have not succeeded in reducing the public enterprise deficit. As the staff indicates in Box 3, Romania emerged with many big-loss-making public enterprises. The reason for the low profitability is its extremely high employment level. In addition, the financial situation has deteriorated further in Romania while it has improved in other central and eastern European economic transition countries. This report indicates a clear delay of reform in this sector. Therefore, as I mentioned above, I hope that the authorities will make immediately a domestic consensus for the implementation of reform and see it through.

Mr. Hagan made the following statement:

I sadly find myself in agreement with the staff appraisal. The paper and Mr. Wijnholds' statement rightly point to areas where progress has been made over the past 12 months. Although we should not ignore the successes, progress in some areas is threatened by inaction in other areas. Overall, the report on Romania should state that progress has been slow and inconsistent, and that the country should try harder. Unfortunately, the current political situation does not realistically allow for the implementation of the sort of program necessary for Romania to start regaining ground on other economies in the region, particularly those seeking to join the EU.

As the paper points out, the situation in the capital markets at present is likely to make it difficult for Romania to roll over its external financing needs. Investors, including those involved in FDI, are likely to become increasingly more discriminating between markets. There is likely to be a high premium placed on poor economic policies, particularly on the fiscal position. Unfortunately, Romania does not score well against other economies in the region.

The movement of quasi-fiscal operations onto the state budget last year was an important step forward; however, expenditure control remains weak. Examples of worrying areas have already been brought up, and I would include proposed military expenditures, continuing enterprise subsidies, and the lunch ticket program. I would urge the authorities to tighten fiscal policy and to accelerate the reform effort. The current policy mix seems likely only to prolong the pain of transition.

We would also like to endorse the concerns raised by the staff on statistical data. Whatever form future policy takes, it cannot help if those taking decisions are ill-informed about what is happening in the economy. It is disheartening that discrepancies remain on government deficit data. Large discrepancies in balance of payments statistics are even more concerning. Efforts to improve statistical data are an urgent priority, which can be addressed with moderate resources in an economy of this size and importance.

Finally, I strongly endorse the continuing efforts of the staff to establish an effective program for Romania. I agree with Mr. Sobel's remarks on what a program should look like, particularly his comments on prior actions. Continued dialogue is important, even when short-term prospects seem gloomy. The Romanian authorities clearly value the advice of the Fund, even if they do not always act on it. I hope that at the next Article IV discussion we might also be discussing progress on a strong Fund program.

Mr. Zurbrugg made the following statement:

I fully share the thrust of the staff's concerns as well as the measures it proposes that should help avoid the hard-won progress that the Romanian authorities have achieved until now being put at risk. The Romanian people have suffered heavily during the deep recession experienced over the last two years. It would be a pity if this sacrifice would not at least pay off in terms of a brighter economic outlook.

The risk of rapidly sliding into a situation characterized by an unsustainable fiscal position, high inflation, and an unsustainable current account deficit is very real. This is not only because of macroeconomic factors, but also because of the attractiveness of populist proposals in such a situation. I urge the authorities to continue their reform efforts and rapidly make the necessary policy corrections, especially in the fiscal and structural areas. It goes without saying that such policy corrections would have to be the sine-qua-non condition for any future Fund support.

I would only like to solicit the staff's view on two specific topics.

Staff mentions the authorities' intention to rectify the budget, in order to take into account revenue shortfalls. Inevitably, such an exercise has a high probability that social expenditures will also be cut. According to our sources, the appropriations of the Ministry of Health will not only be cut, but will also be among those, which will take the hardest hits. This is generally worrying, but even more so when considering that a new insurance system is just being put in place. I would appreciate staff's comments on the quality of the adjustment in the planned budget rectification.

Turning to the banking sector, the report focuses on the high fiscal costs incurred by the bail out of the two major banks, delays in credible restructuring processes and delays in privatization. According to some of our sources in the field, there seems to be a problem of financial intermediation. While the liquidity situation of the banks apparently is relatively comfortable, it seems that SMEs are having a hard time getting credits, even investment credits. Banks appear to prefer holding government bonds issued last year, which have extremely attractive returns. I would be interested in the staff's view on this issue.

Mr. Rodriguez made the following statement:

The Romanian macroeconomic performance has been disappointing: output is expected to decline for the second consecutive year; inflation has fluctuated sharply and remains high; the current account deficit has been rising; and pressures on the budget are mounting. This performance has been largely a reflection of the political situation, which has been unstable and not supportive enough of the program of stabilization and structural reform. The authorities seem to have the commitment and the political support necessary to implement structural reforms. Progress in this area will be determined by the appropriate policy mix to be followed. Although the authorities are optimistic about the pace of reform, the output response, and the trend of the fiscal and current account deficits, the policy mix should shift toward greater reliance on fiscal consolidation, as this would ensure the sustainability of the stabilization process. Further, exchange rate flexibility might be necessary for the same reason. In this way, the appropriate monetary policy stance will depend on the progress in fiscal consolidation and structural reform, as well as on the evolution of other domestic and external variables, which are somewhat volatile. The approach should be careful to avoid the extreme stop-and-go policies of the past.

The current account deficit is projected to worsen this year as a result of an increase in imports, while exports as a share of GDP are expected to remain at a similar level. This situation may reflect the effects of the reduction in customs duties and the evolution of the real exchange rate, which has appreciated in terms of the CPI, but not in terms of unit labor costs. In this regard, as pointed out by Mr. Wijnholds in his statement, it is striking that imports have not been affected by the decline in economic activity.

In the fiscal area, the shift of quasi-fiscal operations under the budget is welcome as it has released some burden from monetary and exchange rate policies. Yet, this has created higher expenditures, which requires some fiscal adjustment. In this context, the tax cuts could not have been more untimely. The authorities have taken some partial steps to offset the effect of these factors in the budget, such as raising some tax rates, scaling down capital outlays, reducing the wage bill, and trimming subsidies. Nevertheless, there remain important pressures in the budget, which, according to the staff projections, could lead to a doubling of last year's general government deficit. Also, there is a valid concern about some of the actions taken which may be reverted in the future. In light of these circumstances, a more ambitious fiscal target for 1999, as proposed by the staff, is preferable, although this would clearly depend on the feasibility and sustainability of the actions required to achieve such a target. Among the possible measures, improving tax collections and eliminating tax exemptions and incentives are important steps in the right direction, but further revenue increases may require some tax rate hikes without resorting to distortionary import surcharges. On the expenditure side, some actions might be identified to further reduce the deficit. Further, pressures to increase spending in certain areas should be resisted. Unsustainable cuts should be avoided, and social spending and capital outlays should be protected.

In the structural reform area, the progress achieved in price and trade liberalization is commendable, but enterprise restructuring and privatization has been slow. More recently, the new authorities seem to be making some headway. As noted by Mr. Wijnholds, the electricity company and the railways have been reorganized, corporatized, and will be privatized. The forthcoming privatization of two state-owned banks is also encouraging. However, this is an area in which much more needs to be done. The large number of loss-making enterprises requires a comprehensive strategy to ensure that only viable enterprises remain open, and that these undergo a thorough restructuring process and be privatized. As part of this strategy, the problem of interenterprise arrears should be addressed. Also, in order to improve their financial situation, these enterprises should be able to effectively charge for the goods and services provided, reinstating the policy of cutting supplies to delinquent customers and avoiding the accumulation of additional arrears by other enterprises and institutions.

With these remarks, I would like to wish all the success to the Romanian authorities in their challenges ahead.

Mr. Rigász made the following statement:

Romania economic situation is not a pleasant one. Real output is falling, the external deficit is swelling, public finances are stumbling, and investor confidence is dwindling. Add some political instability, and you cannot escape the impression that the pot is about to boil over.

The only bright spot in this picture is the continuing decline of inflation, but the accompanying real appreciation of the leu has seriously weakened external competitiveness, and high real interest rates are aggravating the effects of the recession. But even Romania's success against inflation will be threatened if August's premature easing of monetary policy leads to a resurgence of inflation and exchange rate pressures similar to last year's. Perhaps my reading is wrong. If so, I ask the staff to correct me, but I find it plausible that the recent exchange pressures that cost the central bank more than US$300 million in reserves during the month of August may have been triggered by the markets' interpretation of the discount rate cut of August 1, 1998 as the prelude to a replay of last year's scenario.

Obviously, this has not strengthened public confidence, already weak, in the authorities' policies; and not only exchange rate pressures but also inflationary expectations were heightened. Last Thursday's auction of six-month treasury bills to residents--the first ever--remained badly undersubscribed despite ex-ante positive real interest rates. Hostile external borrowing conditions, added to the difficulty of finding domestic credit, will perhaps make the authorities receptive to the staff's suggestion for pursuing a more balanced mix of financial policies.

The fiscal package approved by the government last week aims at holding the budget deficit to 4 percent of GDP in 1998, but it relies so heavily on spending cuts, especially in the traditionally weakly funded sectors of health and education, that its success is rather uncertain. On the revenue side, doubling the excise taxes on tobacco and alcohol is as likely to encourage more smuggling as to produce more revenue for the budget. And no matter how difficult they may be politically, it appears that additional tax increases are needed at this moment if macroeconomic stability is to be preserved.

In addition, recent developments on the privatization front suggest that this year's privatization revenues will be a good bit smaller than projected, not only because of the slow pace of privatization, but also because the bids are running smaller than expected. And although privatization officials claim that the delays in the sale of two state banks and telecommunication company were requested by the investors to give them more time to evaluate the transactions, I suspect that the offers did not measure up to the authorities' price expectations.

In any case, we urge the authorities to do all in their power to secure the necessary political consensus on additional revenue measures.

It is essential to preserve stability for the present as a basis for embarking on the long-overdue radical restructuring of Romania's economy. The present imbalances were basically caused by the authorities failure to move forward with structural reforms or even just to consolidate and preserve the gains already made against the fierce resistance of the vested interests. The staff correctly points out that this has not only delayed restructuring but has encouraged the vested interests to test the government's resolve to continue implementing reforms. In the end, the authorities' weak performance has delayed Romania's integration into the EU. One EU official recently observed while visiting Romania that "if things do not change, Romania risks being the only applicant country which instead of progressing, is actually regressing."

It is thus all the more regrettable that the government has not yet developed concrete policies to speed up the restructuring of the key enterprise and banking sectors, essential for Romania's fiscal and external viability. In this connection we agree with the staff that last week's imposition of an import surcharge is clearly at odds with Romania's fiscal and balance of payments problems, since it does nothing to address their causes. Like the staff, we call on the authorities to reconsider this decision. At the same time, we strongly urge them to start considering a comprehensive package of policy measures aimed at the domestic and external imbalances, including the measures suggested by the staff in its report. We also agree that the Fund's involvement should be made conditional on the prior implementation of a restructuring plan for ailing state banks, and the application of clear criteria for closing nonviable enterprises.

Ms. Wang made the following statement:

After several years of effort, it seems that Romania is still struggling with the transformation process. This is the case for most of the transitional economies, although to different degrees. However, the challenge for Romania is how to maintain and strengthen the patience and support of the common people and politicians toward reform, when the benefits of such reform efforts have not yet been fully realized. In meeting such a challenge, it is difficult to be optimistic in light of the recent developments in international capital markets and its possible impact on Romania. I agree with the thrust of the staff appraisal and would like to concentrate my comments on structural reform issues.

Progress has been made in the structural reform area, especially in the agriculture and external sector. The process of agricultural production has been liberalized. Export bands and quotas were eliminated and the average customs duties declined from 42 percent in 1996 to 20 percent by end-1997. The acceptance of the Article VIII obligations, the strengthening of the central bank's independence and the discontinuation of directed credits are all encouraging and welcome developments. However, progress in other aspects of the structural reform agenda is slower than expected, especially in banking and enterprises reform. To make solid progress in this area, the strategy should be suitable to the specific situation of the country. In that connection, I am pleased to learn that cooperation between the Fund and Romanian authorities is frank and continuous, and that the authorities have already requested discussions on a program that could be supported by the Fund. However, I was concerned when I read in the staff report that, "Generally, the staff believes that the basic strategy and policy focus underlying last year's program remains valid" and from Mr. Wijnholds' statement that, "The authorities' agenda has been heavily loaded and sometimes the targets were perhaps too ambitious compared to the available means to achieve them." Given the recent external developments and their possible effect on Romania, staff comments on this difference will be appreciated.

Given the fact that the possibility of privatizing all the large enterprises overnight is limited, it seems that alternative methods might be needed to improve the performance of the large state-owned enterprises. In this regard, could the staff elaborate on the causes for the loss-making SOEs. From the staff report we learned that prices for agricultural products have be liberalized. To what extent could the elimination of price distortions improve the performance of the SOEs? How is performance of the privatized enterprises? It seems that too much emphasis has been put on the number of privatized enterprises when developing the reform plan rather than on evaluating the progress in the structural reform area.

In light of the recent experience of some of the emerging economies, it seems that without the improvement of the SOE's performance, it is difficult to make fundamental improvements in the balance sheets of banks. Besides privatization, what other measures could be taken to improve the performance of the large state-owned banks? Given the current situation in the banking system in Romania, and the international market sentiment toward emerging and transitional economies, what is the likelihood that Romanian Development Bank and Bankpost will be privatized? Who will be the potential buyers of these two banks? If they are foreign investors, what would be the impact on Romania's banking system, given its current weak conditions? Like the staff, I was surprised to learn that after bailing out the two ailing banks at a cost of about US$1 billion, one of the banks is still allowed to develop its own restructuring plan without government intervention. I join the staff in strongly urging the NBR and the Ministry of Finance to take a lead role in developing such a plan.

On improving technical assistance in the area of statistics, I wonder whether that effort could be supported by financial assistance from the World Bank or other agencies in the area of statistical infrastructure construction and training of personnel.

The transition of the economic system is a painful process for most countries, and, unfortunately, there is no shortcut or panacea. While the cost is unavoidable, it is important to minimize the cost and hardship that might be suffered by the common people. I encourage the Romanian authorities to further strengthen their will and determination for reform, and wish them good luck in their efforts.

The staff representative from the European I Department agreed that one should focus on the parts of the structural reform program that were essential for the sustainability of the macroeconomic program, banking system, and loss-making enterprises. However, he did not agree that the authorities' limited capacity to implement reforms had been the key impediment to progress in that area. There had been numerous cases where the authorities had been ready with concrete programs, but those measures had been stopped by fierce resistance from vested interests.

The public sector's ability to provide basic services in health and education was questionable, the staff representative continued. Therefore, rather than relying on ad hoc expenditure measures, the authorities should accept tax increases. The staff fully agreed that there was no scope for further reductions in health and education spending, and felt that such spending had already been cut too much. It was not possible to provide data on health and education expenditures in the rectified budget because that budget only contained aggregate numbers.

It was true that small- and medium-sized enterprises had been crowded out, the staff representative said. In response to the high interest rates offered by the NBR, banks had found it more attractive to acquire treasury bills rather than to lend to small- and medium-sized enterprises. In addition, the failure to restructure the large ailing state banks meant that the scarce resources were being channeled by the same banks to the same enterprises instead of to small- and medium-sized enterprises.

On the privatization of the Romanian Development Bank and Bankpost, the staff representative stated that the authorities had solicited, and received, offers from abroad. The staff felt that it was important for foreign investors to invest in Romania, as they could facilitate effective credit intermediation in the economy.

On exchange rate policy, the staff representative clarified that the staff did not recommend that the authorities abandon the exchange rate anchor as it had served Romania well. The staff, in their daily communications with the Romanian authorities, emphasized the need to underpin the anchor by undertaking a comprehensive program that would make it sustainable. Given that over the past three weeks the authorities had lost US$200 million by intervening in the market, it was possible that the authorities might have no choice but to abandon the anchor, especially since the rectified budget went in the wrong direction.

Mr. Esdar cautioned that the summing up should not give the impression that there was an easy solution to the exchange rate problem.

The staff representative from the European I Department agreed with the Acting Chairman that ownership was indeed a problem. Nevertheless, the staff was encouraged by the new government's declaration that they wanted a program with the Fund, but that they wanted to develop it. The new government was keenly aware of the ownership problem.

Mr. Wijnholds made the following concluding remarks:

> There was a good discussion on Mr. Esdar's point on the exchange rate regime, and I am satisfied that the staff is careful in its recommendations. Although reserves have been falling in recent weeks, they are still higher than at end-1997. The loss in reserves should be kept in perspective, while recognizing that these were turbulent times.
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> Given that Romania was moving away from a centrally-planned regime, it is not that surprising that progress in the structural reform program is proving to be more difficult than in some other countries in the region. When comparing Romania to other countries in the region, we generally mean countries in Eastern Europe and not the former Soviet Union; however, in terms of its economic structure, Romania was more akin to countries east of it. I think Mr. Lushin understood this very well when he explained a few things. Perhaps comparisons with eastern European countries are not completely fair. Romania was particularly sensitive to comparisons to Bulgaria because they thought that they were in a better position than Bulgaria, which is no longer the case. It seemed that in early 1997 Romania had a chance to turn the corner, and an ambitious program was designed with the Fund. In retrospect, that program was perhaps too ambitious. Nevertheless, some achievements were recorded. Unfortunately, the cycle of political infighting ensued and this has been a big factor in setting back the country. In addition, the strong vested interests reared their ugly head, and that has definitely complicated matters. Although the new cabinet was off to a somewhat rocky start, there is a clear sign of hope now that the Minister of Finance is working closely with the staff, and is taking some courageous steps against tough opposition, sometimes also within his own cabinet. For instance, the Minister of Finance is clearly opposed to the lunch ticket program and has also come out very courageously against the Bell helicopter deal. The issue of unproductive expenditure is a serious and difficult one in Romania.
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> On the policy mix, I agree that there is a need for further budgetary adjustment. As noted by Ms. Abdelati, there has been quite an effort and one can also discuss the extent of the adjustment. However, one has to keep in mind that Romania is in a severe recession. On the basis of some indicators, one would believe that the situation is perhaps not that bad. Pressing the country into further large fiscal adjustments, such as increasing taxes, is not feasible politically. In comparison to other eastern European countries, the level of revenue as a percent of GDP-at 31 percent-is not low.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the focus of the National Bank of Romania on inflation control, but warned that the underlying policy mix was unsustainable, primarily because lack of fiscal support was overburdening monetary policy. Directors also welcomed the increased reliance on market forces. They found, however, that structural reforms had generally not been advanced since the Executive Board's review of the Stand-By Arrangement last year, in particular in the enterprise and banking sectors.

As to macroeconomic policies, Directors noted that the de facto exchange rate anchor had served the authorities well in bringing down inflation, and that it would be regrettable if the anchor had to be abandoned because of policy slippages. However, in the face of an increase in the current account deficit from an already high level, the anchor had required very high real interest rates, and sustaining it was imposing a rising cost in terms of output and employment. In order to prevent a third year of deep economic recession in 1999, it was now a matter of urgency to unburden monetary policy, which would require a considerable fiscal tightening. Directors emphasized that the continuation of the anchor would only be possible if supported by strong fiscal policies, and some speakers noted that exchange rate policy would have to be geared toward preserving overall balance of payments equilibrium. In this regard, there was a general consensus that the current turmoil in international capital markets had significantly limited the authorities' room for maneuver. While the current evidence on competitiveness was unclear, Directors noted that structural reforms would be crucial in allowing productivity increases.

Directors noted that the proposed rectified budget for 1998 would likely lead to a relaxation-rather than a tightening-of fiscal policy. The assumption of a major increase in revenues, including privatization proceeds, was at odds with the fact that the economy was contracting, and with the state of the privatization program. They urged the authorities to base the rectified budget on realistic revenue assumptions. It should also be calibrated with a view to ensuring a sustained reduction in the fiscal deficit in the coming years in order to reduce the current account deficit to a sustainable level.

Directors stressed that fiscal policies in 1999 should be formulated in a medium-term framework, taking account of the objectives of stabilization and reform. In their view, a significant increase in revenues would be essential. Directors recognized that there was considerable scope for improving tax collections. They doubted, however, that the needed strengthening of revenue could be secured without an increase in tax rates, although they did call on the authorities to reconsider their decision to introduce a temporary import surcharge. Directors also underscored that the policy of relying on ad hoc expenditure cuts was not viable-the burden had fallen mainly on capital expenditure and reform-related outlays-and that several costly programs and policies currently in the pipeline were incompatible with fiscal constraints. Emphasizing the need to improve the quality of fiscal adjustment, some Directors also urged the authorities to curtail some planned military expenditures.

Turning to structural reforms, Directors welcomed the liberalization of the foreign exchange market and the switch to market-based instruments for reserve money management and placement of treasury bills. They noted that this had resulted in a much increased reliance on market forces, and had unburdened monetary and exchange rate policies of quasi-fiscal functions. They also commended the authorities for the important price and trade liberalization measures they had taken in the agricultural sector, and welcomed the acceptance of the obligations of Article VIII, Sections 2,3, and 4 of the Articles of Agreement.

Apart from these market liberalization efforts, Directors found, however, that little progress had been made in advancing other structural reforms, in particular reforms aimed at ailing state enterprises. Noting that the Romanian economy was burdened by a relatively large number of heavily loss-making enterprises, Directors emphasized that an early reduction in the claim on resources by such enterprises would be necessary to enable the emergence of a dynamic small- and medium-sized enterprise sector. The reform program should, therefore, give priority to the privatization of large enterprises, the restructuring or closure of unviable entities, and the enforcement of financial discipline, including by addressing the problem of enterprise arrears. It was also pointed out that the correction of enterprise problems was a necessary prerequisite for tackling the difficulties of the banking sector.

Directors were particularly concerned about the failure to come to grips with problems of ailing state banks, and pointed in this regard to the fact that the largest bank had been recapitalized without there being any concrete restructuring plan for it. Directors stressed the importance of developing a restructuring plan for the banking sector, and urged the National Bank of Romania to take an active role in the restructuring of the largest bank. They noted that implementation of such a plan would be key to the sustainability of macroeconomic stabilization.

Looking ahead, Directors underscored that the Fund stood ready to continue to support Romania, but reiterated that such support would require up-front structural reforms and adequate fiscal consolidation. Directors noted that, in setting policies, due regard would need to be paid to the ongoing contraction of GDP. Directors were encouraged by the fact that the new government appeared to recognize that reforms had been lacking, and that its broad objectives and priorities for reforms were mostly in line with what was required. The key issue now facing the government was, first, to develop concrete plans for achieving these objectives and priorities, and, second, to mobilize the political resolve required to implement these plans in the face of what undoubtedly would be fierce resistance from vested interests. While recognizing that the reform process would necessarily have to be protracted because of the attendant social costs, Directors noted that the deep-seated nature of the structural problems made it necessary to move boldly ahead. In this regard, they emphasized the considerable potential for foreign direct investment, which could facilitate the reform process once a critical mass of reforms had been put in place.

It is expected that the next Article IV consultation with Romania will be held on the standard 12-month cycle.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/98/98 (9/14/98) and EBM/98/99 (9/15/98).

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Alternate Executive Director as set forth in EBAM/98/153 (9/11/98) is approved.

APPROVAL: March 30, 2001

SHAILENDRA J. ANJARIA
Secretary