December 10, 1996

Approval: 12/17/96

# INTERNATIONAL MONETARY FUND

## Minutes of Executive Board Meeting 95/49

10:00 a.m., May 19, 1995

Contents

## Executive Board Attendance

M. Camdessus, Chairman
S. Fischer, Acting Chairman
A. D. Ouattara, Deputy Managing Director

| Executive Directors | Alternate Executive Directors |
|---|---|
| M. Al-Jasser | A. A. Al-Tuwaijri |
| M.-A. Autheman | M. Sirat |
| | E. Srejber |
| L. E. Berrizbeitia | V. J. Fernández |
| | A. Galicia, Temporary |
| | A. Ruocco, Temporary |
| I. Clark | |
| | D. Z. Guti |
| | Y. Patel, Temporary |
| H. Evans | J. Shields |
| | J. Dagustun, Temporary |
| K. P. Geethakrishnan | W. Hettiarachchi |
| J. E. Ismael | L. M. Cheong |
| | K. Sundara, Temporary |
| D. Kaeser | R. F. Cippa, Temporary |
| A. Kafka | A. Calderón |
| | A. Chang Fong, Temporary |
| | G. P. Ramdas, Temporary |
| | J. Hamilius, Temporary |
| | D. Daco, Temporary |
| Y.-M. T. Koissy | |
| G. Lanciotti | R. D. Bessone Basto, Temporary |
| K. Lissakers | B. S. Newman |
| | T. Fukuyama |
| | S. Ishida, Temporary |
| A. Mirakhor | M. Daïri |
| C. Saito | A. G. Zoccali |
| | E. Wagenhoefer |
| | Y. Y. Mohammed |
| | T. K. Gaspard, Temporary |
| | A. V. Vernikov, Temporary |
| | V. Verjbitski, Temporary |
| E. L. Waterman | |
| J. de Beaufort Wijnholds | |
| Zhang M. | |

L. Van Houtven, Secretary and Counsellor
J. W. Lang, Acting Secretary
S. Bhatia, Assistant
D. Rajnes, Assistant

Also Present

IBRD: M. R. Lav, Financial Policy and Resource Mobilization; R. Nallari, Latin America and the Caribbean Regional Office; A. van Trotsenburg, Africa Regional Office. African Department: E. A. Calamitsis, Director; P. A. Acquah, G. Belet, C. Brachet, A. O. Brender, R. O. Carstens, P. Dhonte, I. A. H. Diogo, C. A. François, J. Le Dem, J. Mueller, E. Sacerdoti. European I Department: M. Russo, Director; J. R. Artus, Deputy Director; S. B. Brown. European II Department: J. Odling-Smee, Director; E. Brau, Deputy Director; Y. Horiguchi, Deputy Director; D. A. Citrin, L. Hansen, P. M. Keller, H. R. Lorie. External Relations Department: S. J. Anjaria, Director; R. R. Brauning, H. P. Puentes. Fiscal Affairs Department: V. Tanzi, Director; G. T. Abed, V. Bedague, J. A. Clément, C. Grandcolas, E. Harris, Z. Hu, M. Verhoeven. IMF Institute: N. E. Esso. Legal Department: R. C. Baban, F. M. Zeidan. Middle Eastern Department: P. Chabrier, Director. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; R. M. Brooks, B. Christensen, M. E. Edo, R. T. Harmsen, A. C. Kouwenaar, K. J. Langdon, C. Puckahtikom, J. P. Pujol. Research Deparment: M. S. Khan, M. A. Savastano. Secretary's Department: R. E. Bradshaw, A. Mountford, W. Tseng. Southeast Asia and Pacific Department: E. Sidgwick. Statistics Department: K. Yao. Treasurer's Department: W. J. Byrne, C. A. Hatch, H. Hessenius, D. M. Hicks. Western Hemisphere Department: J. P. Guzman, J. Fajgenbaum, S. P. O. Itam, O. Nyawata, L. L. Perez, B. C. Stuart, J. Yang. Office of the Managing Director: S. Sugisaki, Special Advisor; G. R. Saunders, Personal Assistant. Advisors to Executive Directors: J. O. Aderibigbe, B. Andersen, He J., A. R. Ismael, R. Kannan, B. Konan, M. F. Melhem, S. N'guiamba, S. O'Connor, R. Rainford. Assistants to Executive Directors: S. Al-Huseini, P. I. Botoucharov, M. A. Brettschneider, D. Desruelle, M. Dzervite, L. Fontaine, R. Glennerster, C. M. Gonzalez, A. Guennewich, M. A. Hammoudi, O. Himani, G. H. Huisman, W. C. Keller, K. Kpetigo, T.-M. Kudiwu, G. A. Kyriacou, N. Laframboise, J. A. K. Munthali, Ng C. S., J. Pesola, H. Petana, N. Prasad, K. Sakr, A. Sighvatsson, Song J., V. Trivedi, R. von Kleist.

1. REPORT BY MANAGING DIRECTOR

The Managing Director, reporting on his recent visit to Uzbekistan, Georgia, and Moldova, noted that, in Uzbekistan, he had met with President Karimov, Deputy Prime Minister and Minister of Finance Hamidov, and Chairman of the Central Bank Mulladzhanov, as well as with the ambassadors of the leading creditor countries. President Karimov, well informed and forthright, had said that, while at first he had underestimated the importance of the Fund, he had subsequently developed a different understanding of the Fund's role. The President had emphasized that he perceived the Fund more as a source of policy advice for reform rather than a source of credit, and that he wished to expand and deepen the dialogue with the Fund staff. In that connection, he had indicated his appreciation of the staff's work during the stabilization program supported by the systemic transformation facility (STF). The President had concurred with his own assessment that it was critical that inflation be brought down substantially in 1995, and that the STF-supported program should pave the way for a stronger program, which would accelerate and deepen the stabilization and reform of the economy.

During a joint press conference, the President had been extremely candid about the need to eliminate official corruption and reduce the size of the bureaucracy, as those were hindering reforms, and had emphasized the need to restore private ownership, the Managing Director noted. President Karimov had stressed that Uzbekistan had a tradition of entrepreneurship and trade that was rooted in the culture of the country and predated the relatively recent command system, and that reclaiming Uzbekistan's tradition would foster the transition to a market economy. The President had requested the Fund's assistance in support of Uzbekistan's reform efforts. In response, he had outlined some of the measures that would be needed to move to a program that could be supported by a stand-by arrangement, and the President had been amenable to those suggestions. They had agreed that the discussions on the details of a possible program could begin shortly. He was certain that Uzbekistan would be successful in its efforts to move to a market economy.

In Georgia, he had had extremely useful discussions with the Head of State, Mr. Shevardnadze, Prime Minister Patsatsia, and other senior members of the Government and the central bank, the Managing Director observed. The sea change in the economy under the STF-supported program, was impressive, especially in view of the earlier crises that the country had experienced. The stabilization program had succeeded in reducing monthly inflation from an average of 60 percent in 1994 to 3 percent in January-April 1995. The lower rate of inflation was reflected in the improvement in the exchange rate of the Georgian coupon, which had gone from GEK 5 million per US$1, to about GEK 1.3 per US$1. The authorities had also taken strong structural measures, including eliminating consumer subsidies and liberalizing prices. Those efforts were particularly impressive, given the difficult environment in which the adjustment program had been launched.

Georgia was an unusual case, the Managing Director considered. In a number of countries, the problem was usually one of excessive state involvement in the economy. In the Georgian case, one of the fundamental challenges was to create an efficient government that was necessary for a smooth-functioning market economy. Although much remained to be done, the authorities had assured him of their commitment to stay the course with stabilization in order to establish the appropriate conditions for the introduction of a new currency--which they would like to see soon--and to intensify their efforts to privatize state enterprises, liberalize trade, and restructure and strengthen the Government.

Georgia had a severe debt problem and needed further humanitarian and other external assistance, but its debt-servicing capacity was limited, the Managing Director noted. Mr. Shevardnadze had requested the Fund's assistance in raising the resources needed for Georgia's adjustment program and in obtaining the agreement of all Georgia's creditors for a comprehensive rescheduling of its external debt. The Georgian Government and the Fund staff had written to Georgia's creditors and donor governments inviting them to a meeting in the Fund on June 6 to discuss those and other matters. A donors' meeting would also be held for Armenia. The economic situation in Armenia was severe, and the authorities were fully committed to reforming the economy. The forthcoming donor meetings should not be seen as "business as usual." He reminded Directors of the creditor governments that active participation by, and firm financial assurances from, their authorities and the European Union were critical to stabilizing the economies of Georgia and Armenia.

His visit to Georgia had coincided with a staff mission, and the staff was continuing its negotiations with the authorities, the Managing Director remarked. The Board would be considering in due course Georgia's request for a stand-by arrangement and a second purchase under the STF.

He had also visited Moldova, where he had addressed the Parliament, as well as key leaders of the financial and economic community, the Managing Director said. In meetings with the President, the Prime Minister, the Speaker of the Parliament, the Minister of Finance, and the Governor of the National Bank, he had commended the authorities for their perseverance in adopting prudent financial policies, which had led to a stable exchange rate, lower interest rates, and a strong external position. He had emphasized, however, that the authorities needed to remain vigilant with respect to inflation, and to accelerate structural reforms in several areas in order to secure sustainable growth and consolidate financial stabilization. In addition, he had stressed the importance of establishing and improving the effectiveness of the basic institutions of a market economy, and the need for imposing hard budget constraints on state enterprises. In particular, there was a need to implement effective bankruptcy procedures, enforce payments discipline in the state enterprise sector, and avoid the use of the tax system to stimulate sectoral output. In view of the importance of agriculture in the Moldovan economy, he had urged the authorities to give priority to measures to develop a market for land and to enable individuals to establish independent farms easily. His proposals had been well received, and the authorities had pointed out that a number of the suggested measures were already at different stages of implementation. They had also emphasized the inherent difficulties in the transition process. Recalling his initial conversations with the first Government of Moldova in the early stages of transition, when the country had been faced with numerous difficulties, he considered that Moldova had come a long way since then.

Before returning to headquarters, he had spent a few days in France, where he had addressed a banking convention and the Social and Economic Council of France, the Managing Director said.

Mr. Kaeser noted that the Managing Director's visits to countries that had recently embarked on Fund-supported programs, and particularly his encouragement to the authorities to take all the steps to keep the programs on track, were extremely valuable. There were a few other countries in the Caucasus that would benefit greatly from a visit by the Managing Director, and he hoped that the Managing Director would visit them in the near future.

Mr. Wijnholds agreed that the Managing Director's visit to Georgia and Moldova had been extremely useful and successful, and his authorities were grateful for the visit. The Managing Director's messages had been well received and timely.

## 2. BILATERAL AND MULTILATERAL AID FLOWS AND FUND-SUPPORTED PROGRAMS

The Executive Directors considered a staff paper on bilateral and multilateral aid flows and Fund-supported programs (SM/95/73, Sup. 1, 4/25/95) together with a background paper (SM/95/96, 5/5/95).

Mr. Fukuyama made the following statement:

> I would like to begin my statement by making comments on the issues for discussion in the staff's paper.
>
> Regarding the outlook for balance of payments support, I cannot say anything definite because I am not in a position to predict the amount of assistance from other donors. I can say, however, that it would be appropriate to make a conservative estimate on the trend of balance of payments support, in light of the severe fiscal situation of major donors.
>
> I therefore fully agree on the need for more cautious medium-term projections in balance of payments assistance with

future programs, compared with the past. In this regard, I have lately occasionally observed that financing requirements in Fund programs seem to be too large. Consequently, in some cases, financing gaps expected to be filled by bilateral donor assistance are quite substantial; in others, the staff projects unrealistically large constant capital inflows.

I can understand the necessity of pressing urgently ahead with economic reform, especially in the case of economies in transition, and of designing a program that requires large external financing. However, I would encourage the staff to be realistic. In view of the current outlook for a decline in balance of payments support over the next few years, I would recommend that the staff be more cautious in preparing medium-term projections for total financing need.

I agree with the staff's conclusion that strong programs will be required to attract support from a limited pool of funds. I would further suggest that donors somehow send a strong message that they will not provide balance of payments support to countries lacking a strong and ambitious Fund-supported program. This message will strengthen recipient countries' incentives to embark on ambitious economic reform.

If many bilateral donors concentrate on certain specific sectors, the Fund is expected to play a major role in coordinating donor assistance and in providing useful budget-formulating advice, in an effort to avoid support shortages for other key areas of government expenditure. In order to facilitate the Fund's activity in this respect, I urge all donors to be cooperative with the Fund and to make every effort to submit detailed information as soon as possible, especially on the conditions and timing of disbursement.

Regarding post-conflict cases, I concur with the view that the Fund should intensify its efforts at providing policy advice and technical assistance to the post-conflict countries. I would not, however, support any proposals to give "post-conflict" a special status--to be considered when determining use of Fund resources--or to make the "post-conflict" function a tool for relaxing conditionality.

With regard to the financing assurance issue, if the Fund faces a lack of financing assurance from donors for whatever reason, I believe that the staff should accept the amount of donor financing as a basis for the program and try to adapt the program in accordance with the financing. I cannot support the view that the Fund should withhold support until adequate financing assurance is available because it would not only make the program hang in the balance but would also put undue pressure on donors.

With respect to proposals on the preparation of policy framework papers for certain programs supported by the extended Fund facility (EFF), or country strategy papers to be coordinated with the Bank's country assistance strategy, I would like the staff to be cautious. I agree that these proposals will strengthen a close Bank-Fund collaboration in the design of a medium-term economic program and will greatly benefit recipient countries through more effective and coordinated assistance by the Fund and the Bank. However, the following points should also be taken into consideration.

First, in the current budgetary situation of both the Fund and the Bank, it would be unrealistic to make a proposal resulting in more staff work load. If the current proposal is implemented, extra efforts would be required to maintain the current work load of both institutions because more policy framework papers mean more work load, not only in the Fund but also in the Bank. In the case of country strategy papers as well, the estimated additional work load in the Fund would be substantial. The only possible way to meet this condition would be to ensure that greater collaboration between the Fund and the Bank will result in a more desirable allocation of resources in both institutions and that they will make efforts to minimize duplication of work.

Second, it will be necessary to consider the publicity implications of the current proposal. Specifically, more policy framework papers bring more publication of Fund documents.

The staff raises a very important issue regarding the authorities' ability to meet difficult sectoral conditionality and to mobilize external financing committed by donors. My authorities have recently experienced a number of cases where disbursement of committed assistance was delayed considerably because the authorities could not meet the required conditions for disbursement, such as submission of import documentation.

In order to avoid problems arising from a members' lack of administrative capacity, Fund/Bank technical assistance is crucial. In addition, in cases of actual delay of disbursement, I expect the Fund to play an important role as mediator in trying to remove disbursement obstacles caused by the authorities. In order to facilitate this Fund activity, I urge all donors, whenever they encounter disbursement difficulties caused by the authorities, to immediately report them in detail to the staff and to ask for staff cooperation. I believe this will lead to smoother program financing.

I would like to make two additional general comments.

The paper focuses on concessional flows; nonconcessional loans are not considered and therefore not included in the tables. I believe, however, that the paper should have included non-concessional loans because they also play a very important role as a means of balance of payments support. In particular, regarding the linkage of balance of payments assistance to Fund arrangements, I would have appreciated mention of the parallel lending of the Export-Import Bank of Japan which, although the lending term is nonconcessional, is closely linked with Fund arrangements and helps strengthen the authorities' incentives to comply with Fund programs. I would welcome a brief explanation of the staff's views on how nonconcessional loans have contributed, and are expected to contribute, to financing Fund programs.

Needless to say, the amount of bilateral financial assistance should be determined independently, taking into account each donor's fiscal situation, the donor's historical and economic ties with the recipient country, the strength of the program, and the extent of international cooperation. I believe the staff should not be deeply involved in this decision-making process. The staff could provide projections of the financing gap to donors and urge them to fill it. I do not believe, however, that the staff should suggest specific expected amounts to individual donors. Such an action would influence the decision on burden sharing, which is supposed to be decided among donors and on a case-by-case basis. Moreover, such suggestions could adversely affect other donors, those not included in the staff's suggestions or having intended to provide more assistance than the staff expected, by decreasing their motivation for assistance. This outcome is unfortunate for recipient countries as well. I hope that the staff will bear this in mind when requesting donor assistance.

Mr. Berrizbeitia made the following statement:

The interesting staff papers provide a clear picture of the current situation and future perspective of concessional balance of payments assistance to developing countries from bilateral donors and multilateral agencies and their implications for Fund-supported programs. On the basis of the information contained therein, one can only answer affirmatively to most of the issues for discussion presented at the end of the paper. Nonetheless, I would like to make some specific additional comments.

For reasons well explained in the staff's documents, the basic fact is that bilateral aid flows are declining and are likely to continue declining in the foreseeable future. This is the case in spite of donors' nominal commitment to the increasingly elusive official development assistance target of 0.7 percent of GDP. For the Fund, the issues are how this affects its programs and what should be done about it.

Faced with the reduction of bilateral assistance, the arguments in favor of making the enhanced structural adjustment facility (ESAF) a self-sustained facility become all the more important. This would at least ensure that the level of Fund concessional, yet conditional, balance of payments financing for low-income countries does not also diminish over time.

At the same time, because official concessional finance has been an important element in the success of Fund-supported programs, it will be necessary for the Fund to exercise more effectively its catalytic role, and also intensify its coordinating role, with respect to both other multilateral institutions and bilateral donors. In this context, although the Fund should be cautious in projecting available external financing over the medium term, it should also make special efforts to obtain firmer assurances from donors than in the past. However, if the situation is such that adequate bilateral financing is not readily available, Fund programs should not be unduly delayed but rather adapted to the existing availability of resources.

The staff suggests that more ambitious programs will be required in order to generate more internal savings, attract greater private capital inflows, and facilitate access to the limited pool of concessional funds. In light of the reduced availability of external concessional financing, such additional efforts will apparently be inevitable. However, as they imply even stronger adjustment, and possibly stronger conditionality, care must be taken to ensure their credibility and political viability.

The staff document notes that donors increasingly rely on or link their balance of payments assistance to Fund- or Bank-supported programs. At the same time, donors' policies are evolving in ways that could result in unbalanced adjustment programs, unless effective coordination is achieved. In this regard, through the policy framework paper process, the Fund and the Bank should continue playing a central coordinating role, at least under ESAF arrangements, and possibly also in middle-income transition economies. The policy framework paper has proved to be an effective instrument in coordinating the appropriate mix of financial assistance and can be particularly useful in helping meet donors' aid policies, while ensuring the adequacy and effectiveness of their concessional financing.

In cases where a program does not fulfill the three criteria identified by the staff as necessary conditions for the policy framework paper process, as is likely to be the case in most extended arrangements, but where coordination is nonetheless required between the Fund and the Bank, the alternative approach suggested by the staff would seem to be the more cost-effective route. Even so, the use of policy framework papers for some middle-income countries should not be discarded as a matter of course, but assessed on a case-by-case basis.

Finally, early technical assistance and policy advice involvement by the Fund in post-conflict situations would seem to be appropriate. This is necessary to help catalyze donors' resources and to ensure that aid decisions are consistent with a sound macroeconomic stance. The Fund can also assist the authorities in developing contingency measures to minimize the impact of potential aid shortfalls on the fiscal situation and on the performance of subsequent Fund-supported programs.

Mr. Kaeser made the following statement:

The staff has prepared a concise and realistic presentation of the medium-term outlook regarding volume, distribution, and composition of expected aid flows. The picture is in most respects considerably less encouraging than the one presented in June 1990, the last Board discussion on policies of aid agencies. It is clear that in view of the pressing need to implement and strengthen fiscal consolidation in most donor countries, aid budgets have come under pressure and must be expected to remain so in the near future. Against this background, it is realistic to assume that disbursements of official development assistance will continue to decrease in real terms over the next few years.

In the context of an overall stagnation, or possible decline, in official development assistance, I agree with the staff that particular attention must be paid to balance of payments support, which may decrease disproportionately over the next years. The identified factors that are leading major donors away from balance of payments assistance toward other forms of aid should not be considered as temporary. With geopolitical considerations receding in decisions on volume and allocation of official development assistance, new criteria such as poverty reduction, reform commitment, good governance, and policy track record are growing in importance. In addition, competition for public resources in major donor countries has increased public awareness regarding aid effectiveness.

Against these developments, balance of payments support has several weaknesses. Compared to other aid forms, the degree of donor control, and therefore the possibility of targeting specific sectors, is relatively small. Furthermore, if there are concerns with respect to the accountability of recipient governments or absorption and implementation capacity, aid flows not channeled through the government might be preferred.

In my view, uncertainties as regards volume and timing of expected balance of payments support and the implications of changes in aid policies must be considered more thoroughly by the Fund when discussing future programs. This leads me to the following, more specific, points:

The staff needs to be even more cautious when making medium-term assumptions on balance of payments assistance by objectively assessing the firmness of external financing commitments and by transparently presenting any possible remaining financing gaps. As past experience has shown, shortfalls in external financing have occurred with some frequency. Although financing assurances always contain an element of uncertainty, it is important to include in projections only reasonably firm commitments so as to reduce the probability of underfinanced programs. It is understood that the staff is often confronted with the problem of residual financing gaps and that in these cases a degree of calculated optimism comes into effect; this should, however, be qualified candidly.

Against the quite sobering experience with external financing in Fund-supported programs, staff reports should clearly indicate the conditions under which the projected financing should materialize. They should also carefully consider the vulnerability of different sources of financing with respect to possible policy slippages. The fact that large shortfalls in external financing--unfortunately--cannot be considered exceptional, isolated incidents requires decisive action on the Fund's part to substantially reduce this risk in future programs. In this respect, a more cautious approach is required in assessing the authorities' capacity to implement policies and projects, and thus their ability to meet conditionalities implied in various external financing.

The issue of often lacking administrative capacity in recipient countries as regards disbursement procedures and project implementation should be specifically targeted in the context of institutional capacity-building measures and public sector reform, in collaboration with the World Bank and other relevant multilateral actors.

At this point, I would like to make an additional remark: The analysis presented by the staff does not substantiate, in general, the argument often heard in the Executive Board that a country has fallen off track owing to delayed, or not forthcoming, financial support from donors. On the contrary, the analysis testifies to the fact that weak institutional capacity, resulting in slippages in policy and project implementation, is in most cases making it difficult, or indeed impossible, for donors to promptly disburse committed financial support.

It might be wiser in some cases to withhold Fund support until adequate financing is available, in view of the negative effects caused by going ahead with underfinanced programs. The more cautious and transparent approach in projecting external financing in Fund-supported programs may lead to more cases in which the staff will be confronted with insufficient financing assurances from donors. In these cases it will be important for the staff to objectively assess whether a tighter program to compensate for lower financing would be sustainable in the medium term.

The increased focus of major donors on budgetary support would require the Fund to present in its documents a more detailed picture of trends in and the outlook for public expenditure. However, the Fund's role in this area, which is the prime responsibility of the national authorities and within the competence of the World Bank, should remain limited. Still, by encouraging a more transparent discussion of national expenditure priorities and the various donors' financing intentions, the risks of underfinancing in certain key economic sectors could be reduced.

The role of the Fund in post-conflict cases is currently rather vague and should be further examined. Although in the immediate aftermath of a conflict the necessity to ensure that aid decisions are consistent with a sustainable fiscal position is not exactly top priority, the Fund should provide early technical assistance in order to rapidly establish a viable macroeconomic framework. As regards the Fund's financial involvement, I expect the Fund to apply normal standards and procedures with respect to program strength so as to ensure that its catalytic role can be maintained.

The importance of an efficient and broad coordination of aid efforts is dramatically increased by recent diversifying trends in aid policies, including stronger targeting of special sectors, channeling aid through nonstate actors, and directly supporting private sector development. The positive experience with the policy framework paper process for low-income countries provides an excellent basis on which aid coordination can further be improved. The Fund should encourage the broadest possible participation in the formulation of the policy framework paper so as to take into account the preferences and views of the various actors concerned with providing international aid.

For middle-income countries, however, aid coordination by the Fund should rely on the more cost-effective preparation of country strategy briefs. Such briefs--to be established in accordance with the World Bank's country assistance strategy, before Fund negotiations on extended arrangements--would provide a consistent medium-term framework for donor financing. This solution would also present less additional burden on already strained staff resources. In order to avoid difficult case-by-case decisions and pursue an evenhanded approach, I would suggest that country strategy briefs be prepared for all extended arrangements. I would appreciate it if the staff could elaborate on the feasibility of this approach.

To conclude, I have two additional brief remarks.

All the issues raised on expected future aid flows require the staff and management to closely and permanently follow developments and promptly inform the Board if any changes in the outlook could have a substantial impact on the possibility of providing Fund support to member countries.

The rather bleak outlook for expected future aid flows prominently includes concessional aid. I thus find that our substantial doubts on the ready availability of concessional financial means--inter alia for continued substantial flows to severely indebted low-income countries to help them finance their multilateral debt service--are confirmed.

Mrs. Guti, speaking on behalf of Mr. Dlamini, made the following statement:

In the aftermath of the cold war, concessional financing, particularly balance of payments support, to developing countries has assumed a declining trend, and the prospect for an early reversal of this trend is not very bright. The sharp reduction in aid budgets by virtually all the bilateral donors is accompanied by a shift in the focus and mechanism of the allocation policies. These developments seem to have rendered the adjustment process more difficult for many low-income countries that are faced with high debt-service burdens and limited access to private financing. Against this background, our major concerns are as follows:

Although we welcome the focus on poverty reduction, the rapid shift away from balance of payments support toward social projects and programs could slow the adjustment process, particularly structural reforms, and weaken the implementation capacity of most recipient countries with adverse consequences for balanced economic growth and poverty reduction.

The importance of good governance to sound economic management can hardly be overemphasized. However, the increasing emphasis on its political element could lead to the introduction of additional political conditionalities for which objective criteria may be difficult to establish.

The overall contraction of aggregate aid flows, in the face of competing demand from the transition economies and crisis-induced emergency and humanitarian needs, could jeopardize reform efforts in many poor and heavily indebted developing countries. We are, however, encouraged that many donors have indicated willingness to protect the poorest adjusting countries, most of them in sub-Saharan Africa, from the full impact of aid cuts. We also commend the efforts of the few donors that have maintained a high level of development assistance, including Japan, which has budgeted further increases in real terms.

The need for pragmatism on the part of the donor community, acting together, to reverse the current trend in concessional assistance should be underlined. In view of the small size of the current level of the UN target of official development assistance contribution relative to the total budget spending and GNP of donor countries, we believe that a reversal of the current decline would not weaken donors' fiscal consolidation efforts--to which we fully subscribe. It is also important to note that the past poor public image of aid reported by many donors was itself a product of the cold war when aid policies were guided more by political interests than factors based on economic efficiency. The change in policy orientation since the end of the cold war should contribute tangibly to efforts toward repairing this damage. Moreover, an appropriate strategy for enhancing the efficiency and effectiveness of aid flows, an issue which the Development Committee considered in its fall 1994 meeting, should be put in place urgently.

Meanwhile, all parties concerned, including the Bretton Woods institutions, official donors, and recipient countries, should respond appropriately to the current changes in order to mitigate the negative impact.

The recipient countries should recognize that available donor assistance is likely to be concentrated more on those countries that are consistently implementing sound and growth-oriented macroeconomic policies and structural reforms. In this regard, adjustment effort should be sustained, with due emphasis placed on policies directed toward increased domestic savings and efficiency in resource utilization. Experience so far has shown that countries with sound economic policies tend to attract more external financing and enjoy a higher growth rate than those without.

Donors, on their part, need to recognize that the best way to help poor developing countries escape from poverty and be weaned from aid dependency is to support their reform efforts with adequate and timely financing in a manner that would promote balanced and sustainable growth in output and investment. The appropriateness of the mix of their financial assistance should be tailored, in collaboration with the Fund and the Bank, to meet the medium-term objectives of sustainable growth and external viability. Such assistance should include more generous relief of the external debt burden and improved market access for their exports.

The change in donor policies, including increased involvement of nongovernmental organizations in the operation and direct financing of the private sector, would have serious implications for Fund-supported programs. In particular, program design and the strategy for implementation should reflect the new realities. We agree that, in view of the uncertainty of financing prospects for programs, particularly in light of the expected sharp decline in global volume of balance of payments support, a more cautious approach for medium-term projections, with adequate contingency mechanisms for unanticipated shortfalls in disbursements, is warranted.

The staff's proposal for more ambitious programs should be considered on a case-by-case basis, with due attention given to individual countries' implementation capacity and potential for generating increased domestic savings. For most of the low-income developing countries in sub-Saharan Africa, this option may be limited. In fact, most of those countries would face a dilemma between choosing a tighter, but credible Fund-supported program with short-term horizon in the absence of donor support, or suspending Fund-backed programs until financial support becomes available. Past experience has shown that the structural nature of adjustment needs in these countries should appropriately be addressed in a medium-term context. That was the rationale for the establishment of the structural adjustment facility (SAF) in 1986, and the ESAF a few years later. At the same time, a delay to Fund-supported programs could be an endless one, leading to further economic deterioration that would be more costly to reverse. A more feasible option would be to allow increased access by low-income countries to concessional financing from multilateral institutions, including the Fund and the World Bank. The Task Force on the Role of Multilateral Development Banks in the Development Process, recently set up by the Development Committee, should act expeditiously and come up with useful recommendations in this regard. The study on the sale of gold by the Fund would also be extremely important in this context.

The policy framework paper process should continue to provide the framework for improved cooperation and policy coordination among all parties concerned in the adjustment process--the Fund, donors, and recipient countries--in program preparation. This would facilitate the streamlining of conditionalities, which could otherwise be more complex, and thereby facilitate program implementation and enhance its sustainability.

Finally, in view of the medium-term context in which a policy framework paper is prepared, we agree that its extension to some extended Fund facility arrangements could have merits. We also believe that it would be too costly and inappropriate as a standard requirement for all stand-by arrangements, save in a few exceptional cases of ESAF-eligible countries, as identified in the staff paper.

We commend the staff for its excellent work in preparing the informative documents for this discussion.

Mr. Clark made the following statement:

It is useful from time to time to assess the trends in aid flows and to examine their significance for Fund-supported programs. As the documents before us show, this review is especially timely in view of expectations about changes in the volume and the allocation of aid flows.

The staff is probably right to assume that balance of payments support is likely to decline over the next few years. The attempt at fiscal consolidation in many donor countries is putting aid budgets under downward pressure. This is certainly accurate for Canada, and public statements elsewhere make it obvious that constraints on aid budgets are widespread. It is important to keep in mind that the fiscal pressures affecting bilateral aid flows are also at play on contributions to multilateral facilities and on increased activities by multilateral institutions that would call for budgetary appropriations. Thus, an underlying assumption about aid flows for the years immediately ahead should certainly err on the side of caution.

In view of constraints on the availability of resources, it is reasonable to assume that assistance is more likely to be directed to areas that are believed to produce the "biggest bang for the buck." That translates into priority allocations to the poorest countries and those making the greatest adjustment effort, and particularly to some combination of the two. This is certainly true of Canadian aid, a trend which one would expect to be reinforced worldwide over time rather than reversed.

At the same time, it seems likely that donors will further direct the allocation of their aid by raising standards in relation to issues like governance and human rights. The human rights aspect derives from the political mores of donors and responds to increasing domestic political pressures in donor countries. The governance issue may arise for the same reason but is more importantly linked to the capacity and willingness of the recipient country to successfully complete its economic program.

The staff noted that donors wish to concentrate aid increasingly on specific areas--frequently, poverty reduction and certain social policies. Again, this is dictated by the evolution of domestic political interest in donor countries as well as the drive to optimize the use of scarce resources. This is a trend that is likely to continue and one that the Fund has to accept. The Fund's role is to ensure overall balance and efficiency and long-term sustainability of macroeconomic policies. It must take clear account of the choices of donors, but should avoid at the same time extending the Fund's own reach too far into areas of domestic policy choice or areas that are the responsibility of the World Bank. Close collaboration with the latter is key to avoiding duplication in this regard.

The choice between supporting a tighter program with higher risks--aggravated by a lack of external financing--and withholding support until adequate financing is available poses a difficult challenge for the Fund. It may imply proceeding with a program considerably revised from that which the Fund would prefer; however, if the reasons behind donor intransigence are sufficiently strong, the Fund should consider waiting until adequate financing is available--and the underlying causes of financing shortfalls have been corrected. Directing aid flows to countries with bad policies would be a poor use of scarce resources; the financing needs of countries pursuing unsustainable policies are only likely to rise.

A very important question arising from the staff paper is whether we should make programs more ambitious in light of the shrinking pool of funds. Strengthening Fund programs is a worthy goal in its own right as a means of raising domestic savings; however, one would have assumed that programs are already designed to be as tough as realistically possible. Thus, although welcoming a general tendency to strengthen, one should be careful not to make the exercise counterproductive. Fund programs have to be feasible with a reasonable chance of success at the outset. To set up a system more likely to generate a series of failures would obviously not be in the interest of the institution or the recipients.

In the past there have been many cases in which waivers have been requested because external assistance shortfalls have derailed program targets. This undermines the integrity of programs and suggests that: (1) more caution should be exercised when projecting medium-term balance of payments assistance, and financial programming should leave room for a margin of error with respect to external assistance flows; (2) contingency measures should be built into programs, or at least considered a priori by the staff and the authorities, in the event that external flows fail to meet expectations; and, (3) more emphasis should be placed on improving the administrative and absorptive capacity of members.

In response to the staff's question about asking donors for firmer financing commitments, the answer is, of course, yes. I am skeptical, however, that this will produce significant results.

The value of policy framework papers is clear. They provide a yardstick for donors and recipients alike to measure the direction of policy progress over a medium-term framework. They also provide a good cooperative basis for the Fund, the World Bank, and the authorities by focusing attention on prioritizing and by encouraging participatory development. Nevertheless, the background documentation suggests that the expanded use of policy framework papers as formal structures might be quite costly to the Fund; consequently, their expansion should only be undertaken with a reasonable assessment that the benefits justify the costs. Thus, although I do not favor a hard and fast rule for a greater use of policy framework papers, I would support the extended use of policy framework papers on a case-by-case basis, that is, when the criteria outlined in the document are satisfied and the potential results warrant it. I would also encourage the more cost-effective, less formal arrangements suggested by the staff.

Finally, the Fund does need a clearer strategy in relation to post-conflict cases. I would see this being initially a technical monitoring and assessment role, helping authorities where appropriate to identify avenues of progress. However, I would urge caution in relation to premature financial involvement in such situations. The commitment of resources should in all cases be made only after some form of sustainable political stability exists.

Ms. Srejber made the following statement:

The recent decline in official development assistance and indications, based on discussions with the authorities of several donor countries, of continued retrenchment of official development assistance budgets in coming years--moving them further away from the 0.7 percent UN target--is cause for some concern. Nevertheless, the causes, meaning, and consequences of the latest developments are open to varying interpretations. Recent developments do not lead to straightforward conclusions about likely trends in the volume or effectiveness of official development assistance flows over the medium term. There are several reasons for this.

It is somewhat uncertain to what extent cyclical factors have had an impact on the recent flow of official development assistance. Recovery from the global recession will bring some relief on budgetary pressures, at least in countries without large structural deficits, which perhaps might allow official development assistance budgets to expand faster or contract less than now envisaged. It would be interesting if the staff could share with us any information they might have as to whether official development assistance flows have responded to cyclical developments in the past. It is also not entirely clear to what extent there is a flexibility to respond to particularly large needs should they arise. The 1993 decline must also be seen in the context of factors that led to previous expansion in registered official development assistance flows, such as the timing of the Managing Director's replenishment cycles and concessional rescheduling by Paris Club creditors. The stream of benefits stemming from these operations will not vanish as quickly as the gross figures indicate.

The causality is not entirely unambiguous. Although constraints on resources for aid purposes in many cases may have led donors to drop less needy recipients, aid flows to such countries may also have been reduced directly as a result of their success in achieving self-sustained development.

The overall volume of aid is not necessarily to be equated with its effectiveness. Although the decline in net official development assistance is indeed worrisome, the effect of the decline might to some extent be mitigated by enhanced efficiency of aid as some donors move away from the cold war geopolitical determination of priorities to criteria based on development objectives. Although it is difficult to assess the magnitude of such increased efficiency, it might not be insignificant, especially in view of the large amounts spent basically favoring strategic allies in the past. The fact that concessional flows are now increasingly being directed to countries pursuing Fund-supported programs, which indeed have been outperforming those without programs, could be another indication of increased effectiveness of the flows.

It seems likely that an expanding number of IDA-eligible countries will cause the demand for official development assistance to rise. However, not all IDA-eligible countries have an equally large need for official development assistance, and some have very little. Moreover, it is difficult to assess the effects of, on the one hand, a shrinking pool of traditional recipients versus an expanding pool of nontraditional recipients and, on the other hand, a potentially expanding pool of contributing donors. There is a growing trend toward official development assistance becoming essentially a sub-Saharan African phenomenon. The notable exception is the addition of a number of low-income economies in transition. With few exceptions, Asia and Latin America seem destined to wither away from the official development assistance scene. This should be less a source of concern than a reason to celebrate. Once development takes off, official development assistance flows tend to be dwarfed by flows of private capital, which in turn causes its own problems but nevertheless is far preferable to continued dependence on official development assistance. The future need of the economies in transition for official development assistance seems to be rather uncertain. For those countries with a good physical and human infrastructure the need for official development assistance might be rather temporary. Although contributions from emerging donors are at present rather small in size, the replenishment of the ESAF serves as an example that some official development assistance resources may soon be available from an expanded pool of donors. Also, Japan's rapid rise from small donor to the world's largest official development assistance donor indicates that this could change quickly. Nevertheless, it would be safer to assume that new sources of official development assistance will come on stream in substantial amounts only in the medium or long term.

The increasing reluctance of donor countries to provide balance of payments assistance is the most worrying aspect of the recent trends. If a number of important donors severely limit their balance of payments support to only exceptional circumstances and rely increasingly on multilateral organizations to provide such support in other cases, a sharp drop in overall balance of payments assistance is likely to result, despite an outlook for somewhat higher potential for multilateral support. This is serious, because it implies a weakening of the Fund's catalytic role and of the incentive for member countries to undertake strong adjustment measures.

How the Fund should respond to such developments is an important question. In my view, the Fund should by no means passively assume an increasing role as bilateral donor support becomes less forthcoming.

Although the public image problem of official development assistance--particularly balance of payments assistance--referred to in the staff paper, may, to some extent, respond to cyclical developments, it is safe to assume that some of the image problems stem from real long-term problems with the efficiency of official development assistance.

The Fund's scope to turn around this poor image in the short run is limited, but the Fund can turn this weakness to its advantage. For example, in cases where the lack of financial assurances stems from problems with aptitude or corruption of recipient governments, the difficulties in getting financial assurances should be taken less as an obstacle to stabilization than as an opportunity to promote good governance. As the Fund and other multilateral institutions, owing to their nondiscriminatory character, are not always in the best position to press for reforms of this character, the pressure from bilateral donors in the area of good governance can be as important for the efficiency of Fund programs as Fund programs are for the efficiency of bilateral official development assistance. Hence, bearing in mind the Fund's monetary character, any idea of letting the Fund increase its share in balance of payments financing and assume greater risk by loosening the standards with regard to financial assurances--perhaps even relaxing conditionality--should be considered with a healthy degree of skepticism. Rather, the

Fund must do its utmost to point out to donors the importance of continued availability of balance of payments assistance for securing the efficiency of project-based official development assistance.

The large number of program countries experiencing shortfalls in external financing is worrisome, but somewhat less so when it is considered that in many cases these shortfalls have occurred for "good" reasons. Nevertheless, firmer financing assurances would be highly desirable, although this may involve many practical difficulties. Building sufficient contingency mechanisms into programs to meet possible financing shortfalls is therefore highly advisable, and projections of available finances over the medium term need to be more cautious.

The trend among donors to provide more budgetary support with attached conditionality to specific expenditures makes it important to strengthen the cooperation among bilateral and multilateral donors and between the Bretton Woods institutions in order to ensure consistency with the fiscal framework in Fund programs. Improving the exchange of information is essential, and the policy framework paper process is one way to achieve this. However, based on the information given, I would not conclude that there is a need for a general expansion of the policy framework paper process. It seems sensible to keep open the possibility of using a policy framework paper process in other cases than the ESAF, but to leave a great deal to the staff's judgment in choosing between a policy framework paper approach, internal country strategy papers, or other approaches.

Mr. Zhang made the following statement:

First of all, I wish to thank the staff for the well-focused and organized paper. As I agree with the thrust of the staff's findings, I would like to focus my remarks on the following.

As developing countries, particularly the heavily indebted poorest countries, struggle to alleviate poverty through stabilization and structural adjustment, it is extremely disappointing to note the dim prospects for financial aid from both bilateral and multilateral donors. As indicated by the staff, official development assistance, as a share of GNP, fell from 0.33 percent to 0.30 percent in 1993, the lowest level since 1973. More worrying are the worsening prospects for the years to come. We share the staff's concern that the potential decline in aid flows will have a particularly important impact on the low-income countries with heavy debt burdens but limited access to private financing. Like Mr. Berrizbeitia, we are very much concerned about the impact of decreasing aid on Fund programs. The staff's comments would be appreciated.

To address this situation, it is critical that the industrial countries, despite the need for domestic fiscal consolidation, assume due responsibility in assisting low-income countries emerging from poverty to embark on a path of sustained welfare improvement. In this respect, we have also noted the public image issue raised in the staff paper. Mr. Dlamini correctly points out that the past poor public image of aid was unfortunately a product of political motivation. It is our belief that this issue should be seen as having two complementary dimensions, that is, understanding the aid implications, and the attached conditions, by the public in both the donor and recipient countries. Thus, improving the public image would entail greater recognition by the donor public of the positive effects of improved welfare on global prosperity and greater awareness by the recipient public of the favorable potential outcome of internationally supported adjustment programs. In this connection, it is important to integrate into the program recipe, where appropriate, local ingredients tailored to local symptoms. Better understanding of internationally assisted programs would result in additional support for further bilateral commitment and its smoother implementation.

To avoid potential disruption to program implementation, the predictability of external financial support is essential. In this regard, although we understand the necessity for providing direct support for projects, we also see the need for adequate balance of payments assistance by the Fund and stronger financing commitments by donors. In this respect, we fully share the staff's view that "lack of adequate balance of payments support for strong programs could lead to unbalanced adjustment programs with slower structural reforms and economic growth, which would have adverse consequences for poverty reduction and the effectiveness of donor project and technical assistance."

In view of the potentially limited availability of financial aid, priority should be given to those recipients where assistance is most needed for the pursuit of strong reform programs and where it is most likely to have optimal results. However, it must be emphasized that the aid resources should be distributed in a balanced way. The traditional criteria, particularly in terms of per capita income, should continue to be respected in qualifying countries for assistance. Regarding the sectoral focus of aid, it would be desirable to have close cooperation among bilateral and multilateral donors in designing and implementing programs and to take full account of the views of the recipient authorities, who, after all, play the major role in this process. Although recognizing the need for social sector assistance, we should not overlook the critical role of infrastructure development support in sustaining long-term economic growth.

Regarding the role of the policy framework paper, we encourage early involvement by all parties in its preparation to facilitate a general consensus and greater consistency of conditions for bilateral aid with the objective of multilateral assistance. However, we believe that extending the use of the policy framework paper to other facilities would be unrealistic, taking into account the large cost increase involved. In this respect, I share the concern expressed by Mr. Fukuyama.

The Director of the Policy Development and Review Department remarked that the staff would be taking great care in designing programs to ensure that the financial needs identified in the program matched the amount of financing available. The staff would also be examining other options, such as measures to increase domestic savings; however, the staff was aware that it took time to build domestic savings. In that context, the staff concurred with the sentiment of a number of Directors that creditors and donors should be as forthcoming as possible, particularly with respect to the composition and form of assistance they would be providing, so that the staff was aware of the amount and nature of financing available for a particular country. In that connection, he would mention the importance of the forthcoming meeting of donors on June 6.

There were, however, some bright spots in an otherwise grim picture of declining concessional assistance, the Director considered. Donors were increasingly turning their attention to the poorest countries that were showing improvements under adjustment programs. He had recently attended a high-level meeting of the OECD's Development Assistance Committee (DAC) in Paris, and donors had confirmed that the adoption of adjustment programs by the poorest countries was a critical criterion in their allocation decisions. Another positive development was that, with the appropriate policies in place, countries were able to attract private capital flows to supplant declining official flows.

Although nonconcessional loans were important--particularly lending by export credit agencies was an important source of support for middle-income countries with Fund-supported programs--they could play only a limited role in those countries that did not have the capacity to absorb nonconcessional financing, the Director observed. The focus of the present paper had been on the poorer countries and on concessional assistance. Nonconcessional official flows, such as those from the Export-Import Bank of Japan, had been covered in some detail in the debt paper that had been discussed by the Board in 1994.

The staff representative from the Policy Development and Review Department commented on the cyclical variation of ODA that it would appear from the data from the early 1980s to the present that, for individual countries, cyclical factors had played a role in explaining declining official development assistance. However, for the DAC countries as a whole, there was no indication of any correlation between cyclical factors and declining assistance, which would indicate that the present declining trend in ODA in relation to GNP was expected to be reversed because of changes in the cyclical position of donor countries.

Mr. Wijnholds made the following statement:

This is a welcome document and the discussion of its contents is timely. Indeed, there appears to be a clear trend toward the shrinking of aid flows in general, and of balance of payments support in particular. The staff notes that "almost all the major bilateral donors, with the exception of Japan, are budgeting a reduction in aid as a share of their GNP in the near term." As a footnote, I would mention that while the Netherlands does not appear to fall under the staff's definition of a major donor--although its annual ODA of about $3 billion--at present exchange rates--is sizable compared with that of some bigger countries--its aid contribution in GNP terms is expected to remain roughly the same in coming years.

The trend toward overall lower aid flows is, of course, regrettable. However, insofar as donors now concentrate more on countries most in need of aid, and countries that pursue sound macroeconomic and structural adjustment policies, this cloud may have something of a silver lining, as Ms. Srejber has pointed out in her statement. Indeed, this shift in emphasis could help create the right stimuli for low-income countries to improve their economic policies and external positions. Another element to be taken into account in an overall assessment of the aid flow picture is that a growing--but still limited--number of developing countries are becoming able to raise funds from the international financial markets.

On the matter of how diminishing bilateral balance of payments support affects the Fund's position, there are some difficult issues involved. The experience with large shortfalls in external financing of Fund-supported programs may point to the need for more cautious medium-term projections for balance of payments support in future programs, including for the poorest among the transition economies. It would also be welcome to obtain firmer financing assurances from donors and to establish contingency mechanisms in cases of shortfalls. I would, however, be reluctant to err strongly on the side of caution here, as the problems facing a number of countries are acute, and extended delays in implementing programs on account of trying to reach firmer financing assurances can create serious difficulties. An alternative is, of course, to insist on an even stronger adjustment effort by the recipient countries. This is another dilemma to which easy answers are not available. Requiring a too-large adjustment effort under a Fund arrangement in a relatively short period of time would risk blowing up the program at an early stage. This would not be in the interest of the member country nor of the Fund. My remarks should not be interpreted as advocating mild adjustment programs; but there may have been some instances where the lack of financing assurances has led to an unrealistic stepping up of measures required from the authorities in a brief span of time. Of course, the threat of withholding Fund support could possibly help to elicit financing assurances, but it is a tricky game of chicken to play. Following a case-by-case approach in such circumstances would be my recommendation.

The staff points to a clear trend among donors towards providing more specific forms of budgetary support instead of the more general balance of payments support: aid flows are increasingly directed towards specific sectoral and project support. Furthermore, in an increasing number of cases conditionality is attached to specific public expenditures, especially in the social sector, which may lead to a lack of support for other key areas of expenditure. This development underscores the importance of coordination between the Fund, the World Bank, bilateral donors, and recipient countries. The Consultative Groups organized by the World Bank constitute an important forum for coordination among donors. At an earlier stage, the policy framework paper process can prove to be very useful. This brings me to the question of how widely to use policy framework papers. Extending the policy framework paper approach beyond ESAF-eligible countries has a certain appeal, particularly for countries in transition, as the staff indicates. The staff is clearly reluctant to require policy framework papers for all EFF credits, citing the cost implications. As an alternative, the preparation of a country strategy paper is suggested, which would be coordinated with the Bank's country assistance strategy paper. The Fund's country strategy papers, we are told, include much the same topics as the policy framework paper; the country strategy papers are not, however, available for outside use. The question then arises why the policy framework paper route is considered to be so much more costly. I, therefore, conclude with a question: are there perhaps other considerations involved here?

The Director of the Policy Development and Review Department remarked that a policy framework paper, unlike a country strategy paper, had to be negotiated with, and endorsed by, the authorities, and it became effectively a document of the authorities. The two papers were substantially different in terms of the mission time and the extent of coordination with the World Bank that was required for preparing them. Moreover, the country strategy paper, was an internal document and was intended for the staff's reflection of the past policies of a particular country, their impact, and how the policies could be adjusted in light of the country's experience.

Mr. Ismael made the following statement:

> During last month's Interim Committee meeting, it was emphasized that timely financial assistance, including external debt restructuring, was crucial to the restoration of economic growth in the low-income and heavily indebted countries. However, the staff paper before us today paints a somewhat gloomy picture of a declining trend in overall aid flows. The paper also raises many pertinent questions on the Fund's appropriate response to this turn of events. I will focus my comments on three issues, namely, the role of policy framework papers and technical assistance in mobilizing external assistance, and the response of the Fund to the absence of adequate financing assurances from donor countries.
>
> Policy framework papers play an important catalytic role in mobilizing external aid flows by ensuring a consistent policy framework for a country's medium-term reform program. However, the staff has indicated that extending policy framework papers to all cases of programs supported by the extended Fund facility would not be feasible because of the high costs involved. I could, therefore, go along with the staff's suggestion for a case-by-case approach in extending policy framework papers to those programs supported by the extended Fund facility that meet certain criteria. Nevertheless, I would not be averse to a policy framework paper if the authorities request one. At the same time, I support the suggestion for the staff to prepare their internal country strategy briefs in consultation with the Bank's country assistance strategy as a more cost-effective means of promoting closer Fund-Bank collaboration.
>
> The role of technical assistance in facilitating aid flows is an important issue, because the paper noted that shortfalls in aid were often due to a country's lack of administrative and implementation capacity. Here, again, closer Fund-Bank collaboration is important to identify any shortcomings in a country's capacity to mobilize import or budget support funds and implement projects. The Fund could then provide the necessary technical assistance, in

collaboration with the World Bank and other donors, to alleviate such weaknesses, particularly in the areas of public expenditure policy and management and government financial statistics.

On the Fund's response to a lack of donor support, I share the view that closer Fund surveillance of donor and recipient countries is important, so that any problems can be identified and resolved quickly. In the process, this would reduce uncertainty and help ensure timely aid flows. However, in the event that donor support is inadequate, the Fund should tailor its program to the amount of financing that is available rather than leave the program in limbo, as this will have adverse implications. This issue of donor "fatigue" underscores the need to accelerate the pace of the Eleventh Quota Review, so that the Fund's liquidity position is sufficiently strong to meet members' requirements. It is to be hoped, then, that the fate of Fund programs will not be too dependent on whether adequate financing assurances are forthcoming from donor countries.

Mr. Autheman made the following statement:

I find this staff paper excellent, with one exception, already mentioned by Mr. Wijnholds--the sentence on page 6 that states that almost all of the major bilateral donors, with the exception of Japan, are budgeting a reduction in aid as a share of their GNP in the near term. Perhaps France falls in the same category as the Netherlands, which pleases me very much, because the Netherlands has shown that it is feasible for a country to implement stringent fiscal consolidation while maintaining a high ratio of aid flows to GDP.

I am pleased to see that Japan, whose ratio of aid flows to GDP still remains rather low, is considering following such a policy, to which my country also remains committed. I am not much concerned by the reluctance of countries to provide substantial bilateral balance of payments support; I think we should remember that balance of payments support is not a normal use of official development assistance. I am more concerned by the reason given--which seems to be taken for granted by the staff--to justify the decline in official development assistance. The usual explanation is that fiscal consolidation in donor countries will reduce their aid flows. Quite frankly, I find it difficult to understand how countries where the level of official development assistance related to GDP is already very low will achieve great progress in fiscal consolidation by reducing further official development assistance. I think that the Fund should be very explicit that this explanation is not very convincing.

On the contrary, our experience has been that adjustment programs very frequently succeed in bringing back sustainable growth for the benefit not only of the recipient country but of the world community. To put it in another way, the Fund should give more publicity to the beneficial impact of aid flows granted under appropriate economic conditionality and to the weakness of the fiscal argument.

As for the specific trend, that is, the reluctance of countries to provide substantial bilateral balance of payments support, I think it is justified because balance of payments support should remain of a transitory nature. It is not the best use of official development assistance, which should remain related to direct development purposes. Countries are not well equipped to address usefully the macroeconomic issues related to balance of payments support.

Furthermore, in the medium term, one should expect that growth in developing countries and the emergence of private financing could help reduce the relative share of balance of payments support provided by countries. We also point to other positive trends: the reluctance to provide any balance of payments support outside the framework of a Fund program, the greater focus on the poorest countries, the so-called good governance issue--I do not know what "good governance" means, among other reasons because we have no translation of this word in my language, "bonne administration" being a cliché. But we know very well what corruption means, and I think that corruption is an issue that is relevant to the Fund.

Because the Fund is involved in fiscal policy, it should not be reluctant to address corruption issues, to the benefit of everyone. My greatest concern is related to the availability of balance of payments support by multilateral development banks. I think that the issue in the years to come will not be bilateral balance of payments support so much as whether there will be enough balance of payments support from the concessional windows of multilateral development banks.

Turning to more specific issues, it is not very easy to answer the question raised on page 29: the choice between supporting tighter programs that entail greater risks or withholding support until adequate financing assurances are available. I do not consider this question a new one; I thought that it had always been present in the Fund. It seems to me that the right way to address it is on a case-by-case basis. Sometimes it is possible to go ahead with tighter programs; sometimes it is more reasonable to wait until enough financing assurance could be provided. This very much depends on the circumstances, so I am not able to provide a general answer.

On the question of aid coordination in the policy framework paper process, it seems that the reasons for not extending the policy framework paper instrument too much are regrettably strong. I would be reluctant to ask for more procedure and expenditures, but at least we must find a way to strengthen our cooperation with the World Bank in all circumstances where the extent of structural reforms needed and the importance of the Bank's financial contribution are critical to the success of a Fund program.

Finally, I do not know what the outcome of our discussion will be--perhaps it will be the Chairman's summing up--but this issue could be of some interest to the Development Committee. The Chairman's report or the report by this Board on this issue may be of more relevance than a report on infrastructure or other issues, which are usually on the agenda of the Development Committee. This issue fits within the mandate of the Development Committee and would be appropriate at the Annual Meeting.

The Chairman noted that the trends in official development assistance were at the heart of the responsibilities of the Development Committee. He would follow the guidance of the Executive Board in reporting to the Development Committee, and, in that context, it would be important also to take note of the recommendations of the Committee of the Whole on the Development Committee.

Mrs. Wagenhoefer made the following statement:

I want to thank the staff for the comprehensive and well-prepared documents we received for today's discussion. I especially welcome the fact that an executive summary was included at the beginning of the main document; this practice should become a regular feature in policy documents.

The staff documents portray the current situation clearly and comprehensively. I therefore do not need to add to this, especially as I could not detect any fundamentally new insights regarding bilateral and multilateral aid flows in support of Fund programs.

In all discussions it is generally helpful to retain a broad prospective. For today's discussion it is therefore helpful to remember the central mandate of the Fund, namely, to help member countries counter balance of payments imbalances by supporting stability-oriented, fiscally sound, medium-term economic development. To retain its monetary character, the Fund will also have to ensure that its financial support remains catalytic. This obviously means that in times of possibly decreasing balance of payments support from other sources the Fund cannot step in and fill the gap with its own money. In such situations, it is necessary to strengthen programs in order to enhance domestic savings and attract foreign private capital. The Fund should therefore resist all attempts by other parties to burden it with "international welfare cases." As we have remarked at previous occasions, financing of development aid is incompatible with a monetary institution.

On Point 1 of the issues for discussion, the staff asserts that "there is a danger that the expected decline in global balance of payments support could lead to unbalanced adjustment programs with slower structural reforms and economic growth." We have to remember, of course, that one of the central lessons of the debt crisis at the beginning of the 1980s was the fact that too much external financing can certainly also lead to lagging reform efforts. The principal difference between the real world and biblical paradise is that in the real world resources are scarce and not all demands can be fulfilled. This is true for personal consumption for the overwhelming majority of people, and it is true for the financing demands of countries. As the Fund also only has limited resources, we should concentrate them on those countries with good track records, promising sustained adjustment success. We agree with the staff that firmer financing assurances from donors are necessary for the program period to protect the Fund's own resources.

Turning to the so-called post-conflict cases, we do not believe that the Fund needs a new facility to deal with such cases. Technical assistance, economic advice and, if necessary, financial assistance are available to all member countries on the same terms, including those re-emerging from severe crises. Keeping the monetary character of the Fund in mind, we maintain that an evenhanded approach best suits the needs of all member countries.

We do not feel that, in general, a wider use of policy framework papers for extended arrangements is warranted. Apart from the higher cost-effectiveness of other collaboration mechanisms, we believe that a stronger involvement of the Fund would shift the balance of Fund support from short-term to medium- and long-term involvement, which again does not seem to be compatible with the monetary character of this institution.

We fully support the staff's view that there is a need for more emphasis on improving members' administrative capacity in general. Experience has shown over and over again that in those countries where programs have gone off track, it was mostly a question not of too weak programs but of lack of implementation.

Mr. Wijnholds considered that the debt problem in the 1980s had been caused by excessive amounts of unconditional lending, and the Fund had been crowded out by commercial banks that had been eager to lend even to those countries that were not creditworthy. Had lending been conditional, the outcome would have been different. Moreover, if the Fund were to lend to only those countries with good track records, those that had not yet developed good track records, such as the transition economies, would not have access to any concessional financing. In his view, those countries also deserved the Fund's support.

Mr. Autheman wondered whether there were many countries with good track records that needed the Fund's support.

Mrs. Wagenhoefer said that she agreed with Mr. Wijnholds's first point. As regards lending to new members, it was true that they could not possibly have established track records. There were very few countries that had yet to become members of the Fund.

The Chairman remarked that, in some cases--such as Moldova and Georgia--the Fund would have to take the risk of being the first to provide support for a country's program.

The Director of the Policy Development and Review Department observed that, for countries that did not have a track record, a stand-by arrangement was often agreed to in order to establish a track record, prior to embarking on a medium-term program supported by the EFF or the ESAF. Countries that were faced with difficulties--economic, political--also had a right as members of the Fund to seek the Fund's support. There were cases in which commitments and prior actions had to be accepted, instead of a track record, when making a decision whether to go forward with Fund support.

Mr. Al-Tuwaijri made the following statement:

At the outset I would like to compliment the staff on the interesting and thought-provoking set of papers before us. It is clear that trends in bilateral and multilateral aid flows have significant implications for Fund programs. However, in analyzing trends in aid flows, we should not lose sight of the very fundamental role of the Fund, which is essentially catalytic. Thus, Fund financing should not replace declines in aid flows from bilateral creditors or donors.

The papers before us raise a number of important questions. Regarding the operational implications of recent trends in aid flows for the Fund, I will make four remarks.

Any potential decline in balance of payments support over the next few years should have two general implications for the design of Fund programs. The Fund needs to be more cautious in its medium-term projections for balance of payments assistance; at the same time, Fund programs should be more ambitious in terms of promoting domestic savings. The staff appropriately points out the dangers of relying too heavily on short-term capital inflows. I would agree that the volatility of such flows could add another element of uncertainty to the economic environment. Thus, it is particularly important to place emphasis on promoting an environment that is conducive to attracting direct foreign investment. Certainly, the ultimate objective of every Fund program would be to create precisely such an environment. At the same time, the large differences in the flows of foreign direct investment among developing countries raises the question of whether it is possible for Fund programs to be designed in such a way as to help attract such investment at an early date in the adjustment process.

The changing focus of aid from bilateral donors poses certain challenges to the Fund. The paper raises the important question of how to deal with post-conflict cases. I am not sure, however, if and how the Fund should be more involved in this area than it already is. A greater share of aid budgets is being earmarked for post-conflict cases, which will help alleviate some of the difficulties these countries face. Fund financial involvement, of course, can only take place once the situation has stabilized enough for these countries to be in a position to embark upon a Fund- adjustment program. Like Mr. Fukuyama, I would not support proposals to give post-conflict cases a special status to be taken into consideration when determining the use of Fund resources or as a tool to relax conditionality. Of course, the Fund can provide technical assistance to the authorities after the conflict has been resolved to help establish the necessary conditions for program implementation.

Another challenge arises in cases where the Fund is faced with little or no financing assurances from donors owing to the donors' concerns regarding governance issues. In circumstances where financing is expected to be small, Fund programs would need to be tighter. In this connection, I would emphasize that the Fund should not get involved, or be perceived as being involved, in issues that are beyond its mandate and political in nature.

I found the discussion on policy framework papers particularly interesting. I share the view that policy framework papers could play a wider role. However, we should not cast the net too wide. Rather, policy framework papers should be used in some select cases where the structural reforms needed are substantial enough to warrant a more formal approach to Bank-Fund collaboration, and where there is reason to believe that such papers would be of assistance to the authorities in mobilizing the necessary external financing.

Mr. Geethakrishnan made the following statement:

I must compliment the staff not only for the extremely thorough and exhaustive analysis presented to us but, more important, for presenting the data and the conclusions in an "as is" condition. Nothing has been swept under the carpet and nothing has been embellished. They have called a spade, a spade--nothing more, nothing less. What we have before us is the naked truth. The naked truth always poses problems, quite disturbing at one level and embarrassing at another.

The data clearly show a declining trend in bilateral trade flows in absolute terms. In real terms, that is, at constant prices and as a proportion of GNP, the fall is quite steep. The total net official development assistance as a share of the GNP has now come down to 0.30 percent, a level that compares very unfavorably with the target of 0.70 percent set by the UN and agreed to by all countries. There has also been a perceptible change in the geographical distribution of the flow of these funds, with a shift away from the traditional borrowers in Asia, Africa, and Latin America in favor of Eastern Europe and other countries of the former Soviet Union. This by itself could be considered a good development if it is the result of an increasing demand by the latter set of countries, on the one hand, and a considerable improvement in the economies of the first set of countries, on the other. Whether it is so will need to be examined carefully. However, this does not seem to be the case. There is also a shift away from the earlier predominantly project-oriented assistance--which in essence provided balance of payments support--toward cofinancing arrangements--wherein the bilateral aid is tied up with policy prescriptions for different sectors by the multilateral agencies--and also toward increased emphasis on social sectors and poverty alleviation programs as well as assignment of an increasing role in project advice and implementation to the nongovernmental agencies of the donor countries. To put it differently, the pattern of aid flows is reflecting increasingly the strategic considerations of donor countries more than the heartfelt needs of the recipient countries.

In view of the above trends in bilateral aid flows, the question that arises is what we in the Fund should do. In this context, we must also bear in mind that private capital flows, where profit motive and security of investments are the prime motivating factors, will naturally bypass a vast majority of the developing debtor countries for quite some years to come. Thus, a reduction in balance of payments support flows to the vast majority of these countries is clearly in the cards. It would be a mistake to assume that, correspondingly, the requirement for balance of payments support funds for these countries will also go down. These reflect the needs of these countries as assessed, among others, by the extremely well qualified and highly experienced professionals of the Fund. To therefore infer that in line with reduced aid flows the requirements will go down would be totally erroneous. The total requirements will remain the same; what changes is the pattern of financing as from among the various sources of funds.

Returning to the question of what the Fund should do, the immediate answer that comes to my mind--a perception that may be common to all developing country chairs--is that we must redouble our efforts to persuade the donor countries to not only increase the aid flows but also reduce the conditionalities, that is, reduce and loosen the strings attached. This has been our approach each time this issue has come up so far in any forum, and I will not be surprised if we end up by taking it on this occasion also.

But prudence requires that we also consider the option wherein the white man's burden is increasingly determined by the white man's own domestic burden.

We have already looked at this problem when we were examining the multilateral debt of the debtor nations. We then reached a consensus that the debt burden was extremely heavy; that there was a case for putting multilateral support for such heavily indebted countries on a permanent footing; that there was also a case for increasing concessionality; and also, that the debtor countries in turn should pursue vigorously the reform process aimed at integrating their markets with the global economy. As far as the last aspect is concerned, it is necessary to inject a certain amount of realism into our thinking. Although these countries should take all possible steps in all areas of action, within their control, we need also to note the limitations to the speed at which we wish these extremely poorly endowed countries--be it in terms of financial, natural, or manpower resources--to achieve market orientation and the necessary economic and political stability for putting the transformation on a sustainable basis, goals that many of the industrialized countries took several decades to achieve. Mr. Clarke and Mr. Wijnholds also highlighted this point.

We need to add one more dimension to the broad consensus that we have already achieved, that is, that although the Fund will continue to play the role of catalyst, the time has also come to increase the Fund's share in meeting the balance of payments needs of these countries. While we pursue with the donor community the question of their increasing aid flows in general and balance of payments support to these countries, we should also make a realistic assessment of the end result of these efforts and provide the balance required ourselves. Our willingness to do this will also establish our bonafides in the Mexican crisis where we departed from the normal book of rules and increased very steeply not only the total order of support but also the amount of up-front disbursement. Quite a few had at that time raised questions about the order of support and attributed motives. We need to make clear that our Mexican approach is not an exception but the rule--an approach that we are willing to extend in all cases where the need arises. This approach will also provide the solution to the problems posed by the declining trend in bilateral aid.

This approach would definitely increase the Fund's overall credit support for such countries. If, at the same time, we face difficulties, for some reason or other, in substantially augmenting the Fund's own resource base, then we will be compelled to take a view on how best to utilize or allocate the limited resources for various uses. We could deplete our resources with just two or three more Mexico-type cases. We could also consider spreading the sweetness and the sunshine to a very large number of countries at the lower end of the spectrum of development, with the requirement in each case being only a small dose of sweetness and sunshine. A hard choice indeed, and I hope we will never be faced with this prospect.

This, then, is my approach to the problems raised by the declining trend in bilateral aid flows. The answers to the various questions posed at the end of Supplement 1 flow from this approach.

I share the concern that the outlook for balance of payments support from the bilateral donors is bleak.

I do not think that the next conclusion, that is, the need for a more cautious medium-term balance of payments projection is called for as a result of the earlier conclusion. The medium-term balance of payments support projections reflect the needs of the debtor countries. The scope for dramatic changes in these requirements is quite limited. What can change from reducing balance of payments flows from bilateral donors is a pattern of sharing with regard to the needs of these debtor countries, and not the size of the requirement as such.

Although we must urge all countries to accelerate the reform process and integration of their economies with the global market, the limitations on urging greater speed in this regard will have to be understood clearly.

We must continue our efforts with donor countries to step up their support of developing countries and also to indicate clearly their commitments irrespective of whether these are countries pursuing ESAF-supported programs or not. Whether we succeed or not, the effort must be there.

It is not really clear to me how the policy framework paper is expected to play a greater role in the determination of support by the bilateral donors. After all, the starting point for the paper is the fact that such aid flows are increasingly determined by the strategic considerations and domestic pulls and pressures of these donor countries themselves. Perhaps we should be looking at the policy framework papers of the donor countries themselves and what their priorities are.

As regards aspects such as increasing peacekeeping operations, post-conflict cases, good governance, participatory development, and respect for human rights, we have to realize that if the donor countries' domestic perceptions considerably affect bilateral flows in such cases, then quite naturally the perceptions of the donor countries that hold majority voting in multilateral organizations will be a key factor in any decision that these multilateral organizations may take. Possibly this particular question was intended to be included in the brief for the Managing Director for use at the Halifax Group of Seven Summit. I am looking forward to the replies that the Managing Director will be bringing back from that meeting. My advice is simple: If we are to take a final decision within the Fund impartially and on merits, then I would suggest adopting a liberal approach, while ensuring that we do not tread where angels fear. After all, we cannot afford to jeopardize the Fund's financial integrity.

The question of shortfalls in the medium-term balance of payments projections, which we notice in most Article IV consultation discussions of debtor countries, will become a thing of the past the moment we take a realistic attitude about likely flows from bilateral donors and bridge the gap from the Fund's own resources, rather than doing it the other way around as we have traditionally done.

Mr. Saito made the following statement:

In developing countries, especially those with low income, official concessional financing has been important for the successful implementation of economic adjustment programs and structural reforms. Moreover, for the Fund, the ESAF has proved to be an important lending instrument in supporting strong adjustment programs on concessional terms. I believe concessional lending should continue to play a key role in helping the poorest countries set the base for sustainable growth, but I am concerned about the recent trends in concessional lending, particularly official development assistance.

I will make one general remark followed by specific comments on some of the issues for discussion suggested in the staff paper.

Since the Madrid Declaration, several donors have announced reductions in their budgets that imply, in some cases, further reductions in official development assistance, thus reinforcing the downward trend in aid as a proportion of the donor country's GNP. In fact, this ratio fell from 0.33 to 0.30 in 1993, its lowest level since 1973. With the exception of Japan, where the proposed operating budget for official development assistance assumes an increase of 4 percent in nominal terms in FY 1995, we have seen that slashes in aid budgets have taken place in the context of several countries' fiscal consolidation efforts.

Consistent with this overall trend, the current outlook calls for substantially lower concessional bilateral balance of payments support in the next few years compared to the recent past. This decline will have a particularly important impact on those low-income countries with high debt-service burdens and limited access to private financing. In turn, although concessional multilateral balance of payments support has the potential to increase in the next few years, it is unlikely to offset the expected decline in bilateral support.

Furthermore, all donors have indicated that they would only contemplate providing balance of payments support to those developing countries that have Fund-supported programs, enhanced surveillance, or strong macroeconomic and structural policy implementation track records. A closer link between official development assistance and multilateral-supported programs could be beneficial for many countries already embarked on adjustment programs, making more efficient use of the available resources. However, for countries close to graduating from the Fund's and World Bank's balance of payments support that continue to implement sound policies, I agree with the staff's suggestion that a more gradual phasing out of donor support may better meet their needs. In contrast, for countries that are not ready for Fund-supported programs but are in need of development assistance, a closer link between the two could worsen their situation, as official development assistance would not be available.

I welcome the significant focus placed by some bilateral donors on direct policies for poverty alleviation within individual country programs, such as those supporting the social sectors, and recalling the fundamental role of human capital investment. However, I wonder whether, in order to maintain a more balanced adjustment process and an equilibrium between the social and other sectors' development, it would be preferable for recipient countries to obtain support for sound macroeconomic and structural policies in the form of general budgetary assistance instead of a fixed allocation for a particular sector. The Fund should play a key role in strengthening the quality of public expenditure and the social aspects in ESAF-supported programs. In fact, a closer link between bilateral aid and Fund-supported programs may imply a need for strengthening surveillance by the Fund.

Regarding good governance, I agree with the focus on good governance by many donors, promoting a political and legal environment that is favorable to economic growth and widespread participation in the economic and political life of recipient countries. In this regard, the Fund should play an important role on the economic front on issues such as market rules and regulations to facilitate economic efficiency, transparency and accountability of public expenditure, an increase in direct financial assistance to the private sector and, basically, encouragement of wider participation in the formulation of policies through greater openness. However, I have some reservations about the need for a more active participation by the Fund in noneconomic issues, as expected by several donors. The purpose of our institution should remain within its catalytic role of Fund-supported programs and, in this connection, more ambitious programs must be designed to attract financial assistance from the limited pool of funds.

With regard to extending the use of policy framework paper for some middle-income countries, I share the comments expressed by Mr. Berrizbeitia and Mr. Clark and consider that this extension should be assessed on a case-by-case basis.

With respect to shortfalls in external financing in Fund-supported programs I share the staff's view that, in order to minimize its recurrence, there is a need for more emphasis on improving the system for disbursement of funds for import support and the monitoring of foreign official funding, as well as better project implementation. Also, I agree that future programs for these countries will need to be more conservative in projecting external financing over the medium term.

Finally, this chair welcomes the recent implementation of the Naples Terms at the Paris Club, which constitutes a major step forward in easing the debt of the poorest countries. Notwithstanding this development, the debt problem remains critical. Therefore, as noted by the Ministers of the Group of Twenty-Four, I reiterate the need to urgently reduce the stock of debt and to accompany this initiative with new flows of capital, so as to better support ongoing adjustment efforts.

Ms. Lissakers made the following statement:

Like my colleagues, I welcome this very straightforward and, I think, realistic assessment of multilateral and bilateral aid flows, and the trends we see. I hope that these projections will be incorporated in some of the Fund's other work where we sometimes find the projections for future aid flows somewhat on the optimistic side.

With regard to bilateral official development assistance, I should say in passing that I am sure it has not gone unnoticed that the United States, for one, is engaged in very heated budget debate. Congress seems to have taken to heart the Fund's admonitions about the need to reduce the budget deficit. And unfortunately, although I agree fully with Mr. Autheman's comments--and certainly that is the Administration's view--that these cuts should not be indiscriminate and across the board and that the share of our foreign assistance is very small, both as a part of GNP and of the total budget, and should, therefore, be preserved in view of the high rate of return on this investment, I am afraid that these arguments will not win the day. It is too soon to say. The relevant committees responsible for foreign assistance will be making their recommendations to the full House and Senate next week, and we will have a better sense then. Indeed, there is bipartisan support for assistance, so I would say all hope is not lost, but the outlook is clearly not particularly favorable.

As noted by others, we are not alone in that regard. The trend, as the staff paper makes clear, is for no or perhaps little nominal growth in future bilateral aid flows. Even so, I would say that after reading the paper, my initial reaction was that it is not quite as bad as I thought. I share many of the views expressed by Ms. Srejber, that there are some benefits from this stringency in aid flows in that it appears that bilateral donors are focusing their aid more, and particularly, on human capital--which is certainly a priority guideline for our bilateral aid efforts--and that there is more weight given to good governance and to specific links with Fund programs which, I believe, strengthens our efforts to reform governments and also means that we are probably getting more development "bang for our buck," in effect. We are getting better returns, perhaps, on our streamlined aid investments.

I would also point out that to the extent there has been a strong effort in bilateral debt reduction and debt cancellation, the need for future debt-servicing financing is, of course, reduced. In that sense, more of the aid flows can actually be used for development financing rather than for debt financing and debt-servicing financing. That, I think, is also something worth taking into consideration.

On the question of good governance, I was glad that Mr. Autheman introduced the French word "corruption" into the debate. I think we are rather too polite on this issue. When we talk about good governance, what we are talking about is corrupt governments that misuse the funds they receive from both domestic sources and foreign sources. We ought to address that issue in the development policy debate more openly and forthrightly. It is an issue that should not be ignored by this institution, either. I would point out parenthetically that good governance is not only the responsibility of the recipient countries; corruption feeds on and is fed by corrupt payments from large corporations from the large industrial countries. We could make a contribution to good governance efforts. The French government, the Swedish government, the German government could make a contribution by not treating such payments as legitimate and tax deductible business expenses.

I think the lesson here is that if growth is to be sustained, then good policies and policy management are essential components. We have really internalized that in the Fund, with a greater emphasis on technical assistance and emphasis on the management of budget and government activities, and it seems that bilateral and multilateral efforts in this regard are now meshing very well. That is a trend that we should reinforce wherever possible.

On the question of budgetary as opposed to balance of payments assistance, having bilateral flows go through the budget is not undesirable. It raises certain problems for the Fund, which we recognize, but it argues that these flows may be better managed. I think it is a reality to which the Fund has to adapt itself, as Mr. Clark points out.

In this regard, the policy framework process is really a very valuable management tool that we should try to reinforce. There is general agreement that it has been quite successful in the ESAF process, and we need to consider whether the policy framework paper process can be expanded, first, as a tool in some cases perhaps for middle-income countries as well--although I recognize this could be an increased staff burden--but also more important, whether, without making the process overly cumbersome, we could bring some regional development banks, where they play a major role, into the process. It would not be just the Fund-World Bank process, but, where relevant, the Fund, World Bank, IDB process, for example, or Asian Development Bank. It seems to me to have been a very useful tool.

In his statement, Mr. Fukuyama noted that greater use of the policy framework paper process also raised a question of publication. I would say, particularly with regard to the question of how to coordinate governmental activities with nongovernmental organization activities, that greater publication of these documents could be very useful because it would inform the entire assistance community of the broad policy guidelines and directions that have been agreed at the multilateral level. It would have a very beneficial effect down the line on the activities of other donors. I hope we will give more time and attention to refining what has been a very successful effort.

I was pleased that the paper also raised the question of emergency assistance. This is a somewhat murky area. We have an emergency program that has been used to help countries deal with natural disasters. There is also a question of what we have called the post-chaos situations where there is governmental turmoil. The Madrid communiqué made mention of this. There is some tendency for people to think the post-chaos situation is a figment of U.S. imagination. I wonder whether the staff could give us some examples of post-chaos political situations that pose a practical problem for the Fund either in engaging countries in a program or in policy discussions that are integral to legitimate areas of the Fund's portfolio, as opposed to substitutes for what other bilateral or multilateral donors should be doing in such situations. We have the STF model. It seems to me that there are countries that are not post-communist countries that share some of the same characteristics; circumstances may arise that are similar and therefore could legitimately require some sort of bridge facility along the lines of the STF. Perhaps the staff could comment on that. I hope that we will do more work on this question if the staff thinks that there is a real problem that we need to address and if there is a gap here in our instrumentality, which we tend to think there is.

Finally, we have been having Board discussions on multilateral debt burdens, and, as I said at the beginning, we have to be very realistic when we project continued bilateral and multilateral aid flows as a tool for maintaining debt servicing, and we have to look at some other options in view of the rather bleak outlook for development assistance. I also think that this simply underscores the need to maximize the availability of multilateral resources which are not totally interchangeable. Fund resources should not be viewed as interchangeable with bilateral official development assistance or development bank assistance, but I do think that we need to look at mobilizing all of the resources available in a manner that is consistent with the mission of each of the multilateral institutions.

Mr. Koissy made the following statement:

At the outset, I would like to commend the staff for a comprehensive set of papers, which gives us a useful overview of the recent changes in aid policies of donors and their implications for Fund-supported programs. It is a matter of serious concern that at a time when most low-income countries are embarking on wide-ranging adjustment and structural reform programs, which requires strong external financial support, the donor community, has largely decided to reduce its external assistance programs.

Like previous speakers, we are very concerned about the impact of decreasing aid on programs, which will inevitably have an adverse impact on the reform process of these countries, their debt-repaying capacity, and their growth prospects. I agree with Mr. Zhang that it is critical that industrial countries, despite the need for domestic fiscal consolidation, assume their full responsibility in assisting low-income countries emerging from poverty to embark on a path of sustained welfare improvement. The staff paper also notes the shift away from balance of payments support toward social projects, especially the alleviation of poverty. Although there are certain advantages to this approach, one may wonder whether it is not less sufficient than that of ensuring the overall growth of the economy. These trends in bilateral aid indicate that multilateral agencies, especially the Fund and World Bank, will have to play a more important role in supporting developing country adjustment efforts. In this context, making the ESAF a permanent facility takes on added importance. In addition, as Mr. Dlamini points out in his statement, a more feasible solution would be to allow increased access by low-income countries to concessional financing from multilateral institutions, especially the Fund and the World Bank. In the meantime, and to ensure the success of Fund-supported programs, a better coordination of assistance with other agencies will be required, as well as stronger assurances from donors on their level of assistance and the timing of their disbursement. Obviously, in many cases, there will be a need to strengthen the programs so as to generate a higher level of domestic savings. However, as Mr. Berrizbeitia notes, if the situation is such that adequate bilateral financing is not available, Fund programs should not be delayed but, rather, adapted to the existing facility. For the low-income countries of sub-Saharan Africa, delays in approving a program can only worsen their economic and financial situation, as Mr. Dlamini aptly points out.

As regards aid coordination and the policy framework paper process, experience has shown that the policy framework paper has been an important vehicle for developing a comprehensive macroeconomic framework and financial scenarios, which have helped to better coordinate and mobilize external assistance. Moreover, the policy framework paper, as an internal document that is widely distributed and discussed, gives the public a clearer idea of the direction of policies in the country and thus brings in more support, which can better contribute to the success of the adjustment process. For these reasons, it would appear that extending the policy framework paper approach to some countries with extended arrangements could have some merit. However, I would also note that the preparation of policy framework papers in conjunction with the Bank is a time-consuming process, and with cost implications. It also requires joint Bank-Fund missions which could delay program implementation. Therefore, careful consideration should be given to all these elements before coming to a final decision.

As regards the application of policy framework papers to stand-by arrangements, I do not think that would be appropriate.

On other issues, I would agree that more attention should be given to the development of appropriate systems for monitoring and administering disbursement in recipient countries as it has been shown that this has tended to avoid shortfalls in program financing.

On post-conflict cases, the approach suggested by the staff is appropriate and I can endorse it. On the issue of good governance, the Fund's role should be confined to the economic dimension only. Improving budgetary procedures, increasing transparency in government spending, and encouraging reliance on market forces are issues in our area of expertise. More than that, broadening the role would take us into areas where objective criteria will be difficult to establish and it should be avoided.

Let me conclude by commending those donors who have maintained and even increased their assistance to low-income countries. The indication by some donors that they intend to protect the poorest countries undergoing adjustment from aid cuts is highly appreciated.

Mr. Waterman made the following statement:

As others have noted, the papers are very useful, and I agree with much of the analysis and the conclusions in them. There is agreement that the balance of payments support from bilateral donors is likely to decline in the future, and we need to allow for that. I agree with many of the detailed points made in the statements by other speakers on the consequences of this for policy, particularly on the need for a cautious assessment of the amount of bilateral assistance that might be provided. I will not go over much of that ground now, but there are a few matters in the papers that I would like to touch on.

Apropos a point made by Mr. Autheman, I would like to make a comment on good governance, elusive as that concept might be. I think it was implicit in his comment, and perhaps somewhat more explicit in Ms. Lissakers's comments, that perhaps one can get too intellectual about this. I am reminded of a story about the elephant, that it is always difficult to define what an elephant is, but you certainly know it when you see one. One of the strengths of the Fund, I think, is its demonstrated ability to deal effectively with a wide range of political systems. Nevertheless, good governance in the sense of honest government, a firm commitment to, and an ability to deliver, sound economic policies is important to both the Fund and donors. If there is considerable doubt about the way a country is being managed and the strength of the commitment to improve policies, it necessarily makes participation by the Fund and other multilateral institutions and bilateral donors in assisting the country concerned problematic, particularly when funding is in short supply as it is at the present time.

Moving on to the documentation, particularly for countries seeking an extended arrangement, we could support the idea of a country strategy brief coordinated, as proposed, with the World Bank before the negotiation of such a program with countries meeting the criteria referred to by the staff. Nevertheless, perhaps Mr. Kaeser is correct in saying that if there is such a requirement, it should apply to all extended arrangements. However, as other speakers have already noted, the budgetary and resource implications of the proposal are of interest, and like Mr. Fukuyama, I would appreciate the staff's comments on that. The impression I gain from the paper is that it would not necessarily involve substantial additional resources, but confirmation of that would be of interest.

On conditionality, I agree that there is a need to carefully assess a member's ability to meet the proposed conditions under a program. At the same time, however, one has to recognize that conditions may change in a way that can cause outcomes to deviate from the assumptions used in the formulation of the program. That is why we have argued in the past that there should be adequate flexibility in Fund programs to allow some adjustment to avoid undue disruption in the country concerned that might result from the insistent pursuit of unrealistic performance criteria. That is, we should provide scope for adjustments that do not involve a major policy shift but take account of actual developments. I recognize that that is already done to a degree, but I would encourage more of it. Allowing some flexibility could enhance public acceptance of Fund-supported programs in the countries concerned.

Finally, I agree with others that there is a need to give greater emphasis to improving members' administrative capacity in the areas of disbursement procedures and project implementation. This remains a large problem in many countries, including countries in this constituency. It is often the principal reason for the shortfall in disbursements resulting in costs and missed opportunities for the country concerned, and possibly for other countries that could have otherwise have absorbed and made productive use of these limited resources. This is probably an area where the World Bank needs to take responsibility, but we certainly have an interest in it.

Mr. Mohammed made the following statement:

The papers before us strongly suggest that the recent pressure on aid budgets is, on the whole, likely to continue at least in the near term. Both fiscal consolidation in many donor countries, together with a generally poor public image of aid, underlie this adverse evolution in aid flows. It is not easy to come to a firm view on the likely evolution of these flows beyond the next few years. But it is perhaps safe to say that unless a concerted effort is mounted to achieve improvements in the public image of aid, the pressure on aid budget could well outlast the period of budgetary consolidation in the donor countries.

The staff have identified the key near-term implications for Fund-supported programs of reduced aid flows and changes in donor policies following the end of the Cold War. As I share many of the staff's conclusions, I would like to focus the balance of my remarks on a few selected issues, including those on which Board guidance is sought.

First, the increased emphasis in aid strategies on social programs, particularly in the areas of basic health and education, is welcome. However, particularly where private financing cannot be relied upon for balance of payment support, it is important to avoid an abrupt reorientation of a limited, and shrinking, pool of official assistance away from balance of payments support.

Second, I agree that poorer countries could be shielded from the impact of the expected decline in the global availability of balance of payments support if there is a trend away from support for middle income countries toward support for low-income adjusting countries. Thus, if middle income countries, particularly those with limited capacity to tap private financing sources, are to avoid being rationed out of official bilateral aid flows, they must be prepared to embark on ambitious programs of adjustment and reform.

Third, an environment of reduced and less certain aid flows could be seen as a reason for seeking firmer financing assurances. It should be kept in mind, however, that doing so would increase the risk of delays in the adoption and implementation of adjustment programs. In our view, the emphasis should, therefore, be on incorporating adequate contingency mechanisms in the adjustment programs, keeping in mind the limited implementation capacity of many recipient countries, as pointed out by Mr. Dlamini.

Fourth, if financing assurances are inadequate to the point where a program is judged nonviable regardless of the strength of its policy content, then the Fund's policy on financing assurances would, as it stands, lead to the conclusion that Fund support should be withheld. However, the basis for coming to a view on this matter must be unambiguously clear. Where the political dimension of governance is involved, the basis for making a determination on withholding Fund support must be absolutely clear: It must be firmly grounded in, and solely based on, the Fund's policy of financing assurances in order to avoid the risk of the Fund being seen as a party to the judgements of individual donors on what constitutes good governance.

Finally, a case can be made for extending the use of policy framework papers selectively to non-ESAF programs in cases that meet the three criteria identified by the staff. In any event, we would have a preference for using policy framework papers rather than country strategy papers. The case for using the country strategy paper approach becomes considerably weaker when one considers that the savings realized by virtue of avoiding the need for agreement on a single document could well dissipate at subsequent stages when the program itself is negotiated.

Mr. Shields made the following statement:

I would like first to thank the staff for the interesting papers prepared for this discussion.

I found both papers full of very useful material--both for ourselves and other interested parties. But I agree with Mr. Berrizbeitia's comment on the questions for discussion. I would simply note that there is no need for a summary of points in the paper to be turned into questions if that is not appropriate. However, there is a great deal to discuss in the document, and I hope I can be forgiven for covering a lot of ground this morning.

I have one overall comment on the paper. What struck me most forcibly was that--if anything--the staff may have underestimated the extent to which aid flows are set to fall. This is obviously a difficult issue--but what we have here are essentially assumptions based on the good intentions of donor countries. Although I am encouraged by the optimism of Ms. Srejber's statement, I fear that it is misplaced as far as many donors are concerned. The overall outlook is almost certainly worse than the staff envisages.

One other general point is that the paper talks about aid becoming subject to more delays or shortfalls. It is worth looking at the specifications in the staff papers of three types of donor conditions that recipient authorities might fail to meet to see why this might happen.

The first, economic reform conditions, should generally replicate Fund conditionality, and going off track with a Fund program should trigger a halt in balance of payments support from other donors. I would hope that the Fund would agree that this is a quite valid reason for the withdrawal of donors.

The second, sectoral reform conditions, should be taken into account in Fund programs. The risks involved in the recipients not meeting all sectoral conditionality on time should be taken into account in the financing calculations.

The third, governance conditionality, cannot be built into the Fund's own conditionality, but it must recognize the legitimacy of bilateral donors doing so--particularly in suspending payments because of corruption. The Fund will need to asses, with the authorities, the likelihood of such conditions being met in estimating the availability of finance. It should not seek to offset the withholding of bilateral aid by increased access.

As Mr. Fukuyama points out in the first section of his statement, the adverse direction of the trend for aid flows, and thus the implications for the Fund, is clear. In view of the more uncertain prospects for support the Fund should work with detailed assessments of financing availability before proceeding with programs.

Where such assessments are not possible, however, more conservative medium-term projections are necessary both to address the variability of bilateral support--because of sectoral or governance conditionality not being met--and to allow for the problems of making any sort of meaningful forecast over these periods. We tend to see much too much of detailed figures that extend forecasts far beyond their limits. Broad-based assessments of risks might be much more useful.

A greater emphasis needs to be placed on adequate contingency mechanisms within programs, if programs are to be designed to withstand this unpredictability.

For some countries, for example, poorer countries of the former Soviet Union, the Fund should call for as strong a program as credible rather than withholding support until adequate financing assurances are available to support a more sustainable program. I am less attracted by Mr. Clark's suggestion of delay or Mr. Wijnhold's worries about overdoing the adjustment--although clearly programs need to be feasible.

As the Director of the Policy Development and Review Department said earlier, Fund programs should focus more explicitly than before perhaps on a key component of adjustment efforts, that is, the importance of policies to generate domestic savings and to attract private capital inflows to finance private sector investment. And as many speakers have also suggested, the right path can best be chosen on a case-by-case basis.

I would like to turn now to the issue of policy framework papers. Should we extend policy framework papers beyond ESAF-program countries? It is certainly the U.K. experience that policy framework papers are extremely useful in ensuring that the government has a single, comprehensive, and internally consistent medium-term reform program. In this way, we feel that policy framework papers have been very useful in coordinating donor efforts; indeed, they help to resolve some of the difficulties referred to in the staff paper of overfunding in some areas or of donor funding sometimes running the risk of being inconsistent with the overall reform program.

Would an extension of the policy framework paper process be too costly in terms of Fund resources, in the context of the current period of budget restraint? Here, we would challenge the extent to which an extension of the policy framework paper process--at least to countries with programs supported by the extended Fund facility--would be a costly burden. We in the United Kingdom--and I hope this view is shared by many others around this table--place a good deal of importance in program countries themselves drawing up the policy framework paper; with middle income countries, this ought to be increasingly possible. Presumably country strategy papers provide plenty of raw material for this. Is the staff suggesting that it is the negotiation process itself that is likely to be costly? I would suggest that it is exactly that negotiation/common understanding of the policy framework that is most crucial. I would welcome further comment from the staff.

I would like to say a few words on the Fund's role in aid coordination. I think I differ here somewhat from Mr. Fukuyama. I question the extent to which the Fund actually does--or should--have an overall coordinating role. I would draw my colleagues' attention to the key role the World Bank takes in this regard in organizing donor coordination such as the World Bank's special program of assistance in Africa, and in supporting governments by convening consultative groups as well as assisting with local arrangements for donor coordination. The Fund obviously takes a constructive part but in no way takes the lead in these discussions.

Moreover, I am somewhat skeptical of Mr. Fukuyama's idea that the Fund should act as some kind of mediator between bilateral donors and recipient authorities, although I accept that technical assistance from the Bank to help solve administrative capacity problems is crucial.

I would underline the importance of greater openness in the policy framework paper process. In drawing up the policy framework paper, the recipient country--as well as the Fund and Bank--should ensure that views of other partners--who after all are being asked to support the eventual Fund program financially--are reflected in the priorities that are drawn up.

Finally, several more issues were raised that I would like to comment on less substantively.

I believe that the Fund should be involved in public expenditure reviews only to the extent necessary to ensure that it is sustainable in macroeconomic terms. In this context, I would certainly promote the idea that the Fund has a major role to play in addressing corruption and unproductive expenditures where this impacts on macroeconomic viability. But, in general, public expenditure reviews should remain a job for the World Bank.

On the role of the Fund in post-conflict cases, for us, the key question at the moment would have to be, "In what way are the current arrangements not serving us well?" Some background to the staff's conclusions--which essentially argue for the status quo--might have been useful, including looking at some past examples of Fund involvement in post-conflict cases. I should be interested in the staff's response to Ms. Lissakers's challenge.

This paper contains some important messages for us to take back to our ongoing multilateral debt debate. To what extent will flows to the most heavily indebted poor countries be preserved at current levels? It is clear that good performance will be crucial if severely indebted low-income countries are to expect continued help. As the staff notes, however, with aggregate flows set to decline, this will have a "particularly important impact for those low-income countries with high debt-service burdens." This must be right.

I think that the Fund is probably already doing what it can to help improve the public image of aid and adjustment. Each donor authority should know how best to carry forward this campaign to attract the support of taxpayers. But if the Fund were to have in place a more systematic and open evaluation system to draw conclusions about the effect of economic reform, this would help inform the debate.

The role of the Fund where countries are graduating from balance of payments support is obviously of intense interest. We would certainly support Fund involvement in these cases via precautionary arrangements. That is something with which our own aid agency can work in the context of providing balance of payments support. The key is for the Fund to provide a transparent and credible economic framework.

Finally, I would underline the importance we attach to transparency on the part of the Fund to alert donors to programs that have gone off track, and the reasons for this. Too often, donors are left in the dark about the Fund's assessment of program performance.

Mr. Vernikov made the following statement:

Obviously, the Fund must take into full consideration the recent trends in aid flows on a bilateral level, namely donors' return to emphasis on poverty alleviation, reliance on multilateral institutions for balance of payments support, and increased focus on the policy performance of recipients. These changes are certain to have an impact on the planning of the Fund's support to its members. Another conclusion I drew from the excellent staff papers is that there is room to upgrade coordination between multilateral institutions.

A reduction in the gross amounts of concessional finance transfers will not necessarily lead to a weaker effect on development, because the quality of assistance is expected to increase. As was already noted, in not a few cases in the past, large amounts of unconditional aid are believed to have inhibited adjustment efforts and supported unsustainable policies. Now donors will be looking more closely at good governance in recipient countries. It is also fair that countries able to make an adjustment effort will have to rely more on their own resources. In general, aid recipients must aim their policies at raising domestic savings ratios and encouraging private sector activities and other activities that, as the staff philosophically puts it, "enable people to help themselves in the long run."

Regarding the shifts in geographical allocation of financial aid, I would like to support the point contained in different sections of the staff reports that large-scale balance of payments support to transition economies became possible with augmentations of main donors' aid budgets which otherwise would not have become available, so in this sense the interests of other recipients were not affected. Now concessional flows tend to become more targeted at the most needy countries, and a diversion of balance of payments assistance from middle-income countries in transition appears to be inevitable. However, expected reductions in ODA and official aid should be accompanied by smaller, than hitherto, deviations from program targets that occurred in both the middle-income and poorer countries in transition.

On the issue of better coordination among multilateral institutions, I believe that what the staff suggests about strengthening an informal collaboration with the World Bank is a reasonable, viable, and cost-effective alternative to broadening the use of policy framework papers. This may take the form of discussion of country strategy briefs with the World Bank staff, as well as joint missions, and a broader information exchange. The need for extension of policy framework papers to all extended and stand-by arrangement cases is not obvious, or at least this practice should not become a rule. Whether or not to proceed with a policy framework paper in order to mobilize external support should be decided on a case-by-case basis and with regard to the authorities' wishes.

Before I conclude, allow me to mention one more issue, namely the harmonization of definitions. For example, what exactly are the "poorer countries in transition"? It appears that the list of transition economies eligible for official development assistance, according to the OECD methodology, does not coincide with the World Bank's list of IDA-eligible countries--namely, it includes Kazakhstan, Turkmenistan and Uzbekistan, but excludes the former Yugoslav Republic of Macedonia. Perhaps aid agencies need to discuss this issue at the working level and bring it to their respective Boards, so that we all can arrive at a clearer common identification of recipients on the basis of GNP per capita criterion.

Mr. Daco made the following statement:

The staff has given us an excellent survey of bilateral and multilateral aid flows, together with a picture of how their changing patterns are likely to affect Fund programs. These flows form an important part of the financial resources that the Fund seeks to mobilize via its catalytic role. I will attempt to address briefly at this stage of the discussion the four issues that the staff has proposed for today's discussion.

On the first issue, I agree that the overall decline in aid disbursements, especially for balance of payments support, calls for caution in the design of Fund programs. However, like Ms. Srejber, I think that there are several interrelated reasons why we should not be overpessimistic. Most of the industrial countries are now in a process of fiscal consolidation, which puts every budgetary item under pressure. Once these countries have achieved a better balanced fiscal position, their aid disbursements could again increase provided the public begins to take a better view of official assistance. The number of countries that need bilateral or multilateral aid is decreasing, as shown by the graduation of the high-income developing countries from the list of those eligible to receive official development assistance and these newly graduated countries are themselves becoming donors of official development assistance. The aid now being disbursed has become more narrowly focused and is increasingly being channeled through multilateral organizations. This kind of refocusing does little harm to countries willing to implement sound macroeconomic policies. In the developing countries, the shrinking of aid flows has forced them to think about how to do more with less, leading to healthy efficiency gains in the management and utilization of aid flows.

In conclusion, having all these considerations in mind, I would answer "yes" to all the staff's questions on this first issue. However, our assessment of the implications of recent trends should be realistic and of particular concern, as Mr. Autheman said in regard to the availability of multilateral financing.

On the second issue, we also agree with the staff's observation that the sectoral distribution of aid flows is biased toward social infrastructure and services, notably health and education, and against economic infrastructure, a bias stemming partly from creditor government's decisions no longer to fund major infrastructure projects. This is a worrisome trend to which the World Bank and the Development Committee should be sensitive.

I also noted that a growing share of aid budgets is being absorbed by peacekeeping operations and other emergency situations, which raises the question of how the Fund should become involved in post-conflict cases. My first reaction is that I find the term post-conflict somewhat too limiting; I would prefer a term such as that used by Ms. Lissakers, who refers to post-chaos countries. However, I do not think it advisable to try to devise general rules for dealing with these cases. I prefer the present case-by-case approach. In addition, although I recognize the merits of early Fund involvement in such cases, certain preconditions still have to be met. I am thinking especially of the requirement for the Fund to have a respondent, and the need for the Fund to maintain its catalytic financing role. Therefore, in most post-chaos cases, it seems preferable to restart a normal relationship with the Fund by providing technical assistance.

On the third issue, the proposal to require the preparation of a policy framework paper for countries other than ESAF-eligible countries would indeed be a useful step in cases where the program has a high structural content and where the program requires close collaboration between the Fund and the Bank staff. I would agree to extend it on a case-by-case basis for programs supported by the extended Fund facility, and I was particularly heartened by Mr. Shields's comments in this respect.

The background paper also explores a fourth issue, the implications of shortfalls in external financing. Besides policy slippages, the major causes of these shortfalls seem to be administrative inability to process import support documentation and monitor external financing. I therefore support the staff's proposal for minimizing the frequency of these shortfalls by having programs include a review by the World Bank of the authorities' ability to mobilize import and budget support funds.

Mr. Lanciotti made the following statement:

I welcome today's important discussion on the policies of aid agencies and their relations with Fund programs. I think that the papers before us effectively highlight a number of issues that exert considerable influence on the actions of our institution.

Let me start from the pressure on aid budgets in donor countries, which is likely to depress aggregate balance of payments support to developing countries. The actual magnitude of the decline is difficult to predict, but its determination is not crucial at this stage of our consideration. Regardless of whether it will remain a limited phenomenon or will affect more substantially the pool of external assistance resources available to recipient countries, we must note that the shrinkage of resources is under way and that it is coupled with a switch from balance of payments support to other forms of financial assistance. As a consequence, the Bretton Woods institutions should prepare to design more selective policies with regard to lending. In particular, strong macroeconomic conditionality, stringent monitoring of program implementation, and the efficient use of resources have always been--and should increasingly become--the most distinctive features of Fund action.

In my opinion, the hard-fought debate on the outlook for the debt owed by developing countries to multilateral agencies points precisely in the same direction: regardless of the answer to the question concerning the sustainability of multilateral debt, and my opinion is that a systemic problem is unlikely to arise, the existence of the dilemma demonstrates that the time is ripe for a more qualified use of multilateral resources. A widespread problem should not arise and the multilateral agencies must act carefully to avoid creating a potential debt overhang; were a problem to emerge, this would only demonstrate that multilateral lending must become more performance driven than in the past in order to fulfill its primary role of assuring economic stability, promoting economic growth, and catalyzing adequate flows of official and private capital.

The Fund is learning from its experience that the cost effectiveness of its financing is to be further increased by taking into specific account some persisting structural rigidities in the low-income countries that have delayed the emergence of an improved outlook and are now thwarting the continuation of the development process. In particular, I strongly endorse the staff's recommendation that programs should be more ambitious in terms of promoting domestic savings and private sector development. The sluggish process of building up an efficient private economy has been, so far, the Achilles' heel of the adjustment effort in Africa, as clearly shown by two recent Bank and Fund studies. It is indispensable that external resources be used to increase productive capacity rather than to finance consumption. This would help the prospects for economic growth of the low-income African countries--now improving--gain further momentum and would avert the risk of setbacks. Likewise, the inability of the transition economies in Europe and Central Asia to attract significant private capital inflows to finance investment is symptomatic of a similar need for a strengthened macroeconomic and structural adjustment framework.

In my view, all policy trends outlined in the staff's papers strongly reinforce the basic concept that the Fund should concentrate on countries with a stronger and more reliable commitment to sound macroeconomic and structural policies.

I think that the fact that bilateral donors are leaving the field of balance of payment support and, instead, heavily focusing on budgetary support is also explained by the perceived need for procedures allowing a more conditional and efficient use of resources. Of course, this might cause a risk to arise, as noted by the staff, that some adjustment programs may turn out to be unbalanced. However, it is important to acknowledge that the ultimate meaning of such a shift in resources, that is, what that shift implies, is a definitely more acute need for efficient allocation. The poor public image of aid in most donor countries gives further evidence of this interpretation.

The increased aid claimants, with a substantial number of newcomers from the transition process, is obviously pushing in the same direction of a more qualified use of multilateral and bilateral resources. In particular, the combined effect of fewer resources from the creditors' side and the increased number of recipients' claims is likely to cause international assistance to concentrate on low-income, best-performing countries. Medium-income countries may have to rely increasingly on their access to the private capital market, building upon a credibility capital generated by sound policies.

Let me add that the Fund will have a special responsibility in this adaptation process of aid policies, which is beginning to emerge. The staff papers clearly recognize that bilateral donors' decisions on aid to individual recipients are often influenced--I would add that they cannot but be influenced--by factors other than the recipient country's economic policy performance. These factors may span from historical ties to special commercial and political links. This may cause recipient countries to be in a position to "shop" among the various multilateral and bilateral agencies, in order to obtain funds on the basis of different policy requirements and conditionality frameworks. This may, eventually, dilute and postpone needed adjustment. In my view, this phenomenon suggests that a very rigorous attitude by the Fund in the design of its programs is required. In fact, Fund commitment is still a major prerequisite for other contributors to become involved to a large extent in a recipient country. By not accommodating the natural tendency of borrowers to seek lenders that offer the least resistance, the Fund will improve adjustment programs' quality and enhance its catalytic role.

Moving to debt relief and its effects on the availability of new money, I think that the new terms agreed in Naples last summer provide an effective tool to deal with the external debt of the poorest and most indebted countries. Greater reduction of the net present value of debt, wider debt coverage in rescheduling agreements--including debt previously rescheduled on concessional terms--and stock-of-debt operations represent a powerful new set of instruments. Naturally, debt relief is likely to imply that donors may refrain from new flows for the immediate future. Again, for debt-relief operations on more concessional terms to be conducive to adequate new high concessional financing flows, it is indispensable that the countries concerned keep pursuing strong adjustment and reform policies, thus demonstrating the helpfulness of debt reduction.

This being said, I would like to draw specific conclusions pertaining to some questions made by the staff.

The uncertainties that are inherent in the pledging process of financial assurances make a strong case for the Fund to be more conservative in the medium-term balance of payments projections embedded in its programs. Programs should not be built on the assumption of the best-case scenario of creditors' and donors' potential assistance and should factor effective contingency provisions to take account of external assistance shortfalls.

In case the uncertain political status of governance in the recipient country is prohibiting donors from making explicit pledges, or the financial assurances are all the same unsatisfactory for whatever reason, the Fund should withhold its assistance until the situation is such as to allow international support--other than emergency aid--be actually effective in promoting stabilization and growth. This would turn out to be a powerful incentive to pursue growth-oriented policies. Of course, each individual situation will need to be assessed on a case-by-case basis; however, as a general rule, the fact that programs that do not appear to be sustainable beyond the short term could encourage the "shopping-around" strategy should be kept well in mind.

Finally, I do not think that it is appropriate for the Fund to match World Bank's procedures by creating a country strategy brief to be coordinated with the Bank's country assistance strategy. The World Bank's country assistance strategy is a three-year operational plan, which is fully consistent with a mandate of promoting development and growth. It seems to me that, for the Fund, such a program would be hardly conceivable, since this institution's action is driven by a shorter term, professedly discontinuous, macroeconomic adjustment perspective. Alternatively, a wider use of the policy framework paper, with selected middle-income countries as sketched in the staff papers, is to be encouraged, since the policy framework paper implies a needed macroeconomic and structural adjustment program without the idea of an operational program on a permanent basis.

Mr. Daïri made the following statement:

I join other Directors in commending the staff for a useful set of papers and interesting issues for discussion.

I share the concerns regarding the decline in aid flows expressed by Mr. Zhang and Mr. Berrizbeitia. I also agree with Mr. Dlamini that the bad image of aid comes from its political motivations during the cold war era. Much needs to be done both in donor and recipient countries to improve this image. We may see in the increasing role of nongovernmental organizations both a more efficient means of mobilizing public support to aid, and the possibility of extending the source of financing beyond official aid budgets.

However, official aid decline should not be linked to economic cycles, and, like Mr. Shields, I do not share Ms. Srejber's optimism regarding the scope for improvement in aid budgets with the improved economic position of donor countries. With some outstanding exceptions, the priority given to aid in donor countries has been reduced since the Cold War. However, a more challenging war needs to be fought against poverty and toward the improvement of living standards and economic prospects for developing countries. This could also be seen as a political motivation toward achieving peace and security worldwide.

It may also be useful to reflect on the ongoing trend to multilateralization of aid. This may be considered as a welcome development that increases the scope for better coordination and untying of aid. However, the increased multilateralization requires strengthening the resources of the multilateral financial institutions.

The growing focus of aid on social sectors, such as basic education and health, is a welcome development. We should not see in this development a crowding out of other priority sectors such as infrastructure. Instead, we should draw conclusions from this trend and reassess aid needs not only on the basis of GDP per capita, but also on the basis of social indicators, particularly in health and education.

On the implication for Fund-supported programs of the declining aid flows, the availability of financing should not be the most important criteria for assessing the needed strength of a program. Due consideration should also be given to social and political considerations, including the need to build domestic support for reform. In some cases, a more appropriate phasing of adjustment and reform may be needed. In any case, although I agree with the catalytic role of the Fund, I do not support a complete Fund withdrawal from countries for which adequate donor support is not secured.

Regarding the policy framework paper process, I do not see the need to extend it to middle-income countries. First, one of the criteria for justification of the policy framework papers is that it helps to better catalyze resources from donors. However, such support is not likely to be substantial in the case of middle-income countries, in view of the growing priority given to low-income countries. Second, as stated by other Directors, this process is costly and I would rather support a less formal approach, such as the country strategy briefs.

Regarding financing shortfalls, I share the view that the authorities' readiness and ability to fulfill conditionality needs to be assessed in order to secure continuity in donors' support, but I also feel that the Fund should review donor countries' procedures in order to avoid undue delays in the disbursement of committed aid.

Mr. Ramdas made the following statement:

We agree with the staff that greater coordination among governments, donors, and the Fund will be required. We also agree on the need for consistency between Fund-supported programs and governments' overall expenditure priorities. In a medium term, broad agreements are needed on the mechanics for the pace and sequencing of structural measures.

A potential source of difficulty in coordination lies in the intended role of a policy framework paper. Although we recognize its role in aid coordination, we should also see it as part of a country's development program. Greater efforts may have to be made to ensure consistency between the policy framework paper and longer- term development plans. "Ownership" of the policy framework paper is a key requirement.

To implement a broader sectoral approach the information needed to design a program may not be readily available. Technical assistance in data systems, as well as the development of the country's human and technical resource capabilities in project management, would be needed. In this context, benchmarks for both economic and social variables should be developed, with appropriate contingency measures for dealing with future uncertainties.

Although the policy framework paper instrument must be viewed positively for ESAF countries, in the context of other programs, such as extended and stand-by arrangement, we see no justification for policy framework papers.

We welcome the trend among donors to favor budgetary, instead of import, support. Furthermore, we urge donors not to rely on multilaterals for support of country programs.

We support conservative projections in external financing.

Finally, we appreciate the efforts of the staff in preparing the paper. We would be happier if the issues for discussion section in the supplement were also coordinated with or referenced to the background paper, preferably by paragraph numbering.

The Director of the Policy Development and Review Department remarked that the uncertainties surrounding the availability of multilateral concessional aid were a matter of concern in the near term. Since the writing of the paper, the staff had received no further information about developments regarding the financing of the African Development Fund, the renewal of the Lomé agreements, or the 10th and 11th replenishment of IDA resources.

With respect to providing publicity of Fund-supported adjustment programs, the staff had published the review of experience under the ESAF as an occasional paper, the Director continued. The World Economic Outlook also contained sections on the performance of countries with adjustment programs, and there had been specific articles in various publications derived from both the review of ESAF arrangements and the World Economic Outlook. Some occasional papers on specific country experiences had also been published. However, in view of the depth of skepticism about the efficacy of concessional assistance, both the Fund and bilateral aid agencies needed to make a greater effort to convince the public in donor countries that properly directed aid produced beneficial results.

The increasing focus of assistance on poorer countries with adjustment programs and on education and health was indeed welcome, the Director noted. At the same time, a large share of donor aid budgets was targeted to emergency situations, such as peacekeeping. For example, in the past year, about 40 percent of all development assistance that had gone through the UN had been in that category.

Early on in the discussion of post-conflict countries, an attempt had been made to distinguish between post-conflict and post-chaos countries, the Director recalled. "Post-conflict" had referred to those countries where the government structures and institutions were more or less intact in the aftermath of the conflict, whereas "post-chaos" had referred to those countries where institutions for economic policymaking and other basic government institutions had been destroyed. However, that distinction had not been maintained, as the situations in countries had varied considerably, and the staff had often used the two terms interchangeably.

The cases that could be described as "post-conflict" had faced diverse circumstances, and included countries such as Albania, Cambodia, El Salvador, the former Yugoslav Republic of Macedonia, Nicaragua, and Mozambique, the Director continued. In some cases, as in Cambodia, there had been no Government; in the former Yugoslav Republic of Macedonia, the country had had to become a member of the Fund before the Fund could provide financial assistance; and both Cambodia and the former Yugoslav Republic of Macedonia had had arrears to multilateral institutions that had needed to be cleared. In all the cases, the Fund had provided technical assistance and policy advice early on and up to the period when the Fund could become financially involved. Most recently, the Fund had had to deal with Haiti and Rwanda, and might have to address the problems in Liberia in the near future, if the situation improved. In all those cases, it was important for the Fund to be involved as early as possible. Haiti was a good example of how coordination under a lead organization could facilitate participation by others, including the Fund. There had been a good deal of cooperation among all the parties involved, which had allowed the Fund to proceed to construct initially an enabling macroeconomic framework. One of the problems in El Salvador in 1992 had been that the peace agreement had been negotiated without effective coordination with other parties. As a result, economic commitments had been made that were not feasible, which had created problems for the country's budget and for its relations with the Fund. There was a need for the earliest possible involvement and the sharing of information by all parties involved, whether they were aid agencies providing humanitarian relief, or the Fund, or the Bank, or other organizations. Experience suggested that assistance to countries emerging from conflict worked best when there was a leader to coordinate assistance, whether the leader was a major bilateral neighbor or a multilateral institution.

In Cambodia and in the former Yugoslav Republic of Macedonia, the Fund had been able to support a program under the STF fairly quickly; in El Salvador, the stand-by arrangement had been in place prior to the signing of the peace agreement; and in Albania, the Fund had supported a program under a stand-by arrangement, the Director recalled. The Albanian case showed the benefits of establishing a program under a stand-by arrangement as early as possible, with strong conditions attached. However, in cases such as Rwanda, the Fund would have to be careful with respect to the terms and form of financing that would be required. In Haiti, the Fund had succeeded in putting in place a stand-by arrangement with a very low level of access, but in some cases even concessional resources would not be appropriate in the early stages. In such cases, grant assistance from donors would be more appropriate.

In all the cases of countries emerging from conflict, the problems and circumstances had been diverse, and the Fund had come forward at a relatively early stage to participate by adapting its facilities to individual circumstances, the Director noted. In two of the cases, the program had been supported by the STF. However, the Fund did not have a facility tailored to the needs of nontransitional countries emerging from conflict.

The staff representative from the Policy Development and Review Department noted that, at present, eight member countries had programs supported by extended arrangements, and the Fund staff had prepared country strategy briefs for a number of them. For all eight countries, the Bank had prepared country assistance strategy papers. The costs involved in preparing a policy framework paper were considerably higher than in preparing country strategy papers, which were internal documents. It was not possible to estimate the cost in individual cases because that depended on the amount of work involved, which varied for different extended arrangements. Generally, for most programs, the structural and macroeconomic aspects of the programs required considerable work. In addition, the country strategy papers dealt with the technical assistance requirements of the program.

The Fund had adopted a wider definition of the poorer countries in transition than that of the Development Assistance Committee of the OECD, the staff representative noted. The most important operative distinction of definitions applied by international organizations was between those classified as IDA-eligible by the Bank and those classified as eligible for official development assistance under the OECD's definition. Both the World Bank and the OECD used the World Bank's calculation of per capita GDP to define poverty.

Although public enterprise reviews fell primarily within the World Bank's mandate and area of expertise, the Fund staff often gave policy advice on specific public expenditures, such as wages, and occasionally on health and education expenditures, the staff representative commented. The Fund staff had reviewed recently its experience in that area with the Bank, and had increased its collaboration with the Bank staff so as to make better use of the Bank's expertise in providing advice to member countries.

Another staff representative from the Policy Development and Review Department observed that regional development banks were already involved in an informal way in the preparation of the policy framework papers, especially in cases where these banks were active in the design of the structural components of programs. In the cases of Vietnam, Cambodia, and Mongolia, for example, the staff of the Asian Development Bank had participated in the policy framework discussions on specific sectors. Similarly, in the cases of Nicaragua and Guyana, the staff of the Inter-American Development Bank had also been involved in the policy framework process.

The Director of the Policy Development and Review Department observed that policy framework papers were distributed at Consultative Group meetings, round tables, and other similar meetings. They were also available from the World Bank or the Fund if the countries so wished.

Mr. Daïri wondered whether it would be possible for the Fund to elicit stronger assurances from donors on financing. As the Fund's role was to give confidence both to the donor community and to the country concerned, there should be some provision for the Fund to step in with its own resources--for instance, by increasing access--to offset the financing gap in those cases where there were shortfalls in financing, particularly when disbursements had not come through despite prior commitments.

The Chairman remarked that that would only encourage donors not to do what was required, namely, to provide development assistance. Under the Articles of Agreement, the Fund was required to give confidence to borrowers and lenders; but the Fund's responsibilities did not extend to providing its own resources when donor financing fell short.

Mr. Geethakrishnan, wondered whether the Fund could increase its share of financing, while still maintaining its catalytic role. Rather than the Fund stepping in only to fill the financing gap, countries' access to Fund resources could be increased from the very beginning.

The Director of the Policy Development and Review Department noted that the inability of members to satisfy complex conditionality associated with donors' sectoral and budgetary support often hindered disbursements. The Fund tried to give confidence in various ways by building contingencies into programs. In particular, if reserves were reasonably sufficient for a country's needs, the reserves target was adjusted, thereby allowing the country to remain on track with the program, without disruption in either the Fund's or donors' disbursements.

The Chairman made the following summing up:

Directors welcomed the opportunity to discuss the implications for Fund-supported programs of the recent and prospective trends and policies regarding concessional flows from bilateral and multilateral agencies, with particular emphasis on balance of payments support. Noting that the recent pressure on aid budgets was--with the exception of a few donors--likely to continue at least for some time, Directors expressed concern about the implications for balance of payments support for the poorest countries, and also for the poorer among the countries in transition. In view of the importance of adequate balance of payments support for the successful implementation of adjustment programs, Directors urged creditors and donors to concentrate scarce aid resources on the poorer countries pursuing strong adjustment programs, including those that were supported by the enhanced structural adjustment facility. Concern was also expressed that sufficient balance of payments support should remain available through the concessional windows of development banks.

With uncertain prospects for balance of payments support, Directors saw a need for a more cautious and transparent approach to medium-term projections for such assistance. A number of Directors stressed that programs needed to be more ambitious than in the past in terms of promoting domestic savings, while some others doubted whether that was a realistic option other than over the long term. Speakers also stressed the importance of pursuing policies that aimed at attracting private capital flows, in particular foreign direct investment.

Directors observed that increasing earmarking by many donors of budgetary support for specific social programs could reduce the flexibility of budget management. Concern was also voiced about complex sectoral conditionality in the context of recipients' limited administrative capacity. Directors stressed that the Fund should assist in efforts to coordinate donor assistance to safeguard the efficiency and sustainability of programs, and to ensure that donor support took into account the recipient country's financial and administrative capacities. The enhanced collaboration between the Bank and the Fund staffs on public expenditure issues and the strengthening of administrative capacity in recipient countries was welcomed by Directors.

Directors noted that an increasing share of aid budgets was devoted to peacekeeping operations and emergency situations. The Fund should play a critical role at an early stage in post-conflict cases to help establish a sound macroeconomic framework. Fund support early on should take the form of technical assistance and policy advice. Fund financial assistance on a limited scale could be extended in cases where the political situation had stabilized sufficiently and where Fund financing could play an effective catalytic role for balance of payments financing from other creditors and donors.

Directors noted that donor concerns regarding good governance--that is, primarily, avoidance of corruption--and respect for human rights were likely to create further uncertainty about external financing. Differing views were expressed about the role of the Fund where inadequate financing assurances from donors arose from concerns about the political dimension of good governance in the recipient country. That was a difficult and sensitive area; we would have to examine the situation carefully, case by case, to assure a proper and constructive role for the Fund. Directors generally endorsed the view that the Fund must continue to address economic aspects of governance, especially through advice on measures to promote transparency and accountability.

Large shortfalls in external financing in some Fund-supported programs in recent years were of concern to Directors. They agreed that programs should place more emphasis, in collaboration with the World Bank, on improving members' administrative capacity. Also, Directors urged continued use of contingency mechanisms in the event that external financing fell short of expectations. Some speakers noted that the implications for the adequacy of the Fund's resources and for access policy would need to be considered in light of recent trends in aid flows. A few others emphasized the importance of strengthening members' adjustment policies. A number of Directors observed that the prospects for concessional aid flows increased the importance of addressing the multilateral debt burdens of low-income countries, including by making the ESAF a self-sustained facility.

Directors supported the role being played by policy framework papers in mobilizing external assistance and ensuring a consistent policy framework in low-income countries. As to the possible use of policy framework papers in non-ESAF cases, some Directors considered that those papers would be appropriate in the context of at least some extended arrangements. Other Directors supported the alternative of preparation by the Fund staff of internal country strategy papers, in coordination with the Bank's country assistance strategy papers, before negotiation of extended arrangements. A number of speakers urged caution on both those alternatives in view of the resource costs in preparing such documents. The staff will proceed cautiously in considering in individual cases whether the benefits of either of the options discussed would outweigh the costs involved. Several Directors advocated publishing more widely the policy framework papers, and I concur with them.

May I take it that Directors agree to the transmission of this summing up to the Development Committee? When we meet as the Committee of the Whole, we will consider whether something more must be done in this respect.

Mr. Al-Tuwaijri remarked that, with respect to the reference to governance and corruption in the summing up, his chair and other chairs had noted that the Fund should be cautious and not get involved in sensitive political issues.

The Chairman said that in the summing up he had noted that governance was a difficult and sensitive issue and the Fund would have to examine the issue on a case-by-case basis to assure a proper and constructive role for the Fund. He had also noted that Directors had endorsed the view that the Fund should continue to address economic aspects of governance by providing advice on measures to promote transparency and accountability. When faced with issues of governance, the Fund would need to be prudent in its dialogue with the authorities, while conveying the points that needed to be made. He would discus the issues raised by Directors on good governance with the President of the World Bank and would also bring them to the attention of the Committee of the Whole of the Development Committee.

The Executive Board took the following decision:

The Executive Board approves the transmittal to the European Commission and to the OECD Development Assistance Committee of the staff paper and its supplement on bilateral and multilateral aid flows and Fund-supported programs (SM/95/73; and Sup. 1) together with the background paper (SM/95/96).

Adopted May 19, 1995

After adjourning at 1:00 p.m., the meeting reconvened at 2:30 p.m.

3. COTE D'IVOIRE - ENHANCED STRUCTURAL ADJUSTMENT FACILITY - SECOND ANNUAL ARRANGEMENT

The Executive Directors considered a staff paper on Côte d'Ivoire's request for the second annual arrangement under the enhanced structural adjustment facility (EBS/95/72, 4/26/95; Cor. 1, 5/18/95). They also had before them a policy framework paper for the period 1995-97 (EBD/95/58, 4/24/95).

The staff representative from the African Department made the following statement:

Subsequent to the issuance of EBS/95/72, the Ivoirien authorities have provided preliminary data on the fiscal outturn for the first quarter of 1995. According to these data, the Government's primary surplus for the first quarter was substantially higher than programmed, reflecting a better revenue performance, lower current expenditure, and a slow execution of the investment budget. Central bank advances have been reduced below the statutory ceiling. However, owing to a postponement of disbursements of exceptional financial assistance, there were further external payment delays to bilateral creditors during the first quarter. With the release of program assistance from France and the World Bank, Côte d'Ivoire is expected to be current in its external debt service obligations by end-May 1995.

On May 1, 1995, the authorities announced salary increases for civil servants with effect on June 1, 1995 ranging from 15 percent to 3 percent, with the latter applicable to those at the top of the salary scale. According to the authorities, these wage adjustments represent an average increase in the base wage of 5.5 percent, involving an increase in the wage bill of less than 3 percent in 1995, after taking into account the programmed reduction in the number of public employees, as agreed under the program. The authorities do not intend to increase the minimum wage, and will let the private sector decide on possible wage adjustments in light of the situation of each enterprise or sector.

The authorities have recently finalized a detailed plan of privatization for 1995, which specifies the enterprises to be privatized or brought to the point of sale and the timetable for the different steps in the privatization process, including the dates for completion of feasibility studies, the adoption of a sale strategy by the Privatization Committee and by the Council of Ministers, the offer for sale, and the expected effective completion of sale. An Interministerial Committee has approved the strategy for the privatization of CI-TELCOM, the state-owned telecommunication company, and PALM-INDUSTRIE, a large agro-industrial complex. The Council of Ministers is expected to approve before end-May a parapublic sector policy statement, with a view to reinforcing the control and monitoring of public enterprise performance.

Although there was a marked deceleration of the increase in the consumer price index during the second half of 1994, the consumer price index rose unexpectedly by 9.6 percent during the first four months of 1995. Partial information indicates that this was due to shortages in food supply for domestic markets, on account of poor weather conditions and substantial increases in food crop exports to neighboring countries; the sharp increases in producer prices for the major export crops at end-1994 was also a factor. The staff will carefully monitor price developments in the coming months to assess their possible implications for the program.

Mr. Koissy made the following statement:

At the time of the midterm review, it was apparent that the Ivoirien economy was showing encouraging results in response to the January 1994 devaluation and the implementation of accompanying measures. The latest available economic and financial data confirm this positive trend and indicate that the objectives set for 1994 for real GDP growth, prices, and the external accounts have been met, and in some cases exceeded. Significant progress was also made in the area of public finances and structural reforms, especially in reducing the role of the public sector in the economy and in liberalizing the regulatory framework. However, although the reduction of domestic debt arrears exceeded the programmed amounts, there were some occasional delays in the settling of external arrears. With the release of program assistance from France and the World Bank, this situation is in the process of being corrected, and my authorities have indicated that all remaining external arrears to official creditors will be eliminated in the next few days. Overall, my Ivoirien authorities are very much encouraged by the 1994 achievements, owing in large part to their determined efforts to implement steadfastly the adjustment measures.

This progress provides the authorities with a new impetus to intensify their adjustment efforts, under the second annual ESAF arrangement for which they are requesting Fund support. The medium-term objectives and policy measures as well as the 1995 program are well described in the policy framework paper and the authorities' memorandum. The authorities agree with the staff that in 1995 emphasis should be placed on further improving the situation of public finances and on strengthening structural reform measures so as to consolidate the gains in competitiveness and to ensure that the economy is on the path of higher and sustainable growth.

The Ivoirien authorities have already started to implement a package of measures that should help the country to achieve a real growth rate of 6.4 percent in 1995, a reduction in inflation to about 5 percent on a year-end basis, and a limitation of the current account deficit to 2.3 percent of GDP. Higher activity in almost all sectors of the economy, a sharp recovery in investment, and the coming on stream of new petroleum and gas fields should contribute to the higher growth rate, while tight monetary and fiscal policies will help to reduce inflationary pressures.

My authorities are well aware that, in order to preserve the gains in competitiveness, strong fiscal discipline will have to be maintained in 1995 and that the favorable growth prospects provide an opportunity to improve the fiscal performance further and reduce domestic arrears substantially. In this regard, the revenue measures described in the policy framework paper and which are now being implemented by the Government are aimed at reducing economic distortions and stimulating the development of the private sector, while maintaining an appropriate overall tax burden. Additional measures to broaden the tax base and improve the efficiency of the tax system will be developed and introduced in the 1996 budget after the Fund technical assistance mission to the country.

On the expenditure side, the current noninterest outlays are expected to be reduced by 1 percentage point of GDP, through the containment of the wage and salary bill and other current expenditure. However, outlays on health, education, and other social services, as well as on expenditure for maintenance and investment which had been compressed in previous years will be increased in 1995. Overall, it is expected that the measures being implemented will help generate a basic primary surplus of 4.1 percent of GDP, and enable the Government's overall domestic operations--excluding investment outlays financed by project aid--to register a surplus of 1.1 percent of GDP which will contribute to reducing further the external arrears.

High priority is being given to public investment, considered a key element of the medium-term policy. In this regard, the authorities have held intensive discussions with the staffs of the World Bank and the Fund to ensure that the implementation of the investment program and its financing remain in line with the parameters of the adjustment program. It has thus been decided that capital spending could be increased by 19 percent in 1995, benefiting the development of human resources and the rehabilitation and extension of the economic infrastructure. However, this increase is far below what is actually required, and the authorities envisage a further increase in capital expenditure, if additional resources become available.

As regards the investment project of public enterprises with majority government ownership, financing requirements will be provided mainly from these enterprises' own funds and from public or private external financing which will not be guaranteed by the Government, except in clearly identified exceptional cases. Moreover, the Government has strengthened the mechanism for managing and monitoring the public enterprises that remain in its portfolio.

Monetary and credit policy will be implemented in accordance with the requirements of the fixed parity between the CFA franc and the French franc and with the goal of strengthening the net external assets position of the monetary union. The implementation of monetary policy will be based on the use of indirect instruments as far as possible and in harmony with the other partners in the West African Economic and Monetary Union (WAEMU).

The structural reform measures being introduced in 1995 will continue to aim at developing a strong and dynamic private sector so as to reduce the government involvement in production activities. In this regard, the authorities will intensify the measures already taken to deregulate and improve the legal environment for private sector activity and accelerate the privatization program. With the adoption of new laws regarding privatization in the second half of 1994, the privatization process has been considerably accelerated, with fifteen additional public enterprises programmed for divestiture in 1995. The privatization will be effected through the Abidjan Stock Exchange to enable a wider participation rate.

As regards pricing policy, the Price Equalization Fund is being dissolved, and rice imports are being gradually liberalized. Similarly, maritime transportation will be liberalized in 1995, and the appropriate price structure will be put in place so that the prices of electricity and petroleum products will be adjusted automatically to reflect changes in international prices. These domestic structural reforms will be accompanied by regional reforms in the framework of the WAEMU on tariff policies, business laws, and indirect taxation with a view to expanding intraregional trade and investment.

In the external sector, continued terms of trade improvement and a higher volume of exports are expected to contribute to a trade surplus in 1995. However, owing to increased private transfers abroad, the current account is projected to register a small deficit. As regards official external debt, the concessional rescheduling granted by the Paris Club creditors and the debt cancellation by several creditors have enabled Côte d'Ivoire to reduce substantially the burden of its debt relative to exports. However, discussions with commercial banks are continuing, and the authorities are hopeful that the situation with these banks will be regularized soon.

In conclusion, I would like to reiterate the strong commitment of my Ivoirien authorities to the adjustment process and their determination to implement firmly the measures described in their memorandum. They are aware of the important challenges ahead of them and consider Fund support crucial to their efforts to overcome those challenges and lay the foundation for the resumption of sustainable growth.

Extending his remarks, Mr. Koissy said that the salary increase of 3-15 percent, which had been granted on May 1, 1995, represented an average salary increase of about 5.5 percent. While that might appear large, it amounted to an increase in the 1995 wage bill of less than 3 percent. The staff was advised about the salary matter during consultations, and provision was made for the increased expenditures in the budget.

The increase in prices had been due mainly to higher food prices, owing to adverse weather conditions and higher levels of food exports to neighboring countries, Mr. Koissy explained. That situation was expected to reverse itself during the year with increased food production. The authorities would take appropriate action, if needed.

Mr. Clark made the following statement:

> The authorities in Côte d'Ivoire must be commended for the obvious effort that they have made in recent years in restructuring their economy to achieve and sustain improvements in growth and development. The gains last year in output growth, public sector saving, and external competitiveness through depreciation in the real exchange rate are impressive evidence of their efforts. The staff's projections for the current year indicate that the real economic gains should continue to mount with continued effort to establish effective private markets as the basis of their developmental strategy.
>
> The fact that the authorities have continued to implement program initiatives over the six months since the last review according to the planned schedule is positive testimony to their determination to achieve the program objectives. Among the most notable of these initiatives are those aimed at reforming public finances and public sector operations. Consolidation of the tax structure and improvements in tax administration, coupled with public sector wage restraint, employment reductions, and the elimination of agricultural subsidies, contributed to an impressive improvement in the primary fiscal balance. As a result, the overall deficit of 7.8 percent of GDP was well below program target. Nevertheless, the public debt overhang, and the associated debt-servicing costs, require continued spending restraint and deficit reduction, as outlined in the 1995 ESAF program, to support the debt-rescheduling program of the Paris Club and the commercial debt negotiations with the London Club.
>
> I should add that the plan to establish an effective treasury management system and a unified budget process this year is particularly encouraging in light of the plan to eliminate domestic payment arrears by 1996. The fact that a cash shortfall toward the end of last year required the Government to violate its target on new credit to meet its target on arrears payments, is disturbing. Some of these borrowings are either themselves now in arrears or violate the statutory ceiling on central bank credit.

Apparently, the cash shortfall was, to some extent, the result of ineffective cash management procedures by the Government.

Also indicative of the authorities' determination was the reformation last year of the privatization administration, which has put the privatization program back on track despite a slow start. Similar efforts should be made to invigorate the reform process for remaining parapublic enterprises, which continue to be a serious drag on public sector finances. The authorities have outlined a number of initiatives that they plan to introduce this year to improve the commercial viability of these enterprises and the Government's oversight of their operations. Perhaps the staff would inform us of the status of these initiatives.

As regards monetary policy, financial reform, and external viability, looking through the 50 percent devaluation of the CFA franc against the French franc that contributed to the 32 percent rise in consumer prices last year, the underlying inflation rate in Côte d'Ivoire has increased from 1.6 percent in 1991 to an underlying rate estimated at about 3 percent. The pickup in underlying inflation is due to an acceleration in economic activity in recent years, which has narrowed the output gap that had opened during the recession in the late 1980s and early 1990s. The 8 percent inflation rate projected for 1995 is largely related to residual pass-through effects from the exchange rate devaluation last year.

However, the monetary authorities should be concerned with the inflation drift. Money supply growth in 1994, at 47 percent, was substantially above target. Furthermore, the projected 19 percent growth rate for this year may still be too high in light of the excess liquidity overhang in the banking system and the sharply accelerating pace of real economic activity. Excessive monetary growth could aggravate the anticipated reduction in net capital inflows on the external account at a time when the current account position is also expected to deteriorate because of debt-associated transfers. The Banque Centrale des États de l'Afrique (BCEAO) should, therefore, intensify its efforts to squeeze the excess liquidity from the financial system and to slow the growth in the money supply.

The BCEAO has taken substantial strides in developing the basic tools for managing money supply indirectly in a market-based system. It has promoted the liberalization of market interest rates, although still more effort could be expended on this front. Further, it has established auctions and reverse auction for central bank credit--a tool that is unfortunately blunted by the buildup of substantial excess reserves. In addition, it has securitized central bank loans to the Government and sold them into the market, although overpricing and negative real coupon rates reduced their attractiveness and limited their ability to squeeze excess liquidity from the system. Moreover, it plans to develop auctions for government treasury bills in an effort to improve liquidity management. Even though the basic tools for monetary management are now in place, thin markets still occasionally hamper their effective use. Efforts to develop these markets further would yield a substantial payoff for monetary control.

As to trade liberalization, price decontrol, and regional integration, by 1994, tariffs in Côte d'Ivoire had been substantially simplified in structure and reduced in value. The benefits of this strategy were demonstrated by improved customs revenues to the Government and strong growth in both imports and exports. The focus is now shifting to the elimination of nontariff barriers, and the plan is to decontrol prices in tandem with the elimination of nontariff barriers on the remaining 22 goods and services still subject to administrative price control. I urge the authorities to pursue this objective and even accelerate the timetable if possible since it should contribute to further trade expansion.

However, the staff paper suggests that the pace of reform of tariff and possibly nontariff barriers may now be governed by the strictures of the West African Economic and Monetary Union, which was formed in January 1994. We understand that the staff is now preparing a report on WAEMU for discussion at the Board later this year. We await this report with considerable interest and presume that it will address issues such as (1) the effect that WAEMU may have on tariff structure of member countries; (2) the progress on the plans for common internal and external tariffs and for any interim preferential trade arrangements; and, (3) the extent to which this organization will impinge on the pace and scope of economic reform in individual member countries at different stages of economic development and with different cyclical patterns.

We applaud the diligence of the authorities of Côte d'Ivoire in pursuing the objectives of the program so successfully and support the proposed decision.

Mr. Newman made the following statement:

The outturn for 1994 in Côte d'Ivoire was better than expected in many respects: the devaluation and favorable terms of trade developments stimulated growth in the tradables sector; a modest recovery in output took place; the current account balance narrowed substantially; flight capital returned to the country; and, price pressures were largely contained. Public sector wage restraint was an important element in this success.

Substantial challenges remain, however. A sustained commitment to fiscal restraint is needed to reduce the public debt overhang, clear domestic and external arrears, and restore external viability. Against this background of necessary fiscal contraction, an ambitious growth path in the neighborhood of 5-6 percent a year is targeted. Achieving the growth targets, which are also necessary in order to sustain a modest rise in per capita income, will only occur if a supply-side response is generated in the private sector. Such a response will in turn depend on accelerated policy reforms in a number of areas, particularly privatization.

In the fiscal area, there is a positive direction to both the projected trend in fiscal balances and the tax and spending reforms. The question is whether the scope and timing of action in both areas are sufficiently ambitious. One wonders, for example, whether the pace of deficit reduction is adequate in light of high debt levels. As the staff paper notes, fiscal surpluses will be necessary to reduce the debt overhang. Medium-term plans, however, suggest a rather gradual approach to achieving this objective. Indeed, as described in the staff paper, the authorities appear to favor a looser stance, hoping that a more expansive policy might ensure growth and presumably spark more revenues down the road.

Such an approach would be counterproductive in our view. It would send the wrong signal to creditors, both private and public, and make it more difficult to achieve a satisfactory resolution to the country's debt problems. Clearly, Côte d'Ivoire is one of the countries we will need to look at in the context of our ongoing review of international financial institutions' debt.

Regarding fiscal policy reforms, the overall strategy is on the right track. Spending plans aim to reduce current outlays and shift investment from state enterprises toward social services and infrastructure. Tax reforms seek to broaden the revenue base and reorient collection away from export taxes on cash crops. Clearing domestic arrears should provide a boost to the private sector, including the financial system.

Again, though, questions remain over how and when the strategy is to be implemented. For example, there appears to be broad recognition of the advantages of establishing a more stable revenue base and reducing the distortions caused by levies on coffee and cocoa exports. The authorities, however, want the pace of reduction in export taxes keyed to commodity price developments and fiscal performance. This could be a prescription for delay. As long as export taxes are considered a ready stand-by to make-up for collection shortfalls or spending excesses, changes in other areas are likely to lag. In contrast to coffee taxes, for example, no decline is anticipated next year in the percentage "bite" that cocoa export taxes take from the producer price. To the extent that levies on cocoa export taxes are underpinned by calculations of optimal export taxes--(given Côte d'Ivoire's role as the world's largest producer--it would be useful for the staff to elaborate on the issue in papers prepared for the next review.

Current expenditures are to be reduced in 1995. Wage restraint was a key ingredient in 1994 successes. We understand that the wage hikes announced earlier this month are consistent with the modest rise in the wage bill targeted in the program so long as planned reductions in public sector staffing take place. In this regard, we note that the decline in staffing through the voluntary departure program has been lower than hoped for. Much of the 1994 staffing reduction was achieved by shifting public sector employees off the government payroll and onto state companies' wage bills.

To the extent that this measure truly improves government cash flow--that is, it does not result in increased subsidies to or reduced transfers from the companies--it is a welcomed development. Looking ahead, however, the emphasis appears to be on maintaining 1994 employment levels, as reductions in nonpriority areas are offset by recruitment in human services and education areas. This shift in resources is welcomed, but the overall staffing target does not appear to be particularly ambitious. A more pro-active stance on civil service rationalization seems in order--particularly if overall fiscal surpluses are to be achieved over time. Efforts to enhance the treasury function of the Government could contribute importantly to downsizing efforts by increasing transparency and control over spending patterns.

In regard to structural reform, privatization efforts have clearly lagged in Côte d'Ivoire. We would hope to see a significant pickup in government divestitures in view of the more favorable economic conditions. The staff's and Mr. Koissy's comments on the prospects for accelerating sell-offs beyond the 35 anticipated over 1995-96 would be appreciated.

The financial sector has a key role to play in nurturing a robust private sector. We note, in this regard, that lending rates have come down but that the financial sector is still undergoing growing pains. Balance sheets have been strengthened, liquidity has improved, but interest rate spreads are still high, and lending behavior is still very cautious. In many countries, of course, the financial sector's adjustment to new lending relationships with private borrowers has resulted in profligate and unsound lending. Presumably, effective banking supervision is militating against this outcome in Côte d'Ivoire. However, too much caution can result in suboptimal outcomes as well. Part of this could be the result of a maturation process associated with financial markets and participants gradually becoming more comfortable with new instruments, new relationships, and new risk assessment demands. There may also be barriers to competition. I wonder whether the staff could comment on this sector somewhat more and on what steps are being taken to foster greater dynamism--while also ensuring stability.

One step that is clearly not constructive to the development of financial markets and the conduct of monetary policy is the BCEAO's recent decision to include what is effectively a put option feature in debt issues representing the securitized claims of BCEAO on member governments. This feature, which allows holders to sell the securities back to BCEAO--at any time apparently--effectively eliminates credit risk and interest risk on the security. The absorption of excess liquidity is desirable, but the choice of instruments will complicate monetary policy and do little to develop local secondary markets and banks' participation in them. We fully concur with the staff on the inadvisability of this action.

It is encouraging to see greater liberalization in the agricultural sector. Here we note the reduced role of the Agricultural Price Stabilization Fund (CAISTAB) and the increased transparency over its finances as well as the opening up of the rice sector. We would be interested in the timetable anticipated for CAISTAB's phase-down to a regulatory role.

In conclusion, Côte d'Ivoire has made considerable progress in implementing the devaluation in a manner that maximizes the potential benefits for the economy. However, with elections on the horizon, it will be important for the authorities to resist the pressures that will inevitably arise to ease up, especially on the fiscal side. We urge the authorities to stay the course that they so courageously undertook with the initial decision to change the exchange rate peg.

Mr. Autheman made the following statement:

Like Mr. Clark and Mr. Newman, I believe that the authorities deserve to be commended for firmly implementing macroeconomic policies and achieving satisfactory results. I would like to point to the figures on page 59 of the staff paper, showing the impressive growth of the contribution of the private sector to domestic savings. Private sector net savings doubled from 9 percent of GDP to 18 percent of GDP in 1994 and should remain at a reasonably high level during the next three years. It seems to me that this is a very positive achievement.

As I share the staff's appraisal, I will limit my comments to a few aspects. I welcome the reduction in the level of taxation on coffee and cocoa exports. This decision was expected by our Board, and it is appropriate that the authorities increasingly pass through international prices to producers. We would have appreciated an even faster reduction of this tax, but I understand that we need to take due account of some constraints: first, the need to prevent any inflationary pressure; and second, priority to be given to fiscal consolidation.

In this regard, it is very important that any decline in the taxation of exports, which we think is desirable, be matched by a certain increase in other taxes and not only by the expected increase resulting from upcoming reforms. Furthermore, it is important that such temporary taxation be associated with the meeting of a temporary need--the reduction of domestic arrears--and that this exceptional taxation not develop into a way of financing permanent expenditure to an excessive degree.

Mr. Newman rightly points to the need to strike a balance between the acceleration of fiscal consolidation and the improvement of the tax structure. In the short term, however, I see much merit in the emphasis in the 1995 budget on measures primarily directed at improving the competitiveness of the economy and the prospects for a better resumption of investment. In any case, it is important that this reduction of taxes not prevent the authorities from achieving the objective of an overall government revenue performance that needs to be maintained above 20 percent of GDP.

As a final comment on fiscal policy related to expenditures, I understand the authorities' desire reflected in the letter of intent to increase budgetary appropriations for investment expenditure in order to support economic recovery, but I believe that the authorities should primarily address the reasons behind the recurrent underspending in their investment program before considering increasing it.

Turning to structural issues, it is regrettable that some performance criteria were not met, although there are indications that privatization programs should now gain momentum. I am pleased to note that it will include large enterprises. One can have attractive programs with much privatization of small enterprises, but what matters is the privatization of large companies. It seems to me that the focus on the structural front in the coming years should be placed more on the effective implementation of the structural reform program agreed upon than on its enlargement, and there is already a considerable agenda.

I have mentioned privatization, and I should also mention reform in the agricultural sector supported by the World Bank. I am also pleased that our program gives the right emphasis to structural benchmarks relating to the transparency of the budget accounting and process.

On monetary policy, the strategy implemented by the regional central bank has been appropriate and achieved its primary objective, which is to prevent the development of inflationary expectations. But, looking forward, I am somewhat concerned by the quality and the depth of dialogue between the Fund and the regional central bank. It seems strange that in a country that is the most important in this region, consultation with the central bank has been limited to the National Director of the Central Bank of West African States. The Fund needs a deeper consultation process with the BCEAO, especially as new issues are arising, such as how the central bank will manage the probable growth of demand for credit.

Like Mr. Newman, I was not very pleased that the BCEAO decided to reduce at this stage the prospects for indirect control of liquidity. I would like to encourage the staff to develop its policy dialogue with the regional central bank in a more active way, and I hope that Mr. Koissy will help it to do so. Of course, this is a very unusual organization, and that is why it is necessary to find an unusual approach.

I would like to point out that balance of payments projections clearly show that, even with continued progress, Côte d'Ivoire will need exceptional financing for some time. This situation calls for an enhancement of its relations with its external creditors, and I will point to two specific issues.

The first is the prompt settlement of remaining external payments arrears to official bilateral creditors. The second is the need for an early solution to the protracted stock of commercial debt, which calls for a broad-based solution with the support of the Fund and the World Bank. I would hope that the staff will be able to engage in discussions with the authorities on these issues.

Finally, I welcome the orientation, if not the decision, agreed in April among the countries of the franc zone to consider seriously accepting the obligations of Article VIII, and I would like to ask Mr. Koissy to call upon his Ivoirien authorities to take the lead on this issue.

Mr. Sundara made the following statement:

The Ivoirien authorities deserve to be commended for the economic rebound after the devaluation of the CFA franc in January 1994, and in particular for their success in keeping the 1994 program broadly on track, with almost all the program benchmarks for end-December met. As I am in broad agreement with the thrust of the staff appraisal, I will confine my comments to three areas of concern, namely, the wage policy and voluntary departure program, credit and financial intermediation, and the process of privatization.

As regards the wage policy and voluntary departure program, the implementation of the restrictive wage policy, with average civil service base wages increased by some 10 percent in 1994, was among the key factors contributing to the favorable macroeconomic performance in 1994, as well as to the strengthening of external competitiveness brought about by the devaluation. In the context of a further deceleration of inflation to about 5 percent at the end of the 1995 program, the authorities agreed to continue the firm implementation of tight fiscal and monetary policies, in particular to restrict wage increases to the level of productivity gains or to the progress in the downsizing of the civil service.

It is encouraging to learn from Mr. Koissy and from the helpful statement by the staff that the wage increases announced on May 1, 1995, effective on June 1, 1995, will involve an increase in the wage bill of less than the target of 3 percent in 1995, after taking into account the programmed reduction in the number of public employees.

However, as only a modest success in the voluntary departure program was scored in 1994--only 527 departures out of the 1,500 minimum target--and as the voluntary departure program is the core of the 2.4 percent civil service reduction in 1995, I am concerned whether this target is achievable, especially as no further improvement will be made to the provision for voluntary departures to make it more attractive, according to the policy framework paper, as was the case in 1994. Mr. Koissy or the staff may wish to comment.

On credit and financial intermediation, as noted in the staff paper, the perceived high nominal interest rates were among the main causes for the 12 percent contraction of private sector credit in 1994. Footnote 1 on the same page also advocated that "sluggishness of credit demand also reflected, inter alia, the access of some large firms to cheaper external financing." Such a situation, if left unattended, could be detrimental to the prospects for noninflationary recovery and financial intermediation deepening within Côte d'Ivoire. In this connection, I concur with the staff in urging the authorities to work within the BCEAO to increase the flexibility of interest rate policy, allowing rates to reflect more closely conditions in the money market. I also welcome the authorities' determination to improve the tax laws governing financial savings and credit activities in order to reduce the cost of banking and deepen financial intermediation as well as to enhance competition within the Ivoirien banking system.

In light of the past sluggishness of the privatization process, as evidenced by the fact that only 15 out of 50 state enterprises initially listed for privatization were actually privatized from 1991 to 1994--about 4 enterprises privatized per year on average--the target for privatizing at least 10 enterprises during 1995, or 35 enterprises over the medium term through end-1997, seems highly ambitious. In view of the existing weak institutional and administrative capacity and of the need to complete the privatization process by end-1997 so as to underscore the authorities' commitment to the overall strategy of state disengagement, it is imperative that the authorities make their utmost effort to accelerate privatization and that they request the World Bank for additional assistance, particularly in making the far-reaching medium-term privatization objective into a reality.

With these comments, I support the proposed decision regarding the second annual arrangement Under the ESAF for Côte d'Ivoire.

Ms. Dagustun made the following statement:

Like others, I welcome the commitment and determination that the authorities have shown in implementing their economic reform program during the first-year ESAF arrangement. I can certainly agree that management of the postdevaluation economy has been good. The authorities deserve congratulation for this. Of course, the devaluation--together with the temporary terms of trade gain--was a rare opportunity for Côte d'Ivoire, and the authorities need to take full advantage of it.

In particular, the authorities need to ensure that the relative price change achieved by the devaluation is preserved and not eroded by inflation. The latest data on inflation were disappointing. I found Mr. Koissy's remarks reassuring here but, nevertheless, I certainly agree with the staff that data should be carefully monitored.

I will comment on two particular areas of concern. They relate to areas where significant challenges remain: the fiscal side and the structural side.

The growing economy gives the authorities a good opportunity to put in place sound public finance structures. I recognize that, overall, public finances have improved more than had been expected in the program, but in welcoming this, I would like to stress the need to develop over time more sustainable revenue and expenditure patterns.

I have two points here. First, a key element in the goal of sustainable revenue patterns will be to reduce reliance on temporary export taxes in the coffee and cocoa sectors. Like Mr. Autheman, I welcome the initial steps that have been taken but, as Mr. Autheman noted, much more needs to be done. Here, the medium-term nature of the targets do not seem to be very challenging. I agree with Mr. Newman that more explanation of this issue would be helpful for our midterm review. The comprehensive review of the tax system that will be taking place--utilizing Fund technical assistance--will be useful. The need to broaden the tax base--ensuring that the current export taxes are replaced with a less distortionary taxation of the agricultural sector--and to improve tax collection and administration are clear.

Second, on expenditure patterns, the delay in the public investment program last year was unwelcome, and I note from the staff's statement that these delays are continuing. Although ensuring that fiscal targets are met, this delay may not be the most conducive way to ensure longer-term growth.

Our other area of concern has been the continuing slow progress of structural reform in a number of key areas, notably privatization and public sector reform. It is of crucial importance for the authorities to press forward with structural reforms in a timely fashion. In addition to privatization and parastatal reform, the liberalization of the agricultural sector--including a progressive withdrawal of CAISTAB from the cocoa and coffee marketing--is obviously an area for urgent attention. As regards privatization, I noted that there are now clear plans set out for privatization plans over the next year or two. I wonder whether some more specific performance criteria would have been useful here.

In the financial sector, there is obviously a need to promote better mobilization of domestic savings and to encourage private investment if optimal benefits are to be derived from the repatriated flight capital.

I would also like to say a few words about Côte d'Ivoire's debt situation.

Côte d'Ivoire has a sizable debt burden. As the staff rightly notes, a reduction in the current level of debt overhang will be important for restoring confidence and re-establishing conditions for private sector growth. I very much agree with the staff on the need to see an overall improvement in external debt management in Côte d'Ivoire. I noted--and this perhaps follows on from this morning's discussion on bilateral and multilateral aid flows--that one reason cited for recent payment delays was "a postponement of disbursements of exceptional financial assistance." I would welcome clarification of the reasons for these delays. If it is administrative and organizational problems, or failure in policy implementation--which are actually at the root of increasingly regular accumulations of small amounts of arrears--these must be resolved, not least to demonstrate the authorities' own commitment to playing its part in dealing with its debt problems. Here, I have some sympathy with Mr. Newman's concern about whether this program that we are supporting is indeed appropriately tight.

Importantly, in view of the existing high stock of debt, the authorities will also need to ensure--as the staff notes--that any new debt is of a highly concessional nature. The standard benchmarks used in the program for new concessional lending would have to be sharpened up if this aim is to be fully reflected. This issue is being looked at separately by the Policy Development and Review Department as an important by-product of the multilateral debt discussions, but I feel that the sooner we can introduce tighter criteria into Fund programs for new borrowing by the poorest and most indebted countries, the better.

Finally, I join Mr. Autheman and the staff in urging Côte d'Ivoire, in concert with its WAEMU partners, to accept the obligations of Article VIII. Indeed, I am not sure that I fully understand the obstacles preventing this step from being taken very soon. This might be an issue in which Mr. Autheman's encouragement of better policy dialogue between the Fund and the regional central bank could be relevant. In any case, I would hope that we soon have some good news on this. It seems that every country in this region that we discuss in this Board has the same good intentions; unquestionably, we need to find a way of getting all those good intentions together to arrive at an answer.

Mr. Al-Tuwaijri made the following statement:

It is heartening to see the encouraging economic developments in Côte d'Ivoire since our last discussion in November. I support the proposed decision and will make only four remarks.

Although fiscal consolidation is clearly the centerpiece of the adjustment effort, the quality of the fiscal measures can be as important as their magnitude. In this regard, I welcome the fact that the authorities will be reducing their reliance on export taxes. This chair expressed serious misgivings about these taxes during our last discussion, and I hope that the authorities will begin developing other forms of taxation to replace these taxes at an early date.

Côte d'Ivoire's economic potential is promising. With international competitiveness restored, Côte d'Ivoire is well placed to continue on a path of sustainable growth. The authorities are cognizant that the maintenance of competitiveness will be seriously undermined by a slow pace of structural reforms. Here, I welcome the authorities' recent finalization of a detailed privatization plan. Like the staff and other speakers, I urge the authorities to move swiftly in implementing their structural reform agenda. This is also an essential element for enhancing investor confidence in the economy.

A particularly important area for reform is the financial sector. Indeed, the paper on international capital markets that we will be discussing next week highlights the inherent risks in economies with fixed exchange rates in the absence of a strong and flexible banking sector. Although the situation of the banking sector in Côte d'Ivoire has improved, there is a clear need to enhance competition and implement further improvements to the regulatory framework. I was therefore pleased to learn that the World Bank will be preparing a program to deal with these matters.

I also welcome the emphasis placed by the staff on the importance of regional integration of the financial markets.

Enhancing market confidence in the economy must receive high priority. The authorities' program goes a long way toward achieving this objective. However, I understand that Côte d'Ivoire's debt on the secondary market has lost much of the gains realized at the time of the devaluation. I would appreciate some comment from the staff on this issue.

Ms. Patel made the following statement:

Côte d'Ivoire deserves considerable praise for its economic performance thus far. A great deal has been accomplished in recent years, and the devaluation of the CFA franc, which was accompanied by restrictive financial policies, in particular contributed to putting the economy on a more sound footing. By holding firmly to the macroeconomic objectives in 1994, the authorities have demonstrated their determination to restore financial viability and strengthen the economy's growth potential. The growth rate, although still low, more than doubled the original target, inflationary pressures subsided more than expected, the fiscal deficit narrowed considerably, and the overall balance of payments surplus exceeded by far the program target. Improvements were also noticeable in enhancing the role of the private sector in the economy.

There is no doubt that substantial progress was made toward macroeconomic stabilization. However, in order to consolidate and build on the gains already made, it is important that the authorities remain focused on maintaining their prudent financial stance. In this regard, it is encouraging to note that the authorities intend to persevere with tight monetary and fiscal policies while stepping up structural reforms. Such policies, together with the competitiveness gains locked in from the devaluation, will enable the authorities to achieve the ambitious, but attainable, macroeconomic goals set under the 1995 program. To this end, the current strategy of fiscal consolidation geared toward further strengthening of domestic savings that would bolster economic growth appears to be appropriate. Measures envisaged under the strategy emphasize the strengthening of revenue efforts mainly through rationalizing the tax system and improving customs administration. Expenditure restraint is rightly poised to contain the wage bill, among other measures, while reallocating expenditures to improve the health and education sectors. However, more emphasis seems to be warranted on reducing the high level of subsidies and other current transfers, which are projected to increase further in 1995. In this regard, I wonder what measures are being envisaged to phase out these subsidies in the near term. Comments from the staff or Mr. Koissy would be appreciated. I believe that, as in many other low-income countries implementing strong adjustment programs, Côte d'Ivoire is likely to be contending with the negative impact of adjustment on the most vulnerable segments of the population. However, there appears to be no specific reference in the program to social safety net measures. I would welcome the staff's view on what the authorities are doing to address this sensitive problem. The envisaged acceleration of the privatization program will no doubt assist the process of fiscal consolidation, thus expediting the clearance of domestic debt arrears. Improvements in reducing these arrears are also expected as the welcome measures to enhance the treasury management system are enforced.

On the monetary front, the room for maneuver is limited, as monetary policy will continue to be guided by the principal objectives of the monetary union. However, the commitment of the authorities to contain the domestic demand pressures is noteworthy and will play an important role in containing inflation. Under the existing circumstances, the improvement of the fiscal position becomes even more critical to the containment of credit to the Government and the crowding in of the private sector in credit allocation. Strengthening the reforms in the financial sector can assist in improving the efficiency of the banking system in the mobilization and allocation of financial resources.

Measures envisaged in the area of structural reforms rightly emphasize the acceleration of the privatization process, price liberalization, and reform of the agricultural sector, and are directed toward the phasing out of public intervention in these areas. I encourage the authorities to pursue these objectives firmly. In doing so, they are not only reducing the distortions in the economy, but, more important, are laying the groundwork for a propitious environment for the private sector to assume a greater role in the economy, thus strengthening the prospects for growth.

Despite the recent improvements in the terms of trade and higher export volumes, the external sector remains highly vulnerable to exogenous factors. Exports are still largely dependent on two primary products and are, therefore, subject to the volatility of international prices of these major export commodities. Prospects for achieving external viability in the medium term depend, therefore, on the ability of the authorities to diversify the export base. Also, as in many other low-income countries, the external debt overhang remains a major impediment to improving those prospects. Reducing the debt-service burden and strengthening the reserve position are important steps that can enhance the authorities' ability to guard against unforeseen shocks.

With these remarks, I support the proposed decision.

Mr. Galicia made the following statement:

We concur with the staff that the devaluation of the CFA franc in January 1994, and its accompanying measures, provided the adequate framework in Côte d'Ivoire for a very solid restructuring of the economy. The appropriate handling of the 1994 devaluation showed its results at the end of the year. Prudent monetary and fiscal policies, with improved productivity and limited wage increases, contributed to registering a 36 percent improvement in the real effective exchange rate and a rapid dissipation of the inflationary effect.

The economic program for 1995, supported by a second annual arrangement under the ESAF, will permit the Government to strengthen its medium-term objectives. In this regard, in order to preserve the gains attained and to enhance the potential of the economy, the authorities should move to attenuate the rigidities present in some fundamental areas of the economy.

For this year, the fiscal target is to reduce the overall fiscal deficit by more than 2 percentage points. This means that the authorities will have two tasks at the same time: on the one hand, to achieve the macroeconomic objective with the tools available; and, on the other, to rationalize the tax system and strengthen its administrative efficiency. In the medium term, the success of the fiscal goals will depend on the efficient and careful implementation of the revenue measures envisaged in the staff paper. The excessive reliance on coffee and cocoa export taxes has distorted in the past the production and trade of these important products in the Ivoirien economy, and we commend the authorities' interest in further improving the tax system as a whole.

The implementation of monetary policy requires harmony with other partners within the West African Economic and Monetary Union. For this reason, interest rates should be flexible enough to allow all the forces in the market to achieve equilibrium in the monetary sector at a national and regional level. The undersubscription of government bonds during 1994 showed that the basic tools for managing monetary supply are in place, but that their impact is limited in the present circumstances. Therefore, additional efforts should be undertaken to enhance the variety of instruments of short-term liquidity management. We support all the recommendations made by the staff, in particular the introduction of securities of various maturities and the efforts to deepen financial intermediation within the monetary union. Efforts to develop even more markets and tools of monetary control should be pursued at a rapid pace. Indeed, if inflation starts picking up, and the monetary authorities are unable to address the problem, the cost could be very high for the real sector of the economy.

The structural reforms are an important part of the overall economic adjustment effort. Nevertheless, it seems that the pace followed by the authorities in this respect has been less dynamic than in the past. For example, the agricultural sector has not only been influenced by depressed international commodity prices in recent years, but also by excessive government intervention. This is particularly worrisome, because agriculture accounts for about one third of GDP and two thirds of export revenues, while two thirds of the labor force is employed in this sector. We encourage the authorities to accelerate structural reforms on price liberalization, on the agriculture and transport sectors, and to proceed more aggressively with the divestiture of public enterprises.

Côte d'Ivoire still depends on exceptional financing on highly concessional terms. The pursuit of appropriate adjustment policies should be seen as an important element in re-establishing international creditworthiness and laying the groundwork for promoting domestic savings and attracting foreign investment.

Finally, we support the proposed decision.

Mr. Daïri made the following statement:

The Ivoirien authorities are to be commended for the resolve they have demonstrated in their adjustment and reform process. I concur with the staff's appraisal and support the proposed decision. I wish only to make a few comments.

I am a bit disappointed that the large depreciation did not have substantial effect on the supply side. In fact, growth in 1994 is estimated to be less than 2 percent, and the external adjustment seems to have affected inputs, and therefore growth more than exports. Staff comments on the reasons for this weak supply response would be welcome.

This chair had questioned in a previous Board meeting the rationale behind the Government's tendency to capture part of the "agricultural rent" following world price increases and the exchange rate action. This may have resulted in deviation of official exports to unrecorded exports to neighboring countries. Clearly, a more transparent price structure is warranted, and I am pleased to hear that the authorities intend to further reduce export taxes. However, the authorities' decision in this respect should not be linked to future fiscal developments. Any unfavorable fiscal developments should be faced through measures other than those that would negatively affect the supply side.

Recent developments in inflation raise some concern, and I wonder whether there is any link between this trend and the relaxation of monetary policy by the monetary authorities reflected in recent declines in interest rates.

Finally, I would join other Directors in calling for an adequate international support for the authorities courageous program, including through new concessional assistance, official debt cancellation, and a debt reduction package with commercial banks.

The staff representative from the African Department stated that the Government's primary objective in the area of restructuring was to privatize its holdings in 58 enterprises before the end of 1996. At the end of 1994, only 16 enterprises had been privatized; 42 more enterprises remained to be privatized in 1995/96. The authorities had been able to accelerate the execution of the privatization program, following the reorganization of program procedures in mid-1994. It was to be hoped that the privatization goal could be achieved by end-1996.

The privatization program for 1995 aimed for the privatization of 25-30 public enterprises, of which 10 had been, or would be, privatized by end-June, the staff representative explained. Another 10-15 enterprises with minority government ownership would be sold in the second half of 1995. In addition, 3-5 large public enterprises with majority government ownership were expected to be sold by the end of the year. The latter group included two very large enterprises--the PALMINDUSTRIE, a large agro-industrial complex, and CI-TELCOM, a telecommunications company. All feasibility and valuation studies for these two companies had been completed, and the sales strategy had been approved by an interministerial committee. Further approval by the Council of Ministers was expected in the following week.

Both the World Bank and the Fund were monitoring closely the privatization program for large and small public enterprises, the staff representative went on. The Fund had not established a performance criterion on privatization, partly because privatization was a complex issue, and partly because privatization was a prior action under World Bank programs, and cross-conditionality needed to be avoided.

The staff held twice-yearly consultations with the two central banks, the BCEAO and the BEAC, the staff representative acknowledged. They had been deemed necessary because of the devaluation and the onset of new problems outlined in the staff report.

Restructuring of the financial sector and the banking sector in Côte d'Ivoire had taken place over the preceding two or three years, the staff representative recalled. While substantial progress had been achieved, more work remained to be done. In the succeeding year, the staff of the World Bank and the Fund intended to develop a more comprehensive strategy to deepen the financial system and develop financial markets, in order to provide diversified instruments to deal with the medium- and long-term financing requirements of the private sector.

Prospects for the reform of CAISTAB--the Agricultural Price Stabilization Fund--were good, and the measures and the timetable for their implementation had been agreed upon, the staff representative said. The reform would be phased in over a period of two years, beginning with the 1995-96 crop season. The initial package of measures included liberalization of domestic cocoa and coffee marketing, including the elimination of territorial pricing, as well as measures to make the cocoa and coffee exporting system more transparent and accountable. Direct sales to CAISTAB would be limited. Beginning with the next crop season, most quasi-budgetary expenditures of CAISTAB would be transferred to the state budget, CAISTAB itself would be transformed into a regulatory agency in the course of further liberalization of the cocoa and coffee sectors, and its domestic marketing activities would be reduced in favor of private sector operators.

While the supply-side response of the economy in general had been better than expected, a significant response from the agricultural sector was not expected in 1994, the staff representative remarked. The industrial sector was also not expected to respond quickly to the change in relative prices. Taking into account a one-year lag in the supply response, a rate of growth of 6.5 percent was expected in 1995 and in 1996.

Côte d'Ivoire had not made any payments to commercial banks since 1987, and most of the debt was considered to be in arrears, the staff representative stated. The price of the banks' claims had fluctuated substantially in the secondary market over the preceding few years. After stagnating at about 6 cents on the dollar during 1990-94, the price rose to 30 cents in January 1994, after the devaluation. Subsequently, the price declined and remained at about 16 cents on the dollar during 1994 and during the first months of 1995, except for a temporary fall during the recent crisis in emerging markets. It was clear that Côte d'Ivoire would have great difficulties in finding an appropriate solution to the amount of arrears to commercial banks; its debt-servicing capacity remained limited, and Côte d'Ivoire remained dependent on exceptional resources from the Fund, the World Bank, and some bilateral creditors to fund the up-front cost of a debt reduction operation. The staff intended to help the Ivoiriens to deal with the debt issue.

The increase in the consumer price index had been a surprise to the staff, stressed the staff representative. That increase did not reflect an increase in the underlying rate of inflation, however, since only the prices of a few key food items purchased by lower income groups had risen sharply as a result of poor weather toward the end of the year and increased demand from neighboring countries. It was expected that consumer prices would decline within the following 6-9 months, and that the annual rate of inflation would remain close to that expected in the program.

The pivotal question in the design of the program related to the degree of tightness in monetary and fiscal policy, the staff representative stated. Given the Fund's objective to obtain the largest structural adjustment possible, the three-year program's reduction in the fiscal deficit by approximately 10 percent of GDP was demanding. A reduction in the fiscal deficit of 5.5 percent of GDP had already been achieved in 1994; an additional reduction in the deficit equal to 2.5 percent of GDP was targeted for 1995. Overall, much progress had already taken place.

The authorities were more optimistic about prospects for increasing revenue in 1995 than was the staff, the staff representative admitted. The staff had taken a cautious approach to ensure a lower level of expenditure. Any revenue increases above the program estimates would be used to accelerate the payment of domestic arrears and reduce the public debt overhang.

Better fiscal performance in 1995 might make possible an acceleration in fiscal adjustment, the staff representative remarked. In the program, the staff had had to strike a balance between fiscal adjustment and the structure and quality of government revenue and expenditure.

Because a reduction in export taxation would be necessary over the following two to three years under the program, major efforts would be required to improve the efficiency of the tax system to counterbalance the loss in export taxes, the staff representative considered. At the same time, there was a need for increased investment in social expenditures. In that vein, it was noted that the social safety net implemented after the change in parity included sharp reductions in certain taxes, such as on staples; the doubling of social expenditure on primary education and health; targeted social expenditure for poor regions, urban areas, and certain segments of the population; and a program of public works. There were also modest subsidies for school books--the price of which had not increased following the devaluation--and a number of drugs. The authorities' program for 1994 had initially included substantial subsidies for bread, wheat, and rice, but that had proven to be too expensive. In an effort to encourage domestic rice production, the authorities had increased the price of rice in 1994 by more than had been envisaged initially, and other budgeted subsidies had been reduced to CFAF 2 billion.

Ms. Dagustun stated that she had been reassured that privatization was a condition for World Bank support. If measures such as privatization supported positive macroeconomic developments, then they should be included in Fund-supported programs as well.

The staff representative from the African Department replied that the staff followed privatization developments as closely as it did performance criteria. Both were structural elements of the program under review.

Mr. Gaspard made the following statement:

> I join other speakers in commending the authorities of Côte d'Ivoire on an overall very successful implementation of the 1994 adjustment program. I also join them in noting the lack of progress on the structural front which needs to be urgently addressed in order to consolidate the gains achieved elsewhere in the economy.
>
> It is a measure of Côte d'Ivoire's success in its adjustment efforts that last year witnessed the first positive growth rate since 1986 and, more significantly, per capita GDP in 1995 is expected to increase for the first time in almost ten years. Clearly, maintaining this positive growth path is a fundamental objective, not least because it would be essential for addressing Côte d'Ivoire's problem of high debt overhang and external viability. As I largely agree with the staff's assessment and recommendations, I will restrict my comments to a few points for emphasis.
>
> Let me state at the outset, echoing the staff and other speakers, that only a more dynamic private sector can strengthen Côte d'Ivoire's external viability and bring about the diversification in economic activity that is necessary for sustainable growth. The private sector has already responded quickly to the improvement in the macroeconomic framework by substantially increasing investment and, perhaps most tellingly, by effecting a substantial reflow into the country of flight capital. But private sector investment in Côte d'Ivoire remains at modest levels, standing at less than 9 percent of GDP in 1994 and is, furthermore, only about half the level of private net savings. This fact summarizes well both the constraints and opportunities that are currently facing Côte d'Ivoire's economy. To promote more vigorously the role of the private sector, and thus make strong growth a more realistic prospect, the authorities

would need to strengthen their catalytic role in this regard by persevering in their fiscal consolidation efforts and, above all, by speeding up the structural reform process. This is the central message of the staff for the 1995 program and, as Mr. Koissy reassures us, it is one with which the authorities agree.

As fiscal performance continues to be largely positive, now confirmed by the 1995 first quarter results, I will merely note that, although the authorities have been quite successful in containing expenditures, particularly in relation to nominal wages and staffing levels, progress in terms of revenue enhancement and tax reform has been less notable and is necessary in order to reduce the reliance on export duties on cocoa and coffee. I also agree with the staff that, short of further fiscal tightening, it is important at least to avoid a relaxation in the fiscal stance, even if this is prompted by higher capital spending to strengthen the ongoing recovery. A relaxation in the fiscal stance at this early stage in the favorable economic turnaround could well backfire and induce adverse expectations about the authorities' commitment to stabilization.

I believe we can all agree that progress on the structural reform front should be accorded priority as it has been the only disappointment in an otherwise largely positive picture. As the staff notes, the year 1995 could be critical for the economy of Côte d'Ivoire because a continued lack of progress in the structural domain may stall the momentum of the expansion in private sector activity. Two areas would need particular emphasis on the structural front: the speeding up of the process of privatization and the reform of the parastatal sector. I am happy to note, however, that the updating of the three-year public investment program has just been completed. This program has been long overdue, and its recent completion is a welcome development.

I support the proposed decision.

Mrs. Wagenhoefer made the following statement:

I also join other speakers in commending the Ivoirien authorities for their successful efforts in implementing the program objectives. These achievements are, in my view, clear evidence that the devaluation was necessary. The situation would probably not have deteriorated to this extent had the exchange rate adjustment been carried out earlier.

The results of the first year under the program are encouraging even if I would not call them "very" encouraging. Why? Despite the progress made, we should keep in mind that two program benchmarks were not met and that there were further external payment delays in the first quarter of this year. I am also rather concerned about the unexpectedly high increase in the consumer price index in the first four months, and I agree with Mr. Koissy and the staff that price developments will have to be very closely monitored in the months ahead. May I ask for the staff's assessment of the recent salary increase announcements for civil servants by up to 15 percent? How do they fit into the program we are asked to support today?

I would also like to hear the staff's assessment of the slow execution of the public investment budget during the first quarter, especially against the background that "public investment is considered by the authorities to be a key element of their medium-term policy" and that "capital spending is to increase by 19 percent in 1995."

Apart from that, I cannot conceal some disappointment that performance in structural reforms was again mixed. But I acknowledge that the authorities had to concentrate their efforts on the management of the immediate postdevaluation phase to begin with, and I hope that the privatization plans for 1995 referred to in the staff's statement will shortly be put into effect. In view of the limited room for adjustment through exchange rate policies, structural reforms--in addition to tightening fiscal policies--are of particular importance for Côte d'Ivoire.

With these comments, I am in broad agreement with the staff's analysis. The staff has outlined in detail the strategy and the measures that indeed need to be undertaken. It seems to me that what is of particular importance now is the continuation of the adjustment momentum, the further reduction of the still high overall deficit and, of course, the implementation of the repeatedly delayed structural reforms. In this context, we hope that the forthcoming election does not lead to delays in the adjustment efforts.

At this stage of the discussion I have essentially only a few questions concerning the wage bill. I was pleased to learn from the staff document that the increase of the wage bill was less than programmed. As is pointed out in the document, one factor behind this containment was the sizable reduction in staffing. A footnote on page 4 explains that these reductions include the impact of transforming the legal status of national enterprises into state companies or mixed enterprises. I wonder whether this legal difference also means an economic difference. This change in budgeting for staffing reminds me somewhat of the recent discussion about quasi-fiscal operations (Seminar 95/1, 5/12/95).

Perhaps the staff could comment about the relationship of these state companies to the Government, in particular whether they receive any kind of subsidies or special treatment.

I have two further questions concerning the problem of overstaffing in general. First, can the staff provide a broad assessment of the extent of overstaffing. Second, in view of the small amount of progress under the voluntary departure program, are there discussions on more effective approaches?

Before I conclude, let me raise an issue not directly connected with the economic developments in Côte d'Ivoire and the program. I was somewhat astonished when I recalled that the last Article IV consultation with Côte d'Ivoire was completed in March 1994. As Côte d'Ivoire is on the 12-month cycle, I wonder why today's request and the Article IV consultation are not being dealt with together. In view of our work load and the large number of delayed Article IV consultations, there is no room for organizational inefficiencies. Bearing in mind that program discussions also provide some kind of surveillance, I would suggest holding the 1995 Article IV consultation on Côte d'Ivoire together with the next program review. Perhaps the staff would be kind enough to comment.

Mr. Cippa made the following statement:

I would like to begin by commending the Ivoirien authorities for the consistent and successful handling of the immediate postdevaluation phase. Overall, Côte d'Ivoire managed to avoid the major pitfalls that were associated with the courageous step taken at the beginning of 1994. Although supply response to the substantial shift in relative prices following the devaluation of the CFA franc exceeded expectations, inflationary pressures have been kept under control by implementing appropriate fiscal and monetary policies. Fortunately, the adjustment efforts also took place in a period in which international prices of Côte d'Ivoire's major export commodities rose substantially.

Although Côte d'Ivoire has successfully surmounted the initial obstacles, much remains to be done; in particular, the authorities are now faced with the difficult task of consolidating the gains achieved so far. In this context I would like to underscore the following points.

As regards fiscal policy, the statement by the staff representative indicating a primary surplus for the first quarter of 1995 considerably higher than programmed is reassuring. Over the medium term, however, the pace of deficit reduction is too slow, particularly in light of very high debt levels and the need to attract foreign financing. I welcome the authorities' intention to undertake a comprehensive review of the tax system and its administration. The Fund has already provided Côte d'Ivoire with technical assistance in this area on different occasions and should, therefore, once more be able to provide valuable input. In view of the strong fluctuations of major export commodity prices, it is crucial for Côte d'Ivoire to broaden its tax base and reduce its reliance on export taxes. In this respect, I noted that substantial deviations in revenue estimates in this revenue category were registered in 1994. Although the current estimate of export value of coffee and cocoa is only 8 percent--CFAF 32 billion--below the figure originally projected, export taxes stemming from these products are estimated to lie CFAF 51 billion below the program figure. A more detailed explanation of the causes of this difference would have been helpful to better understand the 1994 revenue performance.

On expenditure policy, I have nothing to add to previous speakers. I welcome the authorities' intention to strictly control the wage bill and other current outlays. The planned expenditure reviews should provide the authorities with valuable insight on medium-term expenditure policy.

In the area of monetary policy, the continuation of the prudent stance followed last year should allow inflation to be contained at the projected level of 5 percent. The substantial progress the authorities have achieved in moving toward indirect instruments of monetary policy should enhance the possibility for commercial banks to react adequately to the expected pickup in credit demand this year. I agree with the staff that all necessary efforts should be pursued to deepen financial intermediation in order to promote savings and encourage private sector financing. In this context, the importance of an appropriate institutional framework should not be underestimated.

As regards structural policies, much ground remains to be covered. Although we recognize that, in the immediate postdevaluation period, the scarce administrative capacity was probably often occupied in resolving more immediate policy issues, we urge the authorities to move ahead rapidly in the different areas mentioned in the policy framework paper. In the medium term, only an environment conducive to private sector development can provide the necessary basic for sustainable growth. The rapid positive supply reaction in nontraditional exports indicates a large growth potential that can be encouraged by appropriate reform efforts.

In conclusion, Côte d'Ivoire's debt situation continues to pose a serious problem. Although generous rescheduling by the Paris Club and debt cancellations by various creditors have substantially improved the situation, under the baseline scenario the ratio of external debt to GDP remains at 124 percent and debt service at 24 percent of exports. When considering these figures, the high vulnerability of the balance of payments position to changes in coffee and cocoa prices must not be forgotten. Also worrying is the fact that a substantial part of Côte d'Ivoire's external debt is owed to multilateral creditors and that this share is projected to increase over the medium term. In view of our recent discussions on this issue, we ask the staff to follow the external debt situation with particular attention.

I support the proposed decision.

Mr. Zhang made the following statement:

The devaluation of the CFA franc in early 1994 offered an opportunity, which the authorities duly captured, to further reduce internal imbalances and restore competitiveness through the implementation of bold adjustment measures. As Mr. Koissy has confirmed in his informative statement, the 1994 objectives for real GDP growth, prices, and external accounts have been met, and in some cases overfulfilled. Substantial progress has been made in improving public finances and in structural reforms. The return of flight capital reflects the increased confidence and serves to acknowledge the credibility of the reform efforts. With the provision of the expected assistance, the authorities will soon be able to avoid occasional delays in settling arrears and become current in external debt service.

The policy measures for 1995 specified in the policy framework paper and the memorandum are well focused. We are encouraged to note the consensus between the staff and authorities on emphasizing further improvement of public finance and structural reform measures aimed at higher and sustainable growth. In light of the authorities' firm commitment and expected external assistance, the 1995 objectives, including achieving a 6.4 percent real growth, reducing inflation to about 5 percent, and limiting the current account deficit to 2.3 percent of GDP, are attainable. However, in view of the 9.6 percent rise in the consumer price index during the first four months this year, I wish to throw in a word of caution that the authorities should be prepared for such unexpected exogenous factors as unfavorable weather conditions, unwanted changes in the terms of trade, or shortfalls in external financing so that timely remedial actions will be in place to prevent program disruptions.

The firm fiscal stance in 1994 was essential to improving the macroeconomic picture. In particular, the restrictive wage policy in 1994 has contributed to a large increase in overall domestic savings and thus to substantial growth in investment. To build on the achievements, such a firm stance should be maintained in 1995 and beyond, together with measures to broaden the tax base and enhance the efficiency of tax administration. It is encouraging to note the substantial increase in public spending in high priority sectors, such as health, education and infrastructure, which, together with an increase in investment financed by domestic resources, will enhance long-term growth prospects.

With regard to the structural reforms, despite delays in implementing some measures in 1994, the authorities have made remarkable progress in liberalizing the economy and encouraging the role of the private sector. The structural measures envisaged for 1995 and beyond appear well defined. We welcome further efforts to restructure the public sector, liberalize prices, encourage the role of the private sector, increase the use of indirect instruments of monetary policy, especially more flexible interest rate policy, and deepen financial intermediation to facilitate mobilization of savings.

In view of the high debt level and population growth, the task of sustaining an improvement in living standards over the long term, if not unattainable, will remain formidable indeed. The authorities have benefitted from external support in their efforts to strengthen economic viability. Further progress will remain dependent not only on appropriate adjustment policies, but also on continued access to financial support on highly concessional terms. Continued assistance from the Fund and other donors will be essential.

With these remarks, we support the authorities' request for the second annual ESAF arrangement.

Mr. Hamilius made the following statement:

It is encouraging to note that recently even the Wall Street Journal has praised the Ivoirien Government for their successful policy. The facts and figures speak for themselves, and indeed the Ivoirien authorities are to be commended for having met most of December's macroeconomic benchmarks.

In view of this general positive assessment, I have only a few brief comments on structural reforms and the external debt overhang.

In the Ivoirien case, the strategy of realigning the CFA franc to the French franc has been successfully managed. The program that followed the devaluation was aimed at a tightening of macroeconomic policy and the accomplishment of real structural reforms. However, as mentioned by previous speakers, the macroeconomic part of the program has made considerable progress not least because earlier structural reforms made it possible to make better use of the devaluation than other CFA countries. Other structural reforms are still missing. To take full advantage of the devaluation, both components should receive equally strong emphasis.

It is more important than ever to exploit the favorable environment in which the Ivoirien Government presently finds itself operating, and to use its momentum to adopt the vital structural reforms. The first priority should be revitalizing the private sector. We were pleased to learn from the staff's statement that an agreement has finally been reached on an overall detailed privatization plan for 1995. However, we were somewhat puzzled by such expressions as "completion of feasibility studies," "adoption of a sales strategy," or "approval of a parapublic policy statement." Do these expressions imply that further delays will occur? Perhaps the staff could provide more details on which state enterprises in addition to CI-TELCOM and PALM-INDUSTRIES are to be privatized. It would also be beneficial to have additional information on the actual schedule. In any case, we urge the authorities to keep to their commitments and continue the steady withdrawal of the public sector from production activities.

In this connection, I would also like to add that the public sector's administrative capacity clearly has to be strengthened, as weaknesses have shown up in such crucial areas as the budget process, external debt management, and the restructuring of the parapublic sector.

Côte d'Ivoire's return to external viability will be a long, costly, and painful process. The staff rightly notes that one precondition to reducing the external debt overhang is to achieve a fiscal surplus. In this connection, I share Mr. Newman's concern about the timing and the pace of fiscal deficit reduction. We ourselves noticed that subsidies and other current transfers have increased during 1994 and would appreciate the staff's comments on this phenomenon. As to the debt overhang itself, Table 3 on page 58 of the staff paper contains the figures for Côte d'Ivoire's external public debt, including its obligations to the Fund. Could the staff give us an idea of the magnitude of the payments made by or on behalf of public enterprises, and indicate what kinds of problems this may create in terms of the privatization plans?

In conclusion, Côte d'Ivoire has taken important and decisive steps. Serious efforts are still needed on the structural front to keep the economy on the path toward strong and sustainable growth. We hope the authorities will be able to resist all imaginable pressures to do otherwise, and will stay on the courageous and correct course they have chosen.

We support the proposed decision.

Responding to a question from the Acting Chairman, Mr. Hamilius said that subsidies and other current transfers had increased sharply in 1994, as indicated in the staff paper.

Mr. Ishida made the following statement:

It is encouraging that 1994 economic performance was better than expected in terms of growth, inflation, and the external position. It is particularly welcome that, as a result of restrictive wage controls and relatively tight fiscal and monetary policy, inflation has been sharply reduced.

Nonetheless, it is hard to commend the authorities on full policy implementation. It is regrettable, for example, that structural reforms--privatization among them--have been delayed and that in end-December 1994 the authorities failed to meet some external obligations. I urge the authorities to continue efforts toward sustainable growth and toward improvement of external viability, particularly in the area of structural reform, while working hard at complete reduction of inflation.

Let me make a few brief comments on the policy issues. On the 1995 budget, it is reported that as a result of tax reform the 1995 revenue/GDP ratio is estimated to decline in comparison with that of last year. This is troubling; the present level is not sufficiently high. Although the tax reform, which is aimed at reducing dependence on export taxes--specifically on coffee and cocoa--is right on track, the extent and pace of this reduction's compensatory measures appears insufficient.

On the external sector, the program projects that capital accounts will move from the large 1994 surplus to a deficit in 1995. Looking carefully at the balance of payments table (Table 10 of the main paper), we found that, in the capital account, "other capital" will decline quite sharply, from $329 million in 1994 to only $16.7 million in 1995. What will cause this large decline in other capital? This demands an explanation.

On external competitiveness, according to the report on the foreign exchange and financial markets in April 1995, the French franc has appreciated against the U.S. dollar by over 17 percent in the last 12 months. Although the CFA franc appreciated by the same margin in that same period, how will this appreciation affect Côte d'Ivoire's external prospects? Although the authorities project that the full-year impact of the CFA franc's devaluation of January 1994 will contribute to a sharp increase in exports in 1995, I wonder whether this projection takes account of the recent appreciation of the French and CFA francs against the U.S. dollar. I would be interested in the staff's comments on these matters.

On the debt issue, although several previous speakers expressed their concern about Côte d'Ivoire's multilateral debts, I wonder whether the staff is of the view that providing the ESAF loan under the present terms of lending can be considered as "appropriately concessional," or in other words, whether the ESAF loan under the present lending terms might bring about so-called debt overhang problems. As I do not think that approving the proposed decision would cause a debt problem, I support the proposed decision.

Ms. Bessone Basto made the following statement:

Like the staff, I find encouraging the recent economic developments in Côte d'Ivoire which have kept the program firmly on track and have led to the observance of most of the program benchmarks set for end-December. With disciplined policies, the country managed to avoid high inflation rates and was, thus, able to obtain the increased competitiveness gains provided by currency devaluation. A firm implementation of wage policy and efforts in the fiscal area concerning both revenue collection and expenditures control were key factors contributing to this performance. Furthermore, improved performance in the public sector contributed to a significant increase in overall domestic savings, and a reduction of domestic payment arrears was achieved.

However, as was already noted during the midterm review of the first annual arrangement, the impressive results on the macroeconomic front are not yet matched by a parallel performance in the area of structural reform. Even though progress was made in liberalizing the economy, delays with respect to the privatization program, public sector restructuring, and the reformulation of the public investment program continued to hamper the achievement of the Government's goals.

In the economic program ahead, Côte d'Ivoire needs to consolidate the progress already made in restoring the conditions for rapid growth and domestic and external financial viability. This requires the creation of an environment conducive to private and foreign investment, which, in turn, calls for a more rapid pace of structural adjustment, and for the continuation of restrained fiscal and incomes policies, and cautious monetary policy. In addition, this strategy is closely linked to the future progress made in finding a solution for the external arrears situation. As I am in broad agreement with the staff's appraisal, I will make only a few comments.

Fiscal policy is correctly aimed at reducing the overall fiscal deficit. This is to be achieved with a tax strategy aimed at improving administrative efficiency and broadening the tax base--for which the Government has requested technical assistance from the Fund--and with an expenditure policy aimed at maintaining wage restraint and relocating spending toward priority sectors. However, concerning export taxes, even though I welcome the planned reduction of the rate of the overall levy on cocoa and coffee exports, I am still concerned by the strong reliance on these taxes, which contribute to distortions in both production and trade. I wonder what the rationale is for maintaining these taxes, thereby contributing to discourage production in the sectors that constitute such an important source of export revenue for the country.

Monetary policy is appropriately aimed at maintaining an inflation rate consistent with the exchange rate peg. While the reliance on indirect instruments for policy management constitutes an important step forward, efforts must still be made to increase the flexibility of interest rates. Moreover, high nominal interest rates have been partly responsible for the sharp contraction of credit to the private sector. Even though the lessening of inflationary expectations and the strengthening of domestic savings should continue to allow the progressive decrease of intervention rates, the reduction of financial intermediation costs through the elimination of inefficiencies in the financial system is crucial for the creation of conditions for private investment.

In conclusion, I am concerned that substantial shortcomings in the timeliness and reliability of national accounts and balance of payments statistics remaining in Côte d'Ivoire could cause difficulties in policy implementation. This notwithstanding, I find the authorities' commitment to resolve these difficulties reassuring, and the fact that they have requested technical assistance in this area is most welcome.

With these remarks, I support the proposed decisions.

Mr. Verjbitski made the following statement:

The Ivoirien authorities are to be commended for keeping their economic program broadly on track and achieving in 1994 almost all program targets. As I share the thrust of the staff appraisal of Côte d'Ivoire's updated medium-term program for the period ahead, and find myself in agreement with most of the previous speakers, particularly with Mr. Newman, to whose statement I can basically subscribe, I shall limit myself to commenting briefly on four selected issues for emphasis.

First, the Ivoirien authorities' macroeconomic policy framework continues to be appropriately focused on achieving a primary fiscal surplus, and eliminating domestic payments arrears. As rapid progress--and even overperformance--in these areas is desirable for regaining the confidence of private financial markets by Côte d'Ivoire, this chair stressed at the time of Board approval of the first annual arrangement under the ESAF in March 1994 that it might be prudent for the Ivoirien authorities to avoid eliminating some of the existing taxes before new taxes take root. In our view, a slightly higher tax burden in proportion to GDP at the initial stage of the post-devaluation adjustment would do more good than harm. In this regard, I welcome the fact that, on the advice of the staff, the authorities quite appropriately decided not to go ahead with the proposed reduction of the normal value-added tax rate. At the same time, I note that the authorities have lowered the import duty on vehicles and the beer tax. I would appreciate the staff's comments on the rationale for these measures, which is not quite obvious in the light of the authorities' stated program objectives to broaden the tax base and redirect taxation away from coffee and cacao exports.

Second, I share the view that Côte d'Ivoire should now intensify its structural reform effort, especially, in the area of public enterprise reform and privatization, while favorable economic conditions created by the courageous CFA franc realignment and significant competitiveness gains persist. It is most important not to allow the pre-election pressures to delay the planned privatizations of large public enterprises. Therefore, I am sympathetic to the view that progress in this area could be made a performance criterion under the program.

Third, a shift by the BCEAO away from direct control over the banking system and toward greater use of indirect monetary instruments in the conduct of monetary policy is certainly welcome. It may very well justify replacing, for 1995 program purposes, the former performance criterion of the net domestic assets of the banking system with that of the net domestic assets of the BCEAO, as suggested by the staff. With regard to the use by the BCEAO of securitized claims on member governments for a sort of "open market" operation to mop up excess liquidity, I share the staff's and other speakers' concern that the main features of this instrument--namely, a fixed interest rate and an automatic repurchase-at-face-value obligation by the BCEAO--make it an unsuitable substitute for Treasury securities in the secondary markets--which normally involve certain interest and credit risks. Thus, development of viable secondary markets for government securities should remain high on the list of priorities of the BCEAO, the Ivoirien, and other regional authorities.

Fourth, as stated by this chair on several previous occasions, my authorities welcome the initiatives aimed at deepening regional economic cooperation and integration. Efforts in this area are necessary to provide a stronger underpinning to the existing monetary arrangements. In this respect, the Ivoirien authorities should be commended for being among the front-runners in incorporating these initiatives in their policies under the present medium-term program. Given the limited administrative capacity of the member states of the West African Economic and Monetary Union, I fully support continued active involvement by the Fund's staff in providing the necessary technical assistance to these countries both individually and at the regional level, particularly in the area of monetary policy, and in the area of tax and tariff harmonization.

In conclusion, I wish the Ivoirien authorities continued success in meeting the challenges ahead and support the second annual arrangement under the ESAF, which fully warrants further generous financial assistance by other international bilateral and multilateral donors and creditors.

The staff representative from the African Department stated that the slow pace of investment during the first few months of 1995 appeared to be inconsistent with the authorities' commitment to public investment. The authorities might have been cautious about public expenditure during the first three months of the year, because of uncertainty about the disbursement of program assistance and revenue availability. Indeed, little foreign assistance had been disbursed during the first three months, and a large part of what had been committed had been conditional on Fund approval of the program. In addition, the World Bank disbursement, which had been conditional on full implementation of the economic recovery program, had been delayed because of difficulties in liberalizing the maritime transport sector. The loan was now in effect, and the disbursement would probably take place soon. Given its heavy external debt service, Côte d'Ivoire remained vulnerable to the pace of disbursements of foreign financing to stay current in its obligations. As the authorities were reassured by the prospect of disbursements from the World Bank and other donors, they undertook to eliminate all remaining external arrears by the end of the week.

The program allowed for an average increase of up to 5.5 percent in the base wage, which translated into a total wage increase of only 4 percent per worker, including indemnities, the staff representative stated. The staff had been concerned about the announced increases of between 3 percent and 15 percent, but the new wage structure showed that only 6 percent of civil servants would receive the maximum increase of 15 percent.

Public employment had been reduced by 3 percent in 1994, and by 18 percent over the period 1990-94, the staff representative said. Most of the reduction had been achieved through early retirement, voluntary departure, and layoffs. In a limited number of cases, employees had been shifted to public agencies made financially autonomous after substantial downsizing. That had happened for several agricultural agencies and the radio and television company in 1994. A further reduction in public employment of 2.4 percent in 1995 would be achieved by the application of the rules on early retirement and further downsizing.

Privatization divestitures were progressing, the staff representative stressed. The limited number of public enterprises receiving direct subsidies meant that their adverse impact on government expenditure was relatively unimportant. However, those enterprises constituted a burden to the Government in that they did not produce a sufficient return on the investment made by the Government. Other public enterprises constituted a drain on government expenditures because of the inability to pay their external obligations--obligations eventually assumed by the Government and currently included in the government budget.

Replying to a question from Mr. Verjbitski, the staff representative said that the tax rate on beer had been reduced from 25 percent to 20 percent in early 1994. Some officials in the Government had recommended a further reduction to 15 percent. The anticipated revenue loss from lowering the rate to 15 percent would be large--substantially larger than the revenue loss resulting from the reduction in the import tariff on vehicles and equipment. Therefore, the staff believed that such reductions should await an improvement in the fiscal situation.

The staff representative from the Policy Development and Review Department noted that the staff believed Côte d'Ivoire's multilateral debt service to be at manageable levels--less than 10 percent from 2005 to 2014--given concessional interest rates and anticipated rates of growth in exports.

Côte d'Ivoire should be able to service its debt to the Fund, the staff representative said. However, with unfavorable assumptions about the terms of debt and the rate of export growth, debt-service in relation to exports of goods and services would be less comfortable. That could be taken into consideration if the ESAF lending terms were to be reviewed.

The staff representative from the African Department, recalling a question of Mr. Autheman, said that the effects on the balance of payments of the appreciation of the CFA franc vis-à-vis the U.S. dollar had probably been neutral.

Mr. Koissy stated that he was grateful to Executive Directors for their constructive comments on Côte d'Ivoire's economy and for the strong support for the authorities' adjustment efforts. The authorities were strongly committed to the adjustment program and were determined to pursue the reform measures, as needed.

The authorities had made progress toward fiscal consolidation, Mr. Koissy stated. As described in the policy framework paper, they would continue to take measures to ensure deficit reduction over the medium term, and that more resources would become available to the private sector. Under current conditions, fiscal balance might be achieved earlier than projected. In the same context, structural adjustment efforts were being strengthened. The authorities were committed to the privatization process and were working with the staff of the Fund and the World Bank to ensure its success.

The Fund consulted with the BCEAO at several levels, Mr. Koissy remarked. During the Fund mission to Côte d'Ivoire, the staff had had an exchange of views with staff of the branch of the BCEAO in Abidjan. Some staff from BCEAO headquarters in Dakar had participated in the discussions as well. There were also twice-yearly meetings to exchange views. Ministers of the CFA franc zone countries did not rule out accepting the obligations of Article VIII, but they intended to give more thought to the issue at the time of the next meeting of the CFA franc zone in September 1995.

The authorities appreciated the external assistance they had received, which had made it possible for Côte d'Ivoire to achieve positive results, Mr. Koissy concluded. Serious challenges remained, including the large debt overhang. Côte d'Ivoire's success over the medium term would depend on continued access to financial assistance on highly concessional terms, and on debt relief.

The Executive Board took the following decision:

1. The Government of Côte d'Ivoire has requested the second annual arrangement under the enhanced structural adjustment facility.

2. The Fund has appraised the progress of Côte d'Ivoire in implementing economic policies and achieving the objectives under the program supported by the first annual arrangement, and notes the updated policy framework paper set forth in EBD/95/58.

3. The Fund approves the second annual arrangement set forth in EBS/95/72, Supplement 1.

Decision No. 10974-(95/49), adopted
May 19, 1995

4. ST. KITTS AND NEVIS - 1995 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1995 Article IV consultation with St. Kitts and Nevis (SM/95/86, 4/21/95). They also had before them a background paper on recent economic developments in St. Kitts and Nevis (SM/95/98, 5/5/95).

Mr. Clark made the following statement:

My St. Kitts and Nevis authorities are in broad agreement with the thrust of the staff report, and wish to signify their appreciation for the frank and open exchanges with the staff and the valuable advice tendered by them both on the occasion of their visit for the 1995 Article IV consultation and during the interim staff visit of April 1994.

The positive efforts of my authorities to pursue sound macroeconomic policies and the beneficial effects of membership in the Eastern Caribbean Central Bank (ECCB) monetary regime combined to make the economic outlook for St. Kitts and Nevis favorable in several respects. Stemming from successful diversification into tourism and from the implementation of infrastructure projects, annual real GDP growth was maintained at an average of about 3.5 percent during 1992-94, following a period of stronger growth in earlier years, and is projected to increase to about 5 percent in 1995. Monetary growth has been restrained, with net credit to the public sector by the banking system steadily declining. Accordingly, 12-month inflation, after reaching 4.5 percent in 1991, fell to 1.3 percent in 1994, and although expected to increase again in 1995, will remain low at just over 2 percent.

The sizable deficits that characterized the external current account for several years have been associated largely with the growth of the tourism sector and with implementation of public and private sector projects. Relatively large net private capital inflows--a substantial portion in the form of foreign direct investment--have therefore been sufficient to render the external current account deficit sustainable and to leave the overall external position in surplus, even though this surplus is presently at a very modest level. At the same time, imputed net international reserves of St. Kitts and Nevis at the ECCB have been growing regularly, providing a steady three-months' import cover. As a result of what the staff has described as "prudent borrowing policies," public external debt outstanding is relatively moderate at 22 percent of GDP, and the debt-service ratio has been below 4 percent.

My authorities are committed to exercising fiscal prudence and will be sustaining their efforts to strengthen the public finances. The modest overall deficit of the Central Government is widening slightly and the overall balance of the public sector, including the very healthy balances of the Social Security Scheme, slipped from a surplus of nearly 4 percent of GDP in 1992 to an average deficit of 0.5 percent in 1993-94. My authorities managed, however, to increase government revenues, excluding grants, to 25.5 percent of GDP in 1994. They expect to maintain the same ratio of government revenue to GDP in 1995 while cutting back current expenditure to 23.5 percent of GDP from the level of 25 percent of GDP reached in 1994. In this, government expenditure on wages will moderate to about 12 percent of GDP from nearly 13 percent in 1994.

My authorities agree with the observations of the staff on the importance of strengthening public sector savings in order to ensure adequate development of infrastructure in support of the leading role the private sector is expected to play in propelling growth. They accept that there is probably room for government revenue to rise closer to the average of 29 percent of GDP registered in other members of the ECCB, and have taken note of the recommendations of the staff with respect to the updating of property taxes, reduction of customs duty exemptions, and simplification of the tax system. The authorities are also anxious to contain expenditure further, including through a reduction in transfers and subsidies. In this connection, they are actively seeking to address the problem of the loss-making St. Kitts Sugar Manufacturing Corporation and have sought to interest prospective investors in taking over the entity, but concrete developments here are still awaited.

The authorities will be working toward achieving the projected increase in public savings, excluding grants, from over 5 percent of GDP in 1994 to nearly 8 percent of GDP in 1995, with government savings, excluding grants, moving from 0.6 percent to 1.9 percent of GDP. As reflected in the projections for the medium term set out in the staff report, it is the aim to keep public sector saving at about this level during the medium term up to the year 2000.

Regarding other issues, my authorities will be studying possibilities for civil service reform. They look forward to the results of the review being conducted with the assistance of the University of the West Indies, which will aid in drawing up a program to address the issue.

In the financial sector, my authorities are in favor of measures to improve the efficiency of intermediation and are participating in initiatives coordinated by the ECCB toward integrated capital market development in the ECCB group of countries. They expect that the impact of recently adopted uniform banking legislation, strengthened regional supervision of banks and nonbank financial institutions, and the establishment of a regional home mortgage financing entity will contribute to increased efficiency of the financial sector in St. Kitts and Nevis. My authorities note with interest the recommendation of the staff that the existing floor on savings deposit rates be removed, and they expect to address the matter jointly with the other members of the ECCB, as it is a measure that was collectively instituted by the ECCB Group.

Finally, my authorities are sensitive to the issues raised by the staff concerning labor market flexibility in general and minimum wage policy in particular. They reaffirm their intention to allow liberal entry of workers from the region for sectors experiencing labor shortage, and they will keep minimum wage policy under review with the aim of promoting basic social objectives without compromising the efficiency of the macroeconomic framework.

Miss Chang Fong made the following statement:

In the two years since our last discussion on St. Kitts and Nevis, the twin island state has continued to exhibit the signs of a thriving economy: real growth averaging 4 percent over the two years was among the highest in the Caribbean; inflation was down to 2 percent; and the external position was favorable. A number of constituent indicators are also worth noting: GDP per capita continues to rise; public sector savings increased from an average of 6 percent in the previous two-year period to 7 percent of GDP; gross external debt and debt service have been held at affordable levels; and imputed gross international reserves of three months of imports of goods and nonfactor services are also at comfortable levels.

With everything looking positive and in view of the quality of the coverage and analysis contained in the staff report, it leaves one with little to say. However, I will spend some time on two topics, and my comments are more in the nature of cautionary flags--the consequences for the fiscal position of increased capital investment and the diversification strategy and tourism potential.

The diversification of the economic base to tourism and nontraditional agriculture has had a positive impact on recent growth in the economy. The planned increases in public investment in a number of infrastructure projects will provide the basis for orderly expansion. The generally prudent fiscal stance of the Government in the past has enabled public investment to be almost fully covered by savings, but the more ambitious capital investment spending will require, as the authorities are aware, a higher level of savings in the public sector if the low level of debt exposure and debt service is to be preserved.

Improvements in tax administration supported a recovery in the current revenue/GDP ratio to 25 1/2 percent in 1993-94, but current expenditure was also higher, moving from 25 1/2 percent of GDP to 27 percent. Although there were special factors in 1993 and 1994 expenditure--one of which was related to law and order--these should not recur, and two items bear watching: the rising ratio of the public sector wage bill to GDP, which the staff has noted, and the desirability of raising the revenue/GDP ratio. There are two dimensions to the subject of public sector wages--the rates of pay and the total numbers. The general increases in pay including bonuses would seem to be generous having regard to the inflation record. It is to be hoped that the public administration review being conducted with the assistance of the University of the West Indies will be a comprehensive one that will include a review of the scope of services to be provided, manpower needs, remuneration, and the possibility of service charges.

In the quest to increase the level of public savings, it is to be noted that the benefits of improving tax administration will reach their limits, and, increasingly, attention must be paid to raising tax rates or reducing expenditure. With regard to the desirability of increasing the revenue/GDP ratio, although the ratio is not out of line with the rest of the Caribbean, it would be useful to bear in mind that this ratio in other countries is on a downward trend. Increasing the ratio of tax to GDP may have implications for the competitiveness of domestic firms and for the tourism sector. The authorities would need to give careful consideration to the appropriate mix between expenditure cuts and revenue growth.

On the diversification strategy, the relative success of domestic agriculture in the last few years--perhaps spurred by demand from the tourism sector-- prompts me to raise the issue of the sugar company and to ask whether, in reviewing the future of the sugar sector, alternative cropping of land now under sugar cultivation is being considered, having regard to the limited life of preferential arrangements for sugar exports. It is doubtful whether, even with the phasing out of agricultural support in industrial countries in the context of World Trade Organization obligations, the prospects for cane sugar have changed for the better.

On the subject of the tourism strategy, the low-impact nature of the current tourism strategy is a commendable one--the islands are small and the ecosystems are fragile. The ability to attract visitors at the targeted high end of the market will depend very much on maintaining this balance between the growth in tourism facilities and the environment. In this regard, I would be interested in whether the authorities have assessed the capacity potential for sustainable development of the sector or whether there is a desired target for, say, hotel room or visitor capacity. What I am suggesting is that the planning of infrastructure needs should take into account the level of environmentally sustainable tourism growth, which may promote prioritization of these projects to those providing the greatest return.

Diversification has so far had successful results in St. Kitts and Nevis, but the vulnerability to exogenous factors has not declined. The competition is getting more intense; almost every Caribbean island is expanding into tourism. It will be important for St. Kitts and Nevis to remain competitive.

Finally, we ask Mr. Clark to convey our commendations to the St. Kitts and Nevis authorities for the prudent management of the economy.

Mr. Ruocco made the following statement:

I find St. Kitts and Nevis' economic performance broadly satisfactory in recent years; however, I understand that some areas need to be strengthened in order to build a more solid economy. Because I am in general agreement with the staff's appraisal, I will concentrate my remarks in three specifics areas: the public finances sector; the external sector; and the financial sector.

Regarding public finances, I find that in spite of the relatively low level of the fiscal deficit registered during 1994--1.8 percent of GDP--this deficit has increased for a second consecutive year and is projected to reach 2.8 percent by 1995, mainly financed with foreign resources. In this connection, measures oriented toward increasing revenues and reducing current expenditure should be adopted in order to generate enough room for financing public investment.

In this sense, we welcome the authorities' willingness to take note of the recommendations of the staff with respect to the updating of property taxes, the reduction of import duty exemptions, and the improvement of tax administration. In addition, efforts in reducing expenditures are needed--especially on wages, transfers, and subsidies--not only to improve public finances but also to minimize distortions in the economy. I welcome the initiatives of the authorities in dealing with the problem of the loss-making St. Kitts Sugar Manufacturing Corporation, offering it to prospective investors.

With respect to the external sector, I note that the economy will continue to be vulnerable to external shocks and dependent on large capital inflows, which are projected to more than offset the external current account deficit. Additional efforts in seeking diversification of the economy to reduce the vulnerability of the economy remain a challenge to the private sector, and the authorities should be vigilant in pursuing cost-containment policies to maintain external competitiveness. By contrast, I observe that St. Kitts and Nevis has made good use of direct foreign investment as a way of avoiding heavy debt-service pressures, giving the economy a better economic spectrum.

On the financial sector, I have noted that discussions have arisen on the issue of the existing floor on savings deposit rates. On this point, I concur with the staff's recommendation that this floor be removed, and I encourage the authorities to consider this matter jointly with the other members of the Eastern Caribbean Central Bank as a collective decision. Initiatives in improving the efficiency of intermediation and consideration of an integrated capital market among the ECCB group of countries are also very welcome.

Mr. Shields said that he wished to congratulate the authorities on the good performance of the economy and the generally sound policies followed. Those policies were based on a prudent approach to fiscal management that provided room for infrastructure investment, largely provided by foreign investment. He would encourage the authorities to move more quickly to implement public investment projects, however. He noted that monetary policy management by the Eastern Caribbean Central Bank had served the country well. He was gratified that the local security problem had eased in the preceding year.

Despite the overall positive situation, there were still further steps for the authorities to take in liberalizing interest rates and removing the remaining price controls, Mr. Shields noted. In that connection, broadening the minimum wage structure might be inadmissible. Despite the general advantages of greater openness, care needed to be taken that the islands' banking system was not used as an intermediary for illegal activities.

A broader revenue base would increase public savings, Mr. Shields stated. In that context, the suggestions in the staff report for overhauling property tax assessments, reducing import duty exemptions, and making general improvements in tax administration were particularly relevant.

With regard to structural reform, quick divestment of the Sugar Manufacturing Corporation would be a wise move, Mr. Shields considered. Also, he hoped that useful recommendations would come from the current review of the civil service, and that they would be implemented. With an election due at the end of the year, it would be important to keep control of public expenditure, particularly on wages. It would be unfortunate were the generally good performance to be interrupted by political developments.

The staff representative from the Western Hemisphere Department stated that the staff felt that the prospects for divesting the sugar company were not good. It needed to be borne in mind that the authorities were encouraging a gradual shift to nonsugar agriculture, concentrating on the production of vegetables for domestic consumption, but with an eye on the environmental ramifications of such a change. The staff had encouraged the authorities to explore other alternatives.

The authorities were concerned about striking a balance between expanded tourism to obtain higher growth rates and maintaining a healthy environment, the staff representative observed. The fear was that tourism construction would spoil the environment, and the authorities were working with the United Nations Development Programme on guidelines in that respect.

Mr. Clark thanked his colleagues for their comments. Directors had considered that the authorities had not developed a strategy for sustainable development. Therefore, a few wrong moves in tourism development could clearly have a large impact on a country of only 42,000 people, with unfortunate results in five or ten years.

The Acting Chairman made the following summing up:

Executive Directors were in broad agreement with the staff appraisal. They noted the strong economic growth, low inflation, and overall balance of payments surpluses, and commended the authorities for the continued pursuit of a prudent fiscal policy that had contributed to the good economic performance in 1993-94. Although the economic performance during that period had been accompanied by a widening of the external current account deficit--reflecting increased spending on infrastructure projects--it had been financed by continued large private sector capital inflows.

Directors observed that the economy remained vulnerable to external shocks and expressed support for the authorities' strategy of raising economic growth over the medium term and containing inflation through diversifying the productive base. In that context, they noted the importance of ensuring that expansion of the tourism sector was managed in a way that was compatible with protecting the environment. They stressed that implementation of the planned medium-term public investment program would require further strengthening of public sector savings, which should involve action on several fronts: containment of the wage bill, reduction of subsidies and transfers, and measures to raise revenue, such as overhauling property tax assessments to bring them closer to market values.

Noting the deteriorating financial position of the state-owned sugar company, Directors recommended that the authorities intensify efforts to privatize it, while at the same time appraising the long-term future of the sugar industry on the island.

Directors encouraged the authorities to explore the possibility of removing the minimum interest rate on savings deposits, while recognizing that such a decision would need to be taken within the framework of the Eastern Caribbean Central Bank.

It is expected that the next Article IV consultation with St. Kitts and Nevis will be held on the 24-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/95/48 (5/17/95) and EBM/95/49 (5/19/95).

5. ADVISOR TO EXECUTIVE DIRECTOR - WAIVER OF ACCELERATED REPAYMENT OF SALARY ADVANCE

The Executive Board approves the proposal to waive the accelerated repayment of a salary advance of an Advisor, formerly a member of the staff, as set forth in EBAM/95/74 (5/12/95).

Adopted May 17, 1995

6. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 94/47 are approved.

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/95/77 (5/15/95), and EBAM/95/78 (5/16/95), by an Advisor to Executive Director as set forth in EBAM/95/78 (5/16/95), and by an Assistant to Executive Director as set forth in EBAM/95/76 (5/15/95) is approved.

APPROVAL: December 17, 1996

REINHARD H. MUNZBERG
Secretary