CONFIDENTIAL

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COMMITTEE ON THE BUDGET

Meeting 94/4

10:00 a.m., May 31, 1994

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. Al-Tuwaijri
	P. Cailleteau, Temporary
J. Bergo	
	C. Gaseltine, Temporary
	T. Fukuyama
K. P. Geethakrishnan	
J. E. Ismael	
D. Kaeser	
	A. Chang-Fong, Temporary
	A. V. Mozhin
	J. Prader
	B. S. Newman
	P. A. Merino, Temporary
	M. Daïri
	Y. Patel
	R. von Kleist, Temporary
A. S. Shaalan	
	G. F. Murphy
E. L. Waterman	
	Wei B.
	A. F. Jiménez de Lucio

J. W. Lang, Acting Secretary
C. P. Clarke, Assistant

Also Present

Administration Department: A. D. Goltz. Central Asia Department: I. Otani. Legal Department: W. E. Holder, Deputy General Counsel. Secretary's Department: A. Mountford. Treasurer's Department: G. Wittich, Deputy Treasurer. Office of the Managing Director: P. R. Narvekar, Special Advisor; J. Prust; Office of Budget and Planning: L. A. Wolfe, Director; J. G. Blanch, P. J. McPhillips, M. Oka, H. Wiesner, A. A. Zimmerman. Advisors to Executive Directors: M. F. Melhem. Assistants to Executive Directors: O. A. Himani, T. Kanada, E. Kouprianova, N. Laframboise, G. J. Matthews, S. Rouai, M. W. Ryan, A. Sighvatsson.

1. PROGRAM OF WORK FOR FORTHCOMING MEDIUM-TERM BUDGET

The Acting Chairman said that the purpose of the meeting was to consider a possible work program for the medium-term budget in the period ahead. To that end, the staff would begin the discussion by describing the schedule of steps that would be followed during the course of the year in preparing the medium-term budget and the budget for financial year (FY) 1996.

The Director of the Office of Budget and Planning remarked that the budget schedule for the coming year would begin in mid- to late June with the issuance of medium-term budget instructions to departments. That exercise required departments to provide a great deal of information, based on criteria established each year, by early September. With that information in hand, the Office of Budget and Planning would begin to prepare for management a series of options. A paper would be circulated to the Board in mid-November in the form of the Managing Director's statement on the medium-term budget. As in the past, that statement would be discussed by the full Board in December, but it was assumed that there would henceforth be some prior discussion by the Budget Committee in late November or early December.

Following the December Board discussion on the medium-term budget, the Director continued, the Office of Budget and Planning would ask departments for specific information needed to prepare the budget proposal for FY 1996 on the basis of the accepted scenario. The resulting Board document would be issued in March, and would be discussed by the Board in mid- to late April. Again, it was assumed that the full Board meeting would be preceded by a meeting of the Budget Committee. In the coming few weeks, a paper would be issued on the final outturn for FY 1994, and a six-monthly review of the current financial year would be issued in November. Those papers had traditionally been issued separately, although the medium-term exercise included the staff's best estimates of the current year's final outturn.

It was proposed to follow the same procedure in preparing the paper on the medium-term budgetary outlook for FY 1996-98, the Director said. Two scenarios might be included in the Managing Director's budget statement to the Board: one scenario would imply a small reduction in the budget; a second scenario would incorporate an increase in the budget based on the workload of the institution. The paper would be strictly neutral on the choice between the two alternatives. The workload did not appear to be decreasing, so any decision not to increase the resources available to the Fund, or to decrease them, would have longer-term implications that would need to be investigated.

The Budget Committee might want to consider two specific issues over the summer while the staff was assembling the information for the Managing Director's medium-term budget statement, the Director remarked. It was apparent from recent Board discussions that there was a need to focus more on the budgetary aspects of technical assistance and the resident representative program. A third issue that the Committee might want to take up was the changing role of the secretarial staff within the institution, an issue already identified by Mr. Waterman. The staff could aim to include in the forthcoming medium-term budget paper some background information and statistics on that issue, with a view to preparing a full paper in a year or so.

The Acting Chairman commented that there was still a strong presumption that the policy of budgetary consolidation would be continued. Nevertheless, part of the purpose of the forthcoming medium-term budgetary exercise would be to canvass departments on their views in that regard, without making any prior judgments as to major activity cuts, or increases in some cases, that could be implemented in the medium term. The staff was not forecasting, at least in the immediate future, a decline in activity in support of surveillance, technical assistance, or the use of Fund resources, which were the three major categories in the budget; indeed, in areas such as technical assistance, demand continued to be heavy and might be expected to grow. Whether such activities could be increased over the medium term while maintaining budgetary consolidation would depend in part on continued productivity improvements. The budget process each year tried to examine ways in which productivity could be improved, either through improvements in the way that work was done or through greater automation.

Mr. Newman said that it would be interesting to know more about the budget instructions that would be sent to departments, and how they would be developed.

The Director of the Office of Budget and Planning replied that the budget instructions were the result of interaction between the Office of Budget and Planning and management, taking into consideration the overall budget stance agreed by the Board. The thrust of the instructions for the coming budget would be a scenario of no growth in either nominal or real expenditures and in effective staffing. Given the expected workload for the coming three years, departments would be asked to identify the areas of high and low priority and activities that could be eliminated altogether. Detailed descriptions of their work programs for the coming period would be circulated to the Board as a supplement to the medium-term budget paper. Departments would also be asked to provide estimates of their staffing needs under various scenarios, broken down by a number of specified work activities. Thus, they would be asked to describe the implications of no change in staff or even a small reduction over each of the coming three years; a third scenario would be to leave it to departments to indicate their staffing needs without imposing a specific ceiling.

Mr. Newman observed that the medium-term budget reflected a rolling three-year strategy, and that the FY 1995 budget was the second year of the current three-year cycle of zero real growth. He wondered whether the budget instructions would provide alternative options for zero growth, other than zero growth in real terms, and how different assumptions would be factored into those instructions for the out years.

The Director of the Office of Budget and Planning responded that FY 1995 was, in a sense, the first year in a new three-year cycle. Management had taken the view in the medium-term exercise that FY 1995 would be very much a year of consolidation. It was still assumed, of course, that there would be a period of consolidation from FY 1996 to FY 1998. The budget process did, indeed, account for specific activities that tended to have a cyclical character, such as the activities related to holding the Annual Meetings abroad.

Mr. Waterman said that it might be useful to have a general discussion about the way the Committee went about its work, which was very much the theme of a memorandum that he had circulated to Committee Members on May 25 (see Annex). It was generally agreed that the Fund was in a period of consolidation and restraint. There was also general agreement that if the involvement of the Committee in the budget exercise were to be effective, it would be necessary to take a longer-term view. The general approach outlined by the Director of the Office of Budget and Planning made a great deal of sense. The key question was how both the Committee and the staff could work within a somewhat longer-term time horizon.

Any such exercise had to work against some base, Mr. Waterman noted, and he would be content if the Committee's comments and the work of the staff were undertaken against the baseline numbers that the Office of Budget and Planning prepared and updated periodically. In the end, the Committee's input would consist mainly of developing those numbers and refining them into detailed numbers for budgetary purposes. In his memorandum, he had suggested that it might be useful to take the baseline numbers and then analyze the implications of effecting savings on those numbers. Targeting a reduction in the rate of charge was one approach that might bring some focus to the Committee's work, although savings on the expenditure side did not translate in any mechanical sense into a reduction in the rate of charge. Nevertheless, the Committee and management might begin by analyzing the implications of generating savings equivalent to 15-25 basis points. At the lower end of that range, the implied savings would amount to about SDR 50 million over a period of three or four years.

Such an exercise might involve a number of elements, Mr. Waterman considered. The first element would comprise measures that could be taken relatively easily in terms of reducing the costs associated with the Annual Meetings or eliminating subsidies. The second element would consist of the kind of savings touched on by the Director of the Office of Budget and Planning: ongoing productivity improvements existed in all public sector bodies, although they remained difficult to measure. On an earlier occasion, he had noted that a number of countries avoided that problem by assuming a certain increase in productivity, expressed as a percentage of total expenses, which provided a useful discipline on organizations. The third element involved the more difficult task of deciding whether resources were more than adequate to meet the institution's fundamental objectives, whether those objectives had been met, and whether new objectives or responsibilities could be expected.

For his part, Mr. Waterman commented, he would prefer to stay away from a discussion of the details. To get the process moving, however, it would be useful to have some analysis of possible savings over the next few years. A longer-term time horizon offered many more possibilities to effect savings, and most Committee members had views on where savings could be effected. In that context, it would also be useful to have a more general discussion about the role the Committee might play and the way in which it would interact with the existing process.

Mr. Newman said that he appreciated Mr. Waterman's ideas on the role of the Committee in the budget process, which should help to focus the discussion. He strongly shared the view that if the Committee were to be effective, it must be involved in the budgetary process at an early stage. While the Committee should avoid dealing with the details of the budget, its major contribution would be in developing the medium-term strategy for the Fund, and in particular in providing for the Board alternative scenarios. In that regard, it was to be hoped that the forthcoming budget instructions would reflect the request of a large number of Directors to consider a number of alternative medium-term strategies. In his view, the Committee should be involved in developing the budget instructions, as they seemed to be the baseline that drove the budget process.

The second phase of the budget process involved implementation of the agreed strategy, Mr. Newman observed. In that context, staff cost were the largest item in the budget, and the Committee should be able to look at alternative ways of meeting those costs. For that purpose, it might be useful to have some sense of the ratio of economists and administrative staff to support staff. As the Committee developed alternative options, it would be important to know how the three categories of staff had evolved, both within the institution and relative to other institutions.

In implementing any budget strategy, Mr. Newman continued, the Committee would want to focus on specific items in the budget where there might be a need for savings or where there might may be a need to increase expenditures, reflecting changing priorities within an overall strategy. Mr. Waterman had suggested three particular areas that might be examined, but there were obviously others. One of the largest costs, and one that would dominate expenditures over the coming few years, was Phase III. The Managing Director had recently circulated a note to Directors responding to suggestions for greater involvement by the Board in monitoring Phase III, an area where the Committee could play a particularly useful role on behalf of the Board. The Committee could participate in that process directly, recognizing that the related material was generally sent to the Board on a delayed or less-frequent basis than might be practicable for a committee. The focus should be not only on the overall cost, but on how expenditures within those cost ceilings might be altered to reflect changing priorities.

Mr. Geethakrishnan remarked that there were two separate but related issues. One issue was what it was that the Committee wanted to do; the other issue was how to go about it. With respect to the first issue, the

Managing Director in earlier meetings had adopted a golden rule of pursuing an objective of zero growth in the budget, aiming at a certain reduction over a period of time but recognizing that a large organization like the Fund, which needed to adjust to a changing external situation, could not have any preconceived targets. In the absence of preconceived targets, however, it was necessary to impose some other discipline on the process.

The Fund gave advice to the countries that came to it for financial support, Mr. Geethakrishnan observed. In each of those countries, the existence of subsidies had been fully justified over the previous 30-40 years. It was only through the introduction of an external factor--say, the need to reduce the fiscal deficit--that it became necessary to revisit those issues and to subject them to discipline. Similarly, if the Fund did not set a budgetary framework, each item of expenditure could continue to be justified. For that reason, he would strongly favor the approach outlined by Mr. Waterman, Mr. Peretz, and others over the years: even if it was not possible to agree on a zero-based budget, or a reduction of 10 percent over a given period, it should be possible to accept that any review of the budget should stem from the need to reduce burden sharing. In the absence of a goal of some sort, there would be no incentive to consider critically specific expenditures. The cafeteria subsidy was a case in point: the subsidy might have a number of merits, but if it were agreed that the overall objective was to bring down the rate of charge, eliminating the cafeteria subsidy would be that much easier.

With that in mind, Mr. Geethakrishnan continued, the Budget Committee should consider setting itself some framework of discipline within which the entire budget could be explained. In particular, it should begin to consider the framework of discipline within which the budget would be prepared for the coming year or even the coming three years.

In considering how the Committee should conduct its work--the second issue that he had identified--the Committee was hampered by the more or less general lack of detailed experience or knowledge needed to suggest specific cuts in expenditure, Mr. Geethakrishnan considered. If that was to be part of the Committee's mandate, the prerequisite would be to generate within the Committee and the Board the necessary exposure, which could come in the form of quarterly reviews of the budget for the current financial year. If the Committee reviewed the trends in budget expenditure and receipts, Committee members would become familiar with all aspects of the budget and its implementation. Furthermore, the medium-term budget review in December of each year could be combined with a discussion of the budget for the coming year, which would give the Committee and the Board an opportunity to influence the annual budget. Under existing procedures, there was no way for the Board or the Committee to contribute in a meaningful way to the formulation of the budget for a given year.

Mr. Al-Jasser observed that a fundamental issue raised by Mr. Waterman was how Directors could give operational meaning to the agreements that had been reached during the December 1993 Board discussion on the medium-term budgetary outlook. After the large increase in staff and in the budget over the previous three years, management had presented Directors with a plan of consolidation, very much in the spirit of the December 1993 discussion. The question remained, however, whether consolidation should be defined to mean, say, zero real growth, zero nominal growth, or a 15-20 basis point reduction in the rate of charge over the coming one to three years. The next step should be for the staff to report to the Committee on expenditure trends over the first six months or so of the financial year, the expected needs of the institution for the remainder of the year, and the implications of the various budget scenarios that had been discussed. Productivity gains would be an important element in the budget picture, given that the large number of new staff would be expected over time to attain the level of productivity of the existing staff.

Mr. Kaeser remarked that there should be a closer link in time between the discussion of the work program and the discussion of the medium-term budgetary outlook. On issues to be discussed by the Budget Committee, he could go along with the suggestions of the staff on technical assistance, the resident representative program--including the issue of the sequencing and duration of missions--the Annual Meetings, and Phase III.

With respect to the possible targeting of a reduction in the rate of charge, he wondered how Mr. Waterman's idea would deal with changes over time in the volume of Fund lending, Mr. Kaeser said. Changes in the volume of its lending might tend to change the budgetary situation of the Fund.

Mr. Jiménez de Lucio stated that he agreed with both Mr. Waterman and Mr. Geethakrishnan on the need to decide promptly on the medium-term goal for the budget. Different proposals had been made at the time of the December 1993 Board discussion, and the idea of zero real or zero nominal growth seemed to enjoy substantial support, which should help to guide the staff as it began to prepare the budget.

Staff costs dominated the budget, Mr. Jiménez de Lucio noted. Given the fluctuation in real salary increases in recent years and their impact on the budget, the size of any prospective salary increase should be analyzed in detail. It might be useful to explore the implications for other cost items of a real salary increase of, say, 1-3 percent under the scenario of zero real growth in the budget.

Mr. Fukuyama said that given that the Board had judged in recent years that large increases in the budget had been necessary, any decision to reduce the budget should be consistent with the proper functioning of the Fund. He was rather uneasy about agreeing at the present stage to a specific budget reduction goal. It would be useful to hear first from management on the spending reductions that it envisaged under its medium-term strategy of budget consolidation. He could agree on the need for more detail on the implications of different assumptions for the budget.

Mr. Waterman noted that the Budget Committee was not a decision-making body; it was designed to help the Board in its consideration of the budget. The focus of the Committee's work should be on exploring the various options within a longer-term framework. Thus, the Committee might first explore a range of options against a baseline range of figures, and then come to a view about whether or not to make specific recommendations.

Mr. Fukuyama, referring to the presentation of the salary increase issue by Mr. Jiménez de Lucio, remarked that a decision to increase salaries in the context of zero real growth implied offsetting expenditure reductions elsewhere in the budget. It was not clear to him how such reductions could be justified.

Mr. Jiménez de Lucio commented that the largest cost factors in the budget, including the salary increase, should be subject to some sensitivity analysis to assess the implications for the budget of different assumptions about their magnitude.

Mr. von Kleist agreed that the Committee should set a specific budget target but, like Mr. Kaeser, he was reluctant to rely on the rate of charge for doing so because other important factors influenced that specific variable.

Mr. Waterman recalled that he had not suggested that the Committee should set an objective in terms of the rate of charge per se. Rather, an objective could be set in terms of savings equivalent to some fraction of the rate of charge at a certain point in time. A range of 15-25 basis points would imply, at the low end, savings of about SDR 50 million over three or four years. Such a target would not necessarily translate into a 15 basis point reduction in the rate of charge. There were of course a number of factors that affected the actual rate of charge, not least what happened to the size of the Fund's balance sheet. The numbers that he had mentioned had been derived on the basis of the present situation.

Mr. Geethakrishnan said that he had not suggested a fixed target with which to start the exercise because he preferred to keep an open mind on whether the Committee should work toward a reduction in costs or, say, the rate of charge. He had suggested linking the exercise to trends in actual expenditure as a way of encouraging new ideas. For instance, it might be that the volume of Fund lending to traditional borrowers in Africa, Latin America, and Asia in FY 1996 would be somewhat lower than in previous years, in which case the Budget Committee might want to consider whether staff should be diverted from work on those regions to Europe or the countries of the former Soviet Union. In sum, a careful analysis of trends over a three to six month period would reveal numerous areas where closer inspection could be warranted.

Mr. Al-Jasser suggested that it would be useful if Mr. Geethakrishnan could elaborate in writing on his ideas for giving the Committee operational content. In any event, the Committee should agree on a basis for its work and ask the staff to report to the Committee on the implications of the agreed scenarios.

Mr. Murphy remarked that he agreed with much of what had been said, which seemed very much in line with Mr. Smee's views on the budgetary process and the rate of charge. In more general terms, however, the Committee should probably first develop a consensus on the purpose and guiding principles of its work. The Board would then need to give its blessing to the exercise, which would provide the necessary authority for the Committee to consider a specific medium-term budgetary strategy.

Mr. Geethakrishnan observed that, while he could quite readily prepare a paper on the issues at hand with the assistance of the staff, such an approach by an Executive Director should be avoided. As he had suggested previously, the staff should be asked to provide the Committee with a detailed analysis of the budget for FY 1994, both receipts and expenditure, so that the Committee could have an open discussion with the staff on the details.

Mr. Al-Jasser, referring to Mr. Murphy's suggestion, noted that the December 1993 Board discussion on the medium-term outlook had provided the opportunity to agree on the purpose of the Budget Committee. After an increase in the budget of more than 25 percent within less than three years, the Board had concluded that the institution should enter into a period of consolidation, a position that was shared by management. Therefore, the current exercise of cost rationalization was not being conducted in a vacuum; the parameters of the exercise had been set.

Mr. Murphy agreed that the Board had provided general guidance toward consolidation, but general guidance was not enough. It was apparent from the present discussion that Committee members had different views on the implementation of that guidance; the most obvious difference was related to the relevance of the rate of charge to the targeting of expenditure reductions. Therefore, some further effort was needed to agree on key issues, such as the size and pace of the consolidation effort, without which further discussion was unlikely to be productive.

Mr. Al-Jasser said that he was in agreement with Mr. Murphy that the Committee should concentrate its efforts on giving operational content to the Board's general guidance toward consolidation. In the end, the various scenarios being requested of the staff were intended only to help the Committee understand the operational consequences of various suggestions.

Mr. Waterman remarked that he agreed very much with Mr. Al-Jasser. The Board had discussed the general issue in some detail and had reached a considered position. It was up to the Committee to get on with its work, with a view to assisting the Board with its further consideration later in 1994 and early in 1995. In his view, the Committee would be able to consider a broad range of suggestions within the context of the various scenarios that would be prepared by the staff, a process that would not be too complex.

With respect to the relationship between the definition of a reduction in expenditures and the rate of charge, Mr. Waterman continued, he did not have in mind any sort of mechanical linkage. He had used the rate of charge as a benchmark in trying to come to a view about what might be a reasonable objective for savings to the Fund and its borrowing members. He recognized that achieving a targeted level of savings in terms of the rate of charge would depend on a variety of developments and that the precise impact on borrowing members of such an approach by an Executive Director could not be predicted; it would, nevertheless, have a significant impact on those members.

Mr. Newman said that he shared the views of Mr. Al-Jasser and Mr. Waterman. He would be hesitant to encourage the Committee to go back to square one in trying to define the specific guidelines for the current exercise; the Board had already provided the necessary guidance toward a strategy of consolidation. As with national budgets, it was necessary to look at both the revenue and expenditure sides of the Fund's administrative budget. A zero-growth budget, by its nature, focused on the expenditure side; the proposals by Mr. Waterman and Mr. Geethakrishnan focused on the revenue side. It was useful to note, moreover, that the Board would begin a debate in the coming days on the financing of the Fund's operational and administrative structures in the context of the discussion of the Fund's net income, precautionary balances, the rate of charge, burden sharing, and related issues.

In his view, Mr. Newman commented, the Committee's next step should be to decide on the timing and purpose of its next meeting. He would have no objection if, in developing instructions for departments, the staff examined both a zero nominal growth and a zero real growth scenario, exploring their implications for both expenditure and the assumptions with regard to income. If either or both scenario proved feasible in the context of reducing the rate of charge, the Board should of course be made aware of that fact. In the end, the key for both the Committee and the Board was to have access to alternative options, so that a reasoned judgment could be made early on in the process, rather than simply being confronted at a late stage with the assumptions that the staff and management had made. With that in mind, he would hope that a further discussion could be held to consider what the instructions would look like under alternative assumptions before they were sent to the departments toward the end of June 1994.

The Acting Chairman remarked that budget instructions issued to departments, which would be informed by the guidance provided by the Budget Committee and the Board, would have to remain the prerogative of management. Among other things, there were important operational reasons for retaining the existing lines of responsibility.

Mr. Newman said that he was concerned that, under the existing lines of responsibility, by the time the budget proposal came to the Board there would not be enough information with which the Board could make a judgment as to alternative assumptions. There was no desire on the part of the Committee or the Board to involve itself in details; it should be possible, however, to consider the preliminary implications of an alternative assumption of zero nominal growth, for example. Under the process envisioned by the staff, the Committee would not have that information. As long as he could be confident that the instructions would include an alternative option, he would not insist on seeing the instructions themselves.

The Acting Chairman observed that a scenario of zero nominal growth implied a real cut in the budget, a scenario that would indeed be included in the instructions issued to departments. There would also be a scenario showing the implications of a real increase in the budget, with a management proposal built around those scenarios. Therefore, the Board would be able to examine the implications of various alternatives.

Mr. Newman said that he would not have a problem with the staff examining the implications of a real increase in the budget, as long as the documentation circulated to the Board would provide all the options and that the Budget Committee would have an opportunity to vet the documentation in advance. It was essential to avoid a situation in which the only discussion of the forthcoming budget occurred in December when a final decision would have to be made.

The Director of the Office of Budget and Planning noted that the preparation of budget scenarios was a time-consuming and resource-intensive process. Moreover, each scenario could be approached in a number of ways, which in the absence of some limit would quickly overwhelm the capacity of the staff and, indeed, the Budget Committee and the Board. For that reason, the instructions tended to lean toward too few rather than too many scenarios. As had been mentioned, the budget instructions would include a real reduction scenario of some sort; several suggestions had been made by Directors in that respect, which would be taken into consideration. It should also be noted that in considering the zero-growth budgets of the 1980s, the Board had been presented with several options and scenarios; in the end, however, the position of the Board as a whole had not been very clear, an issue that the Budget Committee might wish to consider.

Mr. Geethakrishnan recalled that his suggestion had been characterized by Mr. Newman as focusing on the revenue side of the budget. It was true, of course, that he had referred to the rate of charge, but the rate of charge in the case he had considered did not determine revenue. Given the fact that the projected volume of purchases in FY 1995 would be lower than in the previous year, reducing the rate of charge would result in a contraction of expenditure. Thus, while he and Mr. Newman approached the issue from different perspectives, the end result was the same.

The Acting Chairman commented that it might be useful to have a seminar on the relationship between the administrative budget and the rate of charge. That was a complex relationship, because much depended on the movement of the U.S. dollar vis-à-vis the SDR.

Mr. Al-Jasser remarked that the Director of the Office of Budget and Planning and Mr. Newman appeared to be in agreement. The instructions to departments would take into account various scenarios, the articulation of which would benefit from the deliberations of the Committee. As he understood it, the envisaged process would offer Committee members a chance to better understand how the implications of each scenario had been drawn, and to make their preliminary views known on each scenario. Indeed, it was entirely possible that the Committee would find the implications of certain scenarios troubling.

The Acting Chairman agreed that it would be difficult to predict the reaction of Committee members to each of the scenarios, although the process was likely to be divisive within both the Board and the staff.

Mr. Al-Jasser commented that the divisiveness to which the Acting Chairman had referred was inevitable in any institution. The Committee was helped in resolving that problem by the knowledge that management and the staff would provide Committee members with their best judgment on the most appropriate scenarios.

The Acting Chairman recalled that Mr. Murphy had noted that a consensus had not yet been reached on the kinds of activity cuts that would be necessary to give operational content to the Board's general guidance. It would, indeed, be useful to have that kind of input prior to making decisions, but the circulation to the Board of various scenarios would itself trigger a debate within the Board on the broad activities that should be increased and those that should be reduced.

Mr. Kaeser stated that one relatively easy way of exercising budgetary restraint was to exert control over the size of the staff. It might be useful, therefore, to consider whether a more sophisticated approach to controlling staffing could be introduced, perhaps when the Committee takes up the relationship between administrative and professional staff.

The Acting Chairman observed that the size of the support staff had been quite restrained relative to the size of the economist staff. One of the repercussions of that restraint was a sense among the support staff that they were being squeezed in order to constrain the growth in the budget, an issue to which management would need to devote continued attention.

Ms. Gaseltine said that it was appropriate that the current budget process was starting from a position of quite unusual consensus, among both the Board and management, on the need for medium-term consolidation and the virtues of setting some sort of clear objective for the medium term. There was thus an opportunity to combine a cost ceiling approach with the existing practice of asking different departments to consider alternative scenarios, which was in keeping with the budgetary approach long espoused by her chair. Indeed, when provided with the right sort of incentive--such as through a clear cost ceiling--departments could come up with valuable ideas as to the most efficient and cost effective way of using the resources allocated to them.

She agreed that there was a need to generate a healthy debate, using alternative scenarios, on the meaning of consolidation, Ms. Gaseltine remarked. The process would be facilitated by the provision of a greater degree of information to the Committee and the Board on the alternative scenarios that departments would be asked to consider, including the sensitivities involved. As noted by Mr. Geethakrishnan, there was also a need to find a way for the Committee and the Board to have a better feel for budgetary trends, rather than the underlying details of the budget; too much emphasis on detail would run the risk of micromanagement, which no one desired. A retrospective discussion of the income and expenses for FY 1994 could well be a valuable way of achieving that objective.

A counterpart to the more general exercise was the way in which the Board and management considered proposals during the course of the year for new work, Ms. Gaseltine commented. She wondered whether it would be possible to assign a cost to each such proposal, so that the Board had a better idea of the amount of resources that might be involved in approving specific proposals; indeed, it was striking that the cost element was missing from the consideration of the work program.

The Acting Chairman noted that, by way of background to the present discussion, real expenditure had actually increased between FY 1980 and FY 1986, had declined thereafter until FY 1989, and had then begun to rise again. In fact, real expenditure had not returned to the level of FY 1986 until FY 1991-92. While quantitative overall targets might sometimes be useful, therefore, they could not substitute for a careful examination of the factors driving the work of the institution and, in particular, for decisions on increasing or reducing expenditure, where those decisions were subject to the discretion of the Board. There were many expenditures that were not in fact subject to the discretion of the Board: expenditures had risen dramatically in the early 1980s, for example, because of the debt crisis; expenditures had eased off in the mid- to latter part of the 1980s, because the level of program activities had declined. The establishment of the enhanced structural adjustment facility and, later, the large influx of new members had also led to a big increase in expenditure.

As noted by Mr. Waterman, decisions taken in the coming months would influence budget expenditures only in the more distant future, the Acting Chairman remarked. As observed by Mr. Geethakrishnan, the evolution of expenditures during the course of a year provided an important input into the budget discussion, which was nevertheless driven largely by a medium-term perspective on the future direction of the institution. In effect, the direction for the FY 1996 budget had been set in broad terms by the Board discussions in December 1993 and April 1994; the emphasis on consolidation and, if anything, a reduction in the size of the institution was already affecting the thinking of the staff, management, and the Board on a day-to-day basis with respect to the assumption of new activities.

The December 1994 discussion on the medium-term budgetary outlook would offer an opportunity to reflect on the evolution of the institution beyond the three-year planning horizon, the Acting Chairman said. An important consideration in that respect would be the rate of progress in the countries in transition, because a large part of the increase in expenditures over the past few years had been related to the increase in staff resources for work on all of the transition countries. As explained in earlier budget documents, the staff requirements for the transition countries were significantly higher than those for so-called intensive countries, which were in turn a step above those for surveillance-only countries. Thus, in looking out over a period of three to ten years, much would depend on how rapidly the transition took place and how quickly the associated technical assistance requirements eased. If the staff requirements for the transition countries were to approach those of so-called problem countries, staff savings of the order of 250 staff years might be possible, a consideration that had already informed the staff's thinking on future space requirements. On the other hand, efforts to intensify surveillance over the previous two years had increased and, if continued, might offset some of the savings in respect of the transition countries. Needless to say, the possible savings associated with a given scenario were difficult to quantify precisely. At the time of the December 1994 medium-term budget discussion, the Committee would also have to consider the documentation outlining the implications of various scenarios.

In the interim period, the Acting Chairman continued, there were a number of specific subjects that could be addressed. First, there was a need to return to the budgeting aspects of technical assistance, including the extent to which additional resources could be obtained from users of technical assistance and other sources of financing. Second, a paper was being prepared for Executive Directors and the Committee on the scope and cost of the resident representative program, the budget for which had been affected significantly by work on the transition countries. Third, the Committee might wish to take up the papers that were under preparation for the Board on the arrangements for and cost of the Annual Meetings. Fourth, the Board would be kept appraised of developments under Phase III, the scope of which had largely been set by the Board, and the plans for a possible Phase IV. The coming six months to a year would have the biggest impact on the actual cost of Phase III, which was typical of new construction projects; additional uncertainties included the parallel construction of a new World Bank building on 19th Street and the closure of the alley located on the site of Phase III. Phase IV could be a subject for discussion by the Committee and by the Board in the coming weeks. Fifth, a paper on subsidies could be prepared as part of the background for the medium-term budgetary outlook.

Mr. Waterman said that it was unclear how the Acting Chairman saw the interaction between the Committee and management on the budget instructions that would be issued to departments in June 1994. It would not be helpful for the Committee to concern itself with detailed instructions, but it would be useful to have confirmation of the broad scenarios that would be used, which would presumably pick up some of the flavor of the present discussion. In that context, a brief report from the Office of Budget and Planning would be appropriate.

The Acting Chairman explained that the guidance to staff would be designed to obtain the information needed to enable the Office of Budget and Planning and management to put forward various scenarios for the medium-term budget for discussion in December 1994. The medium-term budget would include a central management proposal, which would follow the general thrust of the April 1994 Board discussion. In addition, two alternative scenarios would be included, illustrating the kinds of activities that would need to be reduced or eliminated in order to meet a specified reduction in the budget.

Mr. Al-Jasser wondered whether the Committee would have an opportunity to share the findings to which the Acting Chairman had referred. He shared the view of Mr. Waterman and Mr. Newman that the Committee would need to share in those findings if its work was to have any substance; other issues, such as the possible introduction of fees for attendance at the Annual Meetings, while important, were not critical for the financial health of the institution.

The Acting Chairman replied that the budget document would lay out separately the underlying analysis and information on which management was basing its judgment, and would provide background on the alternative scenarios.

Mr. Al-Jasser remarked that if Executive Directors were to learn of management's findings only at the time of the medium-term budgetary outlook paper there would be little need for a Budget Committee.

The Acting Chairman responded that management's findings would be made known to Executive Directors at the earliest opportunity, given the need to put those findings in the form of a reasoned document and the schedule of work of departments, the Office of Budget and Planning, and management. Of course, the Committee would also want to take up some of the specific topics he had mentioned earlier.

Mr. Newman remarked that there should be some room for the Committee to express a view on the substance of the negotiations between management and departments on priorities. Involving the Committee in discussions of staffing, which drove the budget of the Fund, would be especially helpful to management, the Board, and the Committee. Under the proposed approach, the Committee appeared to be left only de minimis items--items with only a marginal impact on the budget.

The Acting Chairman said that he disagreed with Mr. Newman. Nothing in the proposed approach would prevent the Committee from taking up issues presented to it or the Board in the documentation for the medium-term budget. As mentioned previously, that documentation would include management's central proposal as well as an analysis of alternative scenarios requested by the Committee. The Committee would thus be able to discuss the medium-term budget in greater depth than had proved possible in the Executive Board.

Mr. Al-Jasser wondered how the substance of the Committee's discussion of the medium-term budgetary outlook paper would differ from that of the Board. He wondered whether the paper would be circulated first in draft form, allowing the Committee to discuss the substance of the paper before it was finalized for the Board.

The Acting Chairman remarked that the Committee would have an opportunity to discuss the medium-term documentation containing management's proposal in much greater detail than had been possible in the Board. The documentation would not be circulated to the Committee in draft form; rather, it would take the form of a statement by management of how it saw the medium-term prospects and the budget requirements, together with background information.

Mr. Geethakrishnan commented that the Acting Chairman's remarks should allay the concerns of both Mr. Newman and Mr. Al-Jasser. He agreed very much that the Board and the Committee should discuss management's proposal and should not deal with staff direct; it was management's responsibility to act as the link between the Executive Directors and the staff. Nevertheless, to be effective, the Committee should have an opportunity to influence management's thinking before its proposal became frozen. Management should actively seek interaction with the Committee as a kind of half-way house between the staff and the Board.

The Acting Chairman observed that the present meeting was itself part of the process advocated by Mr. Geethakrishnan. Indeed, the preparation at the Committee's request of alternative scenarios was a major step that would not ordinarily have been taken in preparing the basic documentation for the Board on the medium-term budgetary outlook. The suggestion that the Committee should have a role in finalizing that documentation before it was circulated to the Board was not, however, consistent with the terms of reference of the Committee, which were agreed following a lengthy negotiation. While there remained different views on the role of the Committee, its terms of reference were precise: to consider from a broad perspective the Managing Director's budget proposals and other materials circulated by the Managing Director regarding the administrative and capital budgets of the Fund. It had not been envisioned that the Committee itself, as distinct from the Board, would play a role in the formulation of management's thinking in the context of the budget process. The agreed role for the Committee allowed Executive Directors to consider in greater depth proposals put to the Executive Board, ultimately with a view to providing advice to the Board.

Mr. Geethakrishnan commented that if management's proposals were frozen when they were discussed by the Committee, there would be little point in discussing them in any more depth than at the Board meeting. One of the benefits of establishing a smaller group of Directors was presumably the possibility of more intensive interaction and input before proposals were frozen.

Mr. Al-Jasser said that the text of the terms of reference for the Committee probably did restrict the role of the Committee. However, the spirit of the establishment of the Committee had been to allow the Board and management to exchange views on the broad outlines of the budget and the orientation of the fiscal policy of the institution prior to the formal Board meeting. Therefore, it was hoped that management would avail itself of the opportunity to use the Committee as a balancing board. There was no desire to tie the hands of management in managing the institution. However, it was widely agreed that existing procedures did not allow for a healthy or useful exchange of views once, as Mr. Geethakrishnan had said, management's proposals had been frozen.

The Acting Chairman replied that realizing the role of the Committee envisaged by Mr. Al-Jasser and others would entail a broader Board discussion, because such a vision implied a change in the agreed role of the Committee. The most difficult decisions that management made in the context of the budget were choices among priorities; by their nature, they were priorities that influenced the work of the institution, and thus had an implication for every Executive Director. Moreover, if asked for its advice on the setting of priorities, there was no guarantee that the Committee would speak with a greater sense of unanimity than the Board itself. More generally, it was important to keep in mind the longer-term context of the process of forming budgets in the Fund: management and the staff were still internalizing the guidance from the December 1993 and April 1994 Board discussions, and would present proposals that would again solicit guidance from the Board. In that sense, nothing was frozen; the purpose of a rolling medium-term budget process was to allow over time a consensus to develop in the Board.

Mr. Waterman remarked that he agreed very much with Mr. Al-Jasser and Mr. Geethakrishnan. At a minimum, there should be a further iteration with the Committee before management confronted the full Executive Board with specific budget proposals.

Mr. von Kleist said that he supported the views of Mr. Al-Jasser, Mr. Geethakrishnan, and Mr. Waterman.

The Acting Chairman commented that he would discuss the outcome of the present meeting with the Managing Director on his return. In so doing, he would advise the Managing Director not to change the timing or the process for the preparation of the medium-term budget. On the timing, realistically there would not be an opportunity to have a general discussion prior to the circulation in November 1994 of the medium-term budgetary outlook paper. On the process, the ideas that had been put forward would change significantly the nature of the Committee, involving the Committee in the basic judgments that management had to make in putting proposals to the Board.

Mr. Kaeser noted that the Board retained the power to send a budget back to management if it considered specific elements of the budget to be out of line with the Board's expectations.

Mr. Cailleteau said that he understood the concerns expressed by some Executive Directors, which appeared to deal with the nature of the Committee itself. He wondered whether further discussion of those issues should not take place in the Board, which alone had the authority to consider or amend the mandate of the Committee.

Mr. Al-Jasser commented that the power of the Board to reject a budget presented by management was akin to a nuclear weapon, which everyone hoped would never need to be used. Such an option was available, of course, but avoiding such an outcome was exactly the motivation underlying the establishment of the Budget Committee.

He agreed with the Acting Chairman that the Managing Director needed to be fully aware of the sentiments that had been expressed in the present meeting and the various readings of the mandate of the Committee, Mr. Al-Jasser considered. It was to be hoped that there would be a rethinking of the existing approach, and that management would not hesitate to share its thoughts with Executive Directors earlier on. A more open-minded approach could only make more productive the deliberations of the Committee and the Board. There had clearly been a convergence of views during the previous medium-term outlook discussion between the Board and management. Unlike in previous years, there was general agreement on the budget strategy and, to a certain extent, its main element. The task at hand, therefore, was to operationalize and institutionalize the process of moving from one year to the next of the medium-term budget cycle. On the attendance of nonmembers of the Committee at the present meeting, he was certain that Executive Directors would continue to follow the strong urging of the Managing Director by attending all of the Committee's deliberations.

Mr. Newman said that he wished to echo Mr. Al-Jasser's comments, particularly in wishing for a cooperative rather than confrontational approach. It did not seem to him that the mandate of the Committee had to be revised. If the Committee were to fulfill its mandate to make its views known to the full Board on budget proposals, it would need to understand the reasoning behind the priorities that management had assigned to various proposals, as well as the alternative options and why they had been dismissed by management.

The Acting Chairman stated that the purpose of the Managing Director's statement on the budget was to provide the Board with precisely the information that Mr. Newman had described. Presumably, the Committee would then wish to ask more detailed questions about the priorities identified by management. The documentation provided for the medium-term discussion would be extensive and would provide ample opportunity for give-and-take discussion. Nevertheless, the division of responsibility had to be respected: management had clear responsibility for managing the institution and needed to be able to put forward a set of proposals on how it saw the organization and the staffing requirements of the institution. It was then up to the Board to express its views; the budget itself would evolve as a compromise out of that give-and-take discussion.

Mr. Waterman remarked that the process described by the Acting Chairman was fine in theory. In practice, however, the role of the Board had never taken the form of an iterative process in which a proposal was tabled, discussed, modified accordingly, and then approved. In his experience, the Board served merely to approve management's formal proposal. What he and others were asking for was an opportunity for a more general discussion about the general thinking behind management's views on the budget for the coming financial year before those views were frozen.

Mr. Fukuyama said that the suggestions that had been made should be viewed as merely facilitating the Committee's comments on management's proposals.

The Acting Chairman, while agreeing with Mr. Fukuyama, noted that some Executive Directors wished to view the Managing Director's statement on the medium-term budgetary outlook as a preliminary statement, which would then be discussed in the Committee before being finalized for the Board. As he had stated repeatedly, such a role for the Committee was not consistent with its terms of reference. Moreover, a careful examination of the recent history of the budget process would reveal that the Board had been provided with ample information with which to assess management's explicit proposals. On each occasion, there had been an extensive discussion in the Board; of course, the Board could have rejected management's proposals and issued alternative guidance on the future path of the budget. Thus, Executive Directors would have an opportunity at the time of the medium-term outlook discussion in December 1994 to comment on the continued appropriateness of consolidation as the guiding force behind the budget.

The Board was not merely a rubber stamp, with little or no influence on the substance of management's proposals, the Acting Chairman stated. Moreover, the establishment of the Budget Committee would allow the Executive Directors to spend more time on the budget and so better shape the Board's guidance, which would continue to have a big impact on the process. The medium-term budget discussion would influence the FY 1996 budget up to a point, but it would certainly influence the budget presentation for the following year.

Mr. Newman wondered what role the Acting Chairman envisaged for the Committee through November 1994 in terms of setting the budget priorities that would be presented by the Managing Director at that time.

The Acting Chairman responded that it was certainly possible for the Committee to hold meetings to discuss budget priorities. There would not be any new documentation for that purpose, however, other than updated information on the FY 1994 budget.

The meeting adjourned at 12:30 p.m.

APPROVAL: February 8, 1996

To: Members of the Budget Committee May 25, 1994

From: E. L. Waterman (sd.//)

Subject: Medium-Term Budgetary Objectives

"...what sense is there in continuing the present, when one has seen the future?"*

I thought it might be useful in stimulating the reactions of others if I set down some thoughts about the issues that we might address over the next year. It is important that we agree on some broad objectives that could form a focus of our ongoing discussions, to make our work as constructive as possible.

A Focus on Medium-Term Planning

One of the great advances in budgetary procedures in many countries over the past 20 years or so has been a lengthening of the time horizon that policymakers apply in arriving at decisions about budgetary matters. In this regard, it was interesting that much of the focus of Executive Directors' comments at the recent discussion on the budget for financial year 1995 was, in fact, directed at emerging trends in the following two years. This reflects the reality that near the start of a particular financial year, the die is pretty much cast for that year, and the Board cannot expect to have a great deal of influence on the outcome. The focus on the outyears in our recent discussion also reflected a fairly general agreement that we should enter a period of consolidation and restraint following the solid expansion of recent years. Many Executive Directors have arrived at the implicit or explicit judgment that we should be able to meet our broad objectives with the same, or a somewhat reduced, level of real resources than we deploy at present, particularly as new staff members become more skilled, and as the hump in demand associated with new members passes.

Output Specification

The general experience is that it is very difficult to develop output measures for public sector-type activities, and the Fund is no exception in this regard. But we have been attempting in recent times to get a measure of both the volume and, more important, the quality of our

*Einstein's Dreams by Alan Lightman

work, whether it be analytical and research work, technical assistance, or work related to country programs. We still have some way to go in allocating expenditures between various activities but it is important to combine that with ongoing work on the assessment of outputs, imperfect as that might be. An important output on which we can get an objective measure is the cost at which we provide capital to member countries. We cannot influence the SDR rate but we can influence the margin that we need to charge on top of that. We also recognize that the total cost to borrowing countries is very important to them, as well as the effectiveness of the advice that goes with an agreed Fund-supported program. Financial markets are very competitive these days and we are likely to face increased competition in the period ahead, particularly for the better credits. Cost is likely to be a very important consideration in the demand for any fast-disbursing, short-term facility we might decide to offer to countries that experience destabilizing speculative capital flows but whose underlying economic situation is quite strong.

Controlling Real Growth

There have been different views within the Board on budget issues, but what I think we can all agree upon is that the burden of higher spending falls heavily on borrowing members. Some Executive Directors have expressed a wish to see no real growth in the cost of operating the Fund in coming years or some real decline in that cost. Personally, I think maintaining real outlays would be a relatively easy objective to achieve, given the strong growth of recent years, unless there were some very unexpected development that no one can see on the horizon at present. It was for this and other reasons that I raised the possibility of focusing instead on an objective that would generate real savings equivalent to a reduction in the rate of charge of an agreed amount over the next few years. That would give us a very positive objective to aim for, particularly at a time when borrowing countries are going to face some--possibly sizable--increase in their borrowing costs owing to the inevitable increase in the SDR rate from its current low level.

Setting Rate of Charge Targets

As I have previously suggested, we could aim to reduce real expenditures by 10 percent over a ten-year period by capturing just part of the productivity gains that come through the normal process of doing our jobs better and smarter. But I expect that too would be fairly easy to reach. An alternative approach would be to review the implications of reducing expenditure by an amount consistent with a reduction in the rate of charge of, say, 15-25 basis points over three to five years. The main purpose of either approach would be to focus very explicitly on the cost of achieving our objectives, the importance of those objectives, and ways in which we might achieve desired outcomes more efficiently.

Staffing Issues

One thing is obvious, however; we need to start somewhere by developing a framework for our decision making, recognizing that it will be an iterative process. Only after we have given some consideration to our broad objectives would it make sense for staff to be asked to undertake some more detailed analysis of the implications of what we are seeking. But in time I could see us asking for some reflections from the staff on how we might do our work more effectively at all levels and what might be required to achieve particular outcomes. This necessarily requires taking a broad view of the Fund's role and what is good for the organization, rather than a more narrow interest in what the organization can do for us.

Like others, I have my own biases and thoughts on where we could make some savings and improvements, but it is important to involve the staff in the process in such a way that it has a central role to play in a forward-looking review process. I think decentralizing decision-making is critically important to developing both efficiency and greater work satisfaction, which is clearly to the advantage of the organization. It is possible that the incentive structure could be changed to encourage savings and by giving departments greater flexibility in terms of carry forward from year to year--and scope to retain some of the savings they give effect to.

Given the nature of the Fund, the overall level of staffing is clearly very important to our cost structure. I think it is relevant to note here that during our recent budget discussion, a number of Executive Directors questioned whether or not it was appropriate for the organization to expand to a point where the agreed ceiling for total staff numbers is reached.

Many of us have been through exercises involving public sector restraint and efforts to give organizations a sharper focus. Those exercises are challenging, but they have the potential to generate both financial savings and provide for a work effort that is directed very squarely at the requirements of the main shareholders, who are forced to think more explicitly about what they want from an organization.

Technological Advances

One thing that many organizations have had to address is the impact of changing technology and whether or not they are obtaining all the benefits that they should receive from the increased expenditure on such things as computers and improved means of communication. We all know, for example, that the use of desktop computers has meant that redrafting is a much easier task than it used to be, but the net result is that sometimes the search for "perfection" is taken to extremes. It has also greatly increased the capacity of secretarial assistants, but in my experience, that is not always reflected in changed office arrangements.

I believe in the importance of face-to-face contact with officials and others to get a completely informed picture of a country's economic policies and development. However, in view of the integration of world financial markets, there is today a vast volume of information available at short notice on all the major economies, which is given in specialized news services as well as more general media reporting. Combined with fax and other services, it means that we can monitor economies from a distance much better than was the case even ten years ago. As a result, I believe that some missions (I have Article IV consultations particularly in mind) could be of shorter duration and/or comprise fewer people than has been the case in the past.

Anyway, the purpose of this note is primarily to set down a few basic ideas, with the objective of furthering the debate on the general matter. There is every reason to believe that we can make the Fund the standard by which other international organizations are judged in terms of financial management and control. The more we do on the budgetary side, the greater is likely to be the financial and other support of member countries for the activities of the Fund. The rate at which we lend can have an important bearing on the range of credit risks that come to the Fund for financial support and the overall size of the balance sheet against which we can recoup our fixed costs. I suspect I am preaching to the converted in arguing the case for taking more active steps to shape our own future rather than having it determined by external developments and pressures. But to conclude with the words of William Gladstone: "You cannot fight against the future, time is on our side." (Reform Bill debate, 1866).

cc: Executive Directors
Deputy Managing Director
Secretary
Director, Office of Budget and Planning