June 28, 2001
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 00/4

10:00 a.m., January 12, 2000

Contents

Executive Board Attendance

M. Camdessus, Chairman
S. Fischer, Acting Chairman
S. Sugisaki, Acting Chairman

Executive Directors	Alternate Executive Directors
	A.S. Alosaimi
	A.R. Ismael, Temporary
	T.-M. Kudiwu, Temporary
T.A. Bernes	P. Charleton
	J.A. Chelsky, Temporary
	H. Oyarzábal
R.F. Cippà	W. Szczuka
	R.J. Singh, Temporary
	W.-D. Donecker
	D.H. Kranen, Temporary
	O.A. Hendrick, Temporary
	P. Cabezas, Temporary
R. Faini	J. Spraos
	D. Nardelli, Temporary
K.-T. Hetrakul	C. Harinowo
V. Kelkar	
W. Kiekens	S. Çakir, Temporary
O.-P. Lehmussaari	
K. Lissakers	
J.-C. Milleron	G. Bauche
	I. Mateos y Lago, Temporary
A. Mirakhor	
	C. Rustomjee
	A. Lushin
	S. Vtyurina, Temporary
S. Pickford	S. Collins
M. Portugal	R. Junguito
A.S. Shaalan	A.F. Al-Faris
	I.M. Woolford, Temporary
Wei Benhua	
J. de Beaufort Wijnholds	Y.G. Yakusha
	H. Toyama

S.J. Anjaria, Secretary
J. Prust, Acting Secretary
C.E.L. Andersen, Assistant
G. Nkhata, Assistant

Thailand—1999 Article IV Consultation
Staff representatives: Teja, APD; Josefsson, MAE; Lipschitz, PDR

Compensatory and Contingency Financing Facility—Extension of Deadline for Review; and Extension of Operation of Cereal Element
Staff representative: Siegel, LEG

Medium-Term Planning Options and Resource Estimates
Staff representatives: Conrad, OMD; McClellan, OMD

Also Present
IBRD: M.M. Amin, East Asia and Pacific Regional Office. African Department: S.L. Rothman. Asia and Pacific Department: Y. Horiguchi, Associate Director; A. Singh, Deputy Director; W.S. Tseng, Deputy Director; E.R. Elson, T. Endo, M.E.L. Griffiths, V. Haksar, I.H. Lee, K.M. Meesook, R.S. Teja. European I Department: A. Leipold. External Relations Department: G. Hacche, Deputy Director; R.R. Brauning, N.V. Shastry. Fiscal Affairs Department: M. Asakawa. Human Resources Department: M.R. Kelly, Director; U. Baumgartner, Deputy Director; J.-P. C. Golle, R. Ramaciotti. IMF Institute: G.C. Dahl, A.M. Kim. Legal Department: W.E. Holder, Deputy General Counsel; S.C. Ho, H.W. Krull, N.S. Kyriakos-Saad, D.E. Siegel. Middle Eastern Department: Z. Iqbal. Monetary and Exchange Affairs Department: S. Ingves, Director; M.A. Josefsson, C.S. Lee, C.-J. Lindgren. Policy Development and Review Department: J.T. Boorman, Director; T. Leddy, Deputy Director; L.J. Lipschitz, Deputy Director; J. Herderschee, G.R. Kincaid, T. van der Willigen. Research Department: P.B. Clark, P.N. Loungani. Secretary's Department: A. Mountford, B.A. Sarr. Statistics Department: E.W. Saunders. Technology and General Services Department: B.C. Stuart, Director; S.H. Choi. Treasurer's Department: E. Brau, Treasurer; J.E. Blalock. Western Hemisphere Department: P.D. Brenner, F. van Beek. Office of the Managing Director: M. Cross, Personal Assistant; D.A. Citrin, S. Tiwari; Office of Budget and Planning: E.-A. Conrad, Director; N.H. Bradshaw, F.J. Gaitain, J. Hudson, P.J. McClellan, P.J. McPhillips, H.L. Mendis, M. Oka, N. Sachdev, C.L. Vehorn, T. Wolde-Semait. Advisors to Executive Directors: M.A. Ahmed, P.A. Akatu, B. Couillault, J.C. Estrella, O. Himani, Luo Y., M.F. Melhem, H. Mori, Nguyen Q.T., A.R. Palmason, M.R. Shojaeddini, T. Turner-Huggins, F. Zurbrügg. Assistants to Executive Directors: T. Belay, J.G. Borpujari, P.A. Brukoff, G. De Blasio, R. Djaafara, K. Gobe, I.C. Ioannou, A. Kapteijn, B. Kelmanson, S.K. Keshava, W.C. Mañalac, Y. Moussa, L. Redifer, J. Schaad, C.-P. Schollmeier, A.W. Scoffier, A. Sutt, Y. Tong, Vongthieres O., M. Walsh, Wang X., R.P. Watal.

1. THAILAND—1999 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1999 Article IV Consultation (EBS/99/230, 12/17/99; and Cor. 1, 12/27/99). They also had before them a statistical appendix and a background paper on selected issues in Thailand (SM/99/304, 12/23/99; and Sup. 1, 12/27/99).

Mrs. Hetrakul submitted the following statement:

The Thai economy is reviving with returning market confidence, macroeconomic stability firmly established, and financial and corporate restructuring progressing in an orderly manner. Thus, the process has strengthened with recovery being more widespread across most industrial sectors, while consumption and investment have begun expanding and export and import growth continued to strengthen. At the same time, economic stability is maintained with inflation remaining low and the official reserves gradually being accumulated with stable exchange rates, albeit Thailand's decision to forego further financial support from the Fund.

While the growth of 4 percent for the year 1999 has resumed mainly through government spending under the fiscal stimulus package, the driving forces behind the 4 percent growth rate for the year 2000 will be more balanced, relying on both domestic and external demand.

Macroeconomic figures suggested continued improvement of the performance of the economy with the quarterly GDP growth registering 0.9, 3.3, and 7.7 percent year-on-year for the first, second, and third quarter, respectively. On the supply side, the agricultural and manufacturing sectors grew by 2.6 and 7.8 percent in 1999, respectively, compared with -0.7 and -9.6 percent in the previous year, in line with the revival of exports that performed well in almost all categories and the resumption of domestic demand. Concurrently, the industrial capacity utilization indicator also showed the utilization rate rising to 60.0 percent from 52.1 percent in the previous year. On the demand side, domestic expenditure is estimated to expand by 8.5 percent, compared with -24.2 percent in 1998, with private consumption growing by 3.8 percent and private investment rising by 1.1 percent in 1999, up from -14.0 and -44.4 percent in the previous year, respectively. Recovery of domestic demand was also reflected in a smaller current account surplus.

Stability remained robust and favorable on both domestic and external fronts. Inflation moderated to an average of 0.3 percent, despite upward pressure from rising oil prices and resumption of demand. Factors contributing to the moderation of the inflation rate included stable exchange rate and declining world commodity prices. Meanwhile, the inflation rate for the year 2000 is expected to average 2.4 percent in line with the rising prices in the world market and the economic recovery. External stability continued to strengthen with the current account surplus of US$11.3 billion, declining external debt to US$74.6 billion from US$86.2 at year-end 1998, and a debt-service ratio of around 20 percent at year-end 1999. Official reserves as of December 30, 1999, stood at US$34.8 billion, compared with US$32.4 billion as of end-October 1999.

On the financial front, liquidity in the system continued to remain high. In light of the remaining excess capacity, stable exchange rates, and the absence of inflationary pressure, the authorities' monetary policy stance continued to be geared towards fully supporting the economic recovery. This contributed to successive declines in market interest rates, which in turn helped to foster an environment supportive of financial and business restructuring.

At the same time, as the outlook of the economy becomes increasingly favorable, commercial banks are more willing to extend new loans. Bangkok International Banking Facilities (BIBF) credit continues to decline, while non-BIBF credit is growing moderately, although some of the increased non-BIBF credit was due to the switching of BIBF credit to baht-denominated credit. Although commercial bank credits are not expected to expand significantly, liquidity is no longer a severe problem in the economy, and particularly for viable borrowers, as a balance of payment surplus and fiscal stimulus have contributed to liquidity without having to rely heavily on the credit creation process of the banking system. Moreover, with the low interest rate environment, direct funding from the capital market and corporate bond issuance has played a larger and growing role in mobilizing capital.

With improvements in financial market conditions, volatility in the foreign exchange market has dropped significantly. The baht has strengthened from the low of 41.42 baht per US$ at end-September to the current level of 36.80–37.70 baht per US$ as the political conditions in the region stabilized and domestic demand for foreign currencies to repay foreign debt subsided. Furthermore, the Bank of Thailand's reiteration and clarification of the regulation on the nonresident's Thai baht position without an underlying transaction, announced in early October, and the rising capital inflows to purchase Thai assets have contributed to the recent appreciation of the baht.

My Thai authorities have turned their attention towards the establishment of the structural framework for the medium-term policy implementation under a stable macroeconomic and financial environment.

Notwithstanding the favorable macroeconomic indicators, the persistence of the high level of nonperforming loans, currently around 42.27 percent of total loans in the system, poses concerns over the robustness of the recovery. To address this issue with urgency, the Cabinet, on

October 5, 1999, approved the policy and guidelines to eliminate obstacles related to the setting up and the operational process of asset management companies. As of December 30, 1999, four private asset management companies have been set up, with three currently in the process of receiving licenses.

The Corporate Debt Restructuring Advisory Committee continues to make progress in the original 702 target companies with outstanding credit of 1.5 trillion baht. Of these, the debt of 157 companies with outstanding debt of 434.7 billion baht have been successfully restructured; 213 companies with outstanding debt of 413.1 billion baht have been taken to court; and 60 companies with outstanding debt of 169.7 billion baht have successfully turned around and resumed debt repayment and thus do not require debt restructuring.

In addition, the Corporate Debt Restructuring Advisory Committee has approved another 989 target companies during October 1999 with outstanding credit of approximately 600 billion baht to be restructured under CDRAC supervision and guidance, bringing the total number of cases to 1,691, with a total outstanding credit of approximately 2.1 trillion baht.

The bankruptcy court now has 441 cases under consideration. Of these, 416 are bankruptcy cases, of which 210 have been completed. The reorganization cases totaled 25, of which 21 have been approved by the court to revive business. In the past six months, since the establishment of the bankruptcy court, new filings have reduced to approximately 60 cases per month, compared with 200 cases per month during the period before the establishment of the court. The reduction in the number of cases could also be perceived as a positive sign implying that restructuring and out-of-court solutions were also being pursued by creditors and borrowers.

Recapitalization of financial institutions continues to show satisfactory progress. From January 1998 to October 1999, over 859 billion baht of capital was raised, of which 358 billion baht was raised by private commercial banks, 469 billion baht by public banks, and 32 billion baht by finance companies. For private commercial banks, further capital of 95 billion baht is expected to be raised by the end of 2000 to cover losses from operation and nonperforming loans.

Privatization of intervened banks has also been progressive. The winning bids for the two out of six state-intervened banks—Nakornthon Bank Plc and Radanasin Bank Plc—have been announced. To this end, the Financial Institutions Development Fund has entered into the Share Purchase Agreements with Standard Chartered Bank to sell 75 percent (the approximate price being 12.38 billion baht) of Nakornthon Bank's common shares, and with United Overseas Bank Limited of Singapore to sell 75.02 percent (the approximate price being 15.09 billion baht) of the Radanasin Bank's common shares. The sales of Bangkok Metropolitan Bank Plc and Siam City Bank Plc are in the process of winning bid selection, which is expected to be announced by the first quarter of 2000. Concurrently, the Financial Institutions Development Fund is gradually reducing its stake in Bank Thai Plc and Krung Thai Bank Plc over the medium term.

Significant progress has been achieved in the reform of the legal system, prudential regulations, and supervisory frameworks, which are essential to economic and financial reforms. Recently, as part of the rewriting of the financial institution law, the landmark event has been reviewed by the industry; the event was held twice, last November and December, where the authorities received feedback from the financial industry regarding the scope of operation and supervisory practice in the future. This event was regarded as highly significant for it marked the beginning of a new era where the regulatory authority showed its readiness to listen to the concerns of the industry in the process of the making of the law, thereby enhancing mutual understanding between the public and private sectors and increasing transparency of the public sector.

Furthermore, the passage of the Foreign Investment Law and Corporatization Law were announced in the Royal Gazette on December 4 and December 26, 1999, respectively, while the Financial Institutions Bill and Bank of Thailand bill are awaiting approval from the Cabinet. Both laws, once enacted, are expected to increase efficiency and transparency in the financial system as well as the operation of the Bank of Thailand.

Although the progress has been substantial, more effective and rigorous practice needs to be reinforced. Meanwhile, the bankruptcy court plans to implement procedural changes in order to accelerate the consideration of cases.

Other structural issues include the reorganization of the Bank of Thailand, where the organization has become flatter with shortened but explicitly stated line of commands and responsibilities to foster full accountability. This will not only expedite the decision making process, but also improve the accountability of the Central Bank.

With regard to the social safety net, the step-up of the disbursements from the Miyazawa plan and the World Bank loans remain the cornerstone of the government public finance policy. Meanwhile, the unemployment rate estimated for 1999 stood at 4.2 percent, or approximately 1.4 million persons.

To speed up debt restructuring, intensifying efforts are put to strengthening and speeding up the implementation of measures designed to deal with nonperforming loans in the system. Following the first monthly proposal of target debtors by financial institutions to restructure under the Simplified Agreement in June 1999, a total of 2,801 debtors with outstanding loans of 218 billion baht have been accepted as of end-October 1999. The Simplified Agreement advocates a restructuring time frame of 60 days for debtors and creditors to resolve the case. As at end-October, 337 companies have completed debt restructuring with outstanding loans of approximately 3.8 billion baht. The remaining target companies are within their time frame for restructuring and are in the negotiation process.

To prevent and control occurrence of new nonperforming loans, the public and private sectors have been working closely together to establish a credit bureau, a private company where member creditors can acquire financial information on potential debtors of concern. To date, the Thai Bankers' Association has formed a credit bureau called "Central Information System Company Limited" with 13 members at present, consisting solely of Thai commercial banks. However, the company is planning to extend its membership to other financial institutions including foreign banks and finance companies in the near future. Concurrently, the new Credit Bureau Act is awaiting cabinet approval, while the present credit bureau is operating under the old law.

Concerns over fiscal sustainability have been recognized by the authorities.

With the vigilance over the development of the economy, the government continues to be cautious in withdrawing further fiscal stimulus. Given a continuing budget deficit, the government is fully aware of the need to ensure medium-term fiscal sustainability. In this regard, budgetary discipline remains the cornerstone of fiscal policy, while avoiding too rapid budget consolidation that may derail or deter the dynamic of the recovery path. The government is confident that the fiscal stimulus package recently implemented will not only revive growth but also help to upgrade supply-side efficiency, and hence foster a healthy potential growth and restore healthy tax revenue, thereby achieving fiscal sustainability in the medium term.

In addressing the important issues of efficiency, transparency, and accountability of the Central Bank, the Bank of Thailand Act is now being amended and is likely to be approved by the Cabinet around the middle of this year. Crucial issues in the proposed reforms are as follows. Firstly, the objectives and the scope of operations of the Bank of Thailand are to be redefined to focus on price stability and the health and stability of financial institutions. To this end, a monetary policy board, an independent body consisting of appointed distinguished economists both within and outside the Bank of Thailand, will be formed to take charge of monetary policy decision making without intervention from the government. Measures will be taken in order to increase the operational transparency and responsibility of the Bank of Thailand; for example, the requirement for the Bank of Thailand to submit, on a regular basis, reports on the status of foreign reserves to the Cabinet and reports on the implementation and performance of monetary policy to parliamentary committees and the Cabinet, and the establishment of an internal auditing committee responsible for scrutinizing the internal affairs of the Bank of Thailand.

As for the monetary framework in medium-long term, once the new Bank of Thailand bill has been passed by the Parliament, the Bank of Thailand will adopt flexible inflation targeting as a monetary policy framework for Thailand. In the meantime, the Bank of Thailand is actively setting up the institutional framework necessary for the implementation of inflation targeting.

One of the prominent features of the inflation-targeting framework is the authorities' commitment to the preannounced inflation target, which in turn helps tie down inflation expectation and ensures coherent, forward looking, and transparent monetary policy. With the announced inflation target, the public can closely evaluate the performance of the monetary policy board. Hence, transparency and credibility are the cornerstone of monetary policy conduct under this framework. To encourage this, currently, the Bank of Thailand is organizing the Economic Symposium 2000, entitled Thai Monetary Policy in the 21st Century, with a view to improving public understanding of the conduct of monetary policy and providing a forum for discussion among economists from both the private and public sectors, where flexible inflation targeting will be discussed at length.

To ensure sustainable growth and promote higher efficiency in the economy, my Thai authorities plan to continue with fiscal stimulus measures, supportive monetary policy which remains vigilant of stability, structural reforms, and more aggressive debt restructuring, while gradually consolidating government budget in the medium term. To this end, the government role will be reduced, while encouraging market-oriented mechanism in a stable macroeconomic environment.

In closing—and in appreciating the invaluable input made by the Fund's mission staff and the resident representative—on behalf of the Thai authorities, I would like to express our sincere gratitude to all of them for their technical assistance, hard work, and dedication throughout the past difficult times.

Extending her remarks, Mrs. Hetrakul stated that the Bank of Thailand had announced new legislation that allowed banks to establish asset management companies to promote debt restructuring. The legislation allowed nonbanks' financial institutions to extend loans to the new asset management companies. Furthermore, the regulations concerning the length of time that financial institutions could hold property had been relaxed from five to ten years to allow the asset management companies to better administer their portfolios. The new legislation also made nonperforming loans subject to the Bank of Thailand provisioning requirements, and stipulated that the pricing of asset transfers must be determined by an independent appraisal company recognized by the Securities and Exchange Commission.

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

Looking back at the time of the last Article IV consultation in June 1998, Thailand has clearly made impressive progress in adjusting its economy and restoring both financial stability and growth. The past year has seen the economic recovery take hold and gain in strength, even though the rebound estimated at 4 percent in 1999 remains moderate compared, in particular, to Korea. In this connection, we found particularly interesting the first chapter of the background paper, which highlights the inherent weaknesses in the high-growth, precrisis years, thereby shedding some light on the possible causes of the relative modesty of the Thai recovery in comparison to Korea's. Nonetheless, the question remains why the drop in output was so large in Thailand even though the general overinvestment in the precrisis years was common to both countries. Was the overexpansion in the nontraded sectors, particularly in the construction sector where excess supply takes longer to absorb, the important variable that could account for the severity of the output drop in Thailand? Furthermore, why was the rebound in economic activity slower in Thailand despite substantial fiscal stimulus and a run-up in public debt? These are difficult questions that are worthy of some reflection. We wonder if staff can elaborate further on possible answers.

Turning to the outlook for 2000 and beyond, we find ourselves in broad agreement with the staff appraisal and therefore will confine our remarks to a few key points.

A continuation of the supportive stance of financial policies into 2000 is warranted in view of the still-weak investment demand and only moderate growth in consumption. Both monetary and fiscal policy should continue to be geared to supporting the recovery. On the fiscal side, strong efforts should be made to maintain the programmed budgetary disbursement rates in order to derive maximum benefit from the fiscal stimulus implied in the budget deficit. We therefore welcome the intended front loading of government expenditures. Social safety net expenditures should also continue to cushion the impact of the still-high level of unemployment and to alleviate the difficult social conditions of the most vulnerable members of society.

The incomplete transmission of monetary policy to bank lending rates remains a concern. Here we would appreciate more elaboration by staff on what is required to address the situation which is preventing the economy from benefiting to a fuller extent from the accommodative monetary policy. While staff refer to moral suasion applied by the political establishment, the authorities seem to be referring to pressure on banks from the general public. Perhaps Mrs. Hetrakul or the staff can shed some more light on the problem.

We agree that with macroeconomic stability reestablished, the exchange rate should be allowed to respond more flexibly to market conditions. We therefore concur with staff that the depreciation of the baht over the past few months should be considered a positive development, especially since the baht had appreciated in nominally effective terms against the other Asian crisis countries over the course of 1998 and the first half of 1999. The recent depreciation should contribute to stronger export growth to the key Asian markets, which have traditionally accounted for a large share of Thailand's total exports.

On financial and corporate sector reform, while much has been accomplished, like other countries in the region, the pace of bank and corporate debt restructuring needs to be accelerated to allow the economy to reach its full potential. Even though it appears that there is technically no credit crunch at this time, the persistence of a high level of nonperforming loans heightens concerns that banks will not be in a strong enough position to support the recovery as investment demand strengthens. Action on a number of fronts is required. First, the authorities should take steps to speed up bank recapitalization including through the provision of state support. Thus serious consideration should be given to modifying the conditions that have prevented banks from drawing on existing schemes for public capital support. Adequate safeguards to protect public resources should, of course, be maintained. Second, the new bankruptcy and foreclosure framework must be strengthened to make the threat of bankruptcy proceedings more credible. The aim should be to provide sufficient incentive to debtors not to default and when they do to rapidly reach agreement with their creditors outside the court system. As the staff notes, a rapid submission of unresolved cases of disagreements between debtors and creditors to the courts could provide a key signal as to the seriousness of the process. Third, the restructuring of the state-owned banks, including the Krung Thai bank, should be expedited in preparation for their eventual privatization.

Finally, while acknowledging the significant progress already achieved in education in Thailand, the importance of a further strengthening of the human resource base for Thailand's future economic prosperity cannot be overemphasized. Increased emphasis needs to be placed on technical training and higher education with the aim of achieving a smooth adjustment away from labor-intensive products, whose production is being taken over by lower-wage countries like India and China, toward more capital-intensive and high-end products.

To conclude, the Thai authorities are to be commended for the rapid economic adjustment achieved in a relatively short period. However, the sustainability of the current recovery cannot be taken for granted. Completing the necessary structural reforms will be the key to its sustainability. We wish the authorities every success in continuing with their reform agenda.

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

We are pleased to note that economic recovery in Thailand is under way. The projected real GDP growth of 3–4 percent in 1999 is the positive result of the authorities' efforts in implementing an appropriate set of policies to overcome the severe financial crisis which led to an accumulated real GDP contraction of 12 percent in 1997/98. It is encouraging that the recovery has become broader based, bolstered not only by exports but also by domestic demand. Exports, which have been growing in volume terms, have now started increasing in terms of value. The role of fiscal policy appears to be fundamental to stimulate the economy. As the staff points out, public spending has represented almost half of the expected growth for 1999.

Another important component for the recovery seems to be the reestablishment of financial stability, especially with the lessening of external financing constraints. This has allowed a robust increase in imports, an area where most of the external adjustment to the crisis was carried out—import volume contracted by more than 40 percent from 1996 to 1998. Improvements in external conditions have also contributed to the stability in the foreign exchange market and the accumulation of international reserves.

The challenge now is to adopt policies to sustain and stimulate further the economic recovery as capacity utilization continues to be low and unemployment high. Investments in the private sector tend to recover more gradually in view of adjustments necessary to correct the overinvestment and excessive capital accumulation observed in the precrisis years. As long as private domestic demand remains weak, there will be room for an active fiscal policy to be maintained. We agree that, in the short term, fiscal policy continues to be an important instrument for stimulus to ensure that the growth momentum is not lost. Nevertheless, the significant increase in public debt during the crisis calls for fiscal consolidation over the medium term as potential output is restored.

Monetary policy seems to be adequately accommodative with money market rates being maintained in the 1–3 percent range. Even so, one could not expect a rapid recovery in credit to the private sector under current circumstances in which the process of corporate debt restructuring and of adjustment in the banking sector is still taking place. In addition, one could also consider the necessary deleveraging, as the economy undergoes an adjustment from overindebtedness and inflated asset prices.

Favorable developments in external markets will be fundamental for a stronger recovery in Thailand by providing higher demand for its exports and the necessary financing for its imports. This will allow the external adjustment to be carried out at a more gradual pace to reduce the external-debt-to-GDP ratio and to accommodate expansion in domestic demand, in contrast to the sharp reversal of the external current account and corresponding decline in private external debt observed in the initial phase of the financial crisis.

On structural reform, we encourage the authorities to reinforce the policy actions to expedite the process of bank and corporate debt restructuring. The report notes that "creditors may be waiting for economic recovery to take hold before taking decisive action on restructuring" as "recovery may improve the outlook for firms, reducing the size of the haircut that banks have taken; recovery should also raise asset prices, increasing the value that banks can recover from their loan collateral." This behavior of creditors could be warranted if the strength of economic recovery is associated with other policies and less dependent on the pace of corporate debt restructuring. If this is not the case, however, creditors' wait-and-see approach may even hamper the economic recovery, and perhaps exacerbate the difficulties as "a stagnation of the recovery may further raise the level of nonperforming loans, depress collateral values, and prolong corporate debt restructuring." A more active role by the private sector appears to be more appropriate to avoid the risk of delay or even a weakening of the process of recovery.

The selected issues paper revisits the developments leading to the crisis and then the recovery. The document notes that "the persistence and then widening of the current account deficit; overinvestment, declining rates of return to capital and the overexpansion of the nontraded sector; and the slowdown in export growth, all pointed on macroeconomic grounds to the need for current account adjustment." The question is whether there was an alternative mix of monetary and fiscal policy that could keep the external current account and domestic credit expansion in a more sustainable path.

The staff considers the role of fiscal policy, noting that "even though the central government ran a surplus during the precrisis period, the impulse analysis suggests that fiscal policy was mildly expansionary, which might have added to the economic overheating resulting from the higher rate of investment growth during the precrisis years." A tighter fiscal policy might have been necessary to contain the expansionary forces.

The acceleration of Thailand's economic growth was primarily investment-led, although the easy monetary conditions had a role. As noted, from mid-1995 through the end of 1996, the growth rate of real private credit averaged well above 15 percent, or twice the rate of real GDP growth. Much tighter credit conditions might also have been needed to avoid the excesses of the precrisis period. One could argue, however, that in view of external conditions, with weak demand in important industrial economies and the unprecedented low interest rates in the major financial centers leading to persistent and excessive capital inflows, the traditional instruments of fiscal and monetary policy might have been insufficient to avoid major imbalances.

Mr. Mirakhor submitted the following statement:

As the staff report and Mrs. Hetrakul's comprehensive statement attest, the Thai economy continues to make significant progress with stabilization and reform. External viability has been restored, exchange rate has stabilized, and inflation has been subdued. Moreover, the economy appears poised to grow at a respectable pace. Fiscal and monetary policies have been appropriately supportive of the recovery and important steps have been taken to implement a broad range of structural reforms. More needs to be done in the structural area, however, for the economic recovery to become self-sustaining.

The short-term economic prospects are good. The recovery is set to continue on the back of rising consumption sustained by a fiscal stance that will continue to impart an appropriate degree of stimulus. In this regard, we are pleased to note that the authorities' recent initiatives on the spending side are expected to raise budgetary disbursements rates—an essential ingredient in maintaining the momentum of the economic upturn. Monetary policy will also be broadly supportive of the recovery although staff expresses the view that a more complete transmission of the accommodative stance of monetary policy to bank lending rates is needed. A further generalized fall in interest rates, including deposit rates, would be helpful to the recovery and would strengthen the banking system.

Notwithstanding the promise in the near-term outlook, Thailand's recovery from the crisis has been less vigorous and broad-based than one might have hoped. The staff paper refers to this as an issue of "divergent macroeconomic forces" and asks how the need for accelerating growth can be reconciled with the underlying weaknesses in investment and the inevitable resumption of fiscal consolidation to halt the rise in public debt. While it is safe to assume that the excessive investment of the past should not be expected to recur, one wonders if the staff paper's baseline projections of growth and investment are not too cautious. The medium-term growth could well turn out to be better than projected through the more favorable effect of structural reforms on the ICOR. This makes the need to forcefully address the remaining structural issues confronting the economy all the more urgent.

Mrs. Hetrakul's statement provides a thorough assessment of the impressive actions the authorities have taken in the structural area and those that are planned in the immediate future. The scope for further action and for a pickup in the pace at which reforms are implemented should be explored. Mrs. Hetrakul correctly remarks that the continued stickiness of nonperforming loans "poses concerns over the robustness of the recovery" because it has a crucial bearing on restarting credit flows. The disinclination of banks to draw on the existing public capital support scheme needs to be reversed by, inter alia, imposing less demanding conditions. We note that the staff and the authorities have discussed several possible ways to modify the existing support scheme and that the authorities intend to take action in this area early this year. These efforts will have to adequately safeguard public resources, as suggested by Mr. Shaalan and Mrs. Farid, and be complemented by a strengthening of the bankruptcy and foreclosure framework. In respect to corporate debt restructuring, it is hoped that the remaining weaknesses in the CDRAC framework can be expeditiously addressed—an area where assistance from the World Bank can play an important supportive role.

The legal ruling in favor of the Corporatization Act has removed a key obstacle to privatization of state enterprises. It would seem opportune to consider the modalities of an adequate safety net for public sector employees. This may help attenuate some of the heated opposition to privatization from public sector employees noted in the staff report.

Mr. Kelkar submitted the following statement:

The authorities are to be congratulated for the broad-based economic recovery and return of market confidence. Both manufacturing activity and consumption demand have recovered. The growth rate in 1999 has been 4 percent and could even be in the 4–5 percent range in 2000. These projections augur well for Thailand. The planned fiscal deficit budget for the coming year has been designed to be a tool to stimulate and reform the economy. The authorities also wish to promote Thailand's competitiveness and develop higher technology usage. But now the efforts of the authorities have to shift toward more long-term structural reforms. Mrs. Hetrakul's informative preliminary statement has been very useful and she has highlighted the areas which are of importance.

I commend the authorities for their prudent macroeconomic management as they continue to maintain a supportive monetary stance and an expansionary fiscal policy. This has indeed helped the economy to recover. I also thank staff for the well-written documents. They have focused on structural issues and these should be the main concern of the authorities. The observation made by staff that Thailand's output fell further (during the crisis) and has recovered less compared to other economies in the region is also a timely signal that the embedded structural weaknesses in the economy could still jeopardize economic recovery.

I broadly agree with the thrust of the staff appraisal so I will restrict my observations to a couple of areas of systemic concern. These are nonperforming loans in the banking sector and the debt-ridden corporate sector and a subsidiary area which has not been discussed—i.e., the public consensus needed to sustain the structural reforms. In my view these are the most important goals but will also be the most demanding challenges for the authorities.

Stronger domestic and external demand has fueled a recovery of the manufacturing sector. The regional demand has also helped to maintain Thailand's trade and current-account surpluses. International reserves remain at comfortable levels and outstanding external debt has fallen. But despite these developments, private investment has been slow in its recovery. As observed by staff, the overall capacity utilization is low even though the private sector investment index has risen to 61 last October as compared to 10 in the previous year. There seems to be a peculiar contradiction between the need for growth in bank credit and the equally necessary requirement for structural changes in the financial sector. The reasons for a flat bank credit, despite the recovery, have been given in paragraph 6 of the staff report. I wonder how long the restoration of healthy credit growth will take. Currently the banks are struggling to clear their massive debts and the corporate sector strives to reduce the debt burden.

The nonperforming loans in the financial system continue to remain high, especially among the state-owned banks and finance companies, and this underscores the fragile state of the economic recovery. The sluggishness of nonperforming loans despite the improvement in restructuring of corporate debt could be for more reasons than those given in the staff report. Is there reason to believe that the rescheduled loans are turning bad again? There does seem to be a hint about this in the report. Is it likely that the current situation will persist because of insufficient demand? With the lack of improvement in nonperforming loans, my additional worry is that there will be pressures for a relaxation of nonperforming loans rules.

The restructuring of nonperforming loans has proceeded relatively slowly perhaps because the revamped regulatory framework has been inadequate or is being circumvented by those who can afford to repay loans, but decline to do so. Mrs. Hetrakul has given some details about the work of the bankruptcy court but I am not sure whether there is evidence of at least a few high-profile bankruptcy cases that have been completed. One gets the impression that the bankruptcy laws are not defined very well and have considerable failings. The focus of the exercise seems to be on small debtors. The Krung Thai Bank affair and the political controversy surrounding it only seems to add force to this argument. Perhaps staff could throw some light on the latest developments about this case.

With nonperforming loans remaining high and corporate debt restructuring proceeding slowly, the credit situation has been flat. Yet it has been asserted that liquidity is not a severe problem and most banks are well on the way to meet provisioning requirements against bad debt in accordance with international standards. On the other hand, recapitalization demands have had a severe impact on bank profits, with all listed banks reporting heavy losses in the second quarter of 1999. When it is said that there are no liquidity problems, could this imply that there is a shift in the lending burden to state-owned institutions while they struggle to cope with their already considerable risk exposure? Staff comments would be welcome.

Several measures are being implemented to encourage private investment by providing tax cuts and reductions in import duties on specified items and deferrals of corporate tax payments and faster depreciation allowances on fixed assets. Other measures reported are inexpensive housing loans and stimulus packages aiming to improve private sector access to capital via the International Finance Corporation to buy equity and provide loans to large companies that are undergoing restructuring. Could these boosters also increase the fragility of the banking system while trying to focus on recovery?

Banks are also forming their own asset management companies to speed up debt restructuring. But despite the official encouragement, the progress in this area has been slow. The setting up of asset management companies reportedly received a lukewarm reception because of tax and regulatory constraints. I would appreciate if the staff could give some information about this.

Regarding the issue of social consensus and political support for the ongoing programs, I make my observations based on some reports that the Senate is likely to become increasingly politicized and could have a critical influence on public policy. The March Senate poll and its eventual composition could even determine the eventual direction of the reforms. There could be a tendency toward backdoor means to protect the vested interests of special groups and even attack reformist legislation. This could jeopardize the efforts of the government in building the necessary support for structural reform. Would staff view this as an important risk to the structural reform process?

The economic condition of a sizable section of the population is still quite bad and unemployment is also high. This can strain social equations and make things difficult for the authorities. At this stage, I would encourage the government to implement the reform process with sensitivity so as to keep the structural reform agenda on track.

In conclusion, I congratulate the authorities for their achievements and I wish them success in their policy endeavors.

Ms. Lissakers made the following statement:

As we have pointed out in recent program reviews, the Thai authorities' reform efforts have brought the country a long way, but the recovery appears to be held up by important, unfinished business.

The staff has tried to explain why the problems have not yet been adequately addressed. One of our concerns is related to the issue of debt restructuring that Mrs. Hetrakul elaborated on this morning, and this is interesting information. I would appreciate the staff's comments on the establishment of asset management companies, because the lack of progress in corporate debt restructuring appears to be the biggest obstacle to economic recovery, with the continued accumulation of nonperforming loans. They clearly impair the banking system's ability to perform normal mediation in the economy. However, there is clearly some sort of credit intermediation taking place in Thailand, because the economy is growing and so is credit.

In her preliminary statement, Mrs. Hetrakul points to the increased role of capital markets in credit intermediation, and that kind of diversification is certainly a healthy development. However, the staff wonders whether a healthy, broad-based recovery can be sustained without a healthy banking system. One has to think the answer is no. Accordingly, the obstacles to loan recovery and recapitalization of the banking system will have to be removed.

The authorities have relied largely on private recapitalization up until now. However, the staff is questioning whether private recapitalization of the banking system will be sufficient, and whether the private asset management companies will be able to increase loan recoveries net of additional demands. There is a waiting game on the part of the authorities, who want to avoid introducing too many public resources into the system and instead let it work its way out. Maybe that can work. The economy appears to be recovering, and credit does seem to be available to some extent in the private sector. However, I would be interested in the distribution of credit. Large companies can always gain access to credit. They have informal lending arrangements among themselves, and exporters have access to retained earnings. The question is whether smaller companies can survive without a healthy banking system and whether they are being denied credit because of the weakness in the banking system. I wonder if the staff could comment on that.

My biggest concern is that if small- and medium-sized enterprises cannot find credit, their growth will be impaired. On the one hand, a more proactive recapitalization strategy based in part on public funds would be needed if the latter is the case. On the other hand, there are factors that speak in favor of letting the private sector work it out. The banks do have legal means to force debtors to pay. One of the most worrisome facts mentioned is that even profitable companies appear not to be servicing their loans because they believe that they are entitled to loan restructuring. That points to a fundamental flaw in the loan recovery process, both in terms of legal options and the willingness to use them. I wonder if the new measures referred to by Mrs. Hetrakul will be sufficient to address this fundamental moral hazard and whether a sound credit culture will return in Thailand.

On a related issue, I thought that Box 3 in the staff report is a useful way to present the vulnerability issues, and I hope that other departments and country missions will take heed. One of the interesting features in this respect is what will happen to the net open foreign exchange positions of banks, which is obviously an important indicator, recalling the origins of Thailand's financial blow-up. I wonder what the staff makes of the numbers. There has certainly been some reduction in foreign currency lending to domestic borrowers, but it is pretty modest, down from $19.5 billion to $15 billion. The net open position is not excessively large when off-balance-sheet positions are taken into account. However, as noted in the staff report, the maturity of assets and liabilities is problematic, given that a large part of the banks' assets are comprised by foreign currency loans to Thai companies, whose ability to generate payments in dollars is unknown. Given the level of exports of the Thai economy, this might, however, be less worrisome than in other countries where exports constitute only a small part of the total economy.

We know that, before the crisis, a large part of the dollar-based credit went to fund mortgages and purely domestic business activities. This constituted one of the main problems when the exchange rate came under pressure. It is interesting to observe the extent to which emerging market economies rely on foreign-currency-denominated loans to finance commercial activities. We do not yet know the impact of such financing and how countries may protect themselves against the consequences. To the extent that the authorities continue to allow the currency to float, fewer borrowers will include the fluctuation of the exchange rate into their calculations, assuming that the borrowers themselves will manage their foreign currency risk better than they have in the past. Even then, however, it does raise questions about whether this is a viable credit structure. There are dual currency economies, and our standard way of looking at banking supervision and the financial sector does not take that into account to a sufficient degree.

It is interesting and encouraging that the Thai authorities are considering the adoption of an inflation-targeting framework. This is a complex undertaking, but it does suggest that they are committed to letting the exchange rate float.

With respect to the banking system, the staff report, quite rightly, points to concerns about the apparent failure to adjust deposit rates downward even though lending rates have come down. Credit demand is still quite modest, but there seems to be stickiness on the deposit rate, and I would be interested in hearing from Mrs. Hetrakul about the Central Bank's proposed response.

There has been a dramatic deterioration in the fiscal situation, and the authorities are therefore understandably reluctant to rely on massive fiscal stimulus to restore growth, even though domestic demand remains subdued. However, looking at the Japanese situation, the combination of low domestic demand and severe weakness in the banking system suggests that continued fiscal stimulus will be necessary. Therefore, the staff is right to argue that more fiscal stimulus is needed.

Finally, a comment on labor issues. While we welcome the ongoing corporate restructuring and privatization, the private sector in Thailand has a history of ignoring workers' rights. Indeed, Thailand has yet to ratify the majority of international labor standards, which signals endorsement of poor labor standards as a matter of principle. As the Thai economy continues its integration into the global economy, the government should keep up pressure on the private sector to respect core labor rights.

Mr. Pickford made the following statement:

I would like to thank the staff for its clear, comprehensive, and frank analysis of the outlook for Thailand and the main issues facing the authorities. Progress appears to have been made with respect to economic recovery and structural reform. However, as the staff report makes clear, much remains to be done. The authorities must ensure that the economy does not lose impetus. I agree with the staff that the immediate priority is to speed up corporate debt restructuring, and will focus my comments on that.

Let me say a few words about fiscal and monetary policy first. The staff is right to argue that fiscal and monetary policy must remain supportive of growth at present. But at some point—and when circumstances permit it—it will be important to start the process of fiscal consolidation.

On monetary policy, I note the authorities' intention to develop an inflation-targeting framework. This will take attention away from the exchange rate, which has proved helpful in other Asian countries. It will, however, entail significant preparations, as Ms. Lissakers pointed out. We have argued in recent Board discussions that inflation targeting must be accompanied by measures that will ensure its credibility. I would be interested in hearing the staff's assessment of how far advanced Thailand's inflation-targeting framework is at present and how the authorities plan to address the remaining issues. While I do encourage the authorities to adopt the new framework, publishing a quarterly inflation report will be important to ensuring full transparency and accountability. Like Ms. Lissakers, I would be interested in hearing the staff's view on the authorities' exchange rate policy. If inflation targeting is to succeed, price stability must be the dominant target.

Turning to financial restructuring, the key risk to the economy recovery is a continued slippage of structural reforms. The approach taken by the Thai authorities of having the banks themselves raise new capital does not seem to result in an adequate pace of bank recapitalization. Paragraph 22 of the staff report notes that the adequacy of bank capital cannot be taken for granted—that appears to be an understatement. It seems to me, therefore, that the size of the recapitalization gap must be determined as a priority. I also believe that a case can be made for a more radical and faster approach for recapitalization such as the one adopted by Korea.

While the staff has commended the authorities on their efforts to eliminate obstacles for the establishment by banks of asset management companies, the debt restructuring process has taken far longer than anticipated. Krung Thai Bank is a case in point—the setting up of an asset management company by that bank could be an important signal of the authorities' resolve. Another area where the authorities should make progress is to move the nonperforming loans of intervened banks into the financial institutions development fund so that they are effectively outside the banking system.

Foreign investment in the banking sector is another important issue. The staff report says little about this, but it is unlikely, in my view, that the recent interest of foreign investors in that sector will be sustained, unless clarification of existing laws is forthcoming. Let me give you an example. The law states that foreign investment in a domestic financial institution may exceed 50 percent for up to 10 years. But it is still unclear whether that investment must be reduced back below 50 percent after the 10-year period. Potential investors have raised this question on a number of occasions, and I am disappointed that there has been no clarification from the authorities on that point yet.

Another priority in the financial sector is the drafting and implementation of planned financial legislation. First, the financial institutions law will bring together the servicing of banks, finance companies, and home loan lenders. Second, the deposit insurance law will replace the bank guarantee currently in place. Third, the central bank law will make the Bank of Thailand independent. That would be essential if Thailand is to move toward an inflation-targeting framework. However, the new legislation has slipped considerably, and swift progress is important. If the authorities really want to convince international investors that they are committed to rebuilding the economy on a sound financial footing, it seems to me that adopting these new laws ought to be a priority.

On corporate restructuring, which Ms. Lissakers touched on, I agree that progress so far has been rather disappointing. Many corporate debtors seem to be engaging in strategic defaults in the hope of receiving a more favorable treatment from banks later on.

It was disappointing to read in the staff report that there are weaknesses in the recently adopted bankruptcy law. It is surprising that this legislation, which has only just been adopted, makes no provision at all for creditor filing. The implementation of the new CDRAC framework is also happening slowly. I understand that the first major debt equity swap has only recently been completed, and that progress generally has been slow, as the CDRAC framework apparently suffers from significant capacity weaknesses.

Finally, on external vulnerability, like Ms. Lissakers, I think the presentation in Box 3 is good. But given continuing concerns about the pace of reforms, it is worrying to read that the level of freely usable reserves is lower than the level of total reserves. If a new crisis did develop, resulting in significant pressure on the exchange rate, I wonder what would be the implications for financial balance sheets.

In summary, progress has been made to the point where the authorities do not need to draw further on Fund resources. But there is a significant agenda of legal reforms which remain to be completed. I would urge the authorities to proceed as quickly as possible with those reforms and wish them well in that process.

Mr. Chelsky made the following statement:

I would like to join Ms. Lissakers and Mr. Pickford in expressing my appreciation for the frank and well-focused staff report. With two Article IV discussions and eight reviews under the Stand-By Arrangement since 1997, the last of which was only a few months ago, most of what needs to be said about the Thai reform effort has been said. Nevertheless, despite the progress so well documented in the various preliminary statements prepared for this discussion, there remain serious concerns that need to be address expeditiously.

Briefly, on monetary policy, while its transmission through lower interest rates continues to be constrained by the slow pace at which deposit rates have declined, I am hard pressed to think of how to facilitate clearly appropriate faster declines. I will therefore not dwell on this point other than to ask staff to elaborate on what they have in mind when they call for "clearer government support for lowering all interest rates in the banking system."

More generally, I have a few questions on the discussion of the medium-term monetary policy framework contained in Mrs. Hetrakul's preliminary statement. First, Mrs. Hetrakul indicates that "the objectives and scope of operations of the Bank of Thailand are to be redefined to focus on price stability and the health and stability of financial institutions." I would be interested in staff's assessment of a mandate articulated in this manner. In particular, is a "focus" on price stability the same as adopting the "objective" of price stability and to what extent might there be a conflict in an explicit dual focus on "price stability" and "the health and stability of financial institutions"?

Second, Mrs. Hetrakul makes reference to the adoption of "flexible" inflation targeting for the medium-term monetary policy framework. What is meant by flexible inflation targeting? Is this well understood by the public or is there a potential for such flexibility to undermine the credibility of the Central Bank's efforts to pursue price stability?

My most acute concerns are with respect to the lack of substantive progress in achieving the corporate debt restructuring necessary to permit the economy to recover at an appropriate pace and in a sustained manner. In particular, I was somewhat dismayed to detect a more sanguine assessment of the situation in parts of the selected issues papers and in a number of the preliminary statements prepared for this discussion. Granted, the authorities have been successful in passing a number of politically sensitive pieces of legislation. This is all well and good, but what matters in the end is what the legislation achieves and, as staff note, the amended bankruptcy law has yet to have a major impact on credit discipline and debt restructuring. Therefore, while it is reasonable that staff would suggest that "the authorities have made important steps in designing legal and institutional reforms that will promote corporate debt restructuring," I believe it is equally reasonable to more clearly state that these steps have, to date, been inadequate.

As noted, the legal system remains weak, and this can undermine the efficacy of even the most well-designed legislation, which, it is turning out, is not how the existing legislation could accurately be characterized. A key concern is the difficulty in commencing bankruptcy proceedings and the absence of involuntary filings for reorganization. Confidence in the system is further undermined by an inadequately skilled judiciary. I would welcome a sense from staff what specifically is being done to address these problems. The staff report is mostly silent on these questions, beyond calling for the "courts to counteract the existing impression that the commencement criteria for involuntary reorganization procedures are too onerous." I am uneasy with reliance on a court-led public-relations campaign. Given the private sector's propensity to pursue its own interests, I find it difficult to believe that the lack of court examples is largely responsible for the absence of better results. It seems likely that the problem is rather more substantive than cosmetic.

I appreciate the detailed articulation in Box 4 of the selected issues paper of why the new framework is not functioning as expected. However, to suggest, as do the authorities, that the reliance on nonconcessional rescheduling is appropriate since it resulted from "a commercial decision of banks not to accept cuts in the NPV of debt," misses the point, which is that the incentive structure arising from the legislative framework and the context in which it is applied does not seem to have been adequate to achieve a faster resolution of the debt problem, including by encouraging creditors to initiate insolvency proceedings over the objections of recalcitrant debtors. To the extent that banks cannot accept cuts in the NPV of debt because of weak capital positions draws into question the adequacy of efforts—both public and private—at recapitalization of weak banks. Here, staff are clearly justified to highlight the importance of proceeding in a deliberate, albeit responsible, manner.

The progress in corporate debt restructuring in the state-owned banks is even more a source of concern because it is here that one would have hoped to see leadership by example from the authorities. While I understand the reason for the slow progress, I do not understand why this has not been addressed more aggressively. In particular, if employees are concerned with personal liability, it would seem that the law governing state-owned banks needs to be changed—and soon. To the extent that high-profile examples of successful restructuring are of value, clear examples of vigorously pursued corporate debt restructuring by the state-owned banks would go a long way to spurring the kind of debtor willingness to reach agreement outside the court system that staff seek to inspire in paragraph 44 of the staff report.

On the fiscal side, I am pleased to see that the earlier exuberance to ensure that there was no shortfall in planned fiscal stimulus has abated. Previously, while we agreed with the need for significant fiscal stimulus, we were concerned that an overemphasis on meeting quantitative targets would result in an erosion of the quality of expenditure. What is also welcome is the more balanced perspective on the fiscal position which embodies a more immediate awareness of the problem of medium-term debt sustainability. This is particularly welcome given that staff's estimate of the recapitalization gap for the banking system is well below that of many in the private sector.

I will admit to being somewhat harsher in my criticism of the authorities in today's discussion than has previously been the case. The change in tone is intentional. It is motivated by an acknowledgment that the recovery remains fragile and progress in addressing major vulnerabilities has not met expectations. Looking ahead, it should be noted that Thailand's program with the Fund is set to expire in June 2000. Parliamentary elections are scheduled prior to, or in, November 2000. Pressure to ease off on politically difficult reforms and appropriate macroeconomic management in the period between June and November will no doubt be acute. The Fund cannot, therefore, retain any complacency about suboptimal performance in key areas in the months ahead. Regrettably, this timetable also does not bode well for long-overdue progress in another key area in need of reform, that being trade liberalization.

A brief word on the selected issues paper is warranted. I read with interest the work done on fiscal stimulus and credit growth. At the same time, I have reservations with respect to the paper on the "Real-Sector Perspective." In particular, while it is important to understand the ongoing repercussions of overinvestment prior to the crisis, this was but a symptom of more fundamental problems with the unsupported and arguably inappropriate exchange rate peg, deteriorating competitiveness, and governance shortcomings in central bank management. Discussing the real sector without mentioning this underlying context results in an overly sanitized picture of the crisis itself, thereby cloaking the most important lessons the Thai experience has for policymakers.

This sense of "sanitation" is also evident in the paper on financial sector restructuring where there is insufficient attention given to the governance dimension of developments. In particular, paragraph 50 notes that "more severe liquidity problems emerged in early 1997 in response to which the authorities provided support to select finance companies." This is certainly a diplomatic way of describing the provision of low-cost, unconditional credit by the Central Bank to financial institutions owned by politically well-connected individuals. Diplomatic, but not wholly accurate, that is. It would have also been valuable to have been more explicit about the reluctance of the authorities to more expeditiously pursue the closure of 56 finance companies. If I recall, initial confidence in the commitment of the authorities was eroded by delays and at least one false start in shutting down insolvent finance companies. Such information is important to obtaining an understanding of progress—or lack thereof—in stabilizing the economy.

Mr. Wei made the following statement:

Let me join the previous speakers in thanking the staff for providing us with a set of well-prepared and informative papers, and we also thank Mrs. Hetrakul for her preliminary statement for today's discussion. The staff report gives us a very comprehensive and concise picture of the difficulties experienced by Thailand during the past few years, and a deep understanding of the remaining challenges facing the authorities.

Compared with a year ago, the efforts of the Thai authorities have resulted in a broad-based economic recovery, a return of market confidence, and the absence of inflation. The authorities should be commended for those achievements. While I generally agree with the thrust of the staff appraisal, I would like to make a few comments.

First, we share the staff's view that fiscal policy should continue to be supportive of economic growth. While the current recovery is broad-based, only moderate growth in domestic demand should be expected. Therefore, in order to maintain the growth momentum in 2000, fiscal stimulus will be necessary. While we understand the authorities' concerns about the financial sustainability of the public sector over the medium term, we believe that with a further recovery of economic growth and reform of the tax system—as recommended by the staff in paragraph 45—the fiscal deficit will be eliminated over time.

Monetary policy should continue to be accommodating in order to sustain the economic recovery. In this regard, we share the staff's concern about the stickiness of deposit rates, and encourage the authorities to take a more active role to facilitate the transmission of low money market rates to bank lending and deposit rates. This will, in turn, contribute to economic recovery and strengthen bank balance sheets. As for monetary policy over the medium term, we note the authorities' intention to adopt flexible inflation targeting. This will require making the Bank of Thailand independent and strengthening its efficiency and transparency. The Fund should stand ready to provide technical assistance if the authorities request it.

Progress on structural reforms has been made; the authorities have addressed in an orderly manner the high level of nonperforming loans. However, much more needs to be done in order to secure a significant breakthrough in this area and put banks in a stronger position to meet credit demands, as the recovery takes hold. The establishment of asset management companies is a welcome step, which will help address the high level of nonperforming loans. However, to ensure that the banks continue to have access to necessary financing, we encourage the authorities to play a more active role in the restructuring of nonperforming loans, including by providing capital to banks. In this respect, we welcome the new measures announced by Mrs. Hetrakul in her opening remarks.

On the privatization of state-owned banks and enterprises, we note that legislation has been put forward to ensure that privatization is carried out in an orderly way, and that the legal and the regulatory framework to ensure the successful operation of the soon-to-be privatized banks and enterprises has been put in place.

In conclusion, the Thai authorities have been very successful in adjusting their economy. Many useful lessons can be drawn from their experience, and should be taken into consideration when the Fund is providing policy advice to other member countries. With these remarks, we wish the authorities further success in their endeavors.

Mrs. Mateos y Lago made the following statement:

First, I would really like to commend staff for the very insightful set of reports provided for this consultation. As this chair fully agrees with their appraisal, I will just make a few remarks, mainly for emphasis.

Since the last article IV consultation, and even to some extent since the last program review in October 1999, significant progress has been achieved in the area of structural reforms, particularly in the financial sector. At the same time, external vulnerability has been markedly reduced, and the overall economic outlook for next year is clearly improving, against a background of buoyant exports.

Nevertheless, as noted by many others, full recovery is still a long way off. Unemployment remains three times as high as before the crisis, in spite of an increase in part-time jobs. Capacity utilization still falls short of precrisis levels. Both of these suggest that private demand may remain rather sluggish for the foreseeable future. Meanwhile, the expansionary stance of fiscal policy will soon have to be scaled down, albeit gradually; otherwise the debt dynamics could rapidly turn unsustainable. This combination of factors clearly makes growth prospects at best uncertain.

In addition, supposing that private demand does eventually pick up, on account of improved business and consumer confidence, it can be feared that demand recovery will be nipped in the bud by sustained credit tightness. Since monetary policy could hardly be more accommodating than it presently is, there is little doubt that the present reluctance of banks to extend new loans is due to their lack of profitability and uncertainty about future earnings and recapitalization prospects.

As rightly pointed out by the staff report, the only way out of this impending credit crunch is to increase banks' lending spreads by allowing for a cut in deposit rates and to decisively upgrade both the scale and the quality of corporate debt restructuring. Regarding the latter, we could not agree more with staff that the kind of restructuring that has taken place so far has been inadequate to effectively address the problem of nonperforming loans. A particularly unambiguous illustration of that point is that 10 to 15 percent of restructured loans subsequently revolve to nonperforming status, in spite of the economic recovery and the downward trend of interest rates.

In addition, the lack of boldness of the actions taken by creditors, as well as the flaws of the legal framework, seem to have encouraged a wave of strategic nonperforming loans, which is a very worrying development. I would appreciate hearing the staff's views on how to address this tricky issue beyond the improvements to the bankruptcy system advocated in the report. Also, in light of the particularly alarming picture drawn in Box 2 of the staff report, it would be of considerable interest to find out in more detail what the authorities' intentions are, regarding the ways in which they could speed up the banks' recapitalization process.

Finally, even though the financial sector rightly attracts most of the attention, there are other structural reforms whose implementation would bolster recovery, in particular those related to the tax system. In this respect, we welcome the authorities' intentions to address the deficiencies of the personal income and offshore banking tax systems. But we would like to join the staff in urging them to consider a drastic reform of Board of Investment incentives as well.

In sum, we commend the authorities for their wise and skillful macroeconomic management as well as for the progress achieved with structural reforms in a number of fields, but warn them that the crisis is not quite over yet. In particular, the situation of the financial sector remains a major threat, which must be dealt with as swiftly as possible.

Mr. Toyama made the following statement:

The perception of Thailand's economy presented by the staff does not differ much from ours. The economy is on the path to recovery, with exports and fiscal expenditures taking the lead. Recovery has remained modest, however, principally due to some structural problems. This chair will call for more efforts to deal with such problems later. At this time, I would like to express my sincere appreciation for the authorities' initiatives in mobilizing full resources for, and removing any obstacles against, this recovery.

One of the areas this chair would like the staff to elaborate on is how pressure from the general public prevents banks from cutting deposit rates further than would otherwise be allowed. I share Mr. Shaalan's concern over the limited effectiveness of an accommodative monetary policy.

Over the medium term, the critical policy matter will lie in the timing and pace of the shift of focus in fiscal policy from recovery of the economy to consolidation. In this regard, whether domestic demands, such as consumption and investment, can sustain stable growth without fiscal expenditures as an engine, and whether exports can continue to increase along with the expansion of intraregional trades rather than with reliance on industrialized countries, should be the points for analysis.

This chair agrees that progress in corporate debt restructuring is the key to stronger economic recovery. Because of this, quick action on the part of the authorities for strengthening the CDRAC framework and bankruptcy system is required. It has been suggested that the United States' type of legislation in a country where lawyers were more accustomed to civil laws than to common laws made it difficult for them to practice this law style. This chair would like to hear the staff's views on the necessity for technical assistance in this area in order to advise professionals of the new law.

On the other hand, the authorities should deal with the bank recapitalization issue in a decisive manner. In order for corporate debt restructuring to advance, the banking sector must have the capability to absorb losses in disposing of nonperforming loans. Effective solutions, including debt relief rather than debt restructuring, can be accelerated. While the existing public capital support scheme has not attracted popularity among banks, the need for bank recapitalization is apparent. The lesson learned from experiences of other countries that dealt with nonperforming loans problems previously is that quick and decisive action by the authorities in addressing the problems is essential for rebuilding confidence in the banking sector and thus paving the way for a country to realize stronger recovery. A wait-and-see stance would only eventually raise the bill to taxpayers.

While avoiding moral hazard is important, any plan for bank recapitalization is futile unless actually utilized. The deficiencies of the existing scheme should be quickly rectified. The alternatives proposed by the staff, including temporary injection of nonvoting capital and capital injection into the asset management companies, with the repurchase obligation of the bank, deserve consideration. Also, setting a time limit would precipitate use of public funds.

With bank recapitalization, nonperforming loans should be quickly reduced on the bank balance sheets. Any hindrances should give way to restoration of the soundness of the banking sector. If the flow of "new" nonperforming loans is generated partly by debtors who have sufficient cash flows but who withhold payments in the hopes of obtaining debt write-downs, strong action against them would be warranted. By the same token, bank management who fear that write-downs of nonperforming loans would result in its responsibility issue, and thereby withhold disposition of nonperforming loans, should be penalized for not exercising appropriate write-downs. This chair would like to hear the staff's firm resolution to deal with this problem.

Mr. Alosaimi made the following statement:

Let me first thank the staff for a thoughtful and balanced report on Thailand's continued economic recovery. Their projection that the favorable trends will be sustained are encouraging and can be attributed to the authorities' ongoing adjustment and reform efforts.

As the informative selected issues paper underscores, Thailand's economic growth potential has improved. The recession and subsequent recovery has marked a rebalancing of the economy away from the previous imbalances of excessive investments and overexpansion of the nontradable sector. The new challenge is to build on recent gains to ensure that the economic recovery gathers further momentum. Clearly much remains to be done. Indeed, as the staff report points out, compared to other crisis economies in Asia, Thailand's output not only fell further during the crisis, but also has recovered less well despite strong fiscal stimulation and an increase in public debt. I broadly agree with the staff recommendations and will only add a few remarks for emphasis.

Priorities include reducing the large and rising fiscal deficit. However, action to that end requires careful phasing in view of the still relatively weak recovery. The slight increase envisioned for this year's overall deficit is, therefore, appropriate. With that said, I welcome the decision to leave the tax-to-GDP ratio unchanged. I am also encouraged by the authorities' commitment to use unanticipated tax dividends resulting from higher than expected growth for deficit reduction.

As emphasized by previous speakers, the continued problem of nonperforming loans poses a serious threat to economic recovery and requires a decisive response. Indeed, the staff identifies this problem as the principal source of market pessimism. As is the case with fiscal policy, this will require balancing, on the one hand, the need to ensure the provision of adequate credit and, on the other hand, the restoration of credit discipline.

Ongoing efforts to ensure the recapitalization of banks are clearly crucial. I also urge the authorities to step up efforts to ensure corporate debt restructuring. The complex interplay of undercapitalized banks, a weak bankruptcy regime, and the banks' attitude towards debt write-offs has hindered progress and is a cause for concern. Simplifying the legal procedures governing bankruptcy proceedings is a critical step in that regard.

With these remarks, I wish the authorities further success.

Mr. Spraos made the following statement:

As this is the first time I tackle Thailand around this table, let me begin by saying that if a year and a half or two years ago somebody had told me that the Thai economy would be where it is now and would be moving the way it is moving now, I would have thought that he needed to have his head examined. So I say with alacrity that this performance is highly impressive. I have noted reservations expressed around the table with respect to some major aspects of performance but despite these my verdict remains that the performance has been impressive. But the position of strength associated with this good performance emboldens me to ask whether sights are being set too low for growth in the years immediately ahead. The reason for my question is that, as other Directors have also observed, comparatively Thailand has lagged in the recovery league. Malaysia and Korea, which went through the same economic torment, have outperformed Thailand in output recovery and their growth prospects are viewed more optimistically. Somebody has to have the bronze medal of course, but it is always a good question to ask—why not gold? Especially when Thailand was a close contender for gold earlier in the decade.

For the longer term I can give a partial answer to my own question. It is not an original answer. In the years before the crisis, when Thailand was running neck and neck with the best Asian tigers, it was also running a high current-account deficit, which suggests that its vying for first place was not quite sustainable. The first chapter of the selected issues paper lists other weaknesses as well. It would not come as a surprise, therefore, if in the longer term it moves at a somewhat lower speed.

But for the next year or two the current account will not be a constraint and Thailand, having had a bigger output decline than Malaysia and Korea and having so far climbed more slowly out of the trough, should be in a position to move faster than the others right now and in the years immediately ahead.

In October this chair raised the question whether, despite the (frequently unreliable) statistics showing low capacity utilization, there was more of a capacity constraint than met the eye on account of low investment in the last couple of years. The staff denied this at the time, and the Article IV staff report in front of us affirms that excess capacity persists. If so, growth is demand constrained. Consumption and net exports are not a problem. Private investment is. And it is difficult to imagine a rapid increase in investment if capacity utilization is as low as the data say it is. One or two sectors may be approaching capacity limits and will present investment opportunities but aggregate private investment will increase slowly. Of course the volume of investment should not be judged by its precrisis level. That was too high and was only made possible by unsustainable capital inflows. But even judged by a more modest standard, private investment is seriously lagging now and can be expected to continue to do so. The staff rightly projects only a modest recovery.

Are there other impediments to investment besides excess capacity? The staff mentions anecdotal evidence of a credit crunch. In the staff report and in a chapter of the selected issues paper, they offer alternative (demand side) explanations for the observed credit contraction and draw attention to nonbank sources of financing that have expanded. But, if I read them correctly, they accept that a negative supply shift of credit has also taken place and that it could be acting as a constraining factor currently and even more so prospectively. It is not surprising that banks should become overconservative in their lending after their traumatic history and while a ratio of nonperforming loans persists at nearly 50 percent. But the question arises whether an injection of some extra liquidity into the banking system might help. I know it is difficult to interpret the present situation as marked by scarcity of liquidity. But bank credit is well down and needs to be coaxed up. In her preliminary statement, Mrs. Hetrakul affirms that liquidity in the economy is now adequate. But how confident can we be about this? No avenue for raising private investment above its recent low levels should be left unexplored. Japan is a case of even more accommodating monetary policy. But we still ask Japan to explore whether it can do more on this front. Perhaps Thailand can do more, too.

If a monetary stimulus will not help or not by much, can the fiscal instrument contribute more to demand? The Fund has learned a lot about the fiscal instrument in the Asian context and the staff rightly say that, given underemployed resources and subdued inflation, a high level of public sector deficit is appropriate. After a deficit of 6.6 percent of GDP in the fiscal year 1998/99, they project 6.8 and 5.8 percent in the subsequent two years. Allowing for the precrisis fiscal surplus, the turnaround is very substantial and must imply no mean amount of fiscal activism. Is it enough? With the debt-to-GDP ratio at 60 percent, it is a moot point whether there is scope for a yet more ambitious use of the fiscal instrument. Given the continuing demand weakness (paragraph 33 of the staff report), a case could be made for it. Of course, in the long term the debt must be addressed and I agree with Mr. Pickford's formulation: consolidate as and when circumstances allow. But here I am talking about the next year or two. It is important to work off excess capacity in as fast a time as possible in order to get private investment going again at a good pace. But right now I will not press the case for yet more fiscal activism. I will confine myself to questioning the understanding (indicated in paragraphs 13 and 42) that, should a faster than anticipated recovery produce a windfall increase in revenue, it would not be spent. Of course this is not new. It was there in the last review. But it is too sweeping a prescription. It would be the right prescription if the unanticipated acceleration of recovery is so big that demand weakness is no longer a problem. But if it is not so big, if demand weakness persists, why not spend the windfall? Such spending could now be undertaken, not just without any adverse effect on the total debt, but with an improvement on the scenario for the debt-to-GDP ratio set out in Table 11, thanks to a faster rise in the denominator. I repeat, faster growth in the next couple of years, if it can be generated, will be the key to a quicker easing of the burden of excess capacity, which is needed to reinvigorate investment and thus bring the economy soonest to its full self-sustainable growth potential. In this context, Mrs. Hetrakul's concluding statement that her Thai authorities "plan to continue with fiscal stimulus measures" gives the right flavor.

I will raise only one other matter—nonperforming loans. This has been highlighted by all preceding speakers. Most were viewing it in the context of the wider banking weakness. But I will concentrate on nonperforming loans. The subject was also taken up by many chairs at the last review and emphatically so by this one. The fact that the NPL ratio is still not falling from the very high level of nearly 50 percent, despite the improvement in the economy and the apparently greater conservatism in bankers' lending policies, is a serious weakness that deserves to be given even higher priority than it has had so far. The more the question of loan restructuring remains a live public issue, the more a culture of nonpayment develops and the more conservative the banks become in their lending—a vicious circle that needs to be broken if credit is to resume lubricating the economy efficiently. Whatever we call it—"moral hazard" and "strategic nonpayment" were terms used—this is dangerous. Many things are being tried but in a gradual way and the problem drags on. This is one instance where my general preference for gradualism in structural reforms over big bangs is being sorely tried. Can we have an up-to-date assessment of the nonperforming loans situation? If it is not improving, is it known why the proportion of nonperforming loans among new loans is so high? This is a key bit of knowledge. If it is not available, it needs to be acquired in order to design measures to counteract it.

But critical though this is, it would take time to fix it and to see results from it. I do not think that trying to fix it obviates the need for other action designed to loosen the demand constraint on growth.

Mr. Singh made the following statement:

Like other speakers have already noted, the current assessment of Thailand's economy shows a mixed picture. On the one hand, the economy is recovering from the crisis. Economic growth has gathered momentum. The fiscal stimulus seems to have had its effect, but exports are also flourishing and consumption is on the rise. On the other hand, however, there are still serious structural problems that need to be dealt with, especially in the banking and corporate sectors. This lack of progress is a source of concern and calls for prompt action.

On the macroeconomic front, although the base of the current recovery is broadening, supportive fiscal and monetary stances are still called for. On the fiscal front, we therefore view the proposed budget deficit as appropriate. However, the expansionary fiscal policy to fight the crisis, together with the need to recapitalize weak banks, has led to a substantial increase in government debt that is not sustainable in the longer run. With economic growth gaining strength, the focus of fiscal policy will have to move from stimulus to debt reduction. We welcome, therefore, the authorities' intention to set aside any windfall of revenue above the projected 15 percent of GDP, if recovery were to be stronger than expected.

On monetary policy, the stance remains correctly accommodative to support the recovery, although one could regret that lending rates have not declined more rapidly. In addition, we welcome the authorities' increased inclination to accept greater flexibility in the exchange rate. We agree that the development of an inflation-targeting framework would seem to be suitable for Thailand in the future. However, as Mr. Chelsky and Mr. Pickford have already pointed out, the development of such a framework will take time, as many institutional prerequisites are not yet in place—such as the institutional independence of the Central Bank.

The structural front is, however, the most problematic. The current recovery may not be sustainable, if significant progress is not achieved, especially in the banking and corporate sectors. We are concerned, for instance, that the rescheduling of nonperforming corporate loans has not led to any reduction in their net present value. If these loans are truly nonperforming, banks have to recognize now that their value has decreased and should not postpone this decision to a distant future.

This reluctance of banks to provide debt relief may indicate that their capital base remains insufficient and that bank recapitalization is not yet over. New capital has to be found for banks in order for them to be able to make the needed provisions and write off debt where necessary. If banks do not succeed in raising new capital on their own, contributions by the state will again become necessary. In this respect, we welcome the authorities' indication that they would consider such course of action.

Another important step to secure progress in debt workouts would be to strengthen the CDRAC framework. Particularly, the Corporate Debt Restructuring Advisory Committee should be fully staffed as soon as possible. In this respect, as would Mr. Pickford, we would be interested to know from the staff why the World Bank funding has only been limited to some pilot efforts.

However, not only debt workouts have been problematic, but new nonperforming loans also have been accumulating. In this respect, it is imperative that progress be made in the implementation of the new bankruptcy law. It is worrisome to read in the staff paper that some debtors do not pay interest to their banks, even if they have the cash to do so. Bankruptcy should become a real threat to debtors.

Existing obstacles for the initiation of a bankruptcy procedure should therefore be eliminated and a few key test cases should be rapidly brought to court. Some legislative changes may be needed, such as shifting the base for the initiation of the procedure from a solvency test to a liquidity test. There should also be a prompt and transparent resolution of the Krung Thai Bank case.

Finally, with regard to the tax system, a number of tax rules introducing adverse incentives still need to be amended. For instance, the preferred tax status of the Bangkok International Banking Facilities is problematic, since it constitutes a subsidy for borrowing short-term in foreign currency.

To conclude, the Thai authorities possess an impressive record of progress with respect to structural policy. Moreover, their macroeconomic stability policy was a success. For all this, they are to be commended. However, this should not lead to complacency, since there are still important tasks to be undertaken. We wish therefore the Thai authorities all the best for what still lies ahead of them.

Mr. Cabezas made the following statement:

During 1999, fiscal policy helped provide momentum for economic recovery. Given that domestic demand is not yet strong enough to sustain growth, it is paramount that the fiscal stimulus be maintained. However, we advise the authorities not to lose sight of the medium-term goal of fiscal consolidation. In this respect, we welcome the announcement made by the authorities that they plan to set aside any higher-than-expected revenues in 2000 for deficit reduction purposes.

On financial issues, the low recovery of nonperforming loans constitutes a source for concern. On structural reforms, we call on the authorities to continue implementing the bankruptcy and foreclosure framework together with the loan classification policy in order to ensure the recovery of the financial sector and of private investment. With respect to the staff's recommendation about deposit rates, I understand that it sees some room for deposit rates to decrease. I wonder how urgent the need is for the banking sector to raise new capital. I wonder if the staff could expand on its interpretation of this issue.

Mr. Çakir made the following statement:

We are pleased to see Thailand's economy continuing to recover. The Thai authorities' commitment to reform and to necessary adjustment has been key to the recovery process. We also applaud their decision to refrain from further purchases under the arrangement while sensibly retaining their right to purchase should the need arise. Thailand's growth performance has been promising. So far, the motors of this growth have been net exports, reduction of stocks, and increased private consumption. The manufacturing sector's recent strong performance is evidence of the vigor of the economy. These production gains come not only from the electronic goods industry but also from the auto industry, which seems likely to contribute significantly to growth in coming years. Overall, however, Thailand's aggregate output is still well below precrisis levels, and the authorities should continue the fiscal stimulation of domestic demand for the short term.

Nonperforming loans still account for almost half of all loans in Thailand. The staff report examines in some detail the reasons for the persistence of the nonperforming loans. A major reason was that 25 percent of the loans that have been restructured were performing, not nonperforming, loans. Another reason was that the flow of nonperforming loans continued.

As shown in Box 2 of the staff report, there is also concern that the private banks may not be able to raise enough capital from the markets, and that the banks may not be able to carry their nonperforming loans without deflating capital. If Thailand's economic recovery slows down before the framework for solving the nonperforming loan problem is in place, the government may have to increase its contribution to bank recapitalization, which will ultimately lead to a rise in government debt. We agree with the staff that fiscal consolidation should become a central policy goal for the medium term. Fiscal consolidation will be crucial to ensure that the resolution of banking crises does not evolve into a sovereign debt crisis in the future. For this reason, we applaud the authorities' intention to use any windfall revenues for reducing the debt burden.

We were glad to learn from Mrs. Hetrakul's preliminary statement that the problem of nonperforming loans, and the weaknesses in the CDRAC framework and deficiencies in the bankruptcy system, are being addressed by the Thai authorities.

Though money market rates have been held in the range of 1 to 3 percent in 1999, the decrease has not been reflected to deposit and lending rates, which reduces the room for monetary stimulation of growth. Under these conditions the recovery will receive more benefit from continued resolution of nonperforming loans than it would from further interest rate reductions. High lending rates would normally cause the stronger companies to seek financing outside the banking system. Unfortunately, the recent drop in the stock market will discourage such attempts. We hope that this hesitation in the performance of the stock market is only temporary.

With these remarks, we congratulate Mrs. Hetrakul and her authorities on their achievements till now, and wish them continued success in implementing the remaining stabilization and reform policies.

The staff representative from the Asia and Pacific Department noted that the economic situation in Thailand before the crisis had been worse than in other Asian countries, which was why the Thai economy was recovering at a somewhat slower pace than other countries in the region, such as Korea. Before the crisis, Thailand had been running a large current-account deficit, exports had been stagnating, and the financial sector had been overexposed to foreign exchange fluctuations and asset price changes. As a result, the subsequent decline in consumption and investment had been much sharper in Thailand than in Korea. While difficult to document, it also appeared that there was a greater degree of speculative overinvestment in Thailand than in Korea. Thailand had experienced very high investment ratios, averaging 41 percent during the five years preceding the crisis. Whereas investment in Korea had been concentrating on the traded goods sectors, such as shipbuilding, steel, automobiles, and semiconductors, investment in Thailand had, to a large extent, been focusing on the nontradable sectors. The bubble effect had also been larger in Thailand, resulting in a sharper collapse in asset prices than in Korea. Finally, there were differences in the markets' perceptions about the state of the banking sectors. In the case of Thailand, the banking sector was perceived as a much bigger drag on economic recovery than in Korea. While the private-sector-led approach to debt restructuring adopted by the Thai authorities was probably the correct strategy, it was working rather slowly. All these factors accounted for the different pace of recovery in Thailand and Korea. An alternative mix of monetary and fiscal policies might have averted the crisis. In that respect, the staff had pointed to the weaknesses of the Thai economy during a number of Article IV discussions in the years preceding the crisis.

The benefits of an accommodative monetary policy were being transmitted to the economy in the form of lower rates for bank lending and deposits, the staff representative related. However, rates were declining only slowly because of political opposition to lower rates from many quarters both inside and outside the government. Against this background, the staff had interpreted the silence of the authorities on the subject as acquiescence with the continued high level of deposit rates.

Introducing an inflation-targeting framework was a medium-term objective for Thailand, the staff representative continued. Although the institutional structure—including full independence for the Central Bank—was not yet completely in place, the staff considered that the authorities understood the prerequisites of inflation targeting. The Bank of Thailand was currently hosting a seminar on inflation targeting to build consensus on the subject. A study of price determinants of inflation, to which the staff had contributed, would be presented at the seminar. Mrs. Hetrakul's use of the term "flexible inflation targeting" had been intended to convey latitude with respect to the goals of inflation targeting. The authorities did not consider inflation to be the sole objective of the new framework and planned to include other variables, such as short-term output and financial stability, in their policy considerations.

Mr. Chelsky asked whether the Bank of Thailand had decided how to weigh the different objectives of monetary policy after it adopted inflation targeting. Without transparent objectives, the inflation-targeting framework would not be credible.

The staff representative from the Asia and Pacific Department replied that the Bank of Thailand was still considering the details of the inflation-targeting framework, and that it probably would make a final decision in early 2001. Its position on exchange-rate policy had shifted since the agreement of a Fund-supported program. Initially, the authorities had been seeking to stabilize the exchange rate even though a floating exchange rate regime had been adopted in principle. While there was no hard peg, stabilization had definitely been a short-term objective. Now that the crisis had passed, and the risk of contagion had dissipated, the exchange rate regime was allowed to fluctuate freely. In October 1999, the exchange rate had been as low as 41 baht to the dollar. In January 2000, when concerns about possible Y2K-related problems had been at their peak, the exchange rate had come under pressure again. However, the exchange rate had since climbed back to 37.5 baht to the dollar.

Mr. Pickford suggested that the introduction of multiple objectives for monetary policy under an inflation-targeting framework would represent a step back compared to the present regime.

The staff representative from the Asia and Pacific Department replied that the Central Bank already had multiple objectives, and inflation was not presently the central objective of monetary policy. The authorities were seeking to provide support for the economic recovery. The staff agreed with the authorities that economic recovery should be the key priority for monetary policy in the near term.

Bankruptcy law had been strengthened in Thailand, the staff representative explained. The key issue was whether creditors would use that right to force involuntary bankruptcies on debtors, but that had not happened so far. However, uncertainties remained because the law was unclear on key issues.

Rebuilding credit discipline remained a central issue, the staff representative continued. The only way to address that problem was to encourage debtors to settle by threatening to take them to court and strip them of their property rights.

Mr. Chelsky noted that state-owned banks had made less progress than private banks with respect to debt restructuring. The staff report had pointed to a law that made employees of the state-owned banks concerned about their personal liability as a major obstacle in that respect. How could that constraint be addressed and debt restructuring be speeded up?

The staff representative from the Asia and Pacific Department confirmed that the liability issue was the main reason why the process of debt restructuring had been slower in the state-owned banks. However, the authorities were reluctant to revise the law because they feared it would be perceived by the public as a means to reallocate property rights. Giving state employees the ability to write down loans created considerable scope for poor governance. Furthermore, the liability issue was not the only problem blocking debt restructuring. The state-owned banks had also inherited assets that were particularly problematic after having merged with intervened private banks.

As noted by Mrs. Hetrakul in her preliminary statement, 7 of 13 banks had already established asset management companies, the staff representative stated. However, progress with debt restructuring had so far been slow, partly because many of the legal and regulatory obstacles were removed only in October 1999. The new initiatives referred to by Mrs. Hetrakul addressed the remaining outstanding issues. For instance, rules that prevented banks from investing in their own asset management companies had recently been liberalized, allowing for the creation of larger asset management companies with the necessary critical mass.

The authorities had recently addressed the most pressing issues with respect to the nonperforming loans of the state-owned Krung Thai Bank, which was the largest bank in Thailand, the staff representative said. The bank would soon be able to set up its own asset management company, which the staff believed would help pave the way for a restructuring of the bank itself.

The evidence that rescheduled loans became nonperforming once again was mostly anecdotal and therefore difficult to quantify, the staff representative stated. However, preliminary data from the Thai Bankers' Association and the Bank of Thailand suggested that 10 to 15 percent of restructured loans became nonperforming once again. Although there could be many reasons why rescheduled loans became nonperforming, some further restructuring of loans was to be expected in an economy with uncertain cash flows. It might therefore take more than one attempt to realign debt servicing and cash flows. However, the staff was concerned that the restructuring that had taken place up until now was superficial and simply postponed the recognition of losses where loans had clearly been overleveraged. In those cases, simply lengthening the repayment period would not provide true debt restructuring and loss recognition in the banking sector.

Mr. Spraos asked whether it was true that a high percentage of new loans also became nonperforming.

The staff representative from the Asia and Pacific Department replied that there were no data available on the performance of new loans. However, the staff report did contain data on the number of new nonperforming loans. Many of the recent defaults on loans were strategic in nature, which was why the staff was advocating strengthening the bankruptcy law.

Further fiscal stimulus or a more accommodative monetary policy was unnecessary at the current stage, the staff representative considered. The best means to reinvigorate economic growth was instead to increase domestic demand and investment. However, consumers and investors were held back by the unresolved issue of nonperforming loans. The latest macroeconomic data pointed to a healthy economic recovery. Recently published data for 1999 third-quarter GDP was in line with staff projections, and recent data from the manufacturing sector also pointed in a positive direction. Accordingly, there was no need for further fiscal or monetary stimulus at the present time.

Mr. Spraos wondered whether it was premature to suggest that the authorities set aside higher-than-expected revenues in 2000 for deficit reduction.

The staff representative from the Asia and Pacific Department replied that the authorities intended to use additional revenues to reduce the deficit below the projected 6.8 percent if output remained on track.

Ms. Lissakers asked whether the staff would advise against the spending of additional revenues in 2000, taking into account the fact that the authorities had underperformed on the budget in the past.

The staff representative from the Asia and Pacific Department replied that the program deficit for FY1999 had been 8 percent of GDP. The actual outcome had been 6.5 percent, while output had remained as expected, following a stronger-than-projected growth in private domestic demand. Given those satisfactory results, the authorities had decided to adopt a similar strategy for FY2000.

The Acting Chairman said that the staff was suggesting that fiscal policy be judged by the growth outcome rather than by the deficit target announced a year earlier.

Mr. Spraos said he agreed, although he wondered whether the present rate of economic growth was satisfactory, given the continued high degree of capacity underutilization.

The staff representative from the Asia and Pacific Department replied that the program targeted a growth rate of 4 to 5 percent, which the staff considered to be satisfactory. While it might be the case that a higher growth rate could be achieved through additional fiscal stimulus, it was important to ensure that the recovery was not based solely on short-term fiscal stimulus. A lasting recovery of demand could only be achieved by focusing on structural reforms.

On the limits on foreign ownership, the staff representative noted that the 10-year limit rule on foreign investment meant that, if a foreign investor acquired a controlling share in a local bank, the foreign investor would not be allowed to increase its holding beyond that share after a period of 10 years.

Mr. Pickford noted that, according to his information, investors did not regard the rule as clear cut. Although it was clear that they would not be allowed to increase a majority holding in a local company after 10 years, they had yet to receive unambiguous assurances from the authorities that they would not be forced to reduce their holdings below 50 percent after the 10 years had expired.

The staff representative from the Monetary and Exchange Affairs Department (MAE) stated that asset management companies did not constitute a panacea for solving the problem of nonperforming loans. The authorities insisted that there be no economic incentives for shareholders to set up asset management companies. The draft regulations also made clear that there would be no relaxation in provisioning requirements and that the shareholders would have to bear all related expenses.

The World Bank had carried out an assessment of the application in Thailand of the Basel Committee Core Principles, the staff representative continued. Although the study had not yet been finalized, the preliminary assessment indicated that the financial sector did not fully comply with any of the 25 principles, thus highlighting the need to review financial sector legislation. The law on financial institutions and the Central Bank Act had all been drafted in response to that need and represented an important step toward ensuring compliance with the Basel Core Principles.

The number of defaults on bank loans would increase if the spread between lending rates and deposit rates were to become too large, the staff representative from MAE related. Ten to 15 percent of newly restructured loans became nonperforming once again, which was not an exceedingly high figure. During the savings and loan crisis in the United States, nonperforming loans often had to be restructured two to three times before they began to perform.

The state of the banking system in Thailand could be interpreted as generally positive, the staff representative from MAE related. The privately owned banks were performing well, with the restructuring of loans proceeding as expected. However, problems remained with respect to the state-owned banks. The banking sector continued to be characterized by a high level of arrears, which currently constituted more than 40 percent of all outstanding loans—an alarmingly high figure. However, if the underlying dynamics were assessed, a more positive scenario emerged. Private banks had succeeded in raising a large amount of capital since the beginning of the crisis, which they had used to build up reserves for bad loans. The reserves built so far by private banks constituted more than 30 percent of the total amount of nonperforming loans, and their capital ratio stood at roughly 14 percent.

Although banks still needed to raise additional capital before they could fully implement the enacted loan classification and provisioning requirements, the staff saw no reason why banks should not be able to raise the necessary capital—particularly when taking into account that the profitability of the banking sector was improving, the staff representative from MAE continued. The reserves put aside by banks so far allowed them to write off, on average, 30 percent of their nonperforming loans without influencing their capitalization requirements. Hence, banks in the private sector had already, by implication, met a large part of the costs associated with the restructuring of nonperforming loans. Therefore, although the level of arrears remained high, it did not appreciably limit the banks' ability to grant new loans or carry out debt restructuring.

Another issue of concern was valuation of collateral, the staff representative from MAE continued. The valuation of collateral posed problems in this respect: most collateral in Thailand consisted of real estate, but because the property market had not yet fully recovered from the crisis, almost no transactions were being carried out. However, adequate safeguards had been agreed on with the Fund regarding how banks should value real estate collateral, which would prevent them from overstating the value of collateral, thus reducing the need for provisioning.

Some analysts and market participants were of the view that banks were not actively pursuing debt restructuring, thereby hampering economic recovery, the staff representative from MAE stated. Those analysts believed that banks did not have sufficient capital to both grant new credits and restructure old loans. However, the banks themselves had expressed the view that they had the liquidity and sufficient capital because their capital adequacy ratio was 14 percent. According to them, the main problem was to find clients who were in a position to service new loans. Overall, lending was recovering slowly, with both publicly and privately owned banks remaining very cautious. The main problems with debt restructuring were to be found in the corporate sector.

Ms. Lissakers asked why deposit rates had failed to come down if the banking system was not experiencing any liquidity problems.

The staff representative from MAE replied that deposit rates had declined somewhat, although there was still room for them to decline further. However, the banks were reluctant to lower their interest rates before the authorities had clearly signaled their acceptance of such a lowering.

Mr. Palmason noted that the fact that banks did not comply with the Basel Core Principles appeared to signal that problems were more deep-seated than the staff was suggesting. He asked whether the statistics on capital adequacy were reliable.

The staff representative from MAE replied that, although banks in Thailand were not in compliance with the Basel Core Principles, the capital adequacy ratios were calculated correctly. However, because banks were allowed to gradually phase in the provisioning requirements until end-year 2000, the current ratio of roughly 14 percent would be somewhat lower if all banks fully implemented the regulation.

Mr. Spraos asked whether the rise in the provisioning against nonperforming loans was the result of the private banks being able to raise equity capital. Provisioning against bad loans should be achieved through putting aside profits, not through raising equity capital.

The staff representative from MAE replied that it was necessary to make a distinction between state-owned and private banks in that respect. The privately owned banks had experienced a strong improvement in their profitability during the third quarter of 1999. A further drop in interest rates since then had also had a positive impact on their profitability. At present, most private banks were accordingly profitable before setting aside for provisioning, with a few being profitable even after provisioning.

Mr. Spraos asked whether the banks' profitability was adequate enough to allow for substantial provisioning.

The staff representative from MAE replied that most of the private banks had implemented the provisioning requirements faster than required by the regulations. Although the regulations demanded that 60 percent of all provisioning requirements be met at the current time, most of the banks had already completed 80 percent of these requirements. The remaining provisioning requirements could probably be met through the banks' own profits.

Ms. Lissakers wondered whether it was normal for central banks to suggest what banks should be offering in terms of deposit rates.

The staff representative from the Asia and Pacific Department replied that the Bank of Thailand had declined to comment on the issue of deposit rates, suggesting instead that the markets should determine what constituted an appropriate level of interest rates.

Mrs. Hetrakul confirmed that the authorities did not want to interfere in the setting of interest rates, adding that banks had already reduced deposit and lending rates from their previous two-digit level to the current level of 1–3 percent. A further reduction of deposit rates had been announced by a few major banks after the disappearance of the Y2K hazard, with more banks signaling readiness to lower their rates. However, the authorities were preparing the issuance of government bonds in order to finance the budget deficit, which might create some upward pressure on interest rates.

When discussing the appropriate level of deposit rates, it should be kept in mind that a large number of people in Thailand depended on income from interest payments, Mrs. Hetrakul concluded. Those people had experienced a substantial reduction of their purchasing power owing to the decline in deposit rates.

The Acting Chairman noted that an interest rate level of 1–3 percent did not appear excessive.

Mr. Yakusha made the following statement:

> In our view it might be too early at this point to conclude that no additional stimulus will be needed to sustain the economic recovery. As far as we understand the situation, the fiscal package last agreed and financed will be spent by March 2000. The staff appears to indicate that a recovery in domestic demand will compensate for that. We have noticed that, in the past, the staff has displayed a tendency to overestimate the impact of domestic demand on economic recovery. Slow corporate restructuring may well lead to a delayed recovery in private investment. The authorities may therefore have to revisit the issue of fiscal stimulus.
>
> The government may also decide to extend the temporary reduction in value-added tax rates as a means to spur recovery of domestic demand. However, the staff report indicates that the reduction has led to an increase in receipts, which appears to cast doubt on the effectiveness of this measure.

Mr. Rustomjee made the following statement:

> I can be very brief and join others in commending the authorities for taking strong measures to steer the economy out of the crisis. Progress achieved thus far is encouraging; the current account has recorded sizable surpluses, real GDP is growing at a reasonable pace, inflation remains subdued, international reserves are on the increase, and external indebtedness is declining.

In the period ahead, an appropriate fiscal stimulus, an accommodating monetary policy, and current account surpluses will remain essential to provide liquidity for further strengthening of economic recovery. In addition, structural reforms in the banking system and progress in debt restructuring need to be accelerated in order to strengthen the banking system and provide credit to improve capacity utilization. In her comprehensive preliminary statement, Mrs. Hetrakul has detailed the actions being taken by the authorities in these areas and we encourage the authorities to accelerate their pace. In particular, we share the view expressed by Mr. Pickford and others that the authorities should be encouraged to press ahead with enactment of the Financial Institutions Bill and the Bank of Thailand Bill, as this will contribute to further strengthening the financial system.

Unemployment remains high and implementation of structural policies is necessary to assist in accelerating the recovery process. Meanwhile, steps being taken to increase social spending, including strengthening social safety nets, are welcome. These safety nets will also prove useful for retrenched public sector employees and allow the authorities to accelerate privatization.

We also welcome the Thai authorities' decision to adopt flexible inflation targeting as a monetary policy framework for Thailand and understand that the necessary institutional framework is being established for this, pending passage of the new Bank of Thailand Bill.

The recent staff work on inflation targeting in general has shown that there are a series of important prerequisites before countries can consider adopting inflation targeting. My first reaction is that it is greatly to the credit of the authorities that they are able to consider adopting an inflation-targeting approach, as it shows how far forward the country has moved in the last few years. Clearly, from the staff's very helpful clarification this morning, I understand that there is still some work ahead before inflation targeting is fully implemented, not as a flexible instrument of monetary policy, but as the predominant one.

If the factors preventing a shift to full-fledged inflation targeting are substantial policy issues rather than procedural, as I understand it from staff's comments, then I would urge that the pace at which the new approach is instituted be cautious, as it would be important to ensure credibility of the inflation target that is initially set, from the very beginning of the new policy initiative.

Mr. Spraos has raised an important issue, which is the extent of excess capacity in the economy, notwithstanding the recent increase in utilization rate. Clearly the economy is demand constrained and clearly excess capacity will need to be reduced before new fixed investment spending takes place. In terms of the future sources of growth for the economy, it is a fact that in our standard growth accounting framework, we examine increases in the capital stock as a source driving growth but we do not consider increases in utilization of the existing capital stock as a source. Usually, this is because utilization levels are considered to be at or close to their maximum level, so that there is very little more that is thought to be able to be squeezed out of the existing capital stock. However, as Mrs. Hetrakul's helpful preliminary statement shows in paragraph 3, capital utilization has been as low as 52 percent in the recent past and has rebounded to 63 percent. But this is still very low, suggesting, as Mr. Spraos highlights, that there is quite a bit more to squeeze out of the existing capital stock. As for me, it would represent part of the explanation if we come back next year and find that growth continued to increase impressively, even though private investment was not very substantial.

This leads to the question of what should be done with any unexpected windfalls in revenue—use it to reduce the fiscal deficit or use it as a further fiscal stimulus.

For two reasons, I would be favorably inclined to Mr. Spraos's approach. Firstly, because it is clear from chart 1 of the staff report that capital utilization, at 63 percent, is still far off its 1997 levels; and secondly, because as staff note in paragraph 35, higher levels of investment are expected to play a larger role over time as a source of growth.

In conclusion, I wish the authorities well in their endeavors.

Ms. Vtyurina made the following statement:

We would like to congratulate the Thai authorities on the successful implementation of the necessary macroeconomic policies in year 1999, which allowed them to achieve a GDP growth of 4 percent, zero inflation, and a high level of international reserves. We also would like to thank the staff for the two comprehensive papers which cover well the current developments in the Thai economy as well as present further analysis of the causes of the 1997–1999 crisis. We broadly agree with the staff appraisal and recommendations and will only provide brief comments on the issues we see to be of the utmost importance.

On the fiscal front, the maintenance of the fiscal stimulus is necessary for the further support of the economic recovery. In this regard, we welcome the authorities' intentions to fully realize the level of projected expenditures in the coming year by putting to work the recent initiatives such as a quarterly monitoring of expenditures by the cabinet. Also, and as we have emphasized in our earlier statements, we hope that the quality of expenditures will continue to be closely monitored so that the application of the stimulus and the run-up in the public debt are well justified. Since 2000 will be the year of the last and the highest increase in the public sector balance, in future the authorities will be faced with the challenge of sustaining economic growth by other means than a fiscal expansion. Therefore, fiscal consolidation is rightly viewed as a central policy objective for the medium term. As noted by the staff, it is planned to be supported by the adjustment from the built-in tax measures. These measures, however, do not seem to be very reliable since they depend greatly on the consumption patterns which, in turn, are rather uncertain. This has provoked the authorities' hesitation to forecast major recovery in revenues based on the consumption taxes; and they have stated that additional policy actions will be necessary. However, measures described in paragraphs 37 and 38 regarding deficit reduction as well as public debt reduction in the medium term do not provide an adequate explanation of the authorities' intentions in these areas.

We would have preferred to learn more about these additional policy measures and see a table or framework outlining the authorities' strategy in these areas.

We very much agree with the staff analysis of Thailand's external vulnerability. Although the external position has substantially strengthened thanks to the reduction in the foreign debt and improvements in the data coverage, weaknesses still remain and may have negative consequences on the balance of payments as well as on the overall recovery. The country remains vulnerable to shocks in world prices and change in the market sentiment. If one would perceive the vulnerabilities of the external environment as uncontrollable events, the slow progress in domestic corporate debt restructuring and a consequent prolonging of the nonperforming loans problem are domestically determined events and will have a negative impact on the sentiment. These fears have already proven to be valid in the second half of 1999. The external capital account ended up weaker than expected to a large extent due to a decrease in foreign direct investment and portfolio inflows and higher than programmed outflows, both developments directly reflecting the international market sentiment. Also, the domestic pessimism about the future recovery can become a self-fulfilling prophecy, as the staff correctly mentioned, and can result in low consumption and investment. Therefore, we urge the authorities to speed up their current efforts in implementing structural changes.

This brings me to the extensively discussed issue of progress in bank restructuring. It is encouraging that many banks have already come close to meeting the end-2000 provisioning norms through raising a substantial volume of tier 1 capital. However, we are concerned about the expensive hybrid capital instruments that have been used by the banks to raise capital. At present these instruments pay a very high interest rate of more than 20 percent and in future will require payments of dividends as well. In the selected issues paper the staff stated that these instruments will be used only as a temporary measure. We wonder if the staff can elaborate in a greater detail on potential risks associated with the issuance of such securities (e.g., how difficult it will be to switch to other types of securities in the future to escape dividend payments) and how these high-interest payments affect the fragile financial position of banks.

The fact that the nonperforming loans have decreased only slightly since their peak in March of last year is a worrisome fact. We share Mr. Kelkar's concerns about the quality of the restructured nonperforming loans and look forward to the staff elaboration on other reasons behind the stagnation of the NPL ratio than listed in the paper. In addition, we were surprised to learn that in early 1999 the balance of payments relaxed its regulations on the reclassification of restructured loans. The application of only one of the five conditions for the loan to be classified as performing in comparison to basing the reclassification on the three consecutive repayments by the debtor raises questions about the prudence in reclassification. Does the staff think that this kind of relaxation has or can lead to defaults on the newly reclassified loans?

In conclusion, we would like to commend the authorities for their efforts in revitalizing the economy. However, like many other speakers, we would emphasize that there should be no room for complacency and that now, when the market sentiment is fairly positive, it is the time to gain the most momentum in structural reforms.

Mr. Kudiwu made the following statement:

At this stage of the discussion, I will be brief, given that previous speakers have largely covered the major relevant issues.

Like others, I would like to commend the Thai authorities for their strong commitment to the adjustment process and for the sound management of the economy, which have contributed to revitalize economic activity and restore market confidence. As pointed out in the staff report, it is encouraging to note the signs of the restoration of the external viability, as evidenced by the gradual accumulation of official reserves, the stability of the exchange rates, and the low interest rates.

Looking ahead, I agree with Mr. Portugal and Mr. Mori's statement that the main challenge for the authorities is to adopt policies that will help sustain and further stimulate the economic recovery.

To ensure a successful recovery of the economy, with social stability, it is important that an adequate social safety net be in place for the most needy. In this regard, I broadly share the view expressed in Mr. Shaalan and Ms. Farid's preliminary statement.

Emphasis should also be placed on accelerating the structural reform, especially in bank and corporate debt restructuring. Directors have commented extensively on these points and I will not repeat them. However, with regard to debt corporate restructuring, if a timetable had to be set, I will be interested to learn from the staff or Mrs. Hetrakul the authorities' plan to complete the process.

Other areas of reform include tax reform, trade liberalization, and the strengthening of the statistical database. The authorities' agenda for reform is heavy and I would like to encourage them to make good use of available technical assistance.

Finally, I wish the Thai authorities well in their future endeavors.

Mr. Kranen made the following statement:

We broadly concur with the staff appraisal. I would like to take the opportunity to emphasize that the close and successful cooperation between the Fund and Thailand has led to remarkable results. Indeed, many of the critics of the Fund's approach questioned the design of the reform program and even some supporters might not have expected that the crisis would be overcome so quickly. The current program was changed into a precautionary one last year and will expire in June. Against this background, I would be interested to hear from Mrs. Hetrakul or the staff what form of postprogram cooperation is envisaged by the authorities.

The most challenging task ahead is certainly to ensure the development of sufficient endogenous forces of growth. Currently, the development of Thailand's economy is still not self-propelled. According to the staff's findings, nearly half of this year's growth is generated by the enormous fiscal stimulus. Due to the lack of private demand and investment, a continued fiscal stimulus will be needed this year, too. This is certainly not a sustainable pattern of growth as reflected in the huge rise of public debt which has tripled over recent years.

The most crucial impediments to growth seem to be still in the structural area. While I do not want to neglect the progress achieved in those areas, there still remains much to be done. In this connection, I would like to concentrate on three points: 1) reform in the banking sector—especially addressing the issue of nonperforming loans; 2) deregulation and liberalization of the tax and tariff system; and 3) faster and more decisive privatization.

We generally agree with the staff's recommendations to address the problem of nonperforming loans. Nevertheless, we wonder whether additional capital support subject to less-demanding conditions would be the right approach to solve the existing problems as it would not only undermine the consolidation needs of banks but also could generate an additional moral hazard problem.

Given that Thailand will head the World Trade Organization in 2002, it is crucial to address impediments of free trade. The trade and also the tax system do not meet the requirements of a global economy. In particular, the preferential treatment of investment projects should be abandoned.

We encourage the authorities to proceed with the privatization of the state companies. The completion of the groundwork last year and the ruling of the constitutional court should generate momentum to reach concrete results this year.

Mr. Palmason made the following statement:

It is encouraging that the economic recovery has become more broad-based and financial stability has been re-established. Export-led growth and the pickup in the nontraded sectors are encouraging and, although output is still at a level below potential, the output gap has continued to narrow. Thus, concerns regarding the competitiveness and the persistently weak consumer confidence are perhaps gradually fading out. Against this background the supportive but cautious fiscal policy and accommodative monetary policy stance seems appropriate for the time being.

Nonetheless, the recovery is moderate and clearly lagging behind those of others in the region hit by the crisis. Where are the roots of the slower progress? is a legitimate question to ask. As noted in the staff report, downside risks for Thailand lay with the structural issues. I shall address the most critical ones.

First, it seems to me that the slow progress in the implementation of bankruptcy legislation and creditors' hesitancy in contract enforcement have slowed corporate restructuring and kept nonperforming loans at highs. It was disappointing to learn that even the debtors with sufficient cash flows to service debt are withholding their payments in the hope of a debt reduction. Should this continue, it is hard for me to see the emergence of either credit discipline or substantial improvements in banks' balance sheets. More importantly, this reinforces a moral hazard and prolongs a necessary reallocation of resources in the economy which has suffered from years of overinvestment.

Second, the banking sector remains at the heart of the problems. The emergence of new nonperforming loans, despite the rebound in economic activity and the low level of provisions, exposes the industry to significant risks. Moreover, it seems there is considerable ambiguity regarding the "true" level of nonperforming loans. As box 2 illustrates, the private market estimates for capital shortfall differ in multiples from that suggested in staff's baseline scenario.

In addition, *The Financial Times* of January 6, 2000, made a reference to the government's recent action to lower the official appraisal values of land by 25 percent in the Bangkok area. According to the same article, the market sees prices being down even more. As real estate is the most widely used collateral by the banks, it would be interesting to hear staff views on the potential impact of the said government action on the banks' loan books.

Finally, let me make a brief comment regarding the possible implementation of an inflation-targeting framework in Thailand. The recent Board discussion on inflation targeting clearly underscored the importance of having the necessary preconditions in place. While the Bank of Thailand is increasingly geared towards greater exchange rate flexibility, the stickiness of deposit and lending rates evidence shortcomings in the monetary policy transmission mechanism, and the alleged existence of a degree of political interference. It is important that the said issues are properly addressed at an early stage in order to establish the credibility of the whole exercise.

With these remarks, I wish Thailand's authorities every success.

The staff representative from the Asia and Pacific Department noted that there was no timetable for the process of corporate debt restructuring, given that it involved the private sector. However, the Corporate Debt and Restructuring Advisory Committee (CDRAC) had set a deadline for reaching out-of-court settlements for a group of companies that were restructuring their debt under its auspices. Although the deadline would become binding in February and March 2000, it would not necessarily resolve the issues outstanding, and the need for subsequent court settlements could prolong the process even further.

The authorities had relaxed the guidelines in a step-by-step manner for reclassifying nonperforming loans, the staff representative continued. Although the banks had not initially made use of the new possibility to reclassify their nonperforming loans, it was unclear at the present stage whether the relaxation had slowed down economic recovery.

The staff believed that the authorities were right to focus more on output than inflation at this time, the staff representative stated, given that inflation was currently close to zero percent.

Although the Bank of Thailand's strengthening of the requirements for the appraisal of collateral had led to a decline in the valuation of real estate, the staff representative concluded, it was difficult to assess the full impact of the new measures without an independent evaluation.

Mr. Chelsky stated that he remained concerned about the medium-term objective of inflation targeting, given that the authorities were presently aiming for a recovery of output rather than a specific inflation target.

The staff representative from the Asia and Pacific Department replied that, although a premature introduction of inflation targeting had the potential to create confusion, the market participants were aware that the new framework was to be phased in gradually. Currently, the authorities were pursuing an accommodative monetary policy aimed at supporting output. That policy had not raised any concerns, given that inflation remained low. Overall, there were few concerns about the medium term because Thailand had a reputation for being a low-inflation country.

Mr. Chelsky remarked that it was necessary to have a clear medium-term objective if inflation targeting were to be successful. Introducing flexibility into the framework might, therefore, prove counterproductive.

Mrs. Hetrakul noted that the Bank of Thailand was currently working on a draft framework for inflation targeting, which specified that the objectives of the Central Bank included maintaining price stability as well as a stable currency and ensuring the soundness of the financial system. The authorities had specified that the former objective superseded the latter. The amendment of the Bank of Thailand Act embodied that new concept. The monetary policy board and the financial institutions policy board—the two new policymaking bodies—both had price stability as their overriding objective. Decisions regarding the price stability target would be conveyed to the financial institutions policy board through the deputy governor, who also was a member of the monetary policy board. The latter board would be comprised by four independent members and five members from the Bank of Thailand, including the deputy governor, two senior officials in charge of financial framework issues, and two representatives from the Bank of Thailand's senior management team. The deputy governor would have the right of veto.

There was a qualitative difference between strict and flexible inflation targeting, Mrs. Hetrakul stated. In the former case, the Central Bank would only be concerned about meeting a given inflation target, whereas in the latter case, it would also target other goals, including exchange rate stability, output, and employment. In order not to undermine its credibility, the Central Bank would probably choose to pursue a more strict approach in the introductory phase so as to demonstrate clearly its commitment to inflation targeting. It should be kept in mind, however, that inflation—as well as expectations of future inflation—remained low in Thailand. After the Bank of Thailand bill had been passed by Parliament, the inflation-targeting framework would be well publicized.

Although fiscal consolidation was crucial for medium-term sustainability, Mrs. Hetrakul remarked, fiscal stimulus would not be withdrawn straight away. In the draft budget for the next fiscal year, the fiscal deficit and capital spending would both remain at about the same level as in 1999.

Thailand's economic recovery had been less strong than that of Korea, Mrs. Hetrakul stated, because of a number of factors. Budget disbursement, for instance, has been slowed down by a tradition for strict discipline. Overexpansion in the nontraded—and less productive—sectors, such as real estate, had led to a slower downward correction than in other crisis countries. In addition, the industrial structure was less competitive and had a high import content. The benefits derived from the devaluation of the currency were only temporary and had already been displaced by the recent appreciation of the baht.

There was no clear-cut answer to whether the economic recovery ought to be driven by consumption or by investment, Mrs. Hetrakul related. The authorities were of the view that a recovery led by domestic demand would be subject to several downside risks. First, unemployment might increase as a consequence of the ongoing restructuring and downsizing in the private sector, which could subsequently constrain domestic demand by reducing buying power. Second, if an increase in consumption were to be financed through a drawdown of accumulated savings, the size of those savings might eventually pose a constraint to the recovery. Third, the role of the public sector would have to be reduced with a view to achieving medium-term sustainability.

There was less excess capacity in the economy than implied by the capacity utilization rate, Mrs. Hetrakul continued. Although the capacity utilization rate currently stood at 63 percent, it accounted for only 45 percent of all industrial activity. Many of the sectors that were excluded were those experiencing higher growth, including, for example, the telecommunications, trade services, and transportation sectors. Although economic growth would still be driven by export growth, inventories had been run down and would require new investment to rebuild. To improve production capacity, particularly for the export sectors, additional measures would need to be considered to stimulate private investment, especially by small and medium-size enterprises. Those measures included the restructuring of tariff rates—particularly for capital goods—and of income tax. Investment by the private sector was expected to accelerate to 10.5 percent in 2000 from only 1.1 percent in 1999, while public investment was set to decline. To ensure longer-term growth sustainability, private investment was key. Structural reforms were also crucial to increase the potential for economic growth over the medium term. The weaknesses in the legal framework were, for instance, well recognized and would be addressed.

Debt restructuring by financial institutions in the first 11 months of 1999 had averaged 68.53 baht per month, with private banks experiencing a higher success rate than the publicly owned banks, Mrs. Hetrakul concluded. The authorities were considering whether to relax guidelines to enhance the flexibility of the banks in that respect. Furthermore, the progress achieved by the bankruptcy court ought to be assessed generously, as the whole concept of bankruptcy proceedings was novel to Thailand. The number of new cases filed by the court had been increasing every month since it was established, with an increase from 15 new cases in 1999 to 67 cases only three months later. A total of 416 cases had been filed by the court as of end-1999, of which 210 had been completed.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for Thailand's impressive progress in economic recovery and in restoring financial stability. International reserves have been rebuilt to healthy levels; exchange rate stability has been restored, and the recovery has become broad-based. Nevertheless, Directors recognized that economic recovery and restructuring are not yet complete. They stressed that sustained recovery will require determined efforts from the authorities in accelerating structural reform—especially regarding corporate debt and the banking system—and continued application of supportive macroeconomic policies.

Directors considered that the present accommodative stance of macroeconomic policy is appropriate in order to sustain the ongoing economic recovery. Against this background, they recommended that the fiscal stimulus be continued through 2000 to ensure that the growth momentum is not lost.

Moreover, there is a need to preserve government spending on the social safety net until a decisive turnaround in employment and social conditions materializes. However, in the event the budget turns out to be stronger than expected as a result of significantly higher than expected growth, Directors generally encouraged the authorities to set aside the resulting higher revenues for deficit reduction and so help stabilize the public debt. They noted that fiscal consolidation would be needed over the medium term to reverse the recent increase in public debt. While much of the necessary consolidation should take place more or less automatically with the output recovery, Directors observed that the authorities will also need to consider additional measures to broaden the tax base.

While monetary policy has also been supportive of recovery, Directors noted that the benefits of low money market rates had been slow to be fully transmitted to the real sector in the form of lower bank lending and deposit rates. They considered that, despite the recent decline in both deposit and lending rates, a further generalized fall in interest rates, including deposit rates, would help strengthen both economic recovery and bank balance sheets.

Directors welcomed the Bank of Thailand's continued adherence to a flexible exchange rate regime, which had helped restore external viability, and its intention to introduce an inflation-targeting framework over the medium term. However, the success of this new arrangement would require putting in place the necessary preconditions, such as transparent institutional arrangements and clear accountability. Some Directors emphasized that it would be essential to establish that price stability was the overriding objective of monetary policy once inflation targeting was formally adopted. In this connection, Directors welcomed the progress toward the new Bank of

Thailand Act and the Financial Institutions Law, which should contribute to ensuring the independence of monetary management and increasing the efficiency and transparency of the financial system.

On structural reform, Directors agreed that the immediate priority should be to accelerate decisively the pace of bank and corporate debt restructuring. To date, the drop in private demand and the disintermediation process under way had meant that the increased caution of banks in their lending decisions had not been a binding constraint on economic recovery. However, looking ahead, Directors stressed that broad-based economic recovery would entail higher credit demand—especially from newly emerging and smaller borrowers—and that it was essential that the health of the financial system be restored as quickly as possible.

Against this background, Directors were concerned about the continuing high level of nonperforming loans. They considered that the authorities would need to take additional measures in three key areas to strengthen the financial system. First, while some limited success had been achieved in strengthening the capital position of banks under the largely private-sector-led recapitalization strategy, this should be kept under close review. A number of Directors urged the authorities to consider further public initiatives for this purpose. Second, it was important to strengthen the implementation of the new framework for bankruptcy and foreclosure, to ensure that credit discipline is rebuilt. In this regard, expeditious handling of a few test cases, preferably including some where publicly owned banks are creditors, could have a salutary effect on recalcitrant debtors. At the same time, a number of Directors urged the authorities to assess the shortcomings in the bankruptcy procedures, and to consider necessary modifications to address them. Several Directors were concerned at the risk that current arrangements might be encouraging nonpayment on the part of some debtors who could fully service their debts. Third, to enhance competition and efficiency in the banking system, Directors stressed the importance of reprivatizing the remaining intervened banks. It was also essential to ensure that restructuring of the state-owned Krung Thai Bank is not further delayed. With regard to corporate debt restructuring, Directors welcomed the progress made by the Corporate Debt Restructuring Advisory Committee in facilitating debt restructuring, but recommended that the authorities further strengthen the CDRAC framework as a priority.

Directors agreed that other priorities for the medium-term structural agenda include tax reform, trade liberalization, strengthening education, and improving the statistical database. They considered that supporting policies to mitigate the impact of the structural reforms on employment are critical and would help foster and sustain broad public support for these reforms.

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

2. COMPENSATORY AND CONTINGENCY FINANCING FACILITY—EXTENSION OF DEADLINE FOR REVIEW; AND EXTENSION OF OPERATION OF CEREAL ELEMENT

The Executive Directors considered a proposal to extend the deadline for review of the Compensatory and Contingency Financing Facility (CCFF) and the period of operation of the cereal element of the CCFF to January 31, 2000.

The Executive Board took the following decision:

Compensatory and Contingency Financing Facility—Extension of Deadline for Review

Decision No. 8955-(88/126), adopted August 23, 1988, as amended, is hereby further amended as follows: in paragraph 56, "January 13, 2000" is deleted and replaced with "January 31, 2000."

Decision No. 12121-(00/4), adopted
January 12, 2000

Compensatory and Contingency Financing Facility—Extension of Period of Operation of Cereal Element

Decision No. 8955-(88/126), adopted August 23, 1988, as amended, is hereby further amended as follows: in paragraph 23, "January 13, 2000" is deleted and replaced with "January 31, 2000."

Decision No. 12122-(00/4), adopted
January 12, 2000

3. MEDIUM-TERM PLANNING OPTIONS AND RESOURCE ESTIMATES

The Executive Directors considered a statement by the Managing Director on the medium-term plans and resource estimates (EBAP/99/149, 12/28/99), a paper on a supplementary budget request for FY2000, which included an increase in the staff ceiling (EBAP/99/144, 12/23/99), together with a background memorandum by the Managing Director on the midyear review of the Fund's administrative and capital expenditures for FY2000 (EBAP/99/145, 12/23/99). They also had before them a background paper on medium-term plans and resource estimates—program outlook notes (EBAP/99/148, 12/28/99), a paper on medium-term plans and resource estimates—work program by department for FY2001 FY2003 (EBAP/99/151, 12/30/99), as well as a statement by the Managing Director on medium-term planning options (preliminary statement/00/4, 1/11/00).

The Managing Director made the following statement:

Based on the views expressed by Executive Directors in recent meetings, I have asked the staff to prepare two lower options on plans for the medium term. However, I continue to believe that option 1 should remain the preferred option. I could endorse with reservation option 2a, with the understanding that Executive Directors prefer to stretch out some of the work over a longer period.

However, I have difficulty with option 2b in that it cuts out some of the enhancements to surveillance and other work of the Fund. These comprise a number of activities widely spread across departments, which, while small in size, would help address the work pressure situation in some critical areas where the staff is already providing these services; e.g., in the postconflict regions and in regional surveillance. It also includes too deep a cut into enhancements in the area of technical assistance.

I am aware that Executive Directors have also expressed their concern regarding the work pressure situation. A few months ago I asked the staff to prepare a study on negative stress in the Fund. I have now received the associated report, a summary of which is presented in Attachment I. I hope the full report can be discussed soon and that any further measures that the Board would agree on can be taken promptly. In the meantime, I hope that the proposed staffing increases, in particular under option 1, would go some way in addressing this problem and, at the minimum, avoid a further deterioration.

A number of Executive Directors also place emphasis on the objectives of diversity in the recruitment process. I would like to take this opportunity to reaffirm management's commitment to as wide a distribution of staff as possible by nationality and other relevant criteria. A brief statement in this regard is presented in Attachment II.

The review of the internal review process is in an advanced stage. I expect that this review will provide an opportunity for some staff redeployment and savings.

Finally, I would like to reiterate my urgent request to Executive Directors to approve the supplementary budget in order to permit continued work, including travel, on pilot or start-up phases of the major initiatives which have already begun. It would also formalize the measures taken by management in early November to permit an increase in staffing devoted to the work on the Poverty Reduction Strategy Papers (PRSPs), Poverty Reduction and Growth Facility (PRGF), and enhanced Heavily-Indebted Poor Country (HIPC) Initiative.

The Working Group on Stress (WGOS) has recently presented its draft report which discusses sources of negative stress in the Fund and proposes a number of measures to reduce work-related stress. Factors contributing to the chronic high-stress environment of the Fund identified by the WGOS include the ever-widening mandate of the Fund, which, in combination with a lack of prioritization, leads to unrealistic work demands and pressures, with the staff having little control over their work program and the balance between their work and private lives; a virtually permanent crisis atmosphere; the never-say-no and generally hard-driving style of the Fund culture; poor managerial practices with not enough resources and effort being spent on good "people management"; some unnecessarily bureaucratic procedures and insufficiently flexible work arrangements; and the unpredictability and style of mission work.

The report proposes a range of measures comprising steps to provide a sharper focus to and better prioritization of the work of the Fund; ensure visible support from management for stress reduction; strengthen managerial behavior and accountability Fund-wide; create an environment in which good personnel management is fostered and rewarded; increase the efficiency of work processes and the flexibility of work arrangements; strengthen the degree of control individuals have over their work program; and improve mission work organization and reduce the uncertainties arising from mission travel.

HRD is reviewing the report and its recommendations. Following discussions with management and departments, it will present an action plan designed to reduce work-related stress in the Fund. This plan will include measures across a broad front, some of which will require additional well-targeted resources, both in terms of manpower as well as dollar expenditure. The necessary budgetary requests will be presented in the FY2001 administrative budget to be submitted in March 2000.

The Articles of Agreement mandate that "In appointing the staff the Managing Director shall, subject to the paramount importance of securing the highest standard of efficiency and of technical competence, pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible" (Article XII, Section 4(d)). In accordance with this mandate, the Fund has always endeavored to achieve geographic diversity in its recruitment, in particular at Grades A9 and above. The Fund has done so without resorting to quotas or quantitative targets, but through a concerted effort to recruit Fund staff on the widest possible geographical basis and, especially, to increase the representation on the staff of those countries and regions that are underrepresented (using country financial quotas as a yardstick).

I believe that with the help of departments, HRD, and the Senior Advisor on Diversity, we have achieved progress in this respect in recent years. However, there are a number of industrial and developing countries and regions within the large group of developing countries that remain underrepresented; the same applies to the countries in transition. The reasons for this differ from country to country and from region to region, but these underrepresentations do not reflect a lack of effort on our part.

I have requested a significant increase in staff resources for next year and for the medium term to meet the Fund's additional work requirements. This increase in staff positions provides an excellent opportunity to make further progress on diversity and balanced geographical representation on the staff. In fact, management has already instructed departments to pay particular attention to the recruitment of women and nationals from underrepresented countries in filling the new positions and vacancies arising from retirements and resignations. HRD is putting in place the necessary recruitment measures.

I will be happy to report on these efforts. The papers on staff recruitment and retention prepared annually in the context of the administrative budget and the compensation review have reported extensively on recruitment efforts and have also provided information on the nationality distribution both of existing staff and new recruits. We will expand as necessary the information provided in this paper beginning with the report to be issued in April. Subsequent papers will then provide an opportunity to review the progress achieved with respect to diversity in general and geographical balance in particular.

The staff representative from the Office of Budget and Planning made the following statement:

In response to views expressed by Executive Directors at recent meetings of the Committee on the Budget, this statement provides two lower options for the upcoming discussion by the Executive Board on medium-term plans and resource estimates. These options entail reductions in staffing increases, as well as expected results in terms of countries served and work performed. The table provides an overview of these options.

The first lower option 2a envisages more phasing into later years and some beyond the planning horizon, as well as cuts in selected programs. Specifically, it calls for first-year reductions in the planned work on financial sector assessments (-16 percent), international standards and codes (-20 percent), and enhancements to surveillance (-33 percent). But it preserves most of the planned work related to the Poverty Reduction Strategy Papers (PRSPs), Poverty Reduction and Growth Facility (PRGF), and enhanced Heavily Indebted Poor Country (HIPC) Initiative (-5 percent), and enhancements to the technical assistance program as recently discussed in the Board (-11 percent).

The second option 2b further reduces the total staff increase by not supporting the envisaged enhancements in surveillance and other program activities and by reducing by half the enhancement to technical assistance.

Furthermore, options 2a and 2b no longer include any proposal for the media and public relations initiative. Instead, in line with views expressed by Executive Directors, this program will be discussed in the Board within the next few weeks with a view to obtaining guidance as to its implementation.

Planning Options for Major Initiatives in the Medium Term 1/

	Option 1		Option 2a		Option 2b	
	FY 2001	FY 2003	FY 2001	FY 2003	FY 2001	FY 2003
			(In staff years)			
PRSPs, PRGF, and enhanced HIPC Initiative	56	64	53	64	53	64
Financial Sector	25	36	21	33	21	33
International Standards and Codes	40	45	32	42	32	42
Enhanced Surveillance	15	29	10	25	0	0
Enhanced Technical Assistance	19	21	17	21	8	11
Other 2/	11	12	11	12	0	0
Total (1)	**166**	**207**	**144**	**197**	**114**	**150**
Enhanced Media and Public Relations 3/	17	20	...	...	...	...
Total (2)	**183**	**227**	...	...	...	...
Memorandum items:						
Supplementary budget (if approved)	-30	-30	-30	-30	-30	-30
Net resource needs	153	197	114	167	84	120
			(In number of countries served)			
Number of countries:						
PRSPs, PRGF, and enhanced HIPC Initiative	57	61	54	61	54	61
Financial Sector	30	45	23	41	23	41
International Standards and Codes	30	36	22	34	22	34

1/ FY 2001 shows the increase over the base year (FY 2000). FY 2003 shows the total of increases over the three-year period.
2/ This category includes assistance to postconflict regions and other Fund activities.
3/ Options 2a and 2b exclude the estimate for Media and Public Relations, pending discussion of the program by the Board.

Note: Totals may not add due to rounding.

Mr. Mirakhor made the following statement:

We broadly agree with the Managing Director's budget proposal (EBAP/99/149), and thank Mr. Sugisaki and the staff for their hard work and patience in the process of budget preparation. The Fund's wider role in a new globalized environment requires substantial additional human resources. We attach high importance to poverty reduction and growth programs. Other areas of greater Fund involvement include financial sector work, developing international standards and codes of good practices in areas of core Fund activities, and promoting their adoption and use by members. However, we reiterate our earlier position that new initiatives should not distract from, or dilute, the Fund's traditional relationship with its members. In this respect, we appreciate the Managing Director's proposal to expand and enhance Fund surveillance and technical assistance activities. However, we had expected technical assistance and training to receive higher priority than what is reflected in the budget proposal.

We also welcome management's concern with respect to the integration of the new tasks with the actual work program without adding further to the workload of an already overburdened staff. Despite the increase in staff resources in the 2000 budget, the workload indicators do not point to any decline in work pressure. Excessive workload takes a toll on the staff in terms of health and family life and the quality of their work. Therefore, we strongly encourage alternative scenarios that include a timetable for reducing the workload to normal levels in the near future. We welcome management's attempt to address the issue by providing a practical plan for reducing "negative" work-related stress. While on this subject, we would like to point out that pressure on the Executive Directors' offices has also increased significantly during the past few years.

The Fund should not place any of its current programs, activities, or services at risk. Therefore, and in view of the excessive work pressure on the staff and the binding constraints on savings and staff redeployment, we support the Managing Director's request for 227 additional staff positions over a three-year period. Moreover, we support a supplementary budget of 30 staff positions to replace the exceptional and unsustainable use of vacancies to continue our work on major initiatives. This is the minimum required to enable the institution to fulfill its responsibilities. In this respect, we wish to make a few remarks:

a) The savings and redeployment exercises are already stretched to the limit. Unfortunately, as indicated in the paper on the scope for budget savings, most redeployments by departments during FY2000 and FY2001 will be at the expense of technical assistance. For example, MAE's total staff trips as part of technical assistance missions in the first half of FY2000 dropped by 42 percent, compared to the average for the same period in the previous two years. In fact, MAE staff has been redeployed extensively from technical assistance to mainly financial assessment work. In the case of STA all redeployment has been made possible by lowering technical assistance as, on a net basis, there will be a decrease of nine staff years allocated to technical assistance activity. This is not a viable and desirable process to be carried into the future.

b) We are concerned about the continuous weakening of the priority given to technical assistance. The need for technical assistance has become greater not only in traditional areas of Fund work, but also owing to the substantial need in fiscal management, financial sector assessment and reforms, debt management, data compilation and dissemination, and compliance with standards and codes in relation to the new initiatives. The Board has consistently supported the view that technical assistance and training activities are the most productive investments the Fund could make.

While we look forward to receiving management's proposal with respect to the review process, streamlining it should not constrain its role as a channel for internal Fund-wide debate on country-related policy issues. Moreover, we are concerned by the staff's statement that the problem of erosion of technical oversight has been exacerbated by cutbacks in the review process during recent years owing to resource limitation. It is hoped that this experience will not be repeated in other areas of Fund work merely because of the Board's relentless pursuit of savings and our failure to provide adequate staff support for new initiatives.

As has been often stated, surveillance is the most important function of the Fund as mandated by the Articles of Agreement. In the last few years, the number of issues to be discussed by consultation missions with the authorities has increased, and, with the increased focus on financial system and statistical issues in the coming years, pressure on the mission staff is likely to escalate further. Those who have witnessed the work of missions in the field know the extent of the hardship the staff have to endure; we seriously doubt that there is much more room for staff savings from mission work.

While we appreciate the Managing Director's efforts at seeking a consensus (preliminary statement/00/04), we do not see much benefit in rephasing, particularly if it is at the expense of cutback in technical assistance and training.

Mr. Collins and Mr. Kelmanson submitted the following statement:

We are pleased to have the opportunity to consider these important issues again and are grateful to the staff for having attempted to provide some of the additional information requested in previous meetings and also for providing new options. However, we remain disappointed with the response to the views expressed by Directors that a different approach be pursued. Such an approach should start from the notion that resources are scarce and need to be allocated between competing priorities throughout the whole organization. This would implicitly accept that in some lower priority areas not everything can be done; i.e., that new initiatives have opportunity costs.

Yet the options set out in the staff paper (preliminary statement/00/5) are still purely additive and seem based on the premise that if 227 new staff are not provided in the medium term, the new initiatives cannot be fully delivered.

We certainly acknowledge that the Board has made increased demands on Fund staff in agreeing to the new initiatives. We also believe that these are important initiatives, the delivery of which are a priority for the institution and its membership. We are committed to ensuring that the institution is appropriately resourced to deliver on its priorities without an inappropriate burden being put on the staff.

In light of this we agree that a significant increase in staff is warranted.

But the initiatives which are highlighted were not intended to create a whole new institutional structure, nor should they. They are certainly meant to change the way that the Fund looks at issues and ensure that we continue to focus on the most relevant areas. But a change of focus does not imply per se a "quantum increase in the work of the Fund," as suggested in the Managing Director's statement of 28 December 1999, and the associated quantum increase in resources. Why not?

Given scarce resources, the first response to any request for additional work must be to divert resources from lower priority areas to priority ones—across the organization as a whole—and to ensure that the Fund operates as efficiently and effectively as possible. Just as we demand of our members, we too must operate in a world where resources are constrained and where work areas are assessed and prioritized.

All too often, discussions on the budget seem to be purely additive. We never seem to start from a zero-base budget assumption. Like others, the Fund must make hard choices. That is what we demand of our members.

More progress on savings should be possible through reprioritizing work, streamlining processes, and implementing a program for exchanging best practice in budget saving across departments. We continue to look forward to the results of the assessment of the internal review procedure.

In addition, some of the new challenges require drawing on the expertise of the World Bank and others to utilize existing resources and expertise. Over the medium term (the horizon of this request) better collaboration must have beneficial resource implications. Whilst the Fund must be an intelligent customer in such a partnership, we should not attempt to undermine others' comparative advantage by creating new structures or seeking to fill gaps which are the responsibilities of other institutions.

In the Budget Committee the issue of absorptive capacity was raised by a number of chairs. Recruitment and training are themselves resource-intensive. Against the background of historical recruitment figures of around 60 economist staff per annum, we fear that the proposed increases will not be deliverable in organizational terms.

The options presented in the new staff paper (preliminary statement/00/5) still do not address the fundamental requests of Directors to take a Fund-wide view. The options fail to demonstrate how, through re-phasing, prioritizing work throughout the Fund, and eliminating low value-added work, we will be able to deliver on our priorities within a realistic resource envelope.

Option 2b goes some way to accepting that resources are scarce but does not address the issue on an organization-wide basis. As such, whilst it is a move in the right direction, it does not go far enough.

We would like the staff to prepare a new option (or options) which builds on option 2b but takes a Fund-wide perspective. This work should draw more on options 2 and 3 from the original paper on Medium-Term Plans and Resource Estimates (EB/CB/99/6), and on the comments made by Directors in the Budget Committee relating to phasing, streamlining, cutting back on lower priority work, and setting priorities.

This approach accepts that there are resource implications of the Board's decisions, and it responds with a positive mind to meeting such demands. But such an approach also reflects that we live in a world of scarce resources.

As regards the supplementary budget, we note that it represents an increase more than proportionate to the agreed increase of 30 staff. We would be interested to know if the staff would have put forward a supplementary budget had there been no agreement to increase recruitment this year.

Finally, we would reiterate our hope that there will be an external review of the Fund's overall internal procedures, as expressed in the joint statement of 10 Executive Directors last March.

Mr. Cippà made the following statement:

I thank the staff for the additional information provided in preliminary statement/00/5. This provides a partial response to the repeated calls from several members of the Committee on the Budget for a detailed presentation of various options on how to take into account the resource implications of the various new initiatives. It is unfortunate, however, that this comes at such a late stage. The overly concise presentation of the new options in the staff statement and the lack of time have not allowed my authorities to fully consider the new proposals. Therefore, my comments today are preliminary.

Option 2b goes some way in taking into account our concerns. The option shows possible ways to differentiate in the scope and the pace of the various initiatives that have been decided on. In my view, there is still further scope for some downward adjustment in the overall number. Furthermore, I fully support the importance of refocusing and redeployment as a means to reduce the necessity to increase staff resources stressed in Ms. Lissakers's and Mr. Bernes's statement and Mr. Collins's and Mr. Kelmanson's statement. In this respect, I am also looking forward to the requested external evaluation of the Fund's overall internal procedures.

On the PRGF and enhanced HIPC Initiative, I note that the staff has maintained the number mentioned in the original proposal. As I have stressed in the Committee meetings, this chair fully supports the enhancements in this area of Fund activity. However, taking into account the strict division of labor between the Fund and the World Bank that was endorsed by the Executive Board, it is still difficult for me to understand why moving from the ESAF to the PRGF and increasing the pace of the HIPC Initiative must lead to an increase of Fund staff working on our poorest members by around 30 percent.

In the financial sector area, I remain of the opinion that we should not preempt the Executive Board decision. This decision should be taken only after the completion of the ongoing FSAP pilot project. Here again, in my view there is significant flexibility in defining the future pace in the implementation of financial sector assessments. The medium-term budget should contain a significantly lower number until the relevant decisions have been made.

I was interested in the preliminary results of the working group on stress presented in Attachment I. It would have been helpful to have this report before this important decision on future staffing. I have always acknowledged the high quality of our staff and have supported measures to diminish an unsustainable workload. However, the thrust of the report seems to show that stress-related problems within our institution cannot be tackled by simply increasing staff. Rather, it stresses the need for a better prioritization and organization of the work of the Fund. Given the various new initiatives currently under discussion, the time appears appropriate to start moving away from the "never-say-no" style the Fund has been following.

Finally, I welcome and fully support the Managing Director's statement as regards the necessity to maintain and increase the diversity of the Fund staff.

As to the supplementary budget, I can support the request for a supplementary appropriation. However, I believe that the permanent increase in the staff ceiling should be considered within the 2001 budget decision.

Mr. Mirakhor emphasized that the additional staff proposed was the minimum required. The Fund's staffing needs had been significantly underestimated. In a meeting with the staff, Mr. Mirakhor had presented 10 areas where he considered that the required numbers had been underestimated, and the staff had agreed that those were legitimate areas of concern.

Ms. Lissakers commented that Mr. Mirakhor's sentiments were reflected in management's position. She asked the staff to explain the advertisement, entitled "Recruitment Drive 2000," which had appeared in the human resources newsletter, that said that the Fund was embarking on an ambitious "recruitment program this year to find nearly 200 economists." Was there a high vacancy rate for economists in the Fund, or was management starting the recruitment process for the new initiatives before the Board had approved the budget?

Mr. Mirakhor noted that management had not paid much attention to his call for increased hiring, as the Fund still planned to increase staffing by only 227 positions.

The Chairman noted that by calling the recruitment program ambitious in that advertisement, management was echoing Ms. Lissakers's view that the program of recruitment was excessive. It was ambitious to try to find 200 excellent economists in a relatively short time. Management would not recruit staff for the new initiatives without the full consent of the Executive Board.

Ms. Lissakers wondered on what basis the Fund was recruiting 200 economists before the Board had decided on the exact level of the staff increase related to the initiatives.

Mr. Milleron said that a decision had not been prejudged; the increase of 200 staff might be explained by "normal attrition."

The Director of the Office of Budget and Planning said that replacement needs alone would explain a large part of that advertisement. The Fund's recruitment had been running at a rate of about 220 new staff each fiscal year.

Ms. Lissakers explained that she accepted the premise that there was an additional workload stemming from the initiatives that had been approved by the Board, and that some net addition to the staff was probably necessary. The concern was that the numbers proposed were too large, and there was excessive front loading, in terms of both actual need and management practices, and the Board had not had sufficient information to make a considered judgment about the full range of possible trade-offs. The additional scenarios and options that the staff had recently presented had been helpful in providing a better sense of the trade-offs and distribution of the staff. The Lissakers/Bernes memorandum proposed maintaining the new initiatives on the schedule assumed in option 1, which was the original management proposal, while applying the staffing increases called for in options 2a and 2b, to see what impact that would have on the Fund's traditional activities and highlighting the full range of choices and trade-offs.

The Acting Chairman pointed out that the stress impact on the staff caused by work overload, overtime, and missed vacations was at a peak. Management had reached a limit and could not go much further in improving the review process, redeployment, and savings without clearer instructions from Directors on what activities should be minimized. It would not be sufficient to say that with less waste and abuse, management could possibly find scope for more budgetary savings. After all the efforts deployed in the past year, there was little flexibility left to respond to that call.

Ms. Lissakers noted that she was not only proposing a redeployment of resources, giving more work to the same number of people, but hoping to find out what needed to be done to proceed with the initiatives on the maximum schedule using existing staff. Perhaps some countries would have to adopt an 18-month surveillance schedule, rather than the 12-month schedule, or the size of missions in some countries would have to be cut back. Both the report on stress and the Ombudsman's report put substantial weight on management techniques, rather than workload, as one of the major sources of work stress. Nevertheless, it was important for Directors to consider the full array of options. Many of the so-called new activities were not new; they were new ways of doing old things, hopefully better.

The Chairman said that he hoped to soon share the staff report on stress and its conclusions with Directors. That document did not look into staffing increases as a way of alleviating stress. Its working assumption was that any relaxation of stress must come through improvements in prioritization and management at all levels of the Fund. However, the recently approved initiatives would add new tasks, and the staff's culture was to never refuse to respond to the Board's requests, even when the immediate means were lacking. An alternative, in this context, was for management to agree that the staff should only undertake new tasks when it had the means to do so, but that was totally contrary to the current practices, which could only continue if the national authorities reinforced the Fund when enormous new tasks were added to its responsibilities.

Mr. Mirakhor noted that the idea of prioritization was not new, and efforts in that direction had been ongoing for the past five or six years. The memorandum by Ms. Lissakers and Mr. Bernes did not include concrete ideas of where redeployment and cutting back in traditional programs could occur. It did not make sense to suggest curtailing surveillance, because that was a core function of the Fund. Indeed, some of the smaller countries that had been put on 18-month or two-year cycles needed to resume 12-month cycles. The Board was already differentiating too much between member countries in that sense, and it was not helpful to repeatedly suggest, in every budget meeting, that prioritization and savings should take place.

Mr. Donecker said that he supported Mr. Mirakhor's position, although he wondered whether the right balance had been struck between the Fund staffing and the World Bank staffing in some priority areas. For instance, although the HIPC Initiative should be fully supported and adequately staffed on the Fund side, it was not clear that the World Bank could also fulfill its commitments in that regard. The same could be asked about the financial sector assessments. In the past, Directors had made concrete suggestions about areas where there was room for redeployment and cutting back, although admittedly the response was not always forthcoming. Many staff members were working hard, under great stress, and management needed to recognize the fact that there was still room to redeploy and cut back on programs that were not urgent. For example, the time used by area departments to produce additional research papers on special topics relevant to individual countries rather than the total Fund membership could be used for more urgent work. There were also an ever-increasing number of seminars, workshops, and discussion groups that the staff was called on to attend. The Board needed more guidance from the Budget Committee on such issues, rather than just two small papers.

Mr. Collins endorsed Mr. Donecker's comments. The Board would be accused of micromanagement if it were to make precise proposals on the composition of missions; moreover, it was not in a position to do so. Only management and the departmental directors actually knew what the top priorities were and how the staff was actually deployed. It was up to management and the staff to tell the Board what activities could be cut to make room for others.

The Acting Chairman wondered whether Directors would support a move to stop sending staff to meetings of various groupings of countries—e.g., G-7 meetings—that duplicated some of the work of the Fund. Participation in these meetings was a major source of stress for the staff because of the travel and intense negotiations associated with them. However, it was not clear whether the work of the Fund and its purposes would be served if it ceased to be involved in those groupings. As long as member countries of the Fund played a part in them, it was necessary for the Fund to be involved. Other than that, it was not clear where else significant savings could be found. It was clearly not appropriate to cut back on surveillance at a time when transparency and surveillance were at the heart of the new Fund architecture.

Mr. Collins agreed that the demands on senior staff time arising from the need to collaborate with the country groupings were high, but that was not a large proportion of the staff's overall time. It would be interesting to know the actual effects of cutting back staff in certain areas. For instance, would eliminating one person from a country mission render that particular surveillance exercise useless or make it less effective? Such information would help in deciding on appropriate cuts. There was anecdotal evidence that the internal review process was slightly wasteful; the Board looked forward to hearing whether savings could be made in that area. It would also be important to ascertain whether the staff was writing papers that were unnecessary. For example, the staff had produced a paper on the efficiency of education expenditure in a particular country, which appeared to be more the responsibility of the World Bank. The Board needed more information on the possible trade-offs and whether activities could be prioritized or spread out over a longer period.

The Acting Chairman insisted that the contribution to meetings of country groupings were a drain on the Fund especially because they mobilized senior staff.

Mr. Collins said that he did not doubt the importance of that involvement. He just wondered how the staff's involvement in those groupings compared proportionally with the other resources devoted to all other Fund activities.

Mr. Mirakhor noted that the risk of being accused of micromanagement had not stopped Board members from attempting to micromanage in other areas, and was hardly a good excuse for not making suggestions on savings. The question was whether a limit had been reached and whether there were other areas where the staff could make cuts. Reducing the number of research papers, even by half, would not liberate sufficient staff resources to implement the recent initiatives. It was ironic that Directors of developing countries, having been convinced of the need to undertake the initiatives, now had to convince other Directors that had been in the forefront in supporting the initiatives to provide the necessary resources. If Directors were suggesting that resources could be saved by relying more on the World Bank, the staff should not be held responsible for the outcome of the initiatives being undertaken. The Fund would be asking its members to undertake programs with macroeconomic conditionalities, while holding another institution responsible for structural measures that needed to be undertaken in order to make Fund programs a success. The Fund had to either transfer the entire responsibility for the outcome to the World Bank, or give the staff the necessary resources. The question was: Were there really any opportunities for cutbacks as suggested by some?

Mr. Faini commented that the debate was a difficult one, and rightly so, because the Fund's mission was ultimately at stake. It could not be denied that the staff was faced with a heavy workload, which had to be alleviated.

The Executive Board was asking the Fund to take on broad new initiatives and had to find the resources for those initiatives without cutting back in core areas, such as surveillance or technical assistance, that were critical for many developing and emerging markets, Mr. Faini continued. The surveillance report had suggested that the Fund focus on those areas where it held a true comparative advantage. There was no request for additional resources in the area of surveillance, but a clear need to improve the use of existing resources. As Mr. Donecker had said, the Fund needed to concentrate on areas where it could make a genuine contribution. Mr. Donecker had also highlighted the need for better collaboration between the Fund and other institutions. One source of stress was that the staff was being asked to deal with issues for which it did not have a clear mandate or competence. That made Mr. Mirakhor's position questionable; if the Fund was concerned that other institutions were not able to deliver on some areas, it would be extremely dangerous to fill the gap. The Fund needed to focus on its core activities, and could not be a contingency or emergency institution, doing the work of other organizations.

Mr. Bernes made the following statement:

> It is important to bear in mind that this discussion is not about the need to address the overload and stress of the staff, which is clearly recognized. Probably there is a need for some increase in staff resources, but, as others have pointed out, it is more a question of priority setting and management. A total package is required to address those issues.
>
> I have been arguing for three years in support of the new programs that the Fund is embarking upon. I have made the point consistently that the Fund will require new resources to do that. We are asking the staff to assume important new responsibilities. To my mind, the question is not so much that there is a need for new resources, which is uncontestable, but the magnitude and the pacing. There are still questions about some of the new programs. Canada was one of the first countries to volunteer to undergo an FSAP and lessons are being drawn about the scope of the exercise that needs to be considered before agreeing upon some final models for that program. The relationship with the World Bank vis-à-vis the poverty reduction operation would be a learning exercise. Like Mr. Faini, I would contest Mr. Mirakhor's argument: if the Fund is going to be involved, it has to be accountable. However, it cannot be accountable for everything; where there are new forms of cooperation on joint initiatives with other institutions, the Fund will have to find a way to address the accountability issue. But it cannot be assumed that the Fund will provide excessive numbers of staff in order to ensure the success of an operation.
>
> There is a need for an important augmentation of resources, but, as the principal fiscal advisor to governments around the world, the Fund will need to go through the process expected of member countries to identify possible savings. I agree with Ms. Lissakers that it would be useful for the staff to point out the items that would fall off the table in such cases.
>
> This exercise, I recognize, will only take us so far, and the process of deciding what to cut is a delicate one. The Fund cannot eliminate the effort it puts into the country groupings, for example, but perhaps it can cut some of the effort it puts into some of the individual members of some of those country groupings. There is a range of possibilities; it is important to demonstrate that the Fund has gone through the exercise carefully and looked at the possible options and trade-offs. Some progress has been made with the most recent documentation, but it has not gone far enough. I have no problem approving the supplementary budget, but we need to await some further analysis before making final decisions on resource increases.

Ms. Lissakers commented that it was important for management and the staff to provide sufficient evidence to convince the authorities of the Fund's budgetary needs. The question that the U.S. authorities repeatedly asked was whether the needs relating to the recent initiatives could be accommodated with existing staff; for instance, through redeployment or reconfiguration. The staff maintained that this could not be done. The Fund's contribution to the country groupings was indeed staff-intensive and time-consuming. The staff's next investigation could be to estimate the potential savings if the staff cut back 50 percent or withdrew entirely from meetings of those country groupings and of the Financial Stability Forum. The staff could also evaluate the cost savings from other possible changes, such as cutting back on the size and frequency of surveillance or closing the Geneva or Paris offices. That would provide a list of possible trade-offs that could be implemented in the future if necessary and would provide convincing evidence that additional staff was fully justified.

The Chairman said that if the Fund cut its participation to a few of the country groupings, those groupings might recruit participants with less stringent budgetary authorities, and the Fund would no longer be in charge of its own field of competency. The Fund was a victim of a double standard; ever-heavier responsibilities were increasingly being added to its mandate, but its resources were among the most costly. There was a limit on how much additional workload could be borne, and in recent years there were times when even that limit had been exceeded.

Mr. Donecker pointed out that the participation of senior staff in the various country groupings was of great importance to the Fund in defending its interests and bringing its ideas to and eliciting ideas from those meetings.

The Chairman agreed with Mr. Donecker's point, but asked whether all of those country groupings were necessary.

The Director of the Office of Budget and Planning said that there was an example of the issue of trade-offs in the pilot project for the financial sector assessment programs (FSAP) that MAE had recently been asked to initiate. Because there had been no immediate human resource allocation for that project, the resources had come in part from ongoing activities; in particular, through redeployment from predecessor programs through cooperation with member countries providing experts on central banking issues, and through internal redeployment, by transferring resources from traditional technical assistance to staff overtime. Thus, there had been trade-offs and ex post the balance sheet was always even, although not all of those trade-offs would be considered desirable.

Mr. Milleron made the following statement:

> I can be very brief.
>
> First of all, I approve the proposed supplementary budget.

Let me turn now to our human resource needs for the medium term:

- Let me first emphasize my understanding of what has been decided during the last six months concerning the Fund activities:
  - I understood from the last interim Committee that took place not so long ago that the following major priorities have been defined as top priorities of the IMF:
    - one, the enhanced HIPC initiative, coupled with the implementation of PRSPs and the newly established PRGF,
    - two, the promotion of international codes and standards,
    - and three, the promotion of the Financial Sector Stability Assessments.
  - I also understood from very recent boards that enhancements to existing programs and improvements in the area of surveillance as well as in our technical assistance have been more than largely endorsed by the Board.
- As a consequence, to be consistent with what has been endorsed by the Interim Committee and to be consistent with what I have approved at this Board, it seems to me more than logical to provide this institution with the human means indispensable to undertake what we have collectively endorsed.
- Therefore, I support option 1, in as much as it is, as staff and management have stated, the optimal option to enable the Fund to fulfill immediately the new major initiatives while reinforcing some of our core area duties (such as surveillance and technical assistance).
- Of course, I could go along with other options if I could receive firm assurance, *which I gravely doubt*, that a reduction of our staffing plans would not:
  - threaten the implementation *and* the time frame of all the measures we agreed to undertake,
  - *nor* would overburden an already overworked staff.

One last consideration: for the future, it would make sense, when presenting new major initiatives or undertakings to the Board, to accompany the proposals with an assessment, even in broad terms, of the resources needed to implement them. In this way, we may be able to avoid unpleasant surprises when the bill comes due.

Mr. Alosaimi made the following statement:

Let me start by supporting the supplementary budget for this year. An increase in authorized staff by 30 this year, which will be fully compensated by a lower increase next year, will help lengthen the period to recruit and absorb the large number of staff that the Fund is expected to hire over the next 15 months. It should be clear, however, that the additional staff are not the main reason for a supplementary budget. Higher travel costs and hiring short-term versus long-term experts were major contributors. We have to do better on containing these costs in the future.

Turning to the medium-term budgetary plans, this Chair remains concerned that continued expansion of duties and staff could reduce the high quality and efficiency that are the cornerstones of this institution. However, given that a number of new initiatives have been approved by the Board and the already excessive work pressure on staff, I appreciate the request for a large increase in staff over the medium term. Indeed, if the new initiatives are to be implemented within the time frame specified in the papers, then the Managing Director's request (option 1) appears reasonable. However, I believe it may be preferable to be more modest in implementing certain initiatives for a number of reasons. First, there is concern on the feasibility of hiring and training a large number of qualified staff in a relatively short period. Second, one needs to keep in mind the administrative capacity of the authorities and the need for technical assistance and training. Third, there are a number of pilot programs (FSAA and standards and codes) that have not yet been completed and discussed by the Board.

That said, I would like to thank management and staff for the new options they have presented. While we may not all agree on all the details, those new options will hopefully help foster a consensus. Here I will make a few remarks.

Option 2b as presented is not acceptable to this Chair. The provision of additional technical assistance, which is critical in our view, is cut by more than half. Moreover, additional resources for enhanced surveillance including regional surveillance and for other Fund activities, including assistance to postconflict countries, are completely eliminated. As the Fund will likely increase its involvement in these areas, this could only mean further pressure on staff or postponement of missions and further delays in bringing papers to the Board. In this regard, I share Mr. Mirakhor's concern that pressure on the Executive Directors' office has also increased significantly during the past few years.

Option 2a, however, is more appealing. It provides for a smaller increase in staff by at least 22 in 2001 mainly through an appropriately more gradual implementation of some of the new initiatives. However, it is difficult to reach a firm conclusion at this stage given that the pilot projects have not been completed and the comments made by other speakers.

Let me conclude by welcoming the Managing Director's statement on his commitment to regional and national diversity. I also greatly appreciate the efforts of the senior diversity advisor. It is essential, however, to stress on all departments and in particular the Human Resources Department the necessity of translating this most important commitment into concrete action.

Mr. Bernes made the following statement:

First, like others, we join in thanking the staff and yourself for the documents for today's meeting and welcome the efforts made to bring more transparency and understanding to the budget process. We like the attempt to hold departments accountable, and find the mission statements and the details outlined in the estimates paper useful. As I suggested in the budget committee, it would be appropriate to have departments extend the information on a forecast basis over the medium term and also to indicate targets for the workload indicators (as an example, departments need to be setting targets to lower unused annual leave as well as overtime).

This chair associates itself with the views expressed in the statement of Messrs. Collins/Kelmanson and those in paragraph 2 of Mr. Mirakhor's statement on stress and workload.

Like others we are concerned about the resource implications of such a large increase in staff. Let me say at the outset that we are not taking issue with the new programs per se, as this chair has been one of the main proponents of the three initiatives, namely the FSAP, PRGF, and work on standards and codes. However, we agree with those who see the need for some rephasing of the staff estimates in a more realistic time frame—and more importantly, that the resource needs be put within a workload reduction framework. As noted by Collins/Kelmanson, option 2b begins to do this, but as we noted in the joint U.S./Canada memo of earlier today, we need to be able to see what is implied in terms of the opportunity costs of the new work on the existing activities.

I have just a few additional remarks.

Independent Evaluation of Internal Procedures. This chair looks forward to the report underway on internal procedures and commends the work done last year on savings and redeployment; however, we see a need for an independent/external evaluation of these same procedures. There is a need to get a fresh and different perspective on how the Fund does business and we support an early start to this evaluation in FY2001.

Workload Indicators and the Working Group on Stress (WGOS). As noted earlier, we share the concerns expressed in the attachment from the WGOS and we look forward to a discussion of the full report. We are especially anxious given the workload indicators we already know and can imagine that the report validates some of our worst fears about stress in the Fund. We would expect that any additions to the staff over the medium term be sufficient to lower stress and overload on the staff.

Mr. Chairman, with these remarks, we can go along with the views of Directors in support of a more phased-in implementation of the new programs, which implies a much smaller increase in the staff in FY2001 in particular, and over the medium term in general. Furthermore, we would only be able to support the new MT estimates insofar as there are clear reductions in the workload indicators and that management agree to the external evaluation of Fund procedures as soon as possible. Regarding the supplementary budget, we can go along with this with reservations and with the expectation that our requests to explore another option be observed.

Mr. Faini made the following statement:

Let me thank management and the staff for providing the Board with additional elements for decision. If they could take some further steps and meet the request by Mr. Bernes and Ms. Lissakers, that would help in Directors' communication with the authorities.

The statement by Mr. Milleron eloquently stated that the budget should allow the Fund to fully and effectively deliver on the new initiatives that have been endorsed. However, that should not be achieved by cutting core activities, such as surveillance and technical assistance. The excessive staff workload must also be addressed. We are concerned, in particular, by the limited progress achieved to date on work-related stress and the decline in the amount of time that the staff devotes to training and development. Strengthening the human capital of the staff is a basic requirement for maintaining the high-quality work of this institution.

However, we share many of the concerns expressed by Directors regarding the capacity of the Fund to absorb and train such a large number of staff over a short period of time and the need to remain focused on core areas. There is also a margin of uncertainty surrounding the medium-term needs associated with the new initiatives. It could well be that, after the Fund has gained experience in some of these new areas, there would be ground for subsequent redeployment of resources. The question is whether the Fund can confidently make plans for the medium term, as it is moving, to a large extent, into unknown territory. For instance, on the new PRGF, the Fund should stick to its core activities and remain in charge of the macroeconomic component and not cover the gaps in different areas. Covering the gaps would add to the staff's stress and diminish the quality of the work of the Fund.

Some of the staff's traditional tasks will be more demanding, for instance requiring the Fund to keep in touch with civil society; but it is difficult to make a full, confident evaluation of those needs. Regarding the financial sector stability assessment, the pilot project is still at an early stage, and at some point there will be a full evaluation of resources needs.

The work that the Fund has been doing on codes and standards is demanding; however, the collaboration with other institutions is still at an early stage, and there is no clear definition yet on how this collaboration will work and what the demand on the Fund's staff resources will be. I can thus fully endorse the need for additional staff in the short run, although not under option 1. I would prefer one of the options that give the Board some freedom for reconsideration in the light of the experience gained.

I therefore support the request for a supplementary appropriation and an increase in the staff ceiling for FY2000, although this measure should remain exceptional and not lead to a relaxation of the staff ceilings set for each financial year.

Mr. Mirakhor wondered whether, in the context of Poverty Reduction and Growth Facility (PRGF)-supported programs, the Fund could concentrate only on its core areas of responsibility. Could there be a design for PRGF-supported programs whereby the Fund was responsible for the outcome in the macroeconomic area, while the World Bank was responsible for the structural and other areas? Or did it need to be designed as an integrated program in which the outcome was ultimately reflected in the macroeconomic variables and macroeconomic framework?

Mr. Faini said that if the World Bank were planning for a possible failure by the Fund to deliver on the macroeconomic component, the work could be duplicated, although that was not desirable. It was important to solve the difficult problem of accountability when two institutions worked together. The best strategy in that respect was to form contingency plans and allocate resources in case other institutions did not deliver in their areas.

Mr. Mirakhor noted that there was clearly a need for coordination, but was it possible to say that the Fund would be doing the same work as it had under the ESAF program so there was no need for additional staff? For ESAF-supported programs the Fund had clearly been in charge, in the sense that it designed the macroeconomic program, and the World Bank was responsible for social expenditure and structural issues. The work of the staff in the context of PRGF-supported programs had expanded far beyond what was expected under the ESAF-supported program. The responsibility for the new program could not be entirely passed on to the World Bank. The responsibilities of the Fund staff, particularly on fiscal matters, would expand. The staff would have to ask authorities about the savings they were going to achieve and how they would expand the expenditure base on the social side of the programs, which was not a simple task.

Mr. Faini pointed out that staff resources would have to be augmented to accommodate the new, demanding tasks. However, there was an exceedingly high margin of uncertainty about staff requirements. The Board might discover in a few months that it had been exceedingly pessimistic. There were more programs and more poverty reduction strategy papers to be written, and more staff would need to be redeployed to that task. There would have to be experiments in the field to determine exactly what the initiatives meant in terms of the participatory process and the inclusion of civil society, taking into consideration the poverty implications of the Fund's macroeconomic work.

Mr. Mirakhor commented that the margin of uncertainty about staff requirements was bidirectional.

Mr. Milleron observed that because of this uncertainty, there was probably a bias toward underestimating the costs. For instance, the Board had recently decided to conduct a review of Fund facilities, which represented much work, but that was not integrated into the larger effort by PDR.

The Chairman responded that even if there had been a decision to review the facilities, there would have been insufficient means for the staff to respond in a short lapse of time. The uncertainties were bidirectional; there would probably be some staff freed for the PRGF when the debt exercise had been completed. The problem was that by that time, the PRGF poverty-reduction facility would be approaching maturity. If the Fund and the World Bank were serious about ensuring that the new instrument made a difference in their relations with the poorest countries—particularly through increased involvement of civil society—then they would be confronted with great difficulties in the absence of adequate staffing. That issue would be discussed further during the forthcoming Board meeting on external relations, but it was difficult to estimate just how much additional pressure involving civil society would entail. The World Bank was better equipped for that purpose, and could provide insights to the Fund.

Management had made conservative evaluations of the other priorities listed by Mr. Milleron precisely because there were many unknowns, to avoid adding to the workload in advance, the Chairman explained. In addition, the Board had to be prepared for further requests; for instance, there was a pressing and justified expectation that the Fund would soon undertake serious work on the quality of the data it disseminated. Reacting to such requests would involve a fine balancing act, as the Fund currently did not have the means to undertake the work. The Board could enter into an agreement with each country to assess their means or to try to have the work done outside of the Fund, but the quality control would then be questionable.

Mr. Donecker agreed with Mr. Bernes and Ms. Lissakers on the political acceptability of huge increases in the Fund's staffing, as the authorities also had to address new issues, despite their own budgetary constraints. That caused tension when it came to augmenting the budgets of international institutions.

The Chairman said that the Fund could not be compared to national administrations that had been accumulating staff for hundreds of years and had room to reduce and reallocate staff as new tasks arose. The Fund and other international institutions had always tried to set an example; thus the room for savings was far smaller.

Mr. Faini said that his preferred option for the first year was in between options 2a and 2b. The information requested by Mr. Bernes and Ms. Lissakers could be useful in formulating such a solution, with the possibility of reopening the discussion in the medium term in light of experience. Mr. Milleron had suggested that there was a truncated distribution, with only an upside risk, although perhaps the distribution was more balanced and actually truncated in the opposite way. It was important to have some hard facts because there was little ground on which to base a judgment.

The Chairman pointed out that management and the staff needed guidance for preparing the next budget and deciding to what extent to implement the new initiatives. Mr. Faini's suggestion would only launch the initiatives in a symbolic way, but not in the needed dimension.

Mr. Faini said that there was not much difference between the three options with respect to staffing for the PRGF, FSAP, and the international standards and codes effort, but an option in between options 2a and 2b would be preferable for those initiatives.

The Chairman responded that those options were much the same in that regard.

Mr. Faini said that he preferred a linear combination of the two. The decision on the medium-term decision could be deferred until more experience was gained on the three initiatives that contained major margins of uncertainty. For enhanced surveillance and technical assistance, an option in between options 2a and 2b was preferable.

The Chairman said that that would mean doing almost nothing on enhanced surveillance.

Mr. Faini observed that the surveillance report called for redeployment, not additional resources. That reading of the research and the surveillance reports was consistent with the general principles outlined in his intervention.

The Chairman responded that he did not consider Mr. Faini's position compatible with the priority given to surveillance. For the three first categories of programs it was understood that Mr. Faini agreed with option 2a.

Mr. Donecker pointed out that for the financial sector initiatives there were 21 new staff positions, yet that overlapped with enhanced surveillance, for which 50 staff positions were foreseen. Standards and codes were clearly a part of enhanced surveillance.

The Chairman commented that that was not necessarily true, particularly in the countries where surveillance was most difficult. Financial sector assessments would typically not cover poor developing countries, for example.

Mr. Collins observed that the staff increase proposed for financial sector initiatives in option 1 would cover 45 assessments a year over a five-year period. That would be 225 assessments, which was clearly excessive. If financial sector surveillance in the poorer countries was a lower priority, the reduction shown in options 2a and 2b was probably insufficient. It was best to focus the assessments on those countries where the financial sector risks were the highest. Mr. Donecker was correct that the codes and standards and financial sector were an important part of enhanced surveillance, so there might be some double counting.

The Acting Chairman responded that there was no double counting.

The Director of the Office of Budget and Planning confirmed that there was no double counting. Financial sector work was country-specific, covering a number of countries every year, while enhanced surveillance looked at regions, such as the European Union or the Caribbean area. There were recommendations on improvements in bilateral surveillance cross-country comparisons, research, and private sector work, including the discussion on bond contracts and external vulnerability.

The financial sector assessments would not exceed the number of Fund countries, the Director explained. About a third of the 45 assessments to be conducted each year were limited assessments involving follow-up work in countries that had had a full assessment and required a brief follow-up visit, which accounted for the larger numbers.

Mr. Shaalan made the following statement:

> Over the years this chair has been supportive of management's position on the budget and sensitive to the need to expand staff resources in order to meet the increasing demands placed on the Fund. Our position has generally been guided by two criteria: ensuring that the resources requested are the minimum necessary for the Fund to undertake its work priorities within its core areas without compromising the quality of output, and ensuring that the staff finally has some breathing space to allow the workload indicators to decline to a more acceptable level. I am truly distressed at the slow pace of progress in these areas.
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> I thank the staff and management for the useful option they provided two days ago. I can support the supplementary budget, although I have a number of requests for clarification.
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> The Fund faces important new demands that will necessitate an increase in resources; the problem is to determine the magnitude of the needed

increase. The discussions today have underlined how difficult it is to assess the requirements. Some new activities can and should be met through a reorientation of existing resources by refocusing on the core activities of the Fund. However, I am most concerned about the reorientation of resources away from traditional technical assistance areas, which is similar to program countries meeting their fiscal targets by cutting capital outlays—not an efficient way of doing business. Technical assistance remains critical for a large segment of the membership, and we are troubled that allocations to this area come under pressure with every new initiative. Technical assistance should be looked upon as the infrastructure necessary for the membership to absorb the many new initiatives that the Fund is implementing. The total resources that would effectively be diverted from potential deployment in technical assistance under option 2a is not entirely clear. I would appreciate the staff's comparison of the technical assistance available under options 1, 2a, and 2b.

The poverty initiative has raised many expectations among both the membership and the public at large. The Fund must be in a position to deliver on its promises, and we can ill afford delays in this area. The resources needed for the poverty initiative fall in three parts: resources needed to accelerate the work on the initiative; resources needed to include additional countries in the initiative; and resources needed for work on the poverty reduction strategy.

The revised option 2a presented by the staff appears to limit the proposed increase in resources by reducing the number of countries served. That is not something that this Chair can support. The direct work by Fund staff on the specifics of poverty reduction should be kept to a minimum, and the development of the poverty reduction strategy left entirely to the country authorities and the World Bank. Fund staff involvement in missions on the PRSP should also be kept to a minimum and we would expect all missions related to the preparation of PRSPs to be headed by the World Bank.

The recent crises have highlighted the importance of the financial sector assessment initiatives. However, at this stage, the FSAP is essentially a pilot project to be assessed early this summer. It is not possible to come to a staffing decision before then. We would not need all of the resources foreseen merely to complete a pilot project. Furthermore, perhaps management relies too little on the role of the World Bank on the financial sector initiatives. For example, only one World Bank staff member, covering the insurance sector, was involved in the mission on the FSAP in Canada. Although the World Bank is not much involved in Canada, the Fund should not have had to shoulder the burden. That issue can be addressed at the time of the review of the pilot project.

The important work in relation to standards and codes could be irrelevant, unless we provide technical assistance needed by some countries to absorb the new initiative. I have argued previously that insufficient attention was being given to technical assistance in the implementation of this initiative.

The indicators of work pressures have been a serious concern to this chair. We have reiterated on a number of occasions our objections to placing pressure on the staff over prolonged periods of time. Option 1 shows only marginal improvements in a few cases and no explicit allocation to help reduce this burden, despite the significant increase in overall resources sought by management. We are therefore puzzled to find in paragraph 3 of the new statement by the Managing Director that the proposed staffing increases in option 1 "would go some way in addressing this problem." I do not see how that problem was addressed by option 1. While option 2a would go some way in addressing it, it is clear from Attachment I to the Managing Director's statement that well-targeted resources are needed to address this problem. As Mr. Mirakhor notes, we would like to see a timetable to reduce the workload on the staff. Furthermore, regarding the workload, I also fully support a review of the staffing of Directors' offices, as suggested by Mr. Mirakhor.

I would like to see the Fund's activities refocused and the staffing requirements tailored accordingly. One final budgetary request I would like to raise is to add a line item, starting with \$100,000, to finance Board activities such as the monthly luncheons, breakfast meetings, and similar activities, for which there is currently no line in the budget. That would be in addition to the individual representation allowances.

Ms. Lissakers suggested that Mr. Shaalan might want to consider a line-item veto. Mr. Shaalan's point about the trade-offs between standards and codes and technical assistance was a good example of a redeployment opportunity in the medium-term scenario because the Fund was in the design phase of the standards and codes initiative. The staff hired to work on the design would be in a position to help countries implement the standards and codes after they were in place. The standards and codes initiative was part of enhanced surveillance in that it would presumably provide a road map for countries to adopt good policy practices, particularly on budgetary and monetary policies. Thus there would be significant efficiency gains for the Fund and its member countries once that initiative was in place.

Mr. Portugal made the following statement:

I would like to start by thanking the staff and management for providing additional information and presenting new options that I hope will facilitate the Board's discussion. It is not surprising that the Board has had such a difficult discussion; the budget is one of the most important and difficult processes in any organization, involving the allocation of scarce resources for competing aims, almost all of which are worthwhile undertakings. This process is further complicated because we have different views on priorities. Some Directors want more technical assistance, others want to preserve existing activities, and others place greater priority on new activities, which complicates the work of management and requires compromise and flexibility on all sides in order to reach a solution.

I would like to make some general points before discussing the various options. The first one is that it is important to operate with a hard budget constraint as a basic principle, because in any budget process there is a tendency to treat every demand as additive. New activities proposed are usually worthwhile and there are always rigidities on cutting back existing activities. If we do not operate under the assumption of a hard budget constraint, then these difficult choices between two important and urgent priority activities end up not being made. I am talking not only about management, but also about the Board.

A second, equally important point is to avoid the culture of establishing unfunded mandates that end up being accommodated by overworking the staff, creating the problems of work-related stress that the Fund is currently experiencing and which extends to Directors' offices. Reading the initial conclusions of the working group on stress that is summarized in the annex, I notice that among the contributing factors to this situation are the Fund's ever-widening mandate and the lack of prioritization. Perhaps a practical way to operationalize the concept of a hard budget constraint while not overworking the staff is for any proposal for new activities that comes to the Board to be accompanied not only by its costing, but at least two alternatives on how to finance it. One would be a purely additive alternative while the other would point out the less urgent activities that could be discontinued in order to finance the new program. The Board would then decide whether to approve the new initiative at all, to approve it as entirely additive to existing programs, or to decide what should be discontinued. There are many difficulties in implementing a scheme like that. One requirement should be that the costing indicated in any new proposal not be revised upwards later on.

For the approach to work, the Board must have a view of the cumulative staff increase that has been approved so far, as any individual activity usually looks acceptable in isolation. Another general point is the usefulness of having multiyear or medium-term budget perspectives, as presented. For this approach to be useful, it must be as comprehensive as possible, although by being comprehensive and being medium term, it has to include items that have not yet been fully discussed or approved by the Board. That means that whatever decision the Board would take with respect to the costing of funding initiatives that have not yet been discussed or approved would have to be treated as provisional or conditional. There must be a way to reconcile the aim of having a comprehensive picture of all the tasks on the table, for the near future, while preserving the Board's capacity to discuss, modify, approve, or reverse whatever has been decided.

Let me now turn to the question of the medium-term options and the supplementary budget. We are prepared to favorably consider a request for a supplementary budget this year. With respect to the medium-term options, there is no doubt that the Fund needs additional human resources. As Mr. Shaalan said, the Board is discussing how much the increase should be and how it should be phased in.

The Budget Committee discussed Directors' concerns with the substantial increase in staff that option 1 would entail in a relatively short period of time, especially its impact in the rate of charge and its implications for the Fund's absorptive capacity, in light of the high technical quality expected from the staff and the important issue of diversity. Management's assurances that the progress on this issue of diversity will be reviewed are important.

We do not like the way that option 2b has been presented, as it entails a significant cut in technical assistance and in early economic training. Those are two activities to which the countries in my constituency attribute a great importance. As Mr. Shaalan noted, investments in technical assistance and early economic training could save resources in the medium term in other areas and help to establish true ownership in these countries. During the discussions of the Budget Committee, a large number of Directors were in favor of increasing the resources dedicated to technical assistance. Both the substantial cut in this activity proposed in option 2b and the smaller cut for 2001 in option 2a are not in line with that position. I agree that there are problems with option 2b, owing to its impact on surveillance and other activities. However, I am not yet clear about option 2a, and notice for instance that the enhanced media and public relations initiative was kept out of both options 2a and 2b. It has been said that the additional requests in terms of assessing the quality of the data that the Fund disseminates might create an additional demand and that in many of these things the estimates are on the conservative side. It is not clear whether that would be subject to additional increases in the future if the Board approved the new option 2a. Furthermore, I would like to hear how management intends to deal with the issue of the cuts to technical assistance in option 2a. It would help in accepting option 2a if there could be some agreement that the improvements in media and public relations would not increase the figure of 144 additional staff for 2001 and 197 additional staff for 2002. If cuts must be made in order to accommodate the increases in media and public relations, these cuts should not fall under technical assistance or on the enhanced HIPC Initiative.

As Mr. Mirakhor has said, it is incumbent on all of us, when we ask management either to make cuts or redeploy staff, to at least give an indication of where we think additional savings could be made. Like some other Directors have said, including Messrs. Shaalan and Cippà, perhaps some savings could be achieved by spreading over a longer period the implementation of some of the Fund's activities in the financial sector. The work in that sector is crucial and could make an important contribution, not only to member countries and the international community, and we favor an increase in the Fund's activities in this area. But it is not feasible to undertake 23 new financial sector assessments in the next fiscal year. In June, we are going to assess and to evaluate the experience from the 12 cases in the pilot project and decide how to move ahead. I doubt whether it would be possible to make 23 additional assessments, as implied in options 2a and 2b, from June to the end of the next fiscal year. This is clearly an area where we could phase in implementation over a longer period. Whatever staffing decisions are taken with respect to the financial sector must be provisional and conditional on the substantive discussion of the Board on this issue.

With respect to the PRGF and the enhanced HIPC Initiative, we are prepared to accept the need for a substantial addition of staff, because, as Mr. Shaalan has said, the number of countries has increased by 20 percent. We are also interested in providing faster debt relief, which would require more staff. However, there are two options that would allow for a smaller staff increase, neither of which was accepted when the Committee discussed this issue. One was Mr. Rustomjee's suggestion, which I supported, of establishing a five-year period for the PRSPs, instead of the three-year period proposed. That would have permitted a slower pace of implementation in the non–HIPC Initiative countries that must do PRSPs. The other suggestion was that the Fund should not get involved in the consultative process itself but leave it to the World Bank. Unfortunately, Directors did not accept these suggestions, so it might be too late now to raise them. If that is the case, I would have difficulties in cutting additionally in this area if it would hurt these countries.

Ms. Lissakers said that she was puzzled by Mr. Portugal's conclusion that giving quicker, earlier debt relief would be more staff-intensive. Would it not be just the opposite? It was more staff-intensive for a country to have a decision point now and a completion point in a year because that would involve several Board meetings and missions, whereas collapsing the process into three months, with one set of Board papers and one mission, would clearly require less staff.

Mr. Portugal responded that the problem was covering several countries at the same time. More countries would be involved and the whole process would be accelerated. More debt sustainability assessments and other studies would have to be undertaken, and that would require additional staff.

Ms. Lissakers said that Mr. Portugal's point was valid. There was confusion about the medium-term numbers; why was there a need for more people to work on the HIPC Initiative and on standards and codes in two or three years than at the present time?

The Chairman said that the additional resources were not required for the HIPC Initiative. The issue was that it was extremely difficult to anticipate the costs of the PRGF, particularly the involvement of the civil society.

Under option 2a, the reduction in technical assistance was limited and was phased in, the Chairman explained. Option 2a did not cut into the substance of the initiatives, but it slowed down the process. Option 2a would have to be augmented by whatever decision the Board took on a strategy for increasing the effort in the area of external relations. That had a cost, but was necessary. An insufficient effort at communicating the Fund's message could have a tremendous impact on the Fund's actions and make more difficult the needed decisions in certain circumstances. It was also hoped that the financial sector assessment pilot cases could be assessed in March, rather than in June, to get the input of the Board as soon as possible on the basis of earlier experience.

Mr. Portugal wondered whether the assessments of the 12 pilot project cases would be ready by March 2000.

The Acting Chairman replied that they would not be ready.

Mr. Portugal asked whether that meant that the Board would assess only a part of the pilot project at that time.

The Acting Chairman replied that that would be the case; there were enough countries involved to have a good discussion.

Ms. Lissakers pointed out that it had been said that a cost-efficient approach to communication about the Fund was for countries such as Brazil and Thailand to publish their Article IV consultation reports.

Mr. Wei made the following statement:

> I would like to thank the Managing Director for the clear and concise statement and the staff for a set of well-prepared papers and additional information on medium-term plans and resources estimates.
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> Like Mr. Mirakhor, while I fully understand that the Fund should make every effort to adapt to the changing environment, the institution should continue to focus on its traditional core areas. Thus, I would like to reiterate our support for option 1 and the supplementary budget.
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> On the medium-term plans and resource estimates, I appreciate the fact that the staff has provided three options. After further comparison, option 1 is still our preference, although I could support other, compromise options.
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> I do have some reservations about the proposed resources increase in staffing for financial sector work and for the promotion of international

standards and codes in the medium term, because they are still in the pilot stage, unlike the PRGF and the enhanced HIPC Initiative. I would rather agree on a resource increase only for the pilot period, leaving further decision on the medium-term resources increase until the final review of the pilot program. In this regard, I share Mr. Portugal's views. However, any reduction in the budget for the PRGF, the HIPC Initiative, and technical assistance is unacceptable. I read the staff paper on the scope for budget savings in the Fund with great interest, and was impressed by what management and the staff have done to conserve resources. Their efforts in this respect are highly appreciated and should be further encouraged. However, as Mr. Shaalan pointed out to the Budget Committee, the overburdened situation in the Secretary's Department has reached a dangerous level and should be addressed immediately. Unfortunately, this problem is not limited to the Secretary's Department but is Fund-wide. Another example is the Chinese section of the Bureau of Language Services; although the staff in the section is highly qualified and industrious, often working overtime because of staffing constraints, my office must frequently compromise on guidelines for completed translations. The workload in the section has increased to such an extent that a further increase in staff is urgently needed. I hope that management will seriously consider this request.

The supplementary budget essentially covers the work on the PRGF and enhanced HIPC Initiative, which was endorsed by the Board and the IMFC last year. Thus, I have no difficulty with the proposed decision to increase the staff ceiling and with the associated appropriation. The PRGF and enhanced HIPC Initiative are of vital importance to developing countries. One of the Fund's objectives is to foster economic growth and improve the living standards of its member countries. Therefore, I would support a supplementary budget increase for these initiatives through which the Fund, as well as my colleagues, can demonstrate their resolve and accountability.

Mr. Kelkar made the following statement:

Let me thank management and the staff for providing the new proposals, which are extremely useful. We support the supplementary budget for this year as proposed by the management. Regarding the medium-term proposals, I agree with Messrs. Shaalan and Portugal on the allocation of responsibilities between the World Bank and the Fund. The Fund should get involved with meetings organized with civil society and related areas as little as possible and the World Bank should assume leadership in the preparation of the poverty papers.

Regarding the options, I consider almost all of the alternatives under option 2a appropriate at this stage, given the uncertainty about what resources are required. Mr. Faini is right that we just do not know enough about what demands will be made. Given these uncertainties, I would be inclined to support option 2a, with a few observations.

My assumption, given the uncertainties, would be that up to one-third of the new positions could be contractual in order to avoid a permanent load on the system and provide some flexibility if the situation changes. Furthermore, in light of the peak load involved in the initiatives, the Fund should think more in terms of midcareer hiring, which would provide a quick start-up, especially in new areas, rather than depending entirely on young Ph.D. graduates who take time to train.

I agree with Mr. Portugal that the provisions for increased external relations should be accommodated within the overall additionality implied under option 2a; thus, that option would be considered a hard budget constraint on new resources. I also agree with Mr. Collins's statement inviting management to undertake an external review of the Fund's internal review procedures. There is room within the institution to reduce the resource-intensive review mechanism, which would save resources as well as promote efficiency.

Ms. Lissakers expressed concern about the way the options were presented; not only did they leave out the increased staffing in external relations, but they would also need to be adjusted if the supplemental budget were approved.

The Acting Chairman pointed out that after the supplemental budget was approved, 30 staff years would be deducted from both options and advanced to the 2000 recruitment.

A staff paper on the external relations initiative, including proposals for staffing, would shortly be issued to the Board, the Acting Chairman said. Conclusions stemming from the Board's discussions of that paper would be incorporated into management's budget proposal. Messrs. Portugal and Kelkar had suggested that any increase be accommodated within the suggested figure under option 2a. The Acting Chairman's position was that that issue should be discussed independent of others, and the Board could take a position on the staffing implications at that time.

Mr. Kelkar said that in that case he could not accept option 2a. His assumption had been that that option represented a ceiling under which all of the new requirements would be accommodated. If the issue of external relations remained open, then he would opt for a position in between options 2a and 2b.

The Acting Chairman said that he understood Mr. Kelkar's position. The discussion of the external relations initiative in a few weeks' time should not be prejudged by setting the staffing requirement.

Mr. Ismael made the following statement:

We would like to thank the Managing Director for his statement and the staff for the good set of papers prepared for this discussion. This Chair is in broad agreement with the Managing Director's budget proposal and is of the view that a convincing case has been made to support the request for additional resources.

The initiatives and enhancements for which resources are being sought are in line with the mandates of the Interim Committee and the request of the Executive Board. Indeed, the need to address poverty issues and the debt problems of low-income countries; the systemic threat raised by recent financial crises in Asia, Latin America, and Russia; as well as follow-up exercises with regard to previous internal and external reviews have shaped our priorities for the coming years. Against this background, Initiatives and Programs on Poverty Reduction and Debt Relief, Financial Sector Assessment, International Standards and Codes, and Technical Assistance seem particularly relevant. However, like Mr. Mirakhor and others, we are of the view that we need also to continue and enhance our efforts with regard to our more traditional activities, and we welcome the Managing Director's assurances in this regard. We also welcome the concern shown as regards work-related stress on the staff, and we look forward to the implementation of a policy that will address this issue, as suggested in the attachment to the Managing Director's statement.

It is clear that the new initiatives and the increased workload related to existing activities call for additional staff. While on a few programs, we have more or less clear ideas about the work involved, on others we will have to learn by doing, but overall we are of the view that the envisaged programs fit into the Fund's purpose and focus.

On the PRGF and the enhanced HIPC Initiative, which are in the process of being implemented, we can see from the work involved that it will be intense and heavy, and that unless there is an increase in resources, it will be difficult to achieve the objectives set. Already, we note that the African department is having difficulties meeting the request for missions, and this is having an adverse effect on countries' adjustment efforts. Moreover, given the objective laid out by the Interim Committee "to have as many countries as possible reach the decision points by end-2000," it is of critical importance that the appropriate amount of resources be provided to ensure that targets and objectives are met.

On the second initiative, namely the Financial Sector Assessment Program, our views are nearer to those who think that we can wait for the completion of the ongoing pilot program before deciding on the best procedure to follow.

On international standards and codes, we are making good progress in its implementation. While we can see the need for technical assistance, we could go along with a slower pace as regards full implementation.

On technical assistance, its critical importance has been established, and the importance that the membership attaches to it is seen by the continued increase in demand for this service. Therefore, we would support fully the Managing Director's request under this item.

On media and external relations, while we agree with its importance, we have not discussed the details of the changes that we want to make; we would, therefore, favor a more gradual approach.

Overall, we do not think that option 2b is appropriate to meet the needs of the Fund, as it relies too much on a reduction of resources for technical assistance and postconflict cases. Option 2a has many elements that make it more acceptable, but we are afraid that it may fall short of the resource need for the PRGF and enhanced HIPC Initiative and also it may be inadequate to provide some relief to the staff. To us only option 1 meets the requirement of the Fund, and we fully support it.

On the supplementary budget, we support management's request, especially as it will lead to a reduction by 30 of additional resources needed.

Finally, we welcome and support the Managing Director's statement as regards the efforts to make further progress on diversity and balanced geographical representation on the staff.

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

We appreciate the effort made by the staff and the Managing Director to link more precisely the resource requirements with each of the three major new initiatives entrusted to the Fund as well as with the ongoing enhancements to its work program. We also found useful the new information provided by the staff and the options in the Managing Director's latest statement in response to suggestions made in previous Budget Committee meetings. We recognize from the outset that the budgetary implications of the new and enhanced initiatives are significant and that further workload pressures on the staff are neither desirable nor sustainable. Therefore, we agree that an increase in the staff is warranted. Against this backdrop, allow me some brief observations regarding the scale and priorities advance for the Fund's activities over the coming three-year period.

First, like Mr. Collins and Mr. Kelmanson, we consider that the Fund should be seen as operating in a world where resources are constrained and tasks are prioritized. Similarly, we support the external review of the Fund's overall internal process to identify activities of low value added. We concur also that upon completion of the external review, a study with possible recommendations for budget saving should follow. In addition, we remain of the view that the process of shared responsibilities and improved institutional cooperation with the World Bank should be able to produce efficiency gains and cost savings over time.

We welcome the steps taken to improve the efficiency of Fund operations and maintain the hope that the streamlining of the Fund's internal processes will continue to ensure maximum value-added and in so doing help to realize future budgetary savings and/or reduce workload pressures. Moreover, Mr. Chairman, we recognize that the options confronting management in terms of the medium-term staffing requirements are limited.

We remain concerned, however, that the options presented entail a shift in resource concentration away from traditional technical assistance in monetary and financial sectors to remain within capacity constraints as indicated in the papers. Like Mr. Mirakhor, we support a higher priority for technical assistance and training than what is effective in the proposals given the importance of institution building for successful implementation of the new initiatives. We fully agree that these are the most productive investments the Fund could make in the countries concerned.

On balance, while we are still not comfortable with the overall size of the proposed increase, we could go along with option 2a to facilitate a consensus, provided that (i) the level of technical assistance is maintained as in option 1, and (ii) that the Enhanced Media and Public Relation requirements be included in that total. To accommodate any increase in Media and Public Relation, some changes can be made on Enhanced Surveillance or others as suggested by the staff in option 2b.

Looking forward, like Mr. Portugal, we would like to see greater emphasis placed on the evolution of the dollar amount of administrative expenses accompanied perhaps with some greater flexibility afforded to management regarding staffing decisions to accommodate changing priorities.

Finally, as stated previously, this Chair is prepared to support, on grounds of pragmatism, management's request for a supplementary appropriation for FY2000 and increase the staff ceiling to regularize the use of up to 30 vacant positions temporarily to ensure the early implementation of the PRGF and HIPC Initiative.

Mr. Lushin made the following statement:

The new Fund's programs and initiatives being undertaken in the context of strengthening the international financial architecture are both broad and far-reaching. We now have a general Board consensus on the need to proceed with them more or less simultaneously. Also, we are now facing the implications of the adopted decisions in terms of the need to expand the staff and to increase the budget. These figures are impressive. It is regrettable, therefore, that our previous discussions of the new initiatives have been undertaken without due regard to resource constraints and that no consideration has been given to the possible ways to accommodate this new work through both redeployment and staff increases. This practice should definitely be avoided in our future work. In this respect, our recent discussion on macroprudential indicators is an example of a right approach, as not only new possible staff activities have been considered, but also their resource implications.

In addressing the medium-term plans and resource estimates, I base my judgment on a number of initial assumptions, which I would like to make explicit.

There should be no additional workload on the staff resulting from the new programs, and already existing excessive work burden in some departments should be eliminated to the largest possible extent.

The proposed increase of 227 staff years in the medium term represents the minimum resource requirement if the new programs and existing initiatives are implemented according to the plans presented in Program Outlook Notes (EBAP/99/148) and no new redeployment is envisaged.

There should be no calls on management and the staff to accommodate new tasks through additional savings and redeployment without a precise specification which of the existing activities should be dropped or curtailed. As the existing experience suggests, calls for savings made only in general terms would normally lead to reductions in technical assistance, which is not acceptable. I completely agree with the remarks made by Mr. Mirakhor in this regard.

The proposed quantum increase in the staff looks excessive for two reasons. First, its requirements in terms of the dollar budget are large. The staff estimates that the impact of the additional 183 staff years in FY2001 accounts for about $35 million. Other things being equal, this may lead to an increase in the rate of charge for the next fiscal year between three and four basis points. For the countries with a large exposure to Fund resources, this will lead to a significant increase in charges. Second, hiring and absorption of such a large number of new staff within only one year seems to be technically difficult, especially if due regard is given to diversity in recruitment. Also, it may not be efficient operationally, as new staff will inevitably need some period of training and adjustment, thus taking substantial time of the old staff.

On the basis of the aforementioned assumptions, and given that we do not have any well-articulated proposal for staff redeployment, the only way to address new initiatives with a less ambitious budget is to go to option 2; that is, to adopt a less aggressive schedule for implementing some of the initiatives.

I believe that such an approach can be taken with regard to the financial sector and standards and codes programs, as well as the initiative on enhanced surveillance. Speaking about the financial sector program, I agree with those Directors who think that the full FSAP framework and the extent of Fund's involvement can only be decided after the completion of the ongoing pilot program. The commitment to cover virtually all of the Fund membership with FSSA reports within a five-year period is an undertaking too big and too resource-consuming to be started without Board approval. Such a judgment is even more relevant in the case of the standards and codes initiative, where the requested staff increase is based on the assumption that in five years ROSC reports will be prepared for 180 countries; that is, for practically all Fund members. The costs to the Fund of this tremendous effort and its benefits in terms of strengthening the international financial architecture should be thoroughly weighed and a right balance found. I believe that an intermediate review of this exercise is needed after the first 20–25 countries are covered in order to decide on the scale of the future work.

As a preliminary judgment, I can go along with the required staffing for the PRSP/PRGF and enhanced HIPC initiatives. My understanding derived from the staff papers is that these resource needs are only tentative and may be corrected. Therefore, it is almost certain that we will need to return to this issue at some stage later.

I support full additional staffing for the initiative on the enhanced technical assistance and economic training. This is an area where forced savings have already been made and it is not possible to weaken this core Fund's activity, which is highly required by the largest part of the membership.

At this time I cannot make any conclusions on the additional resources needed for media and PR purposes pending the results of Board discussion.

In sum, on a preliminary basis, I favor the overall figure and a breakdown of the staff increase as suggested in option 2a; that is, 144 staff years for FY2001 and 197 for FY2003. This said, I agree with Mr. Portugal that new staffing for media and PR enhancements should be accommodated within this overall limit, mostly through an additional reduction of new staff for the financial sector and standards and codes initiatives. If we do not do this, and just add media staff increases to option 2a later, this will lead to a result not different from the original option 2, as indicated by Mr. Hendrick. At the same time, I believe that there is greater scope for staff savings within the financial sector and standards and codes programs than is envisaged under option 2a.

Finally, I will be prepared to support the supplementary budget for the current fiscal year provided that some moderation for the medium-term plans is envisaged, at least in line with option 2a.

Mr. Donecker made the following statement:

We are aware that rapid implementation of the new initiatives emanating from the IMFC meetings and supported by the Board have necessitated accelerated hiring of new staff and will require substantial additional staffing and related costs in the near future. We are also aware that in many areas of the Fund, the staff is working under considerable stress in trying to cope with an ever-increasing workload. The same is true for Executive Directors' offices. On the other hand, it is still too early to firmly commit substantial human and financial resources in some important areas where there are ongoing pilot projects. Moreover, we shall need to discuss the reviews of internal Fund procedures and the extent of future enhanced media and public relations work. The Fund, and, in particular, management, should give even greater emphasis to prioritization and the related possibilities for redeployment. Some colleagues have correctly stressed the fact that we should avoid overtaxing the absorptive capacity of our organization. I share the position of Mr. Cippà and others regarding the staffing needs of the PRGF and the enhanced HIPC Initiative. I question whether the requested staff positions reflect the appropriate division of labor between the Fund and the World Bank.

We are willing to fully support the supplementary budget proposed for the remainder of the fiscal year.

Regarding the planning options for major initiatives in the medium term, we would like to first see the additional analysis requested by Ms. Lissakers and Mr. Bernes, as well as the stress report, before coming to a judgment on staffing needs for FY2001. We would support a total increase somewhere between options 2a and 2b, amounting to between 114 and 84 new staff for FY2001, on the clear understanding that the additional staff positions would only be used in the priority areas. I agree with Mr. Kelkar that up to one third of those new positions should be filled on a contractual basis to provide more flexibility with regard to changing staffing requirements in later years. The budget discussion has not addressed the proper division between contractual and permanent staffing. We are not ready to commit ourselves yet regarding FY2001, as too much will depend on the outcome of the various reviews and pilot projects that are currently under way.

The Acting Chairman said that the Board had discussed the employment status of the staff some time ago. The Human Resources Department was reviewing the employment status of those staff in vendor status or long-term contractual status to see whether their positions should be converted into regular positions. Staff was typically hired on a fixed-term basis, and then it was decided at the end of that fixed period whether a particular employee's term should be extended. That provided some flexibility in deciding whether to retain a particular staff member at the end of the term.

Mr. Wijnholds made the following statement:

> I fully support what Mr. Cippà said and also agree with most of Mr. Donecker's views. There is clearly a problem, and I doubt whether we can come to a conclusion today, although I support the supplementary budget proposal. The problem is that the numbers have not changed under the new options. In particular, for the PRSP/PRGF, Directors will have to be able to explain to their authorities why increases are necessary and convince them that the Fund is not duplicating the work of the World Bank. We may appear to be getting into a Parkinson's law type of organizational development.
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> An 8 percent increase is bound to create a public relations problem, particularly in light of European parliamentarians' increasingly close scrutiny of Fund affairs. Some initiatives might have to be undertaken in phases to foster some political acceptability.

Mr. Oyarzábal made the following statement:

> I would like to thank the Managing Director for his statement on the Medium-Term Plans and Resource Estimates for the period 2001–2003, as well as Mr. Sugisaki's and the staff's additional information provided after the last Committee of the Budget meeting, together with the rest of the papers presented to the Committee and part of our discussions today. I believe special mention should be made of the paper on the Program Outlook Notes, which utilizes a new form of presentation, representative of strategic planning exercises. I found it particularly useful in analyzing the issues raised related to the medium-term budget because it is concise and clear when it states the mission, objective, and activities that must be realized in fulfilling priority initiatives for the Institution.
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> From my point of view, the exercise of dealing with the supplemental budget and with the medium-term planning have been characterized by trying to confront contradictions, greater requirements, greater country coverage with a staff that is clearly under substantial pressure and that, so far, has not received support with a need to produce results in the relatively short term. Following this line of thought, I welcome the forthcoming report, which discusses the levels of negative stress in the Fund. This must be confronted as quickly as possible. The staff is the backbone of this organization. The

proposals before us today do not indicate any decline in the work pressure; on the contrary, one could expect that work pressure would increase. It should be a priority that the workload be brought back to normal levels as quickly as possible. I coincide with Mr. Mirakhor's concern that the workload has also had a significant impact on Executive Directors' offices.

Recognition must be given to the significant efforts that have already been made for savings and internal redeployment, which have translated into efficiency gains and given more emphasis to areas of higher priority. Taking into account the possibility of diminishing returns on this line of action, I would recommend that efforts should still be maintained to obtain more benefits from this approach.

In general, this chair would have been inclined to support management and the staff's proposal along the lines described in option 1 but, considering rate of charge factors on program countries, as well as what one might term overly ambitious goals in the face of present workload and limited capacity for future savings, we would be inclined to favor option 2a, taking into account the following comments:

The activities envisaged for the financial sector assessment as well as those on standards and codes should be phased out in time so that, without affecting the total estimate envisaged in option 2a of the 144 for 2001 and 197 for 2003, actions could be initiated to enhance media and public relations and give more emphasis to enhancing technical assistance and training. I share Mr. Portugal's proposal.

On this last issue of technical assistance and training, I strongly believe that TA is of critical significance in all of the work priorities set out by the Interim Committee and this Board when relating to member countries that need to develop institutional capacity, as well as the need to develop ownership on policy issues. Traditional areas of Fund work require this type of support, which is greatly accentuated when dealing with financial sector reform, data compilation and dissemination, and the preparation to implement new codes and standards.

In my view, we should not postpone any further actions relating to media and public relations. In effect, efforts along these lines are not image oriented but much more importantly aimed at domestic audiences in a decision making capacity. Postponing action on this front can affect member countries' relationships with the institution if there is little understanding of what the Fund is and does, as well as lack of information to facilitate better-informed decisions and support for Fund initiatives. Although one can envisage that the results of these efforts could take some time, lack of action in this area might lead to greater contradictions and pressures than the ones the institution is presently facing.

Looking at the short term, I would be willing to support the supplementary budget of $9.3 million along the lines proposed to avoid overruns and cut activities in the short term. This would address the regularizing of the 30 staff vacancies that have already been filled because of the permanent character of their assignments. I feel this is the least that could be done under the present circumstances to allow the institution to fulfill its immediate responsibilities.

Mr. Kiekens made the following statement:

Today's discussion of the medium-term planning options is timely. I thank the staff for the papers, which help clarify the problems and the possible choices the Board should make.

I broadly agree with the comments made by Mr. Cippà and Mr. Wijnholds.

I would like to start by commenting on the medium-term vision for the Fund, as spelled out in the statement of the Managing Director. In the second part of my intervention, I will discuss the options for the budget proposed by the Managing Director. Finally, I will give my views on the supplementary budget for the current fiscal year.

As Mr. Prader has made it clear in the Budget Committee, the proposed medium-term planning options have to be seen with a number of qualifications as to their realism and completeness. One such qualifier is the proposal by the major shareholder of significant reforms of the Fund. It is too early to assess the outcome of these proposals. Nonetheless they may affect the functioning and the size of the Fund. Some directors have asked for areas where the Fund could reduce its present activities in order to find new initiatives. At some point in time the Board will have to make up its mind whether the Fund should continue to pursue both its traditional mandate of surveillance and its new role of promoting transparency and adherence by countries to internationally accepted codes and standards of best practices, with the ultimate aim that the market participants—i.e., economic research institutions and departments worldwide—have all the information available to make assessments about countries' policies as good as the Fund's assessments, if not better. This would result in a model similar to the one considered by New Zealand that full disclosure of information makes superfluous prudential supervision by the government. Another area where the Fund could theoretically cut its traditional activity is technical assistance. The issue is to evaluate the efficiency of resources devoted to development assistance by providing free-of-charge technical assistance from the Fund. All in all, I think that in the foreseeable future the Fund will continue on the path we have embarked on as a result of the reflection on improving the architecture of the international monetary system. In deciding how much budget resources to make available we should act with pragmatism and political realism, consistent with earlier principal decisions taken, but also with restraint to avoid engaging resources that cannot be justified by the Fund's highest standards of efficiency.

How does this affect my views on the budget options proposed by the Managing Director? My principal view is that the Board should provide the resources to the institution to enable the implementation of the initiatives that it has mandated. This consistency between Board initiatives and budget decisions would seem self-evident, but the reality is a large degree of denial by some part of the membership. By the same token, the principle that Board-mandated initiatives should receive the needed resources for implementation implies that, if there is only a pilot project, the Board should solely approve the resources required by the pilot project and not more. In this respect, the proposed options are problematic because they more or less preempt full acceptance of what is presented as a trial or experiment. Even in the downsized versions the implicit assumption is that almost all the pilot projects will become full-size initiatives. Therefore the compromise offer of reductions by 16 and 20 percent, respectively, and phasing in over a longer period in the requested resources for Financial Sector Assessments (FSAs) and standards and codes is acceptable only at first glance but ultimately is questionable.

Another issue is that for such initiatives as standards and codes as well as FSAs we need a budget presentation that is comprehensive also with respect to what is going on in the World Bank in these fields. Otherwise we will be making uninformed decisions about the required resources. Such information is, however, lacking. To be able to make an informed decision I would like to see more information.

I would like to reiterate that assessing the stability of the financial sector is a core mandate of the Fund, as is macroeconomic stability. This was a main conclusion of the external evaluators of Fund surveillance and the Board agreed on it. I therefore think that the FSSA should be the sole responsibility of the Fund and not one shared with the World Bank as is presently envisaged. The presently envisaged approach blurs responsibilities and makes the allocation of resources less transparent and less efficient. It would be difficult to allocate budget resources to an ill-conceived approach in this area.

I also think that there might be room for staff savings as a result of making transparent the resources the Fund is devoting to activities commissioned by outside fora not mentioned in the Articles of Agreement and—more importantly—by being very strict when such outside groupings ask for staff contributions on subjects that should be dealt with within the structure of the Fund. I ask the staff to give an estimate of the staff resources provided by the Fund for these external and not Board-mandated demands.

On the proposed options 1, 2a, and 2b. Option 1—i.e., 227 staff years—has been apparently withdrawn by management. Option 2a—management's proposed line of compromise implying the recruitment of new staff equivalent to 197 years over three years—would actually in the end come very close to option 1, once the proposed staff increases for media and public relations will be factored in. Option 2b—150 staff years—differs from 2a in that it eliminates enhancements to surveillance and provides for significantly less TA.

At this stage of the discussion and given the fact that the new options came out only yesterday, we would need more time for further reflection and consultations with our authorities to digest the new options and any additional information that comes out of today's meeting. Nonetheless I can already offer some comments.

Under option 2b, no additional staff is allocated for enhanced surveillance. This looks rather unacceptable. Lessons from the Asian crisis indicate that more attention must be paid to international capital flows and this undoubtedly requires more staff resources. Both option 2a and option 2b give 42 new staff years for the implementation of international standards and codes. This seems rather high since the Board decided that the Fund should be involved mainly in codes and standards that relates to its core business: i.e., transparency in fiscal and monetary affairs and Standards for the Dissemination of Statistical Data.

For the PRGF and the HIPC Initiative, all options include 53 new staff years as of next fiscal year. This is a 30 percent increase of the staff currently involved in ESAF. At first glance this looks rather high since we agree that the Fund should not develop activities that belong to the responsibilities of the World Bank. However, 53 new staff years correspond to one additional full-time staff member for each very poor country. This could be a very productive allocation of resources if the additional staff can significantly help improve policies in poor countries. I think this will indeed be the case. But in light of the reluctance of other directors, I believe it could be useful if the staff provides us with some additional justification that would enable directors to obtain more easily the support of their authorities.

I agree with Mr. Rustomjee that technical assistance can be very valuable in helping poor countries acquire the skills to better manage their economy. For the poor countries it would probably have been more useful if the enhanced HIPC Initiative would have been marginally less generous in order to provide them instead with more technical assistance.

I appreciate that management has made a serious effort to meet the concerns of most directors with respect to staff diversity and nationality distribution by attaching language to the MD's statement. The statement outlines the need for an international staff of the Fund as stipulated by the Articles of Agreement and the need for monitoring the evolution of the composition of the staff. We realize that it will be difficult to achieve this objective and that it can be only a broadly successful objective. Such an understanding that goes beyond the ritualistic and merely symbolic mentioning of staff diversity but instead is monitored by management and the Board is essential for our eventual acceptance of the medium-term budget outlook.

We agree in general with the text on "geographical balance and diversity in recruitment" as contained in Attachment II but have one additional observation: the text is a bit on the euphemistic side. It constantly refers to the "progress achieved with respect to diversity in general and geographical balance in particular." However, in this way it hides the reality of unequal distribution of the huge increase in Fund staff since 1990. We just want to see a correction of this adverse trend in the international character of the Fund and we don't want the currently planned staff increase to result in a repetition of the same experience.

Like Mr. Cippà and Mr. Wijnholds, I agree with the proposed supplementary budget for this fiscal year.

Mr. Himani said that Directors had not suggested that the World Bank do more but that the Fund should not step into the World Bank's business or vice versa.

Mr. Kiekens agreed with Mr. Himani's views on the matter. Regarding the proposals on staff resources, options 2a and 2b appeared to go in the right direction, he continued. The proposals concerning the PRGF suggested using 53 people in 2001, which appeared to be appropriate. On the financial sector initiatives, the figure for international standards and codes appeared rather high, whereas the figures for enhanced surveillance under option 2b seemed too low. The major topic under enhanced surveillance was international capital flows and financial market supervision. An enormous cost to the Fund had been the inability to correctly assess the impact of international capital flows and the functioning of international financial markets. It might seem shortsighted to suggest cuts in that area, but the staffing associated with standards and codes appeared to be high. However, Fund staff was fungible, and it was important to establish reasonable numbers on each of the new initiatives without making a judgment in detail.

Management's commitment to develop better geographical diversification of staff recruitment was appreciated, Mr. Kiekens continued. The supplementary budget was acceptable.

The Acting Chairman said that management had produced program outlook notes on the staffing needs for the enhanced HIPC Initiative and the PRGF, but would look into producing more information on the need to have one staff year per country. The financial sector assessment program was a joint program with the World Bank and an important part of the Fund's surveillance work.

Mr. Kiekens said that if the Fund were to take over financial sector assessments, he would support giving all of the necessary resources and bringing in the relevant staff of the World Bank to work on it.

Mr. Donecker commented that it was important to respect the division of labor between the World Bank and the Fund in such matters, or the Fund could end up being responsible for micromanaging financial institutions in developing countries, among other risks. Perhaps the World Bank had been weak in that field in the past, but financial sector assessments were an important and essential part of its work and the Fund did not want to do the full job.

Mr. Kiekens responded that the World Bank should remain involved in the individual banking restructuring issues. However, there was not a clearly defined division of labor between the World Bank and Fund; instead, the two institutions often ended up doing the same work, which caused some problems.

The Acting Chairman pointed out that the strategy paper had clearly stated that the Fund would not get involved in any areas, such as the social sector, that were under the World Bank's mandate. The PRSP, for example, would primarily be relevant to the World Bank. However, it also had some macroeconomic content, particularly as any fiscal expenditure related to poverty reduction had to be compatible with the overall macroeconomic framework. In that sense it was a cooperative effort. Furthermore, the production of the strategy paper itself was the responsibility of the government. The Fund would not employ new staff to do work in the field that was assigned to the World Bank.

The Fund and Bank Boards had recently decided that it was desirable to accelerate the enhanced HIPC Initiative, particularly for those countries already getting HIPC debt relief, the Acting Chairman noted. The staff was finalizing a paper for a few countries that were candidates for that enhanced HIPC Initiative. The paper was heavily focused on structural issues, such as what kind of poverty indicators should be looked at and what kind of fiscal measures were being implemented, as well as the macroeconomic framework. All of the information was provided by the countries and the World Bank, although the Board paper was largely being prepared by the Fund. The question was whether the Fund should do nothing until the other institutions did their work. The Fund was confronted with such situations every day. The Fund did not have to do the work of other institutions, but it could help to expedite the process.

Ms. Lissakers made the following statement:

> We accept the premise that a number of the new initiatives adopted by the Board will mean a net increase in the workload of the Fund and therefore will require some net addition to staff. However, the numbers proposed by management are much too large and too front-loaded. The key question is the

distribution of work between "old" and "new" activities. That in part goes to the question of how we define "new." We continue to believe that most of the so-called "new" activities are really refinements or modification of old activities; i.e., ESAF to PRGF; regional surveillance; codes and standards; public relations to some extent (this remains to be discussed by the Board). Only the FSSAs seem to be largely a wholly new task for the Fund. The budget options provided to date do not fully acknowledge this fact.

Rigidity in the proposed staffing increase for work related to PRGF/PRSP is unresponsive to the positions taken by many members of the Committee and the Board that this is a reform and reshaping of a preexisting work effort, not a wholly new area of endeavor. Furthermore, there is no sign that management and staff have absorbed the Board's message that with the Bank now in the lead on this endeavor, the Fund's overall role should be smaller, not larger. We acknowledge that the expedited schedule for taking a large number of countries simultaneously to decision points does place significant new demands on the Fund and would see scope for some staffing increase to meet these. However, in the absence of practical experience on which to base a meaningful assessment of staffing needs going forward, we are not prepared to support an increase as large as that proposed in all of the options.

So far there has been virtually no exploration of redeployment options, no effort to follow up on the useful rationalization of suggestions provided by the outside surveillance evaluators, no expectation of savings from the review of the internal review process or other efficiency gains. On this last point, I note the comments by our ombudsperson in last year's and this year's report that much of the job-related stress in the Fund is a consequence of poor management practices. Last year's report noted that "a number of outstanding economists have indicated that one of the major reasons for leaving is that they feel they are not being fully utilized." This year's report notes that "staff and employees are often frustrated by the insistence on antiquated work practices because higher level managers cannot adapt to change ... senior managers are often too out of touch with modern work practices to recognize a good idea when it comes along."

We support Mr. Cippà's observation that, based on the summarized findings of the Stress Working Group, it is disingenuous for management to continue to point to staffing increases as the sole remedy to negative stress in the Fund. Rather, these findings (which should have been distributed to us in full ahead of these discussions) point to such things as lack of prioritization, poor managerial practices, and overly bureaucratic procedures as important contributors. It is precisely these phenomena that we are asking management to address in a direct way and that we have been asking them to address for several years now. This Board has indeed asked the Fund to take on new areas of responsibility, but we will not be made the scapegoat for management's failure to manage. This further highlights the need to undertake an external review of the Fund's overall internal procedures, as called for by Mr. Collins and other Directors today, as well as in the joint statement of 10 Executive Directors in March 1999.

The additional staffing options just provided by the staff are very useful. They help us to assess trade-offs among new activities. We now need to take the alternative scenarios one step further to see what the traditional activities would look like if all new initiatives were carried out on the time frame assumed under management's original staffing proposal, but with the staffing levels that would prevail in options 2a and 2b. With this additional information, the Board would have before it the full array of choices and trade-offs among different staffing levels, different approaches to implementing new initiatives, and modifying traditional activities.

Supplemental budget: in the absence of any effort to assess the Fund's resource needs along the lines described by this Chair and others, we do not have any sound basis on which to judge the merits of the proposal. Once the medium-term outlook is clarified, we can revisit this subject, but ahead of such clarification, we would oppose the request.

Mr. Rustomjee made the following statement:

The Fund has been an effective force in international monetary affairs and in assisting its members to persevere with adjustment programs. It has consistently striven to successfully shoulder its responsibilities, despite resource constraints. A continued increase in the workload without the commensurate increase in resources has often meant excessive work pressure and stress on the staff. The Fund's effectiveness in its activities could be seriously hampered if the situation were to continue unabated.

The vastly changed circumstances in the world economy and the international monetary system have created important challenges which the Fund has to face. The new major initiatives include important undertakings aimed at helping low-income members where the problems of widespread poverty and heavy debt burden remain as onerous as ever. They also embrace measures that can enable the Fund to exercise a greater degree of influence and surveillance over the economic and financial policies of members. In a crises-prone global environment, this, indeed, is an essential task. To meet these additional challenges, while continuing to perform effectively the existing functions, the Fund must be adequately equipped. This is why this Chair was originally prepared to accept the original proposal for an increase of 227 staff years over the coming three years, which, unfortunately, still did not provide an opportunity to alleviate the work-related pressure and stress.

We still favor this option. If essential, we will reluctantly support option 2a of the revised proposal. We are against option 2b because it would leave the Fund's hands tied when the tasks to be faced are so demanding and challenging. The envisaged reduction under this option not only reduces the staff increase for the three major new initiatives but also, more importantly, runs counter to the objective of strengthening surveillance. It also allocated no new resources to postconflict assistance, an issue which, as Mr. Alosaimi notes, is expected to grow in terms of demands placed on our staff. Given the need to start the new initiatives promptly, we also support the proposed supplementary budget for FY2000.

On the issue of technical assistance, I would firstly like to stress that, as with many Directors who have commented on this in the past, our Chair ranks technical assistance, particularly to the poorest members of the Fund, as unambiguously among the highest rates of return per dollar spent by the Fund in member countries. Technical assistance represents for these members, the long-term dimension, the future investment by the Fund in the member's own future. In fact, it fits most closely with what Mr. Milleron reminds us must be the medium-term framework in which we conduct our discussion this afternoon. We therefore want to go on record as expressing our strongest possible concern at the minimal level of additional technical assistance being considered in option 1. This level is completely inadequate. Simply in the context of our decision to increase our involvement in poverty reduction, we would have expected the additional technical assistance to this major initiative alone to have been frankly, vastly greater than is being proposed. As I mentioned in my intervention on PRGF and PRSP operational issues, PRSP and PRGF countries need much greater technical assistance, and the level proposed here is a recipe for quite the opposite of success. I will not prejudge the outcome of the important summit in Libreville this weekend, but I think that substantially increased Fund technical assistance will be an important request of African heads of state at the Summit. The Fund's approach to poverty reduction will not succeed on the basis of current levels of technical assistance being allocated for poverty reduction. If Mr. Mirakhor feels that his minimum level of resources issue has not been taken to heart by management and the staff—and the numbers suggest that he is right—I feel the same way in regard to technical assistance, and on this issue, Chair, I am convinced that in the next two to three years, it will be shown that it is not the heart but the mind that is speaking on this issue.

Chairperson, we talked of unidirectional and bidirectional earlier. It is in fact a tridirectional set of issues, because ultimate responsibility for failure or success with poverty reduction will lie, as it always has, with the countries concerned. It is a pity that in the only area where we could have directly taken up the challenge of giving substance to this third branch in the poverty reduction puzzle—that is, technical assistance to the members concerned—we

> have been so, to borrow a word used by Mr. Milleron this afternoon, "miserable."
>
> Penultimately, I would like to come back to an issue raised by Mr. Mirakhor, on the issue of pressure on Executive Directors' offices. Perhaps no one can better know the character of this pressure than those offices which represent a large number of members, particularly where these members are program-intensive or are in protracted arrears, or are in postconflict mode, or are potential candidates for the HIPC Initiative, or, heaven forbid, some combination of the above. If we are truly speaking of establishing circumstances which can make the workload of the institution in the medium term realistic, manageable, successful, if we are truly talking of empowering the weakest members to own their programs, to effectively elucidate their needs, and to efficiently adjudicate among competing priorities in addressing poverty, one good place we can start is a closer look at the resources of Executive Directors' offices. I therefore fully support the suggestion made by Mr. Mirakhor and by Mr. Alosaimi—and others in the past—that we consider this issue more formally.
>
> Finally, on the Fund's recruitment efforts, we appreciate the endeavors so far to achieve geographical balance and diversity. However, more effort will still be required to increase the representation in the staff of those regions that are underrepresented. In this regard, we continue to believe that this could be attained without necessarily resorting to quotas but by applying other parameters which need to take into account the number of member countries in a given region.

Ms. Lissakers commented that she agreed with Mr. Rustomjee that it would be better for the Fund to devote technical assistance resources to helping countries undertake work themselves, especially in areas such as public outreach, which would be crucial in HIPC Initiative and PRGF countries. The main interaction in that regard should be between governments and civil society. Although countries would require some external support, the Fund should not be talking directly to groups and communities. Governments had to do the work themselves to make poverty reduction feasible and sustainable in the long run.

The Acting Chairman agreed that countries themselves were responsible for conducting dialogue with citizens and various groups, and the World Bank would play an important role in that. The question was whether the Fund should play no role at all. There could be questions about the desirability of fiscal spending in the context of macroeconomics and the Fund could be criticized for not being involved. PRSPs would also come to the Board for endorsement.

Mr. Kiekens agreed with Mr. Rustomjee and Ms. Lissakers that the Fund's most efficient investment was to help countries manage their own affairs better. In that respect, it would have been better for the Fund to make a trade-off between marginally less debt relief and a substantial amount of technical assistance in a budget-neutral way for the creditor countries. The many billions of dollars involved in debt relief could be reduced if marginally more technical assistance could be provided. The Fund could set up channels under which countries could direct part of their ODA resources to the Fund for technical assistance. Japan was one of those countries convinced about the need for that, and more countries could be convinced.

Mr. Lehmussaari made the following statement:

At the outset, let me state that I am in general agreement with the views presented by Mr. Cippà, and I also find much merit in the arguments put forth by Mr. Collins and Mr. Kelmanson in their statement and other speakers who are uncomfortable not only with the current budgetary proposals but also with the budgetary process more generally.

This exercise gives further evidence to the notion that transparency regarding budgetary process is lacking. I truly believe that the only way around this problem is to put the budget and the work program in a closer context. An external review of the Fund's internal procedures could be perhaps one way forward and which might help facilitate more transparent budgetary practices.

Although I appreciate the effort to come up with alternative proposals at such short notice, I am reluctant to go along with what I still consider somewhat excessive expansion of staff resources given the information at hand. However, I can go along with the proposal regarding supplementary budget.

Having said this, I recognize that the major initiatives set in force by the membership will affect the Fund's work program and will have resource implications.

At the same time, however, I put high priority on retaining the Fund as a lean and efficient organization without being nostalgic about it. But it is impossible to keep the Fund lean without putting efficiency and prioritization at the center of the budgetary equation and, by prioritization, I mean prioritization of all new and existing activities. The focus should continue to be on activities that fall within the core mandate of the Fund.

Regarding the staffing needs explained for carrying out the PRGF and enhancing the HIPC Initiative, I still fail to see that resource needs of the magnitude envisaged will materialize as quickly as presented. It is still unclear to me, and to my authorities for that matter, what the division of labor between the World Bank and the Fund in this field will be in practice. There is also the question of the capacity of the HIPC Initiative countries to pen the PRSPs.

Regarding work with standards and codes, as well as with financial sector stability, much of the work is still in an exploratory phase and it is premature to be conclusive about the medium-term resource implications. Here I join the other speakers who have highlighted the need to discuss results of the ongoing FSAP pilot project before reaching any affirmative conclusions regarding the required resources.

Mrs. Hetrakul made the following statement:

At the outset, I would like to thank the Managing Director, Mr. Chairman, and the staff for preparing the notes on medium-term planning options.

First, on the issue of supplementary budget, like Mr. Mirakhor and other Directors, we support the request for the supplementary budget of $9.3 million. The supplementary budget is urgently needed to allow an additional 30 staff positions to replace the exceptional and unsustainable use of vacancies, mostly related to the start of major initiatives.

On the medium-term planning options, our chair has several concerns on the proposed increase of 227 staff as in option 1, which, in our views, will place a heavy burden on the Fund on a permanent basis. We wonder whether we can scale down, in varying degrees, some of the work without jeopardizing our main objectives or adding undue burden on the staff load. Like Mr. Portugal and other Directors, we feel that we may be able to scale down staff in the financial sector assessment as we are still at the stage of pilot project to be concluded in the future.

The Managing Director and the staff have now prepared the revised proposal. Even though the management and the staff's preference is still with option 1, yet they are prepared to accept option 2a. Having carefully assessed the proposed additional resources for each initiative, we could go along with option 2a with slight modifications, as can Messrs. Kelkar, Hendrik, Portugal, and Oyarzábal.

First, the total additional staff needed both for FY2001 (144 years) and FY2003 (197 years) should be the maximum, covering the additional staff needed for enhanced media and public relations activities. Second, we developing countries always rank technical assistance and training highly. Therefore, we would like to keep the additional staff needed for enhanced technical assistance as proposed in option 1; i.e., 19 staff years for FY2001 and 21 staff years for FY2003. Third, the number of additional staff in other initiatives need to be prioritized and redistributed accordingly, taking into account today's Directors' suggestions. Management should know best how to prioritize this. We are not in the position to micromanage this.

Mr. Woolford made the following statement:

It is not surprising, given the expansion of Fund responsibilities into areas beyond the traditional core, that management is seeking additional resources. Two areas that will require additional resources are the enhanced HIPC Initiative and PRGF and technical assistance. Both of these are important and should be appropriately resourced. However, Ms. Lissakers raises a good point about whether some of these initiatives are actually new or not, and I look forward to the staff's response.

Like other Directors, I question the need for resources outlined for the financial sector assessment program, and believe the FSSA should only be finalized after the Executive Board has made an assessment of the pilot project results. I also agree with the point made by Ms. Lissakers that the problem is one of information asymmetry. Like Mr. Collins, I do not think that the Fund should micromanage, but there is a need for explicit information that demonstrates real efforts at savings and specific resource requirements.

We deliberately have stood back over the last couple of years from opposition to regular budget increases on the basis that management would introduce certain budget procedures and that an external review of the Fund's internal procedures would be conducted. It is disappointing that there has not been much progress in either of these areas. Partly because of this, we cannot support any of the options today and support the call for more information as outlined by Mr. Bernes, Ms. Lissakers, and Mr. Collins, amongst others.

Mr. Hinata made the following statement:

Like other speakers, this chair would like to thank management and the staff for their efforts in presenting options 2a and 2b as alternative plans for the medium term in response to requests of Executive Directors in recent meetings.

On the other hand, I could find no clear analysis or picture in all the related staff papers on the possibility of further implementing measures for reductions in both staff and workload, although savings and redeployment of staff over the past few years were mentioned. In addition, the alternative options resulted from trimming the size of the initiatives rather than improving Fund efficiency, something this chair has emphasized the need for. Therefore, I share the view of those Directors who expect the staff to examine possible room for trade-off through reprioritizing work. In this connection, I welcome that the review of the internal review process is in an advanced stage, in accordance with the Managing Director's statement. This chair hopes that the findings of that review will contribute to a more effective and efficient workload throughout the Fund.

Concerning the supplementary budget proposal for FY2000, this chair supports the proposed decision relating to the Administrative Budget for FY2000.

Regarding the issue of a staff increase for the medium term, this chair basically favors a plan for fewer staff increases in the hopes that it will provide incentive for more efficient and effective work. This chair would like to reserve judgment as to which alternative it favors until at least some additional information is provided, including the possibility of efforts toward redeployment and savings of staff.

Lastly, we welcome management's commitment to the issue of nationality diversity. We hope to see significant progress made in this area.

Mr. Collins said that he would like to see some more information and options.

The Director of the Office of Budget and Planning said that no particular amount of staff resources had been set aside under any option to address the stress workload issue. There was also no allowance for preparedness, so that if there was another crisis, the Fund would again have to resort to increases in workload, as has happened in the past. There was, however, some indirect relief with respect to the stress situation under option 1, because some of the extra workload associated in particular with technical assistance for the pilot projects would be distributed among the new staff, thus helping to reduce the work pressures. The staffing increases granted in 1999 had improved the major workload indicators, although that relief had been only temporary because of the subsequent increase in workload. It was hoped that there would at least be no further deterioration, and even, that there could be some improvement.

A major effort to reduce the stress situation needed to be undertaken, in light of the stress report, the Director continued. The report did not propose simply adding resources to address the problem, but suggested changes in personnel management. Nevertheless, there would be some indirect repercussions on resource requirements for training and similar actions that would indirectly address the stress situation.

Regarding Directors' concerns about committing resources to the financial sector work and to the standards and codes initiatives before completion of the pilot studies, the staff had, in the interest of planning, been trying to show what would be required if those programs proceeded, the Director explained. For the financial sector assessment programs, about 12 pilot cases would be undertaken and discussed in May or June 2000. An annual rate of about 20 assessments per year would be reached by the end of the pilot stage. Options 2a and 2b envisaged about 21 assessments per year, which was not a significant increase. Some Directors had suggested in bilateral discussions that it would not be appropriate to stop the pilot exercise and prepare the evaluation when only 12 cases had been completed; thus options 2a and 2b proposed remaining at the current level, or at a slightly higher pace. The proposals for the standards and codes and the surveillance initiatives represented an increase, because the pilot project level was slightly lower than in the financial sector area.

Regarding the request by Ms. Lissakers and Mr. Bernes for more options that reflected the possible trade-offs more clearly, the staff was using a new approach to planning known as a project approach, the Director reported. That approach had made it easier to evaluate the new initiatives for a number of reasons, but it so far covered only a select number of relatively new initiatives. It was much more difficult to prepare a full program approach for the entire range of activities in the Fund. The staff would try to work on that, but in the meantime there were a number of indicators that could be used, including how much the typical Article IV consultation absorbed in terms of staff time, how much the typical Standby Arrangement cost, and what the typical ESAF-supported program required in terms of staff resources. The experience so far had been that an active ESAF country required about seven to eight staff years. The request for additional staff for the PRGF related only to work not covered by the HIPC Initiative and ESAF, which amounted to about one staff year per active country.

The staff representative from the Office of Budget and Planning said that technical assistance activities and resource estimates were shown in the staff papers under the enhanced technical assistance program as well as within some of the new initiatives. There was a small component of technical assistance attached to the estimates in the PRSP and the PRGF. For the enhanced HIPC Initiative, there were two additional staff years in year one, and the estimates for the international codes and standards initiatives included four additional staff years for technical assistance. Directors' comments about the strength of technical assistance and the objectives of the new initiatives would be taken into consideration as the estimates were reviewed.

The budget and the supplemental budget would have an impact on the rate of charge, although only through a decision of the Board, the staff representative noted. There would be a separate opportunity in April 1999 for the Board to review the net income targets, the rate of charge, and all of the factors that needed to be taken into consideration in that regard, of which the budget was only one component.

Mr. Collins pointed out that the requested increase of 1.6 percent for the supplementary budget was more than the proportional increase in the staff ceiling, which was about 1.1 percent. Would there still have been a supplementary budget had management not been asking for 30 extra staff?

The staff representative from the Office of Budget and Planning responded that when the midyear review had been in process in October 1999, the staff's estimate for the outturn had been about $4 to $5 million above budget. That was slightly under 1 percent of the total budget. Had no other actions been taken by the Board, the staff could have gone back to departments and asked them to reduce their activities in order to stay within the budget. However, at a meeting on November 1, 1999, the Budget Committee discussed accelerating the PRGF activity, which brought the supplemental budget to $9.3 million. It then appeared difficult to stay within the budget by reducing or canceling some missions or other activities with an overrun of that magnitude.

Ms. Lissakers said that it was still unclear whether the staff would come back to the Board with alternative scenarios based on the redeployment and rearrangement of current activities.

The Acting Chairman thanked Directors for the frank and lively discussion. All but one or two Directors had said that they were ready to adopt the additional budget for the present fiscal year, which was important. The discussion had shown that Directors shared management's concern about excessive stress of the staff, even if the impact that that concern would have on budget decisions was uncertain. Management recognized the need for further information and possible scenarios that could convince national authorities of the need for the staffing increase. The staff would work hard to provide as much quantification as possible; it was important to have figures solidly rooted in reality.

Directors' priorities were diverse, the Acting Chairman commented. There were not only differences in the size of the effort needed for the financial sector initiatives, but also on the pace of their implementation. There were differences regarding technical assistance, although there was a strong majority in favor of at least the staffing proposed under option 2a, and several Directors suggested that even that was not sufficient.

Management could not suggest any numbers for the external relations increases, as the Board had not yet discussed the substance of the initiatives, the Acting Chairman said. There was not expected to be any material circulated on those increases in time for a decision before the end of January 2000. By that time the Board could consider the medium-term plan and resource estimates for all of the other sectors of the Fund, making clear that there would be future agreement on creating a few positions for an enhanced media and public relations strategy. Those positions would be added at the time of the Board's next budget discussion, if Directors agreed to them.

It was not possible to offer concluding remarks because the discussion had not yet concluded, the Acting Chairman commented. Instead, it would be preferable to quickly provide Directors with as much further information as possible. It was difficult to define the proper phasing of priorities according to what was technically feasible and the requirements and readiness of the membership, as some countries were not enthusiastic about being phased into the initiatives. After Directors had considered the new information, there would be a further meeting where conclusions would be drawn.

Mr. Collins asked whether the next options would merely shuffle the numbers on the table or take into account other activities that might be downgraded to release resources for the new activities.

The Acting Chairman replied that it was important not to make the reasoning too difficult, nevertheless taking into consideration the request of Ms. Lissakers, Mr. Collins, and others for further clarification and information about the staff's evaluations. For example, it would be premature to talk about staff stress, because it would take some time for solid conclusions to be drawn from the report. It was preferable to remain close to the present methodological framework, enriched with new numbers produced by the staff, if there was a conclusion that some phasing was possible.

Ms. Lissakers suggested that the only way to reduce the total cost of the staffing increase was to slow down the implementation of various initiatives. She and Mr. Bernes and others had requested that the staff assume that the initiatives could be carried out at the pace suggested in option 1, but with the staffing levels proposed in options 2a and 2b, to see what the consequences of postponing the increase of 52 staff years would be. Simply presenting current options would not advance the debate much.

The Acting Chairman responded that the staff would try to advance the analysis as requested.

Mr. Mirakhor said that if the ultimate purpose of codes was to allow the private sector to obtain information on countries, as suggested by Mr. Kiekens, then another scenario could also be envisaged. It would be interesting to know what would happen to staffing requirements if the Fund did not undertake the initiatives on international standards and codes, the financial sector assessment, and enhanced surveillance, but let the private sector pay for them, rather than cutting back on traditional activities. The resources foreseen could then be transferred to the ESAF Trust, the SCA-2, and the World Bank, which would do most of the work, whereas the Fund looked at the macroeconomic framework.

The Acting Chairman called on the Board to bear in mind that the work of the staff must be organized to realistically respond to the concerns of the Board.

Mr. Oyarzábal said that he supported Mr. Mirakhor's suggestion. If the Board could not define priorities to help guide the staff, then it should look at extreme scenarios and revise the view of the Fund.

The Acting Chairman said that management's mission was to try to respond to the priorities of the membership, but it was important to have consistency and resources to do that.

Mr. Donecker said that the Board was following the expressed wishes of the national authorities, as set out by the Interim Committee.

The Acting Chairman urged the staff to work quickly in view of the brief lapse of time between the medium-term exercise and the budget date. Directors were asked to formally take the decision appearing on page 4 of EBAP/99/144 on the budget.

Ms. Lissakers asked to be recorded as voting against the supplemental budget.

Mr. Collins said that he would like to be recorded as abstaining.

The Acting Chairman said that on that basis, the decision was approved.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/00/3 (1/10/00) and EBM/00/4 (1/12/00).

4. EXECUTIVE BOARD COMMITTEES—NOMINATION

The Executive Board approves the nomination by the Managing Director of Mr. Lehmussaari for the vacant positions on the Committee on Administrative Policies and the Committee on Executive Board Administrative Matters, as set forth in EBD/00/1 (1/6/00).

Adopted January 10, 2000

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/00/3 (1/6/00), EBAM/00/4 (1/7/00), and EBAM/00/5 (1/7/00); by Advisors to Executive Directors as set forth in EBAM/00/4 (1/7/00) and EBAM/00/5 (1/7/00); and by an Assistant to Executive Director as set forth in EBAM/00/5 (1/7/00) is approved.

APPROVAL: July 6, 2001

SHAILENDRA J. ANJARIA
Secretary