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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 96/55

10:00 a.m., June 7, 1996

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Executive Board Attendance

M. Camdessus, Chairman
A.D. Ouattara, Acting Chairman
S. Fischer, First Deputy Managing Director
P.R. Narvekar, Deputy Managing Director

Executive Directors	**Alternate Executive Directors**
A.A.Al-Tuwaijri	S.M. Al-Turki
	A. Fayolle
L. E. Berrizbeitia	V.J. Fernández
	J. Guzmán-Calafell, Temporary
I.D. Clark	R. Rainford, Temporary
B.S. Dlamini	
H. Evans	
K.P. Geethakrishnan	
E.R. Grilli	N. Coumbis
J.E. Ismael	
D. Kaeser	
A. Kafka	A. Calderón
W. Kiekens	
	H.A. Barro Chambrier
K. Lissakers	B.S. Newman
H. Mesaki	
A. Mirakhor	M. Daïri
C. Saito	A.G. Zoccali
S. Schoenberg	
A.S. Shaalan	
	B. Andersen
	A.V. Vernikov, Temporary
E. L. Waterman	J.-H. Kang
J. de Beaufort Wijnholds	Y.G. Yakusha
Zhang Z.	Han M.
	Song J., Temporary

R.H. Munzberg, Associate Secretary
G. Walton, Assistant
S. Bhatia, Assistant

Also Present

Administration Department: I.E. Prebensen, Deputy Director. African Department C. Brachet, Deputy Director; A. Tahari. European I Department: H.M. Flickenschild, E.J. Zervoudakis. External Relations Department: S.J. Anjaria, Director, C. Hellemaa. Fiscal Affairs Department: T.M. Ter-Minassian, Deputy Director. the Fund Institute: A. Lanyi, Deputy Director. Legal Department: H. Elizalde, J.L. Hagan, Jr. Middle Eastern Department: P. Chabrier, Director; N.A. Chalk, T. Enger, Z. Iqbal, A. Jbili, E.K. Martey, V. Treichel, C. Sassanpour, V. Sundarajan. Monetary and Exchange Affairs Department: M.D. Knight, Deputy Director, H. Mehran. Policy Development and Review Department: J.T. Boorman, Director, T. Leddy, Deputy Director; L.D. Dicks-Mireaux, R.H. Nord, P.J. Pujol, S.M. Schadler. Research Department: R.D. Haas. Secretary's Department: W.S. Tseng, Deputy Secretary; K.S. Friedman, A. Mountford. Statistics Department: J.B. McLenaghan, Director. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; B.E. Keuppens. Western Hemisphere Department: C.M. Loser, Director; B.C. Stuart, Deputy Director; P.D. Brenner, L.H. Duran-Downing, A.S. Linde, F. van Beek. Office of the Managing Director: J.A. Quick, Personal Assistant; E. Brau, D. Burton, A. Coune, L.A. Wolfe. Advisors to Executive Directors: M.A. Ahmed, R.F. Cippa, A. Cserés, T.K. Gaspard, K.M. Heinonen, G. Iradian, A.R. Ismael, J. John, J. Justiniano, R. Kannan, M.H. Mahdavian, J.C. Martinez Oliva, M.F. Melhem, H. Mori, S.N'guiamba, Y. Patel, M. Petrie, M. Sobel, R. von Kleist. Assistants to Executive Directors: R.D. Bessone Basto, A.G. Cathcart, A.L. Coronel, J.A. Costa, D.A A. Daco, J. Dagustun, J.C. Estrella, S. Fukushima, A. Galicia-Escotto, C.M. Gonzalez, D.S. Hakura, M.A. Hammoudi, R.J. Heinbuecher, T. Issataev, P. Jilek, A. M. Koulizade, T.-M. Kudiwu, G. A. Kyriacou, N. Laframboise, B.M. Lvin, I. Moon, J. Roaf, S. Rouai, A. Ruocco, S. Simonsen, T. Sitorus, V. Trivedi, L.B.J. van Geest, A.-G. Yakub, E. L. Zamalloa.

1. REPORT BY MANAGING DIRECTOR

The Chairman said that he wished to report on his recent travel to the Latin American region. The first country visited had been Paraguay, where he had held discussions with President Wasmosi and key political and labor union leaders. In spite of the backdrop of recent political confrontation with segments of the military, which had been resolved without bloodshed, the discussions on Paraguay's economic reform program had been open and productive. Both the authorities and other observers had been impressed by how quickly and forcefully the international community, most notably Paraguay's MERCOSUR partners, had supported the preservation of democratic institutions. A great deal of time had been spent pressing the authorities and business and labor leaders to move forward with the needed reforms. With the lifting of trade barriers and the lowering of trade taxes by its larger neighbors, Paraguay risked losing some of the advantages it enjoyed in regional trade. Moreover, it had become imperative to begin privatizing the large state-owned enterprises, to break away from the practice of backward wage indexation, and to reform the pension system. In addition, the banking system was in need of modernization, and banking operations needed to be made more transparent. Congress had already passed a sound banking law, with considerable involvement by the Monetary and Exchange Affairs Department, and the President had been urged to sign the law as soon as possible, so as not to retard the process of reforming the banking system. Finally, the authorities had expressed a willingness to make a bilateral contribution to the continuation of the Enhanced Structural Adjustment Facility (ESAF).

In Bolivia, there was widespread public support for the government's program of macroeconomic stabilization, the Chairman stated. The hyperinflation of the mid-1980s had been overcome, but the authorities would need to adhere to the prudent monetary and fiscal policies of the ESAF-supported program to keep inflation on a downward path. A large increase in private investment would be needed to put the economy on a higher growth path than the 4 percent a year achieved in the previous few years. There had also been good progress in the privatization program for public enterprises. Investments in electricity and telecommunications had already begun, with the petroleum company soon to be capitalized. A segment of the privatization funds was to be used to capitalize a pension scheme.

Progress in creating a consensus for other essential structural reforms had proceeded more slowly, the Chairman continued. There was a particular need to accelerate the implementation of pension, education, health, and judicial reforms, but the road ahead would not be easy, as the ideologically strong teachers' unions were continuing to resist certain aspects of the education reform.

Some queries had been raised as to Bolivia's eligibility for the multilateral debt initiative, the Chairman added. It was emphasized that the initiative was still very much in a formative phase, and for that reason Bolivia's eligibility remained an open question. It was to be noted that Bolivia had made good progress toward debt sustainability, but remained vulnerable to external shocks.

In Peru, he had spent an afternoon working with the president himself on a housing project. President Fujimori was known among his supporters for his interest in participating directly in tasks that could improve the living standards of the Peruvian population. The occasion of the visit also permitted discussions on the country's reform program. The authorities had become increasingly concerned about the decline in economic activity following a period of rapid growth in 1994 and the first half of 1995. There were indications that a recovery was beginning, and the authorities were stepping up their fight against tax evasion and had reduced public expenditure in the first few months of 1996. They were also moving ahead with the so-called Brady operation and had asked for Fund support for a new Paris Club rescheduling. The authorities were facing opposition to their privatization program, particularly from the petroleum company, but had reaffirmed their intention to move the process ahead.

Although there was a broad consensus for current economic policies, representatives of the business community were concerned about the pressing issue of employment generation, the Chairman said. Relatively high labor costs in Peru, together with the recent currency appreciation, had undermined competitiveness; for that reason it would be essential to reduce the size of the state, foster the decentralization process, and strengthen the institutional framework. Representatives from the private sector felt that the dialogue with the government was not as fluid as it had been previously, but the president was ready to push ahead with the needed reforms.

The last of the countries visited was Venezuela, the Chairman said. During the visit, the authorities had presented a letter of intent outlining Venezuela's economic program for the period through April 1997, together with a request for a 12-month Stand-By Arrangement. Provided that all prior actions were taken, the letter of intent would be issued to the Executive Board.

Program implementation had begun in mid-April, when the authorities had raised domestic fuel prices, the Chairman remarked. The exchange rate system had been unified under a temporary float, and controls on current and capital transactions had been abolished. To date, the response to the program had been encouraging, as indicated, for example, by the stability of the bolivar and the apparent buoyancy of stock market prices. Some pending prior actions, such as the increase in the rate of the sales tax from 12.5 percent to 16.5 percent and a further reduction in external payment arrears to Paris Club creditors, were expected to be adopted.

The Venezuelan authorities had displayed a strong desire for reform, the Chairman said. There was a growing conviction of the need to reduce inflation sharply and to implement structural changes. The proposed Stand-By Arrangement incorporated a number of important structural reforms and would set the stage for further reforms in the coming years. In that regard, the authorities had indicated in their letter of intent that they would like to request in 1997 an Extended Arrangement in support of the remaining reforms.

The most important challenge facing Venezuela was the need to rebuild confidence, the Chairman emphasized. There was a widespread sentiment that the country's main institutional pillars, such as the government, the judicial system, the labor unions, political parties, and banking systems were not functioning properly and required deep reforms. President Caldera was committed to the program and was widely trusted and admired for his personal probity.

Mr. Berrizbeitia said that he wished to thank the Chairman for his visit to Venezuela. The future relations between Venezuela and the Fund had clearly been strengthened, and a strong Stand-By Arrangement and successor Extended Arrangement could be anticipated. The Chairman's public participation in the signing of the letter of intent was a positive demonstration of the authorities' ownership of the program and the commitment of the president to the reform agenda. It should be emphasized that visits of such a nature helped solidify a positive image for the Fund in dealing with its members.

Mr. Saito expressed his appreciation for the Chairman's visits to the countries of his constituency.

2. EVALUATION FUNCTION IN THE FUND—FURTHER CONSIDERATION

The Executive Directors considered the following statement by the Managing Director on further consideration of the evaluation function in the Fund:

> In recent months we have established much common ground on how to carry forward the evaluation function in the Fund, including at the February 26, 1996, Board discussion of my statement (BUFF/95/125). I note that Executive Directors attach considerable importance to maintaining the existing practices of in-house evaluation, both by the staff and by the Executive Board as part of their regular activities; they stressed the importance of building on the record of constructive criticism, objectivity, and detachment that have characterized our in-house evaluations. It is also clear that there cannot be a uniform approach to evaluation, and we must be prepared to experiment and to learn from experience.
>
> Most recently, at the discussion of the work program of the Executive Board, on May 22, 1996, Executive Directors expressed views on my proposals for evaluation work in the year ahead (see BUFF/96/61, and BUFF/96/67), and asked for a separate further discussion on evaluation issues. I think the June 5 meeting would be an appropriate occasion for the Board to decide on the topics for the period ahead, and to resolve the remaining issues relating to procedures for the evaluation projects that we will undertake.
>
> It will be recalled that the Executive Board accepted on February 26, 1996 my proposals to strengthen the Fund's evaluation function on the basis of a pragmatic approach over a trial period of two years, with a review of the experience by February 1998. I think there is also a feeling that, as a practical matter, we should undertake no more than two or three evaluations a year.
>
> There was strong support at the May 22 meeting for the proposed review of the experience with ESAF-supported programs, with a view to learning where we can improve, and to ensure that the Fund does its best in supporting the adjustment programs of its members. I suggest that this evaluation should be undertaken by the Policy Development and Review Department, in conjunction with a panel of outside experts. I propose that the study examine the experience with ESAF-supported programs from a medium-term perspective (e.g., 1986-95); it would not address questions about the basic macroeconomic policy strategy of these programs (which have been consistent with well-established consensus that emphasizes financial stability, outward orientation of policies, and reliance on market mechanisms). Rather, the review would survey the general performance of countries with ESAF arrangements, with a specific focus on a few key issues of concern in ESAF programs, such as the following: why some ESAF countries have succeeded in making faster progress than others toward

stronger growth, lower inflation, and improvements in the external position; what has been achieved in the first stage of the liberalization policies and how program design and implementation for the second stage can be strengthened; and the incidence and effects of discontinuities in programs, and analysis of influences underlying developments in external debt and debt service. We should reach a common view on the role and tasks of outside experts in this evaluation exercise.

In addition, there was support for the proposed study of the issue of "ownership and implementation support," which would cover both ESAF and non-ESAF programs. This is a topic in which we could involve outside experts to assist in evaluating the ownership issue for a sample of ESAF, Stand-By Arrangement, and EFF-supported programs. The study could be designed to include a number of ESAF-supported programs covered by the proposed ESAF review and to identify issues and conclusions specific to these programs. This would help to assure a productive interaction with the proposed ESAF review.

As a possible third project, I noticed some support among Executive Directors for an evaluation of the effectiveness of performance criteria in Fund programs. I would invite further comments on the possible scope of this study, and on what Executive Directors would consider the key issues, before we consider the choice of evaluators and the timing of this evaluation.

There was less support for other possible topics mentioned in my work program statement. Executive Directors referred to the analysis by an outside expert of the Fund's forecasting record in the world economic outlook (World Economic Outlook) exercises, which had already—some years ago—been commissioned as part of the continuing effort to improve our methodology. The results will be circulated as background information for the fall World Economic Outlook exercise, but it is not clear that this topic will require a Board discussion. Also, in response to suggestions at the May 22 meeting, we will give further thought to the issues of Fund work in support of banking sector reforms, and our collaboration with the World Bank in this area.

It would be useful to know if Executive Directors have further views on the choice of topics for evaluation in the first year, or on the scope of the studies.

On the procedural questions, it has been broadly agreed that the Board should be closely involved in establishing, with Management, the terms of reference for each evaluation exercise and whether outside experts should be involved. Mr. Clark has put forward the idea that a small group of Executive Directors be designated to monitor the evaluation function during the two-year trial period. If Executive Directors can endorse that idea, I will present a proposal for such a group, which could work on the implementation issues, and the budgets of the projects, with the assistance of the Director of the Office of Internal Audit and Inspection (OIA). It would be envisaged that proposals resulting from this work would be presented to management and brought to the Executive Board for approval.

Finally, as mentioned in my work program statement, I have decided to strengthen the office of what is now called Internal Audit and Inspection, and Executive Directors may be interested in the planned work of this office. I have asked OIA to undertake, in FY 1997, a work program that will include the following: provision of secretariat support, as requested, for evaluation projects selected by the Executive Board; financial audits of the Fund's accounts; operational audits of selected activities (including major procurement contracts, Phase III construction, devolved travel budgeting, technology system projects, technical assistance seminars and workshops); and effectiveness reviews, particularly of the business processes used in delivering administrative services in the Fund, and of the resident representative program (the latter possibly in conjunction with other departments). On this latter review, Mr. Brau will contact Executive Directors to identify the issues that are the most important, and of course the OIA's review of the resident representative program will be made available to the Executive Directors.

Mr. Grilli made the following statement:

I welcome today's discussion. We wish to proceed with the strengthening of the Fund's evaluation function in a pragmatic and collaborative way over a significant trial period. I am in agreement with many of the ideas expressed in the document before us. It seems to me that the most important task that we face today is that of trying to define a) the criteria for choosing the subjects for which we want to have an external evaluation, and b) the processes for doing so, included the specific modalities of Board involvement in this process. Then we can perhaps fruitfully examine the issues of choosing our first evaluation to be made this year.

On the issue of choice criteria, I think that when we are on the area of policy, we should pick core issues or activities of the Fund. These should be selectively chosen to avoid repetitions or unnecessary invasions of delicate domains and subjects on which an internal evaluation has already been concluded, but it has left some key issues unsettled or serious doubts over its conclusions remains among members of the Board. In the area of country issues, we had in mind Mexico-style situations, but there can be other of general relevance that may warrant an outside investigation. Here again, selectivity is key.

About the process for choice, our belief is that the Board and Management should proceed together and collaboratively. Board involvement can be ensured, for example, in the choice of investigations and with the establishment, each time an external evaluation is decided, of an ad hoc group (a small group) of Directors that will interact collaboratively with Management in the definition of the terms of reference, choice of outside members, budgets, and timetable. The Board at large will, of course, have to pass judgment on the results of the evaluations so conducted.

On the issue of what should be our first evaluation, I believe that a selected review of ESAF-supported programs is a good idea. This is a core activity of the Fund. On it we have had an impressed inside review in 1993. That review left unsettled issues such as a muted response of savings investments and growth to adjustment performance and lack of continuity of social adjustment after the programs ended. An outside review of the causes of these results, included the design of programs and the policy performance of recipients, could be very useful, in light of past and more recent experience.

Ms. Lissakers made the following statement:

I welcome this opportunity to have a more focused discussion on the evaluation function now that we are beginning to get to the activation phase. I am primarily interested in discussing the independent evaluation role of outside evaluators, because I think that is what the Board has been trying to focus on as we debated the merits of having ad hoc outside evaluation as opposed to an internal standing unit for evaluation. As Mr. Grilli said, there are really two issues: which topics we should select and how; and how to manage the process, particularly the role of the Board. I would like to add a third issue, namely, what the follow-up will be of the evaluations.

On the question of topics, I agree fully with Mr. Grilli that our focus should be narrow, rather than broad, in order to have as concrete as possible a proposal together with the recommendations that will emerge from the evaluation process. Your statement makes several suggestions growing out of proposals from the Board and the staff. I agree that there should be some follow-up on the Policy Development and Review Department's previous overall review of the performance of ESAF programs. But, I disagree with the specifics of your proposal in that I do not see much value in having the Policy Development and Review Department go over the same ground. What I would like to see is a group of outside evaluators follow up on a couple of the questions that arose from the earlier review. The first is the question of repeat users. There are countries that have had four or five, even six, sequential ESAFs without showing positive results. I think this suggests the idea of having a couple of case studies focusing on the failure cases, or the contrasting of failures and successes. The second is this question of the growth results. I think we are beginning to get a better grip on that issue and are in the process of redesigning some of our programs. Perhaps having a second opinion from an outside group could give us some additional insight on the effectiveness of program design and what we can do to improve the ultimate outcome, both in terms of growth, and as Mr. Grilli said, investment and savings.

There is also the question of ownership, which you suggest is a separate project. Actually, that is an issue that probably would be better addressed by a staff group rather than by outside evaluators, but I would like the focus not to be on the performance of the program countries, but rather on our own ability to try to stimulate ownership of programs as we negotiate with governments.

I also think that we should proceed with an outside review of performance criteria, perhaps by examining their use in a limited number of countries. We have had an ongoing debate in the Board on the question of how we establish "performance bars." There are two philosophies here. The first involves setting the bar higher than we know the program country can jump, in the hope that it will jump higher than it would otherwise if we were less ambitious. The second approach involves making performance criteria relatively easy to achieve. The former approach does, however, raise the question of repeated waivers and whether they undermine the integrity of programs. I think that would, again, be a useful question for an outside panel to examine. We keep looking at it ourselves, but I think part of the purpose of having outside evaluators is that they may come at it from a different angle and see something that we do not.

Finally, there is the delicate matter of my proposal for a joint evaluation between the Bank and the Fund. I had suggested a specific project on banking reform because we have a lot of undertakings in a number of countries where the Bank and the Fund are trying to or need to work together. We set the umbrella for the program, and the Bank is supposed to follow up with actually delivering the reform. But, I think we all recognize that this process is not working as well as it should. It is obviously somewhat delicate for this Board to propose an evaluation to another institution, but we know that Fund management has a close working relationship with management across the street, and I do not think that should be so difficult to organize. I think it is in the interest of both institutions to have a more effective linkage between what we do and what the Bank does in certain areas. I think this issue of coordination between the institutions is receiving increasing attention in a number of capitals, certainly including my own, and I think that my authorities will be looking to management to come up with specific proposals for responding to the concerns that they have in this area.

In the context of the ESAF, we have the policy framework paper which is the coordinating instrument, at least at the planning stage. My understanding is that in practice, the policy framework paper is really a Fund exercise with the Bank sort of "signing on the bottom line." The policy framework paper has been very useful from our point of view. The question is whether the policy framework paper has any practical operational impact on what the Bank does, and when it does it. That might be a possible focus of the joint evaluation.

On the question of managing the process, there is a very strong sense that the Board wants to be involved. And I think our recent experience with the external evaluation of the technical assistance work of the Monetary and Exchange Affairs Department highlighted the need. Some of the criticisms that arose from the Board could have been avoided if the Board had been involved in the design of the study's terms of reference from the beginning. I am largely agnostic on the question of whether we have a small steering group to oversee the evaluation process as a whole, or whether we have small groups of Directors involved with each evaluation project so that we all participate and also distribute the burden of work. I am open to the views of other Directors on that question. I do think, however, that there should be a small group of Executive Directors who would be involved in the design of the projects, in the selection of the outside evaluators, and to act in a liaison capacity with the panel of evaluators so that they have a direct sense of what the Board is looking for in the evaluation.

Finally, there is the question of follow-up. I would be interested in management's ideas on what follow-up actions will be taken in light of the conclusions and recommendations of the outside panel's review of the technical assistance work of the Monetary and Exchange Affairs Department. I think the evaluators, however politely and carefully, highlighted some weaknesses in that area, and I would like to know what we are going to do to follow up on their recommendations.

The Chairman remarked that some initial discussions had taken place between the managements of the Fund and the World Bank on the Fund's role in the joint Bank/ nongovernmental organization evaluation. A further status report would be given to the Board at a later juncture.

Mr. Kafka made the following statement:

I am grateful for the Managing Director's statement on the Evaluation Function. I have only a few comments to make on the present design of the function.

On the review of the ESAF programs, we welcome the idea of having a panel of outside experts being involved; the basic responsibility must continue to pertain to the Executive Board. We feel that the evaluation should address not only the points made by the Managing Director but also the basic macro-economic policy strategy of these programs. In addition, it should address the political and social situation prevailing in countries with ESAF programs. It is difficult for obvious reasons to separate the causes of the success or failure of ESAF programs from the manner in which such problems are handled.

I am not sure that the discussion of "ownership and implementation support" should have top priority. However, I do think that a discussion of the effectiveness of performance criteria in Fund programs, like the discussion of banking sector reform, could be undertaken after the Annual Meetings.

On the procedural question, I would not object to Mr. Clark's suggestion that a small group of Executive Directors should monitor the evaluation function during the trial period. I look forward to the Managing Director's detailed proposals. However, I would ask that such a small group should address itself to the matter with an entirely open mind and not necessarily rely on the Office of Internal Audit and Inspection. I would hope that the Office could initially concentrate particularly on the effectiveness of our delivery of administrative services.

Finally, I am not convinced of the usefulness of joint evaluations by the Fund and the Bank or for that matter with other multilateral institutions.

Mr. Clark made the following statement:

I agree with the Managing Director that today we should agree on topics for evaluation period ahead, and resolve remaining procedural issues associated with two year trial period.

On the latter, I agree with the Managing Director that it is crucial to involve the Board on decisions regarding what topics to evaluate, the respective terms of reference, whether outside experts should be commissioned, and who those experts should be. Like the Managing Director, I continue to believe that a small committee of Directors should be assigned to coordinate these decisions, supported by the Director of Office of Internal Audit and Inspection.

I could support Mr. Grilli's suggestion that a group be selected for each major evaluation, so long as one or two directors were involved in all evaluations in order to retain oversight for the evaluation function as a whole.

In the interests of making these reviews credible both inside and outside the Fund, the norm should be to make outside experts responsible for these evaluations, although these experts could obviously draw on Fund staff for assistance.

Proposals by the committee, including the Terms of Reference and potential candidates as outside experts, would be presented to the Board for approval.

I fully support the Managing Director's plan to evaluate the effectiveness of ESAF with a panel of outside experts, including his emphasis that the review assess the performance of ESAF borrowers in a few key areas. Given the higher profile on ESAF at this juncture, my authorities believe it is particularly important that this evaluation be done by an outside expert.

I could go along with studying the issue of ownership and implementation support (of programs), although it's not clear to me exactly what the terms of reference would look like—any additional insights from the staff or the Managing Director would be appreciated.

I agree fully with the proposal to evaluate the effectiveness of performance criteria. This subject satisfies Mr. Grilli's condition as being a core activity of the Fund. We need to look at whether borrowers have been successful at meeting these criteria, and, if so, whether these criteria have produced the desired results. The evaluation should assess whether failures to meet the criteria, which result in waivers—or program termination on occasion—were due to poor policy implementation, or to inappropriate or inconsistent performance targets.

There are two aspects of performance criteria that are of potential interest: The level, as discussed in the Board on several occasions—are we setting the bar too high in some cases (are we excessively optimistic and insufficiently realistic) and the number of performance criteria. Some Fund critics suggest that the large number of criteria can be confusing and excessive micromanagement.

Public choice analysts have suggested that this may be part of a strategy to reduce accountability. To quote Dr. Roland Vobel:

> A multiplicity of conditions without weights attached to them makes it difficult to evaluate the efficiency of the program, it raises the cost of monitoring for external observers and permits the Fund to attribute the low degree of implementation to conflicts among targets.

While I do not necessarily agree with the public choice analysis of motivation, I think the multiplicity of criteria does raise issues of transparency and accountability, as well as basic effectiveness.

I think it is worth evaluating the use of performance criteria with these criticisms in mind.

I am intrigued by Ms. Lissakers's suggestion for a joint evaluation of the sectoral activities of both the Bank and Fund. It might help us draw on the extensive experience of the Bank in the evaluation function. As the Managing Director says, it is complex and delicate—but that makes it a perfect subject for this Board and its Chairman to address.

Finally, my authorities would recommend publication of these evaluation papers after the Board reviews.

The Chairman noted that, in view of the highly confidential nature of its subject matter, a decision had been made at the outset not to publish the Whittome report. He was generally in favor of transparency provided that it was known from its inception that an evaluation report would be published. Moreover, previous ESAF reviews, the conditionality review, and the growth-investment study had all been publicized.

Mr. Mirakhor queried whether Mr. Clark and Ms. Lissakers would agree that the question of ownership and performance criteria should be studied in conjunction with program design.

Mr. Clark found that to be an attractive proposition, but thought the idea warranted further discussion, perhaps by a small group of Executive Directors.

Mr. Mesaki made the following statement:

I welcome the proposal in the Managing Director's statement as a basis for today's discussion. With regard to the procedural questions, I would add that the Board should be closely involved in establishing the terms of reference for the evaluation exercise and the selection of outside experts be involved. Evaluations by outside experts, with monitoring by the Board, could provide well-balanced suggestions on the Fund's activities. In this regard, I support Mr. Clark's idea for a group of Directors to be designated to monitor the evaluation function during a two-year trial period.

As my authorities are very interested in the effectiveness of the evaluation function, I look forward to seeing the Managing Director's proposals for the group.

Let me turn to the topics for evaluation. Japan regards ESAF-supported programs as a most important topic, and I generally support the method of evaluation described in the statement. However, it is critical to note that not all Fund programs meet the specific needs of the country concerned, and they are sometimes so strict, ambitious, or confusing that they are difficult to implement. It is more important, therefore, to evaluate the adequacy of program design as well as the implementation of programs.

With respect to ownership and implementation support and the effectiveness of performance criteria, the scope of the proposed evaluation remains vague. I wonder whether we could draw useful lessons from individual evaluations of these two topics. Instead, I would propose that we include them in evaluation of ESAF. These aspects of evaluation can be most effective for ESAF-supported programs which focus on structural adjustment policies. Later, we can judge whether it is necessary to implement them individually and expand them use to non-ESAF programs.

On the issue of analysis by an outside expert of the Fund's forecasting record in the world economic outlook exercise, at this stage I do not see any need for discussing this at the Board.

As for banking sector reform, I look forward to hearing the result of management's considerations on how the Fund can help support such reform in coordination with the World Bank.

Finally, on the issue of publication of evaluations, I must say that I have some reservations. I believe that the follow-up is very important, and I therefore agree with Ms. Lissakers's suggestion.

The Chairman queried Mr. Mesaki's suggestion that ESAF-supported programs were sometimes "confusing."

Mr. Mesaki noted that while he did not find ESAF-supported programs confusing, some outside critics certainly held to that view.

Mr. Andersen made the following statement:

During the discussion on the work program it was clear that there were somewhat diverging views on the role of outside experts in the evaluations as well as on the kind of issues to be evaluated for which outside expertise would be useful. I, therefore, welcome this follow-up discussion regarding the evaluation function in the Fund as well as the Managing Director's statement, which I found to be a good reflection of the views expressed on that occasion, and I am in broad agreement with your proposals. However, I have a few points where my views differ slightly regarding the prioritization and I will also comment briefly on the procedures.

During the work program discussion this chair fully supported the idea to undertake a review of the effectiveness of ESAF-supported programs and can support your suggestion in that respect.

It is evident that ESAF will continue to play an important role in the Fund's policy for many years to come, and I deliberately refrain from using the term permanently, and the resources devoted to this instrument fully justifies an involvement of outside experts to contribute with some fresh views that hopefully can facilitate the efficiency of the many ESAF discussions that still are in the pipeline. An ESAF evaluation is hence my first priority for evaluation projects.

For further projects, I do have some further views on choice of topics for evaluation or at least the scope of the studies, in addition to the points raised in your statement. During the work program discussion both Ms. Lissakers and Mr. Prader together with this chair had some further views on additional topics that could be candidates for evaluation, topics that also are reflected upon in the Managing Director's statement.

When we decided to establish an evaluation function and not an evaluation unit, the cost factor was an important consideration. The need to respect budget constraint is, furthermore, an important argument in favor of restricting the number of evaluation projects to 2-3 per year. Whether we should go for 1 or 2 projects in addition to the ESAF evaluation is partly a question of how ambitious we are with regard to quality, and consequently how much resources we will devote to each project. My preference will be to avoid initiating so many projects that the quality of each evaluation suffers from lack of resources in the end.

In order to achieve that, I suggest that we make a preliminary priority list, and do not proceed to lower prioritized issues until we are convinced that higher priority topics can be carried out without negative effects to the quality. At the same time I would find it reasonable that we allow some flexibility to allow for the inclusion of other topics that may come up down the road. We should not exclude that future Board discussions within the trial period would show other areas that deserve some extra focus. I find that our regular work program discussions could be an appropriate occasion to take stock of our priorities.

As regards the menu of options, I agree that the focus should be narrow rather than broad. I find that some of the arguments in favor an evaluation of ESAF supported programs also are relevant for an evaluation of the resident representative function. As a substantial number of Fund staff is employed as resident representatives, and I would not be surprised if the demands for such representatives are on the rise, I find it important to learn to what extent this important function has reached its goals, whether we can improve it, and how we best can use these resources to the fullest benefit of our members and of the Fund now where we are eager to ensure strong, efficient and continuous surveillance. I note that the OIA will undertake, in FY 1997, a review of the resident representative program. I welcome this information and also the intention to involve Board members in the selection of issues that are most important, and that the review will be made available to the Board. However, as a minimum I would find that a full-fledged Board discussion would be warranted, and that as many as possible aspects of the functioning of the resident representatives are covered—objectives that may be more easily fulfilled with the involvement of some external experts.

Furthermore, I think that Ms. Lissakers's proposal for a joint Fund/Bank evaluation of banking sector reforms is fully justified for the reasons already mentioned.

To sum up, provided that adequate confidentiality can be secured, all three potential evaluation topics that I so far have mentioned-ESAF supported programs, the resident representative function and the joint evaluation of banking problems are of a kind that probably would benefit from participation of external experts. While I see some merits in upgrading the two latter projects, it is, as usual, somewhat more difficult to point to subjects in the present list that appears lesser urgent and where an internal review, followed by a discussion in this Board, probably would be sufficient. I would, however, be prepared to devote lesser priority to the issue of ownership and implementation where I am not fully convinced about the relative advantages of an evaluation compared to a more standard review.

Finally, on procedural aspects, I would like to state my full support for Mr. Clark's idea that a small group of Executive Directors is designated to monitor the evaluation function during the trial period, and I am also open to the ideas of Mr. Grilli in that regard provided some degree of continuity is ensured. I also agree with Ms. Lissakers more general point on the importance of follow-up procedures after the evaluations. I have some skepticism regarding the appropriateness in general of publication of these reports, especially when outside experts are involved, but am willing to look at it on a case-by-case basis. I would, however, in any case support a relatively broad distribution within this institution of the reports.

Mr. Han made the following statement:

I welcome today's meeting for further consideration on the issue of the evaluation function in the Fund. In the Board discussions on the work program, we were in broad agreement on the need to strengthen the evaluation function of the Fund in a number of areas. Like previous speakers, I attach great importance to an evaluation function in the Fund, as it will help us improve our work to meet the needs of member countries.

Let me first touch upon a basic point: the number of issues on which we should focus evaluations in the first year. Taking into consideration restraints on our budget and human resources, I think we should choose two to three subjects for the first year. Moreover, it is not necessary to conduct frequent assessments or evaluations on some subjects; we will need time to digest the evaluations we conduct and make the requisite changes. Therefore, in agreement with the Managing Director, I prefer three issues at most for evaluation by the Fund in the first year of the two-year trial period.

Regarding the issue of subjects for evaluation, I agree with the Secretary's concluding remarks at the Board session on the work program. Two projects for evaluation should be a review of experience with ESAF-supported programs and an evaluation of the effectiveness of performance criteria in Fund-supported programs. As for a third project, the evaluation of banking sector reform, I can agree with Ms. Lissakers's suggestion that we have a joint evaluation program with the World Bank and, may I add, Bank for International Settlements, given their valuable experience in this field. The subjects for evaluation should be agreed upon by the Board and should be considered on the bases of necessity and usefulness to member countries. So, in this context, I think Board involvement in the evaluation of the work program will play an essential role in the process of improving the Fund's operations.

Turning to the issue of who will be conducting the evaluation function—external experts, Fund staff or some other institutions—it is not easy to judge which is best if you do not have background knowledge of their expertise. I feel it would be both safe and practical to have either in-house evaluations or joint work programs with other institutions like the World Bank or, in some cases, with multimateral development banks. With joint efforts, evaluation work will surely be more productive and efficient. While I do agree that the possible involvement of outside experts in the evaluation exercises should be considered on a case-by-case basis, I maintain that we should primarily use our own resources and collaboration with the World Bank in the implementation of evaluation functions.

On the procedural questions, I fully agree with Mr. Clark that the Board should be closely involved in establishing, together with Management, the terms of reference for each evaluation exercise and deciding whether outside experts should be recruited, and that a small group of Executive Directors should be designated to monitor the evaluation function during the two-year trial period.

Finally, it is encouraging to see that the Office of Internal Audit and Inspection in the Fund will be strengthened with the support of the Board and Management. The work program of this office for FY 1997 will be given due consideration by the Board in a short period of time.

Mr. Kaeser made the following statement:

I note with satisfaction that we are making headway in shaping the evaluation function of the Fund, and I thank the Managing Director for his latest statement on this issue. I wish to make the following remarks on the content of this statement.

Let me address first the procedural questions. In my view, the close involvement of the Board in the evaluation activities is of paramount importance, as the evaluation of the Fund activities represents its core responsibility. As it may be difficult to engage the whole Board in detailed discussions concerning the terms of reference for each evaluation exercise and in the monitoring of the evaluation function, I support the idea to create a small group of Executive Directors, which would establish with the management the draft terms of reference for evaluation projects, advise on the involvement of external experts, follow the implementation of the evaluation exercises and monitor the expenses. The positive experience made with the Budget Committee shows that an intense and trustful cooperation can be established between the Management and a small group of Directors.

I can also support the intentions of the Managing Director concerning the future work of the OIA, nevertheless with a note of caution. I am not sure that an internal audit unit is in a position to review the effectiveness of the resident representatives. This should be primarily the task of the concerned area departments in consultation with the concerned Executive Directors. Much has to be done in this respect, because the differences of quality and of dedication of the resident representatives is a matter of concern.

Turning to the substance, I think that we should not be overambitious. We should limit the evaluation program to roughly three projects a year. But it is also very important that the Board remains in a position to request at any time an evaluation on any topic which appears to justify such an undertaking. Therefore, I think that we should retain enough flexibility and not try to fill the evaluation program many years ahead.

Concerning the topics selection, I agree that the priority should be given to ESAF. We recently had a comprehensive review of our ESAF operations, and I wonder if it is necessary to repeat this exercise in full, which would mobilize a large amount of resources. I think that we should rather have a second look at the main weaknesses detected during the last review, that is—if I remember well—the fact that the external sector of the ESAF-users remained weak at the end of the program and that their growth performance was disappointing. If I understand well, the Managing Director's view is that we should not question the basic macroeconomic strategy of the program and that we should seek reasons for good or bad performances in the member countries. In my view, we should ask the external experts to give us a second opinion also on the conception of the programs.

I have some reluctance to embark on a major evaluation of ownership and implementation support, because the political circumstances of member countries are far from homogeneous. But I think that further periodic evaluation should be made of the Fund technical assistance. Like Ms. Lissakers and

Mr. Clark, I think that an outside panel should have a look at the effectiveness of performance criteria.

It goes without saying that I am in favor of the publication of the evaluation reports. In this respect I think that rules should prevail over case by case consideration.

Mr. Waterman made the following statement:

Like others, I welcome the further progress being made in getting our evaluation program up and running. I like the proposal for emphasis on a limited number of quality reviews each year, and not overdoing it. I also support the proposal of designating a small group of Directors to oversee the program, and I see some attractions in Mr. Grilli's proposal of possibly having a separate group for each study. But I think it is important to keep any group relatively small, and specifically I have in mind there numbers ranging from four to six. I could also go along with something like Mr. Clark's variant, in terms of having some common membership in each team, if that could be achieved while ensuring that it did not result in overly large numbers of Executive Directors being involved. It seems to me that we could move now to setting up a group or groups, if that is agreed, and ask it or them to work out detailed terms of reference for the first study, working with the staff and management, and then to submit a proposal for Board approval. As Ms. Lissakers suggested, after each study is launched I think the group could usefully monitor the progress of the work and provide guidance to the participants, if that is either necessary or useful.

Turning to the specific proposals for evaluation, I strongly support an evaluation of the ESAF. It is important, however, that we have a very clear idea of what policy issues we want to explore, and what we want the study to achieve. I agree with the Managing Director, we should not revisit the basic issue of the ESAF strategy. For my part, I would favor the study covering both program design and implementation, and to focus on recommendations for improvements in the Fund's operations and practices.

It seems to me that the study should build on, rather than duplicate, existing evaluations of the ESAF, including the excellent work done by the Policy Development and Review Department staff in recent years. As Ms. Lissakers suggested, perhaps we could conduct an in-depth study of one or more ESAF recipients that have been involved in programs over a long period of time to see what lessons emerge from such prolonged Fund involvement. I also liked Mr. Kafka's suggestion that the ESAF review look at the political and social situation as a factor contributing to differences in outcomes across countries. But it seems to me that we should ask a group of Executive Directors to work with the staff and management to elaborate a terms of reference for external experts, and outline the expected budgetary implications for Board approval. Perhaps we should aim for something to come back to the Board before the summer recess.

The issue of who should conduct the evaluation is an important one. The staff obviously has a wealth of knowledge and experience, and that must inform any evaluation. But outside experts can bring a fresh perspective, detachment, and hopefully a directness that can be useful. For that reason, I favor a lead role being played by external experts.

At a general level, I think no one should feel threatened by a review of ESAF. There is a strong membership commitment to its continued role. It will remain important, but it is a program directed often at countries with chronic problems that require long-term Fund involvement. I do not think any of us expect revolutionary changes, but it is possible that a review will generate some useful ideas on how we can improve its effectiveness.

I do not have strong views on the other two suggested evaluation topics. The issue of program ownership is clearly very important. But, it is not clear to me what a separate study might involve. Making program ownership part of the ESAF review may be sufficient for our immediate purposes.

In terms of the other suggestion, it would be first useful to see a detailed terms of reference for the proposal on a review of Fund performance criteria.

Picking up on a general point made by Ms. Lissakers, there is clearly not much point in undertaking evaluations unless we implement the suggested reforms coming out of those reviews. So we do need some follow-up monitoring of the implementation of changes that we believe would be useful.

In terms of the issue of publication, I agree with the Chairman and Mr. Clark. My general disposition would be to support transparency, but I do not think we should rule out the possibility of restricted reports.

Finally, I welcome the outline of the work program for the Office of Internal Audit and Inspection. I am pleased to see the inclusion of operational audits and effectiveness reviews. I do not think this is an area where the Board wants to get involved in a great deal of detail, but it would be useful for this office to report to the Board from time to time on the outcome of its work.

Mr. Kiekens made the following statement:

Let me discuss a few principles which should characterize the Fund's evaluation activities. Subsequently, I will deal with the topics for which the Board might further discuss and decide to carry out a special evaluation.

I would like to enunciate the following four principles which I believe should guide our evaluation activities.

First, a special evaluation report is warranted when the Board has identified a possible malfunctioning and where improvement is realistically possible.

Second, outside expertise should only be involved if the in-house evaluation, both by the staff and the Executive Board, cannot alone provide a satisfactory assessment of the Fund's activities. I would call this the principle of subsidiarity of outside evaluation to in-house evaluation.

Third, it logically follows from the second principle that outside evaluation and its terms of reference can only be decided on a case-by-case basis. Like most other speakers, for reasons of efficiency I advocate establishing a special Board committee for each item for which outside evaluation is proposed. This committee should further discuss with Management the choice of outside experts and their terms of reference.

Fourth, reports by outside experts can only be a source of information for the Board and Management enabling to take better informed decisions on future courses of action in a particular domain. Outside expertise is not a means to solve issues on which the Board has sufficient reliable information but remains politically divided. In most cases the report of the outside experts will constitute only a second opinion, in addition to earlier reports from the staff, and will almost never suggest clear cut, or to quote Mr. Waterman "revolutionary" solutions for issues concerning the Fund's core activities, which are frequently reviewed by the staff and the Board on a regular basis.

As to what topics are suitable for review by outside experts, I agree that some aspects of the design of ESAF programs warrant such evaluation. The need for successive ESAF programs in many countries and the unsustainable or very weak external positions of many developing countries call for further examination of the appropriateness of the program design, as a complement to our regular reviews of ESAF programs by the staff and the Board. I do not believe that the external experts should focus primarily on the implementation of ESAF programs, which indeed is often problematical and causes failure to meet program targets. I believe that the staff reports and the regular reviews of conditionality already provide reliable information and analysis in this area. What is called for is rather a critical look at the design of the programs themselves. Although I recognize that in practice it will not be possible to evaluate the program design without assessing to what extent failures to achieve the targets are due to design flaws or to faulty implementation. In addition, one must be aware that faulty implementation may well be due to flawed design and that on the other hand, final program targets may be attained notwithstanding the fact that intermediate targets were not met. Like Mr. Mirakhor, I agree that the issue of performance criteria can be seen as part of the broader issue of program design.

I believe a Board committee should further refine the terms of reference for the review of the design of ESAF programs expeditiously, and propose the appointment of the experts.

I have some problems with the suggestion that this review should be jointly undertaken by the Policy Development and Review Department together with a panel of outside experts. I doubt the potential advantages of this approach. If outside experts are to be involved in such a review, they should be given carte blanche in the framework of the terms of reference defined by this Board.

Defining the Fund's role in supporting banking sector reforms surely deserves attention, and it ought indeed to be useful to examine whether the Fund and the Bank are duplicating one another's efforts in this area. I welcome the Managing Director's efforts to reach an understanding on this subject with the Management of the World Bank.

Applying the principle of subsidiarity, I agree that the report reviewing the Fund's Resident Representative Program will be prepared by the Internal Audit and Inspection Office, but I would insist that the Board retain the possibility of asking for an additional report by outside experts in the unlikely event that it is not satisfied by the report of the in-house review. In addition, I agree with Mr. Anderson's observations on the review of the Resident Representative Program.

I have a last observation concerning the functioning of the Internal Audit and Inspection Office. This office reports directly to the Management, but I wonder if more independence would not be obtained by having it report jointly to Management and a Committee of Executive Directors. This is how matters are arranged in many private institutions, and I wonder if we should not imitate their practice in this domain. I thus see some advantages in having the Board establish a standing committee to monitor the evaluation function itself. This approach might also ease the processes of choosing the topics to be reviewed, monitoring the costs of the reviews, and following up evaluation results.

Mr. Schoenberg made the following statement:

I believe the Managing Director's statement constitutes a good basis for today's discussion. I would like, however, to stress one aspect expressed by this chair on the occasion of the Board's recent discussion on the work program, namely, that we must ensure that the proposed approach toward the evaluation function does not become overly ambitious and bureaucratic. In my view, we should take up issues on an ad hoc basis once the Board sees a convincing need for evaluation.

In contrast to such an action-need based approach, we should avoid a routine based approach, with annual brainstorming on whatever issues might be worth evaluating. We would rather prefer to decide on a case-by-case basis whether there is a convincing need for reviews. I think it would be an illusion to believe that the establishment of an evaluation function per se—for instance, for public relations purposes—will substantially improve the Fund's performance. To achieve such a purpose, one needs a very targeted process. Like Mr. Andersen and Mr. Kaeser, I would not support deciding years in advance which topics might be evaluated. In any case, we should not undertake more than two or three evaluations a year. Such a limit strikes a reasonable balance with respect to budgetary requirements, on the one hand, and the preservation of the necessary trade-off between quality and quantity on the other.

The necessity to establish a convincing need for an evaluation exercise would require, to my mind, the Board and management to define precisely which aspects of the Fund's activities may not produce desirable results, deserving, therefore, a thorough evaluation. The commissioning of evaluation studies on the basis of too generally defined mandates—for instance, a mandate to look into the effectiveness of ESAF generally—will probably not reap all the potential benefits of such studies. In any case, I think the Fund would appear in a somewhat strange light when it had already decided on a self-sustained ESAF and then commissioned a study on the overall benefits of this facility. I agree with the Managing Director that an ESAF study should concentrate on a few key issues of concern in ESAF programs; for instance, the problem of prolonged users. We should not forget that we have seen a number of excellent ESAF studies presented by the Policy Development and Review Department, and we have to be very clear which aspects of ESAF we want to see further evaluated.

In defining precise and targeted terms of references for evaluation studies, Mr. Clark's proposed small, ad hoc group of Directors might deliver valuable inputs, but more generally I believe that the Board should be closely involved in all stages of the process. I also believe that the question to what extent outside experts should be engaged should not be decided in an abstract fashion, but should be assessed on the basis of the topic to be evaluated. The proposed study on the issue of ownership and implementation support, for instance, could benefit from the involvement of outside experts.

I also agree with Mr. Grilli's and Mr. Kiekens's observation that outside experts should preferably be engaged only if and when internal evaluation means have been exhausted. I would like to stress Mr. Kiekens's remarks when he observed that outside experts cannot arbitrate in a situation where the Board is politically divided.

Like Mr. Kafka, I am not convinced of the merits of the principle of joint Fund-World Bank evaluations, as such a process would risk blurring the different mandates of the two institutions. I recognize, however, that the activities of the Fund and the World Bank with respect to banking sector reform may involve large areas of overlap, and that this issue must be straightened out between the two institutions.

Lastly, while we can accept the proposed ESAF evaluation as a starting point for the Fund's enhanced evaluation function, I can also support, as a later project, an evaluation of the effectiveness of the performance criteria used in Fund programs. Let me just mention, however, that I consider the issue mentioned by Ms. Lissakers and Mr. Clark—namely, that of whether the Fund should raise the bar of the performance criteria beyond what a country can reasonably achieve—largely a nonissue. Both the Fund prescribing conditions and a government subscribing to obligations it expects it cannot fulfil would in my mind be acting in an irresponsible manner.

The Chairman noted that, while outside experts could be used in the evaluation exercise, the sovereignty of the Fund would not be permitted to be compromised.

Mr. Saito made the following statement:

> Like other speakers, I welcome this opportunity to further consider issues related to the evaluation function in the Fund. In our February discussion on this matter and more recently, at the discussion on the work program, this chair expressed broad endorsement of management's initiative to strengthen the evaluation function in the Fund and to adapt existing practices so as to ensure timely, constructive and detached criticism of the Fund's activities while avoiding a proliferation of evaluation projects.
>
> Allow me to begin my remarks today by touching first on the procedural questions and then on the proposed topics for the present fiscal year.
>
> Regarding the procedural question I strongly support close involvement of the Executive Board in defining the topics for evaluation, establishing the terms of reference for each evaluation exercise, and whether outside experts should be involved. Moreover, I consider that this involvement is essential for an effective and transparent review process. I am not attracted, however, to Mr. Clark's suggestion that a small group of Executive Directors be designated to monitor the evaluation function during the two-year trial period. I prefer that once terms of reference have been established, the group of experts in charge of the evaluation work with the maximum autonomy from management and the Board, and that once their work is finished, they report their findings directly to the Board.
>
> On the topics for evaluation, I agree with the Managing Director's statement that we should be pragmatic and limit the number of evaluations to two or three per year. In this spirit, allow me only to mention our priorities on topics for evaluation.
>
> The work proposed to review the experience with ESAF-supported programs to improve their effectiveness should receive high priority in light of the central role of ESAF in financing adjustment in the low income member countries. Similarly the proposed study of the issue of ownership and implementation support deserves also special attention given the importance that it has on the development and success of Fund-supported programs. Furthermore, I concur with the suggestion to include in this study a number of ESAF-supported programs covered by the proposed ESAF review. I also attach high priority to a joint evaluation of banking sector reform supported jointly by the World Bank and the Fund and would suggest it as the third possible project. Thus, I would prefer to put the evaluation of the effectiveness of performance criteria as the fourth project or place it in next year's evaluation agenda. Regarding the analysis by an outside expert of the Fund's forecasting record in the World Economic Outlook exercise. Like Mr. Mesaki I agree that this topic

should not require Board discussion and that the results be circulated as background information for the fall World Economic Outlook exercise.

Finally I welcome the Managing Director's decision to strengthen the Office of Internal Audit and Inspection to ensure that it becomes an integral part of this effort to strengthen the evaluation function in the Fund.

Mr. Geethakrishnan made the following statement:

Today we are addressing two separate issues. One is the evaluation per se, namely, whether we are doing it well, and whether there is any scope for improvement. The second is a subject to be chosen for evaluation. We have undertaken evaluations in the past. We have had internal evaluations such as the study of the ESAF program countries, which I would describe as outstandingly good. We also had an outside evaluation in the wake of the Mexican crisis, which again I would say was also an outstandingly good report.

Somehow, when we looked at the evaluation of the technical assistance of the Monetary and Exchange Affairs Department, the Board discussion gave the impression that there was scope for improvement in terms of clarity of objectives, design, and so on. So, when you look at the need for evaluation per se, we have a mixed bag calling for a better definition of objectives, better program design, and also choosing the right people for doing the job.

Concerning the question of which subjects should be evaluated, Mr. Grilli made a point which I think is very good. He suggested that we should invite outside evaluators to look at what has already been internally evaluated. Let us carry this idea a little further. We in the Fund have a very healthy practice of self-criticism, in the sense that we do review each and every aspect of our work. If you take a three to five-year period, practically all aspects of the functioning of the Fund come to the Board for consideration. They are examined by the staff, and they are examined by the management. Over a period of time, all aspects of our work have been subjected to the microscope by the staff, the management, and the Board.

It would be very good if we followed Mr. Grilli's suggestion and took up for evaluation an item which has been thoroughly examined like this, because then we will be able to focus attention more on the concerns that have surfaced, either in the board discussions or with the management or with the staff, so that the evaluation has a very good starting point. The outside evaluators do not have to reinvent the wheel since the wheel has already been invented and we have found some flaws in it. I think that should be a very good starting point for an outside evaluation. In other words, the objectives should include the concerns that have been expressed, whether it be by the staff, the management, or the Board, and the design of the evaluation should be such as to address these things very clearly.

So I would support Mr. Grilli's suggestion that we "take up for our evaluation something that has already been internally evaluated." The internal evaluation need not be a totally complete process like the one that we had earlier in the case of the ESAF.

The third point is that, if we decide that we should look at something that has already been examined, the subject of ESAF becomes an automatic choice. It can be ESAF as a whole or it can be some aspects of the ESAF.

There is one point on which I have a slight difference of opinion from the Managing Director. On page 1, in the last paragraph, there is a sentence that says that the evaluation would not address questions about the basic macroeconomic policy strategy of ESAF programs, which presumably are consistent with the well-established consensus that emphasizes financial stability, outward orientation of policies, and reliance on market mechanisms. The next sentence says that the review would survey the general performance of countries with ESAF arrangements, with a focus on a few key issues. I suspect one sentence is missing in between. The first sentence clearly deal with the role of the Fund. It would not be proper for us to invite any outside evaluators looking at a particular aspect to deliberate on the role of the Fund. However, on the presumption we have that the role of the Fund is correctly translated in the program, I would like to place a question mark.

Even if I am taken to be a great admirer of the Fund and all that the Fund does, as a good colleague in the Board I am duty bound to take serious notice of what my colleagues say. You heard Ms. Lissakers refer to the question of whether the performance bar has been set a little too high. You heard Mr. Clark query whether there are too many performance bars. We heard Mr. Mesaki say programs are sometimes confusing, over-ambitious, unrealistic, and too strict. I am drawing attention to all these things because I think we as a Board need to take seriously what many of us feel. All this clearly draws attention to the need to review program design. This is the middle sentence which I think is left out in the Managing Director's statement. We are not questioning the outward orientation of the policies and market mechanisms or the emphasis on financial stability. We are only asking whether all these broad objectives of the Fund have been correctly understood and built into the program.

When we talk in terms of an evaluation, it has got to cover the design stage, which is largely in the hands of the Fund. When a country comes to the Fund for assistance, it invariably seeks it on the verge of bankruptcy. The Fund staff clearly has a dominant role in the design part of program operations. So the evaluation should look at both pre-implementation, which is the design of the Fund, and the implementation stage, where it is largely in the hands of the country concerned. I would suggest that the ESAF evaluation cover both aspects.

The next question would be: what do we address under the heading of ESAF? ESAF itself is too large an area. Enlarging on the point Mr. Mirakhor made earlier, we should examine a few countries where our programs can be called success stories and also a few countries where the programs had not been as successful. This will enable us to find faults in our own program designs in terms of the number and height of performance hurdles, and the number of ESAF programs.

The reason why I am focusing on the success stories is that it would give us some insight into the sociopolitical consensus that contributes to the success. We need to economic factors in their sociopolitical context. If we look at the success stories, very often we will discover the importance of the sociopolitical context of reform.

We have been talking in terms of a group of Executive Directors looking into evaluation. I warmly welcome Mr. Clark's suggestion. But I have some difficulty in fully comprehending the manner in which the Managing Director has expressed it in his statement. The last-but-one paragraph says, "If Executive Directors can endorse that idea, I will present a proposal for such a group, which could work on the implementation issues, and the budgets of the projects..." Maybe my understanding is wrong, but I regard the implementation stage as outside the bounds of the ESAF review. I would rather that the group of Executive Directors whom we select interact very intensively with the management and the staff to look at the design, objectives, and the selection of experts so that out of this will be born a detailed evaluation program on how we are going to proceed. Then it would come to the Board for endorsement.

I agree that there should be a group of Executive Directors to perform this function, but my understanding of the Managing Director's statement leaves a little to be desired. I would like it to go beyond. I think that is what Mr. Clark himself had in his mind, namely, that the group should have a vital input in finalizing the design, the objectives, and the selection of the experts. If that is so, I can go along with it.

Normally, the Executive Directors as a group have not found it feasible to entrust their task to any group on a continuing basis, but I think this is one occasion, if we take it as a one-time exercise, to see how it succeeds.

I have two last points. We are still in the process of deciding how this evaluation should be done. We are trying to invent something new while at the same time trying to perfect it. I would, therefore, feel it is premature to think in terms of any joint Fund-Bank exercise. Ms. Lissakers suggested looking into the financial sector. I think it is premature for us to go beyond our limits to the Bank and choose a subject for joint evaluation. Let us first spend time on our evaluation, and let us be very clear in our mind over the next year or so on how exactly we are doing it, before we think in terms of expanding the scope to cover subjects of common interest to both the Fund and the Bank.

On the last point, I am happy that we have set up an evaluation team. This is a matter on which the Board has not been able to come to a view over the last two or three years. However, I am a little concerned about locating it in the Office of Internal Audit and Inspection. In my assessment, "internal audit and inspection" is a kind of a postmortem unit which typically looks into whether things are being done according to a pre-established framework of rules and regulations. For the evaluation purpose, we want it to go one step beyond. My suggestion is that we also are trying to look at whether the Fund design is proper or whether the design itself should be changed. My evaluation unit should not only examine whether the procedures were properly followed. I would also want it to look a little beyond, into "whether the surgery could have been differently performed to save the patient."

Mr. Berrizbeitia made the following statement:

I agree with Mr. Clark's idea to designate a small group of Executive Directors who, together with Management, would define the terms of reference of each evaluation exercise and the participation of outside experts. The group could also assist the board in monitoring the evaluation function during the two year trial period, by keeping abreast of the evaluation work as it progressed over time, and possibly by informing the rest of the Board before its conclusion, if the group considered it desirable to do so.

Since more than one evaluation is to be undertaken simultaneously during the trial period, it may also be convenient to consider a different group of Executive Directors for each evaluation study, although some overlap would be desirable. This is desirable not only because of the diversity of interests and expertise among Executive Directors, but also to distribute the burden of responsibility more equitably amongst us, and the overlap is intended to ensure that the experience of one group is effectively transmitted to the other.

I agree with the Managing Director that we must be prepared to experiment and to learn from experience as we go along. So far, experience suggests to me that the more focused the subject of evaluation, the more effective is the constructive criticism achieved by the process. Although the Whittome report and the recent evaluation of technical assistance by MAE are not generally comparable, and many of you will recall that I disagreed with much of the contents of the former, the fact that its subject was more focused probably contributed to the usefulness of some of its recommendations, some of which are being reflected in the improvements of our Surveillance activities.

Similarly, I feel that experience argues in favor of greater reliance on outside experts, supported by the appropriate departments, not the other way around. In theory, the use of outside experts should contribute to promote greater detachment and enhance the objectivity of the analysis. This, by the way, also argues against the establishment of a permanent evaluation unit, and rather more in favor of the ad-hoc approach which we are considering. I therefore consider that evaluations undertaken during the trial period should tend to emphasize the use of outside experts.

Like Messrs. Geethakrishnan and Grilli, I feel that evaluation projects would benefit if they build upon prior internal reviews, since they would tend to concentrate on issues that have already been given priority and would help to evaluate the internal review process itself.

As regards the choice of subjects for future evaluations, I agree with the proposed evaluation of ESAF-supported programs and the suggested focus on a few, specific issues. In this context, I feel that program design and program implementation deserve equal emphasis, and I would suggest that the analysis not only cover a broad review of ESAF programs, but also evaluate two or three cases in more detail, so as to provide depth to the analysis.

The effectiveness of performance criteria in Fund programs goes to the very heart of program design and implementation and lies at the core of the Fund's activities. I therefore consider that this is a very significant topic that deserves intensive consideration in the context of our evaluation process and I strongly support the suggested evaluation study. In this case, the group of Executive Directors will have to play a particularly significant role in designing the required terms of reference, so that the study is well focused and productive, and we have already heard some useful ideas from some previous speakers.

Although I have strongly supported the need to discuss the issue of program ownership and support for program implementation, like Messrs. Clark and Kafka I am not sure that this is an appropriate subject for evaluation, but that it is perhaps more related to program design. In this context, I would suggest that the whatever study is agreed upon, it should consider the role of communications policies, both by the Fund and the authorities, in achieving more or less satisfactory program results. I also agree with the idea of linking the issue of ownership with the evaluation of ESAF programs.

Finally, although I support Ms. Lissakers's suggestion for an analysis of the role of the Fund and the Bank as regards banking sector issues, I feel that the important issue here is the need for a clear delineation of the respective responsibilities and roles of each institution, so as to avoid overlaps and misunderstandings. However, I agree with Mr. Kafka that a joint evaluation per se may not be needed nor desirable at this point in time.

Mr. Dlamini made the following statement:

I welcome this additional discussion on the evaluation function in the Fund and I am broadly in agreement with the Managing Director's approach on how to proceed with our work in this area.

Hence, I concur with the Management that we should limit our initial evaluation work to two or three cases a year. I can also endorse the proposals on the topics that should be the object of the evaluation exercise during this trial period. In particular, I am are pleased to note that among the proposed priority cases to be considered during this initial stage, preference has been given to evaluate the experience with ESAF supported programs. This evaluation, which is long overdue, should be able to provide us with analytical considerations on the sources of the weaknesses in cases where, after years of adjustment efforts, no substantive improvement in the overall macroeconomic stability is visible. I agree with the Managing Director that the study should be looking, not so much into the objectives of the macroeconomic policy strategy of these programs. It should focus however, in evaluating if the approach and the instruments to reach such goals are indeed, the most adequate to the circumstances of a specific country. In this regard, it is important, among other elements, to focus the analysis on the correlation of the adjustment pace with growth performance, and if the pace of adjustment suits the actual capacity of implementation. The envisaged evaluation, therefore, should be seized as an excellent opportunity to undertake a deeper and comprehensive analysis of the matter, or we will risk limiting ourselves to little more than the scope of the regular reviews of the ESAF programs, undertaken by the Fund. In this context, I view the participation of the outside experts in this evaluation as highly desirable, in particular, by involving academics and other experts of the countries that will be the subject of review.

I see the evaluation of the issue of ownership and implementation support as very important and to which we should accord utmost priority. In our view the issue of the ownership of the program is critical not only for the success of the reform process but, most importantly, to secure the required domestic political and social support. Its conclusions might also assist in facilitating the analysis of the ESAF programs. We can thus, go along with the approach suggested by the Managing Director regarding the scope and the involvement of outside experts.

On the procedural matters, I agree with those who are of the view that the Board should be consulted on the setting of the terms of reference of each evaluation case and on deciding on the participation of outside experts in a specific evaluation exercise.

Mr. Barro Chambrier made the following statement:

This chair strongly supports the Managing Director's proposals to strengthen the Fund's evaluation functions, during a two-year trial period. I agree that we must be selective in deciding the topics that could be reviewed in order to be efficient. We were particularly pleased with the findings of the team of outside experts who have evaluated MAE technical assistance provided to member countries viewed from the Fund's perspective. We also welcome the fact that studies by outside experts are under way to evaluate Fund's experience with countries' programs.

As we mentioned during the discussions on the work program, our constituency has a particular interest in a review of the effectiveness of ESAF programs. Our interest in this review is to see how the facility can be improved and adapted to each country's needs. While we agree broadly with the Managing Director's proposal on this review, we also share the view that the panel could focus more on the design of the program so as to achieve better results. I share Ms Lissakers view that the panel could also look at ways Bank and Fund coordination could be improved in the design of the programs. I agree with Mr. Schoenberg that we must be specific when we decide to evaluate ESAF. In that context, a study could be carried out to examine how ESAF programs have been effective in addressing the external debt problems of the developing countries and whether this support is likely to alleviate the multilateral debt problem of a number of countries.

In evaluating the success of adjustment programs in aid recipient countries, it is our view that the ownership issue is important, and we share the Managing Director's proposal regarding this review.

As regards the effectiveness of performance criteria in Fund programs, we feel that it could be useful to examine the consistency of performance criteria introduced in ESAF-supported programs. Also the number of performance criteria and how high or how low should these criteria be set are issues that need to be looked at.

On procedural aspects we broadly share the views of Mr. Clark and we agree that a small group of Executive Directors could monitoi the evaluation function during the trial period.

Mr. Evans made the following statement:

I think this is proving to be a constructive discussion. I hope we can decide today both on the priority topics and on the proposal for a small group of Executive Directors to start work on these issues soon.

On the topics for possible evaluation studies, I agree with many other speakers that we need to concentrate on core issues. We certainly need to do more to define what we want the studies to focus on before we can take decisions on the desired balance between Fund staff and outside experts, but in general I think it is important to secure the involvement of outside experts. I would prefer to ask outside experts to take the lead in all these studies after the Board has approved their terms of reference.

In terms of outside experts, I note that a certain ex-central bank governor and Chief Economist at the World Bank, is about to retire. Given the usefulness of ex-World Bank chief economists to this institution, we might try to take advantage of Michael Bruno in some capacity or other.

I think the Fund's work on banking soundness and banking sector reform is very important, and it has become much more important in the light of both the Mexican crisis and also banking crises in a number of transition economies. I agree with Mr. Berrizbeitia that this work needs to focus on what the Fund and the World Bank should be doing, how they should do it, and how they should manage what I think is an inevitable amount of overlap. However, I do think an evaluation of this subject should also address the question of what can we learn from past experience. Therefore, I would strongly support some early work to design a terms of reference in consultation with the World Bank. I appreciate that this has some delicate aspects, but I think this is manageable and an important issue on which we should try to make some progress.

I believe the ESAF evaluation should take priority. I would like to see the study focus on the role of the Fund rather than on the performance of the program countries and, in particular, to try to find the lessons the Fund itself should learn from past experience. I think it was Mr. Geethakrishnan who suggested that we could look at six to eight case studies in depth, building on the evaluation we have already seen from area departments and the Policy Development and Review Department. I think, as Ms. Lissakers suggested, we could include in this study the issue of ownership and implementation.

I could also go along with the proposal for a study on the effectiveness of performance criteria. I think this would enable us to give a useful response to inside and outside criticism of the Fund's performance criteria benchmarks. Even if, as Mr. Clark's quotation from outside critics suggested, the number of performance criteria has not been set up with the purpose of making evaluation more difficult, it is possibly an effect of the present system that it does so. On the performance criteria and benchmark issue, I think we do need to try to focus a study beforehand rather than try to cover too many issues. On publicity, I am content to follow Mr. Clark's advice and the Chairman's own instincts.

With regard to the Office of Internal Audit and Inspection, I would hope and expect its Director would play a key role in guiding the development of evaluation, in addition to other elements in his work program. Like Mr. Kiekens, I see some advantage in his office reporting directly to this Board, as well as to management.

I have just two thoughts on the work program of this unit. The first is that I hope it will be able to look at the issue of statistics gathering in both the statistics and area departments in the context of ensuring efficiency. We frequently hear concerns about the duplication of effort. Second, I would invite the office's Director to tell us about existing procedures for self-evaluation of Fund work, country work, and surveillance. I think it is useful to have a foundation of self-evaluation of the Fund's work to highlight the lessons we can learn. I believe this is a vital complement in the process of ad hoc evaluation which we are now formalizing.

On the next steps, my preference is for a small group which we would ask to prepare work for this Board. I can certainly go along with Mr. Clark's follow-up proposal involving some revolving members, but I think it is important to have some continuity. I hope the Chairman will arrange, in consultation with our dean, to canvass us all over the next few days or weeks to see who would be interested in taking part in such a group, and I would hope that this group would indeed have the support of the Office of Internal Audit and Inspection for help and advice in drawing up proposals for the Board's consideration.

I agree with Mr. Geethakrishnan that the role of the group needs to go rather beyond what is written in the Managing Director's statement. So I hope that the process of selecting a small group can start soon. As Mr. Waterman suggested, the group could report back to the Board before the recess with some recommendations as to where we go next.

Mr. Wijnholds made the following statement:

Like some previous speakers, I would like to see this evaluation function as one offering the possibility for second opinions. In medical work, second opinions are not uncommon, but it is usual to use them sparingly. I agree with other speakers, such as Mr. Schoenberg, who say that we should not overdo things, and limit this exercise. We have talked about two or three studies a year. I think that would really be the limit.

I think it follows logically that, if you go for the second opinion type of approach, you would involve outside experts. I agree with Mr. Clark that in virtually all cases that would seem to be logical, although not to the exclusion of the Office of Internal Audit and Inspection.

I also agree with Mr. Clark that setting up a small group of Directors might be useful. We can determine after a trial period whether we need a full committee to work on this. I am open to that. In fact, Mr. Kiekens's proposal is an interesting one. He asks: should not the Board be involved a little more in terms of the reporting of the Office of Internal Audit and Inspection? If that were the case—and I have not made up my mind—a committee approach might suggest itself.

Having twice agreed with Mr. Clark, I now have a little difference of opinion with him. I was a little surprised by his reference to the adherence of the public choice theory. In fact, I think some of these people, in their opinions of international organizations, are quite cynical. Certainly, I would not immediately look for them as outside experts when we are conducting studies. I am not a great believer in conspiracy theories—not that Mr. Clark is as he said he did not necessarily agree with them.

On the topics to be discussed, I think there is a general feeling that an ESAF study would be useful, and I think the suggestion to include in that study matters of ownership and implementation would be very helpful. Also, I believe a performance criteria study could be an interesting exercise.

There was also the suggestion made earlier by Ms. Lissakers on looking at the banking sector reform, which is indeed an area where there are some difficulties concerning the Fund's and the World Bank's role. However, I did listen carefully to Mr. Kafka's objections in trying to make it a joint effort. That may be difficult, but I am looking forward to management's proposal. I think something needs to be done, but, as I said at the time of the work program discussion, I would like to avoid getting into a finger pointing exercise between the Fund and the World Bank.

On publication, I am in favor of transparency. I have said so on several occasions. Mr. Kaeser made the point that, if we start to pick and choose what to publish, we may have a problem. But there may be some practical difficulties. For instance, the suggestion has been made to make use of in-depth case studies.

I think we might run into trouble if we want to publish such reports. I do not know how to tackle this problem, but I just wanted to flag it. In general, I think it is right to publish such evaluation reports, particularly when we involve outsiders.

Mr. Al-Tuwaijri made the following statement:

I welcome this opportunity to discuss the issue of evaluation function in the Fund. One of the most important functions of the Executive Board is to evaluate the work of this institution. It is with this belief that we have advocated that the Board takes a leading role in the selection of evaluation studies and approval of terms of reference. In this connection, I can endorse Mr. Clark's idea that a group composed of a few Executive Directors be designated to closely monitor the evaluation function, and I look forward to your proposal for such a group.

Turning to the suggested topics for evaluation, I can endorse the review of ESAF-supported programs, and like previous speakers, would like to stress the importance of including outside experts in this exercise.

As regards the evaluation of the effectiveness of performance criteria, I believe that the evaluation should focus on whether it is more effective to have very ambitious performance criteria that usually are not adhered to, or more realistic ones. The review should also look into the issue of waivers. Moreover, I find Mr. Mirakhor's suggestions to look at the issue of program design worth serious consideration. That makes it important not to proceed on any of these proposals until the group of Executive Directors has been formed and reviewed these proposals in detail.

With regard to the idea of joint review with the Bank, I can endorse the position taken by Mr. Kafka, Mr. Schoenberg and others.

Finally, I welcome the strengthening of the Office of Internal Audit and Inspection, and I am certain that it will help enhance the effectiveness of the Fund.

Mr. Shaalan made the following statement:

I very much welcome today's further discussion on the evaluation function. First, on the selection of topics. I certainly favor an evaluation, led by outside experts, of some of the more important aspects of ESAF as described in the Managing Director's statement and elaborated on by Mr. Waterman. In this context, I also see much merit in Ms. Lissakers's's proposal to carry out an in-depth analysis of the experience of a small sample of ESAF countries. Another high priority topic, in my opinion, would be the merit of setting optimistic goals in programs and an evaluation of performance criteria.

Like some other colleagues, I am skeptical of the priority accorded to the ownership issue. In particular, I am not sure what it means or what the focus of the evaluation would be. Accordingly, before embarking on this subject, further clarification of its content would be in order.

I see much merit in having a rotating group of Executive Directors participate in and monitor the evaluation process (with one or two permanent members). On follow-up procedures, I support Ms. Lissakers's ideas. These procedures would certainly enhance the usefulness of the review process.

In principle, I have no problem with the joint evaluation by the Bank and Fund of banking soundness and reform, as these are important issues that have a direct impact on our core activities. I would, however, prefer to await a report from the Managing Director on his deliberations with his counterpart in the Bank.

Finally, on publication of our evaluation studies, I continue to be skeptical. Mr. Clark has on various occasions reminded us of the experiences of the Canadian government, which are interesting and useful. But I wonder whether what may be desirable for a major member country is by necessity good for an international agency like the Fund.

Mr. Fayolle made the following statement:

Like previous speakers, I think the rationale for an evaluation is to get a second opinion on issues which have been acknowledged by this Board as very important ones, and on which our work has not been sufficiently conclusive. I agree with speakers who have stressed the need to limit the number of evaluations. For example, I fully share Mr. Kaeser's view that an ESAF evaluation should focus on weaknesses detected during the previous review. Also, I have no difficulty in supporting an evaluation of the effectiveness of performance criteria. Concerning the idea of a joint evaluation, I support Mr. Berrizbeitia's view.

Finally, on the procedures issue, I have no problem with the idea of a small group of Executive Directors, but, like Mr. Schoenberg, I think this Board has to remain very closely involved at all stages.

Mr. Vernikov made the following statement:

First of all, I welcome the Managing Director's statement as a basis for today's discussion. At this point in time, allow me to comment briefly on three issues.

The role of external evaluations. I agree with Messrs. Grilli, Kiekens, and Andersen, that it will be appropriate to start with internal evaluations, and then, only if necessary, involve outside experts. Certainly, external expertise is not a solution in cases where the Executive Board is divided on policy matters.

If we still decide to go for an external evaluation, then a clear division of labor between those experts and the staff will be needed. In order to avoid duplication of work, I see merit in the concept of a "second opinion" being sought from external experts on a problem previously studied by the staff. Perhaps, emphasis should be placed on the intellectual input from outside experts rather than on field work (in my opinion, within the evaluation effort related to the activities of the MAE Department, those experts carried out an excessive amount of field work, including traveling, questionnaire filling, etc.).

Topics for evaluation in the immediate future. I agree with those Directors who give a high priority to an evaluation of the effectiveness of ESAF-supported programs. This is particularly relevant in the context of our discussions on the modalities of future financing of the ESAF as well as its eventual role in the HIPC initiative. The evaluation must be centered on the design of ESAF programs and on lessons to be learned by the Fund from problem cases.

As for "ownership and implementation support," I agree that this is a very important and challenging topic. I would, however, consider it a little premature to submit it to external evaluation. The reason is that we might not be ready now to formulate clearly the questions we want external experts to address. Perhaps we need some more time to think about the problems of local ownership and so on, and meanwhile to hear the views of the staff—both from the Policy Development and Review Department and area Departments—on these matters.

Procedures. In the course of the February 1996 meeting, this chair held the view that the Executive Board's prerogative of policy making, which includes the evaluation function, should not be delegated to any other body, be it an independent evaluation unit or a group of Directors. Although we still consider this view to be valid, we could nevertheless go along with the modifications to the idea of having a small group of Directors monitor evaluation activities. Particularly, I would support Mr. Grilli's point about small ad hoc groups of Directors being created for each evaluation exercise. Several speakers have mentioned the need for continuity. However, Executive Directors, with few exceptions, serve in the Fund for just a limited period of time, so we will end up having a continuity of Chairs rather than of personalities. Flexible groups with variable compositions seems to be a more appropriate solution.

Mr. Mirakhor made the following statement:

Given the history of the subject before us today, I agree with Mr. Evans that this has been an impressively useful discussion. I must admit, it was beyond my expectations that we would have so many constructive suggestions. Judging by previous discussions, I did not think we could reach this amount of consensus.

I must say I liked Mr. Kiekens's four principles of evaluation. As he said, ESAF eminently satisfies these principles. I also agree with Mr. Wijnholds that a study of performance criteria and ownership questions can and perhaps should be addressed under this topic.

Like Mr. Geethakrishnan and Mr. Kaeser, I believe that the internal review of ESAF was very well done and very comprehensive. Therefore, the value added from outside evaluation would come from what Mr. Kaeser, Ms. Lissakers, and others have called a second opinion.

On the procedures, I can support Mr. Clark's second proposal: that a group of Executive Directors, with some core continuity, help design the terms of reference for the evaluation teams. However, Mr. Saito's remarks should be reiterated that: once the terms of reference are defined and the members of outside evaluation teams have been selected, they should be allowed to work in full autonomy.

I also find useful Ms. Lissakers's idea of follow-up monitoring and look forward to a definition of its modalities.

The Director of the Policy Development and Review Department considered that the issue of obtaining "second opinions" needed to be considered in its operational context, particularly with respect to work that had been previously undertaken within the Fund. A host of new issues had arisen since the previous ESAF review, for example, a range of structural adjustment issues and questions surrounding privatization. Therefore, the time frame for which second opinions would be sought had become critical. In addition, it should be borne in mind that the topic of program design was extremely complex—involving technical extensive work and familiarity with Fund data sources—and and would need to be better defined if outside experts were to be involved.

The Chairman made the following concluding remarks:

I have noted, and share the view expressed by many Executive Directors, that it will be important to build on the existing policies and practices for in-house evaluation, including by this Board and by the Policy Development and Review Department, and from time to time by outsiders. In the period ahead, we must be prepared to experiment and to learn from experience. Executive Directors agreed that we should in general undertake no more than two or three evaluations per year, and that these reviews should be well focused and respond to a need for review. Executive Directors also noted that procedures on follow-up on the findings of reviews must be worked out, given that reviews are intended to identify changes that may be needed. In that regard, management is presently considering the appropriate follow-up to give to the recent review of activities of the Monetary and Exchange Affairs Department, and Directors will be informed of that soon.

On the choice of topics for the evaluations in the period ahead, Directors confirmed their strong interest in a review of the experience with ESAF-supported programs from a medium-term perspective (1986-95), and with a specific focus on a few key issues of concern rather than on the basic macroeconomic policy strategies of these programs, along the lines mentioned in my statement. Executive Directors generally agreed that the exact modalities of the involvement of outside experts would need to be worked out. In the process of elaborating and refining the scope of this study, the choice of outside experts, and the setting of their terms of reference, a small group of Executive Directors should be involved. It was also proposed that the review could focus on areas identified in earlier in-house evaluations, for instance, the issue of prolonged use of ESAF resources, and would also address the lessons to be learned by the Fund.

In addition, while Directors were attracted by the study of the issue of ownership and implementation support, some Directors invited us to explore whether the ESAF study could not include those aspects. There was also support for an evaluation of the effectiveness of performance criteria in Fund programs. Executive Directors provided useful guidance on what they would regard as the appropriate scope of these two studies. Their terms of reference, as well as the nature of involvement of outside experts, would need to be worked out, taking into account Directors' comments, and I will return to the Board with a concrete proposal. We will also involve a small group of Executive Directors in this work.

As regards other possible topics for evaluation, I would note, first, that there was considerable interest in the subject of the Fund's work in assisting in the efforts to promote banking sector reforms, including through policy advice and technical assistance, and we will explore that avenue. As indicated, and in light of today's comments, we will explore with our colleagues in the World Bank the issues involved in the activities of the two institutions. I will come back to the Executive Board with a report on these contacts so that it could then be assessed whether there is a need for an evaluation, and if so, in what form, without ruling out the possibility of a joint evaluation.

Executive Directors also made interesting proposals for other evaluation topics, and we will consider these and come back to the Executive Board about them on a later occasion.

On the procedural aspects, I think we are now well agreed on the general approach to evaluations: management will make proposals to the Executive Board for a choice of topics and the method of carrying them out, including with respect to the participation of outside experts. We will take into account the suggestions made by Executive Directors in the course of the Executive Board's day-to-day work. It was also agreed that the Executive Board would be closely involved in the choice of topics and in establishing the procedures for handling specific evaluations. In that respect, most Executive Directors supported the idea that a small group of Executive Directors be invited to pay particular attention to evaluation issues. Specifically, as I have already mentioned, they would be involved in defining the scope of reviews, the choice of outside experts, and their terms of reference. The possible support by the Office of Internal Audit and Inspection was welcomed, and it was envisaged that the small group would present proposals to management, and that the issues would be brought to the Executive Board for approval. With this in mind, I will make a proposal, in liaison with the dean, for the establishment and composition of such a group, keeping in mind the proposal for some rotation. Interest was also expressed in the publication of reviews, and it was agreed that this issue would be addressed before embarking on specific reviews. It was also agreed that we would review experience with our new approach to the evaluation function after two years, in early 1998.

Finally, I thank Executive Directors for their expressions of support for our recent steps to strengthen the Office of Internal Audit and Inspection, and their endorsement of the role to be played by its new Director. I have noted the views of Executive Directors on these changes, and on the broadening of the mission of this office. As far as its reporting rules are concerned, I would nevertheless hesitate at this stage to agree to an ad hoc change in the organizational rules of the Fund where the staff reports to management. However, you can be sure that we will find the appropriate way for the Executive Board to fully benefit, in the discharging of its responsibilities, from the help of this office. As for the work program established for this office, Executive Directors have formulated several suggestions, including a review of the resident representative program to which I attach great importance. I see the heroic efforts of many resident representatives, but there is, I think, much organizational progress to be made.

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

3. QATAR—1996 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1996 Article IV consultation with Qatar (SM/96/114, 5/14/96). They also had before them a background paper on recent economic developments in Qatar (SM/96/115, 5/16/96).

Mr. Shaalan made the following statement:

The Qatari authorities have made progress over the past two years in adjusting to lower international oil prices and in implementing important investments aimed at setting the conditions for sustainable long-term growth. Overall economic growth has been adversely affected on account of lower oil exports and a contraction in nonoil activities resulting from a tighter government expenditure stance. As is indicated in the staff report, declining oil and nonoil government revenues combined with the ongoing implementation of large public investment projects in the gas and oil sectors have also led to the emergence of short-term liquidity pressures and temporary imbalances. By the year 2000, as the new investments in the oil and gas sectors come on stream and adjustment efforts continue, the expectation is that these imbalances will be gradually eliminated and GDP is projected to rise substantially.

Qatar's overall development policy is aimed primarily at diversifying the economy into export-oriented energy-intensive industries in which the country has a comparative advantage. The strategy is based on enlarging Qatar's productive base by exploiting its huge proven gas reserves (the third largest in the world), developing new oil wells to maintain the level of crude oil production, expanding downstream activities including petrochemicals, and developing other export-oriented basic industries. It is expected that the private sector will play a leading role in the transformation of the economy. This role is likely to be enhanced with the increased emphasis being placed on the privatization of public entities.

The first phase of the giant North Field Natural Gas project was completed in 1991, and is already providing gas for domestic industries and for power generation. The next phase, which is expected to be completed in early 1997, involves two joint venture projects costing about $11 billion for gas gathering, liquefaction, and export of liquefied natural gas, mainly to Japan and other East Asian markets. Gas exports are targeted to increase gradually from 2 million metric tons in 1997 to over 9 million metric tons per year at the turn of the century. In the oil sector, new discoveries and the enhancement and upgrading of existing wells are expected to expand production capacity to 700,000 barrels per day by the year 2000. At the same time the production of natural gas liquids associated with crude oil production and petroleum refining operations are also being expanded. As a result, export revenues from the oil sector are expected to increase by about 60 percent to over $3.3 billion in the year 2001.

In the non-oil sector, efforts at diversification are concentrated in the petrochemical and fertilizer industries which are major users of domestic nonassociated gas, as well as in steel and cement production. New investments are under way which will lead to a doubling of production capacity in all these industries. The expansion in cement production is expected to turn Qatar into a net exporter of cement. To encourage private sector investment in medium-scale manufacturing, private sector access to capital is being facilitated by the establishment of the Qatar Industrial Development Bank and the Qatar Stock Market, which are set to begin operation in the second half of 1996.

On the budgetary situation, the Qatari authorities are aware that with the continued weakness in the global oil market, Qatar will continue to face short-term financial constraints until the large natural gas projects begin to pay off. The fiscal accounts are expected to improve gradually in the medium term and it is projected that the budget deficit will be eliminated by the year 1999/2000. The budgetary improvement is expected mainly as a result of the anticipated sharp increases in oil and gas exports as large investment projects are completed, as well as the continued expenditure restraint and non-oil revenue mobilization. The success of the expenditure restraint policy is reflected in the reduction of total expenditure from 52 percent of GDP in 1993/94 to an estimated 46 percent of GDP in 1995/96. However, this was accompanied by a decline in oil and non-oil revenues, limiting the fall in the budget deficit to 1 percent of GDP in 1994/95. While preliminary estimates based on developments in the first three quarters of the 1995/96 fiscal year indicate that the deficit would remain at the same level this year, a likely increase in investment income in the last quarter could improve the outcome.

The authorities intend to continue the strategy of containing expenditures and mobilizing nonoil revenues by upward adjustment of a number of fees and charges, including those on publicly supplied utilities. In 1996/97, the authorities intend to raise electricity and water charges for commercial use and to introduce charges on household consumption of these utilities above a certain threshold. Consideration is also being given to introducing a fee similar to a turnover tax on specified large businesses and to introducing charges for health services. A further increase in visa and work permit charges is also being considered. The expectation is that the implementation of these measures would mobilize additional revenues equivalent to 2 percent of GDP in 1996/97. In the event of an unanticipated large fall in oil prices, the authorities are ready to take additional revenue measures and to accelerate the implementation of their privatization program. Funds generated from privatization will be used to retire government debt. The recently announced official state budget for 1996/97 projects a deficit reduction of about 3 percent of GDP from the budgeted deficit for 1995/96. This budgeted improvement is expected as a result of strong expenditure restraint as well as the increase in revenues anticipated from the new measures. It should be noted here that the Qatari authorities have consistently been very conservative in their budget projections. For the past several years, actual budgetary outcomes have been significantly more favorable than budget projections.

Qatar's monetary policy continues to be aimed at the regulation of domestic liquidity in order to maintain a stable exchange rate and to ensure an open trade and payments system. In order to avoid crowding out the private sector, the authorities have sharply curtailed their recourse to domestic borrowing from commercial banks to finance the budget deficits. Over the past two years the budget deficits were financed primarily through a drawdown of foreign assets and foreign borrowing. With little growth in non-oil GDP, monetary expansion which had picked up somewhat in 1994/95 was very limited in 1995/96. The banks' liquidity position remained tight and banks borrowed abroad to meet domestic credit demand. To promote capital inflows and stem deposit migration, several steps were taken to further liberalize the banking sector. Following the partial interest rate liberalization which took place in 1994, the limits on commercial bank lending rates have now been completely eliminated and interest rates are market-determined. To strengthen bank regulation, reserve requirements on demand deposits were unified and those on time and savings deposits have been discontinued. The authorities are considering the issuance of government bonds to deepen the domestic capital market and to enhance their ability to regulate domestic liquidity and interest rates, thus facilitating the removal of deposit rate ceilings.

Reflecting the overall weakness in global oil prices, Qatar's external current account, which is heavily dependent on oil export receipts, has been in deficit over the past few years. The external balance is expected to improve gradually, as oil and gas exports increase with the completion of oil field expansions and the natural gas projects. Although the capital account registered record net capital inflows in 1995/96, the overall balance of payments deficit is expected to remain large with only a slight improvement over the past year. The authorities share the staff's concern that current projections for global oil prices, should they materialize, would call for further fiscal consolidation efforts to address these external imbalances. The authorities are also aware that the growth of public sector external debt, which increased as a result of the external financing of the budget deficit, must be contained and that the bunching of maturities needs to be avoided.

The authorities would like to thank the staff for its very useful recommendations which are now under serious consideration within the government. They also wish to record their appreciation for the valuable technical assistance provided by the Monetary and Exchange Affairs and Statistics Departments. This assistance has contributed to the greater efficiency of the banking sector and, as noted by staff, to a significant improvement in data compilation.

Mr. Al-Tuwaijri made the following statement:

It is encouraging that Qatar has made further progress in adjusting the economy and advancing the development strategy. Over the past two years, spending cuts amounting to about 6 percent of GDP were implemented. At the same time, the authorities have been forging ahead with their efforts to lay the foundations for sustainable private sector growth.

The ongoing development of the oil and gas sector will facilitate a substantial expansion of private sector activities and bode well for employment and growth. This should strengthen both the fiscal and external accounts over the medium term. Indeed, the baseline scenario indicates that these accounts will be in approximate balance in five years.

This favorable outlook notwithstanding, the staff paper shows that, in the interim, both the fiscal and external positions will remain under pressure. As a result, the debt to GDP ratio will continue to rise. Such debt buildup will reduce flexibility in the fiscal accounts and increases the risks to the outlook. As noted in Mr. Shaalan's statement, however, the authorities are cognizant of these risks and are in the process of addressing them. In this regard, I welcome the continued emphasis on reducing current expenditures.

On the revenue side, it is reassuring that the authorities intend to introduce revenue measures equivalent to 2 percent of GDP in 1996/97. Full implementation of these measures will not only strengthen the fiscal position but will also improve the structure of revenues. Moreover, the focus on raising utility prices and increasing fees and charges will improve resource allocation.

Turning to financial policies, the gearing of monetary policy to ensure exchange rate stability has served the economy well. Efforts to expand the bond market and to further liberalize interest rates will help deepen the financial market and encourage savings. Furthermore, the planned opening of a stock market would facilitate the mobilization of capital by the private sector and encourage capital inflows.

The ongoing efforts to strengthen financial policies and expand the oil and gas sector should improve the external position over the coming years. Moreover, the planned privatization program would promote capital inflows and enhance private sector participation. Qatar's liberal exchange and trade systems will greatly contribute in this area.

On statistical issues, I welcome the progress made by Qatar in improving the monetary statistics. The success in this area attests to the usefulness of the Fund's technical assistance. In this regard, I agree with the authorities that a technical assistance mission on government financial statistics methodology will be beneficial.

With these remarks, I wish the authorities the best in their endeavors.

Mr. Daïri made the following statement:

The staff has produced a clear and concise report which describes well recent economic developments in Qatar and the challenges in the period ahead. I am generally in agreement with much of the analysis and policy recommendations. The Qatari authorities deserve to be commended for the skillful manner in which they have adjusted the economy to lower international oil prices and for the impressive progress made in the development and expansion of the oil and gas sectors. The coming on stream of these investments promises to confer substantial benefits on the economy, laying the foundation for self-sustained growth and stimulating private sector investment in downstream activities. However, as the staff notes, the key policy challenge facing the authorities in the period immediately ahead is how best to manage the economy in the intervening years in the face of large domestic and external imbalances which have led to intense resource pressures and manifest themselves in a buildup of external debt and drawdown of official foreign assets. The authorities' official policy stance, which, inter alia, aims at eliminating the budget deficit by 1999–2000 through further efforts at raising nonoil revenues and containment of expenditures indicates that they are mindful of the need to redouble their adjustment effort so as to avert the risk of an intensification of short-term financial constraints. Clearly, maintaining an open exchange and trade system with a stable exchange rate and sound macroeconomic and structural policies will be critical to the orderly and timely implementation of the investments on which Qatar's long-term economic growth potential depends and in bolstering confidence in the overall conduct of economic policies. I welcome the recently announced state budget for 1996/97 that aims at reducing fiscal pressures through raising further nonoil revenues while continuing with strong expenditure restraint. However, a number of revenue-raising measures appear to be still under consideration, and it is not clear whether they will be implemented in full. Perhaps the staff or Mr. Shaalan could elaborate on this point. Nor is it clear whether the projected deficit reduction of around 3 percent of GDP from the budgeted deficit of 1995/96 will entail an actual fall in the deficit over the previous years' outturn, although we note Mr. Shaalan's important point that the Qatari authorities have consistently been very conservative in their projections with actual budgetary outcomes being more favorable than budget projections. The staff, for its part, has made the strong case for a front-loaded effort at deficit reduction in 1996/97, suggesting that it should be of a magnitude that would reduce the imbalance to a range of about 7 or 8 percent of GDP. It they see this level as being consistent with the authorities' own commitment to achieve fiscal balance by 1999–2000, while also allowing for a commensurate decline in the external current account and the faster reduction in external debt. Against this benchmark, it would be helpful if the staff could—if at all possible at this early stage in the announcement of the official state budget—provide information on what measures have been incorporated in the 1996/97 budget and whether the projected deficit or the expected outcome is broadly in line with the assessment of what is required to put the deficit on a more sustainable path. In this context, I wonder if the adjustment advocated by the staff for 1996/97 is realistic since even under the baseline scenario debt indicators are projected over the projection period to improve substantially. The staff's comments on these points are welcome.

Monetary policy in Qatar has been guided by the need to maintain a stable exchange rate and safeguard the integrity of the open trade and payments system. We welcome the authorities' decision to sharply curtail recourse to domestic borrowing for budgetary support and commend the steps that have been taken to further liberalize the banking sector.

As in the past, the staff continues to urge the authorities to eliminate the ceiling on deposit rates so as to discourage deposit migration and facilitate the rebuilding of banks' deposit base. There continues to be merit in that recommendation, even though it is to be recognized that the authorities have adjusted the level of deposit rates in a manner that has allowed them to closely track international rates. We support the staff in encouraging the authorities to give early consideration to the issuance of government bonds, which would not only deepen the financial market and enhance the authorities' ability to regulate domestic liquidity, but also pave the way for the eventual removal of deposit rate ceilings.

The authorities' development strategy rightly stresses the importance of reinvigorating the private sector so that it can become an important source of autonomous growth in the economy. The completion of major investments in the oil and gas sector, the establishment of a stock market, and early implementation of plans for privatization can be expected to provide a strong impetus to private sector involvement in the economy. A more clear-cut and liberal set of rules governing foreign portfolio investment and external ownership in privatized activities would, in our judgment, also help define the private sector's role in the economy.

We join the staff in cautioning against the potentially distorting effects of subsidized credits through the newly established Qatar industrial development bank, although I wonder whether a decision to rescind these subsidies can be taken unilaterally by Qatar alone.

The staff has made a number of useful points on labor market policies in Qatar, emphasizing the prospective demands for new skills and the need for steps to reorient educational priorities and develop new skills. They also call for increased integration of expatriate and national labor markets. Perhaps the staff could elaborate on this particular recommendation. We wish the authorities well in managing the challenges that lie ahead.

Mr. Song said that he was in agreement with the staff appraisal of recent economic developments and the staff's policy advice with regard to the authorities' future reform program. While he agreed with the staff that tight macroeconomic policies were needed for the stability of the exchange front in the near future, it was more important that the authorities make efforts to boost diversification of the economy as a medium-term strategy, in light of the current vulnerability of the economy to the volatility of world oil prices. In that context, government investment and financial support for the expansion of petrochemical industries and the development of downstream activities would be necessary. While the government's active support for both economic activity and fiscal consolidation could become increasingly competitive in the near future, he hoped that the authorities would be able to carry out their adjustment in a balanced fashion.

Mr. Guzmán-Calafell made the following statement:

Notwithstanding the important adjustment efforts carried out over the past two years, the Qatar authorities face a complicated macroeconomic situation. The rate of inflation has remained very low, but output growth declined during 1995, the economy is affected by current account and fiscal deficits which as a share of GDP are recording double digit figures, and the size of the external debt is high. Furthermore, these macroeconomic disequilibria may widen in coming years even in the absence of an external shock.

The situation is particularly challenging in view of the high dependence of the Qatari economy on oil revenues. With the oil sector accounting for over 30 percent of GDP, around 70 percent of merchandise exports, and 65 percent of total budgetary revenues, fluctuations in oil prices have a major impact on the domestic economy. The behavior of oil prices is of central importance also for other nonoil activities, since the latter are heavily influenced by the behavior of public finances, closely dependent in turn on the evolution of the oil sector.

In this context, as noted by the staff, the central question from a macroeconomic standpoint in the short run is how to achieve an orderly reduction of the macroeconomic imbalances in the next few years, that allow a smooth transition to the period when the economy is expected to benefit from sharply increased production and exports of gas and oil. The strategy proposed by the authorities in this regard is clearly a step in the right direction. The authorities' willingness to adopt additional revenue measures and to accelerate the privatization program if this is needed is also reassuring. However, the staff's concerns regarding the speed of fiscal adjustment incorporated in this strategy are understandable, given the substantial vulnerability of public finances to the fluctuations in oil prices and in international interest rates.

The staff proposes to front-load the adjustment effort to reduce sharply the budget deficit in the short run, through a number of measures that would yield an increase in nonoil revenues of more than 3 percent of GDP in fiscal year 1996–97. I would be interested in hearing an explanation by the staff of the restrictions that would be faced to set in motion an effort of this scale, as well as of the authorities' views in this connection.

With respect to exchange rate policy, I agree that the current system is working adequately and that there is no reason to modify it. In the case of monetary policy, I welcome the authorities' intention to continue with a prudent stance, and their determination not to monetize the fiscal deficit through central bank accommodation. However, it is important to bear in mind that the existence of fiscal deficits of 11 to 12 percent of GDP may jeopardize the achievement of this objective. This stresses the importance of reinforcing the efforts of fiscal consolidation.

For the medium and long run, the authorities intend to follow a growth strategy based on privatization, realistic public prices, and a reorientation of labor policy. I welcome these measures, as well as the efforts being made to increase the production capacity in nonoil sectors and to encourage private sector investment in medium-scale manufacturing activities, as described in Mr. Shaalan's statement. The implementation of adequate policies of structural adjustment is important not only as a response to the economy's vulnerability to the fluctuations in oil prices, but also in view of the expectation that at the present rate of exploitation the known oil reserves will run out in about 25 years.

With these comments, I wish the Qatar authorities every success in meeting the challenges ahead.

Mr. Rainford made the following statement:

I just want to take the opportunity of associating myself strongly with those Directors who call for stronger up-front adjustment than seems to be the case according to the staff report. A country like Qatar, unlike so many other developing countries, can afford to take stronger adjustment measures with relatively little pain from the point of view of the level of employment prevailing, the level of income prevailing, and so on. Ordinarily, I think it would be best for countries not to borrow their way out of the problems they face, but this is even more so in the case of Qatar, which, can, in fact, afford adjustment without too much social pain.

I would like the staff to comment on two other points. One is the suggestion for diversification as mentioned in the staff report. The action that is being pursued by the authorities seems to focus on a diversification that is essentially linked or anchored to the oil industry itself. Of course, every effort should be made to exploit possibilities in that direction. At the same time, there is a need for diversification on a wider basis, and I wonder whether that is now an area of concern for the authorities and what their long-term outlook for that is. And second, on the question of the management of the reserves, I noted that official reserves are held partly by the central bank and partly by the government. I also notice that over the last four years there has been a steady decline in the official reserves of about 30 percent. Almost all of that decline is attributable to the decline in the government-held foreign assets. I wonder if there is a case for centralization of the management of the reserves. If the reserves had, in fact, been centralized in the central bank, would this have led to a slower decline in reserves and a related stronger containment of expenditure?

The staff representative from the Middle Eastern Department noted that the 1996/97 budget proposed an improvement in the deficit position over the 1995/96 budget; it was also an improvement over the staff's projections. If the current oil prices were to prevail for the remainder of 1996, the fiscal position would be better than presently projected by about QR 600 million, that is, about 2 percent of GDP. However, as oil prices were difficult to predict, it would not be prudent to rely on oil revenues to bring about the necessary fiscal adjustment. The authorities had responded favorably to the staff's suggestion to introduce measures—such as fees and charges on utilities and broad-based taxes—to mobilize non-oil revenues. They had indicated that they would explore those revenue-raising measures after the announcement of the budget. Owing to the lack of an institutional structure, however, it might be difficult for the authorities to introduce those taxes. The authorities had, in the past, tended to be conservative in their projections and budgetary outcomes had exceeded expectations, and the staff hoped that the outcome in 1996/97 would be better than projected. The staff expected that the budget deficit would be reduced to 7–8 percent of GDP in 1996/97, which would help the authorities in their goal toward reducing the external debt. If the oil and gas projects were implemented as planned, the authorities should be able to eliminate the deficit by 2000/2001. However, given the rigidities with respect to government expenditures and structural distortions, it would not be desirable to rely solely on increases in revenue to eliminate the budget and current account deficits. The authorities were confident that they would be able to sustain an adjustment of 3–4 percentage points of GDP, but it remained to be seen whether the adjustment would focus on increasing revenues or lowering expenditures. According to the 1997/98 budget, they planned to do both.

The planned subsidized credit from the Qatar Industrial Development Bank was distortionary, the staff representative considered. The authorities had indicated that the subsidized credits would be restricted to small- and medium-scale export-oriented industries. Other countries of the Gulf Cooperation Council (GCC) provided concessional financing for export industries, and that could be one reason why the authorities had introduced that scheme.

Qatar had a liberal expatriate labor policy, and the supply of expatriate labor was perfectly elastic, the staff representative observed. Over time, wages in the expatriate labor market had declined. Like other countries in the region, the Qatar labor market was segmented. However, with the expansion of the private sector and its growing demands for the cheapest source of labor, there would likely be a convergence of wages and benefits in the expatriate and national labor markets. The national labor force was relatively small and was almost entirely employed by the government. However, in order to meet the private sector's growing needs for skilled labor, the authorities had begun the process of reeducating and retraining the national labor force.

The expansion of the gas sector would increase the economy's dependence on the hydrocarbon sector rather than reduce it, the staff representative stated. In order to promote diversification of the economy, substantial investment had been undertaken in export-oriented downstream activities, including petrochemicals, and basic industries such as steel, cement, and fertilizers. All those sectors were directly or indirectly gas or petroleum based, making the economy largely dependent on the oil and gas sectors. Given the volatility in oil prices, it was essential that the economy have a strong external reserves position.

A large amount of official foreign assets were held by the government, the staff representative from the Middle Eastern Department noted. Those assets provided the government with the cash balances to meet its current expenditure requirements and to earn investment income, which went into the budget as nonoil revenue. The role of the central bank was to ensure exchange rate stability and to meet the foreign exchange requirements of the private sector, whenever necessary. The private sector had generally relied on its own resources or on commercial banks. The question of whether or not official reserves should be centralized was essentially a political one. The important issue was that the central bank had adequate resources to enable it to smooth out any fluctuations in the exchange rate and to ensure confidence in the currency.

Mr. Daïri considered that the staff had overestimated the severity of Qatar's external debt position. Compared with that of other developing countries, Qatar's debt position was not severe. However, he agreed that given the volatility of oil prices, the authorities should strengthen their reserves position. With respect to reserve management, he was under the impression that the authorities did not expect to make use of official assets held abroad.

The staff representative remarked that the staff was concerned about the external debt position, partly because the debt had built up rapidly. There were two components of the external debt. One was the nonguaranteed debt, which was not a matter of concern because that was the responsibility of the foreign investors who were collaborating with the government in the gas sector. The second component of the debt was the sovereign, that is, government-guaranteed debt. A debt-service ratio of 20 to 25 percent was substantial. The staff was concerned that the growing external debt would hamper Qatar's ability to borrow from international capital markets.

Mr. Shaalan noted that Directors had expressed concern about the short-term pressures arising from expansionary fiscal policies, and which were reflected in the increasing current account deficit and foreign debt. It was important to bear in mind that, over the past two to three years, the authorities had cut expenditures by about 6 percent of GDP. The 1996/97 budget targeted a further reduction in expenditures. Those efforts notwithstanding, Qatar continued to have a budget deficit. That was because of the increase in expenditures to finance an expansion in the oil and gas sectors. In other words, they were investment, rather than consumption expenditures. It had been suggested that, in view of Qatar's high per capita income, the authorities ought to be taking more stringent measures. There were numerous examples of countries where the authorities found it difficult to take the necessary supplementary fiscal measures, despite high per capita incomes. The Qatar authorities were cognizant of the emerging pressures in the short run and had begun to take appropriate measures. The medium-term outlook was favorable, with projections of a balanced budget and a healthy balance of payments situation.

As Qatar had a comparative advantage in the oil and gas sectors and as it was a small country, the focus should be on exploiting further the oil and gas sectors rather than on diversifying the economy, Mr. Shaalan considered. While oil prices were volatile, the appropriate response to mitigating the economy's vulnerability to price fluctuations was to build up the external reserves position. Finally, he agreed with the staff's response regarding the centralization of reserves, and considered that centralization would not have resulted in a slower decline of reserves.

Mr. Shaalan thanked Directors for their comments, which he would convey to his Qatari authorities.

The Acting Chairman made the following summing up:

Executive Directors were in broad agreement with the staff appraisal. They commended the authorities for intensifying the adjustment effort in the past two years through increases in nonoil revenues and expenditure restraint, and for advancing the development strategy to lay the basis for private sector-led growth.

Directors noted that the development of natural gas resources would sharply increase export receipts and improve significantly the financial position in the medium term. However, Qatar could face interim financing constraints if the budget and external current account deficits remained high during the next three to four years. It was noted that a further increase in the external debt/GDP ratio would reduce the flexibility of fiscal policy and pose risks to the outlook, especially in view of Qatar's vulnerability to exogenous shocks.

Against that background, Directors welcomed the authorities' intention to intensify the adjustment effort in order to eliminate the budget deficit by 1999/2000, expand the role of the private sector, and diversify the financial market. In this regard, it was important to make substantive early progress in reducing the budget deficit so that external financing requirements could be reduced and the buildup of debt-service payments contained.

Directors welcomed the authorities' intention to implement revenue measures, including the speedy and substantive increases in fees and charges on government services and publicly supplied utilities, along with a further containment of current expenditures. They encouraged the authorities to expeditiously establish the institutional infrastructure that was needed to raise nonoil revenues, including through consumption and turnover taxes, which would also help improve the structure of the budget.

Directors encouraged the authorities to strengthen structural reforms. They supported an early elimination of the remaining controls on deposit rates, a speedy establishment of the stock market with freer access to foreign portfolio investment, and the issuance of government bonds. Directors also encouraged the authorities to move forward with a clearly defined privatization program supported by an explicit widening of the scope of the private sector. In this regard, steps should also be initiated for reorienting educational priorities and for retraining of Qatari labor with a view to creating skills that would be needed by the private sector over the medium term.

Directors commended the authorities on the maintenance of an open trade and payments system. They stressed the importance of prudent fiscal and monetary policies for ensuring the stability of the exchange rate.

Directors welcomed the improvements in the currentness, quality, and coverage of economic data. They stressed the importance of implementing recommendations of the Fund's technical assistance mission in order to make further progress in this regard.

It is expected that the next Article IV consultation with Qatar will take place on the standard 12-month cycle.

4. SOCIALIST FEDERAL REPUBLIC OF YUGOSLAVIA—MEMBERSHIP IN THE FUND OF SUCCESSOR STATES—EXTENSION OF PERIOD FOR FULFILLMENT OF REQUIREMENTS

The Executive Directors agreed to extend until December 14, 1996 the period for the fulfillment of the requirements for membership in the Fund by the successor states of the former Socialist Federal Republic of Yugoslavia.

The Executive Board took the following decision:

The period under paragraph 3(d) of Decision No. 10237-(92/150), of December 14, 1992 within which a successor may succeed to the membership of the Socialist Federal Republic of Yugoslavia in the Fund is further extended through December 14, 1996.

Decision No. 11272-(96/55), adopted
June 7, 1996

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/96/54 (6/5/96) and EBM/96/55 (6/7/96).

5. RELATIONS WITH WORLD TRADE ORGANIZATION—CONSULTATION WITH WTO COMMITTEE ON BALANCE OF PAYMENTS RESTRICTIONS—FUND GUIDANCE

The Executive Board approves the recommendation with regard to the guidance statement for the Fund representative attending the consultation of the WTO Committee on Balance of Payments Restrictions with Tunisia, as set forth in EBD/96/68 (5/23/96).

Decision No. 11273-(96/55), adopted
June 6, 1996

6. TECHNICAL ASSISTANCE—FRAMEWORK ADMINISTERED ACCOUNT—ESTABLISHMENT OF AUSTRALIA—IMF SCHOLARSHIP PROGRAM FOR ASIA SUBACCOUNT

In accordance with the terms and conditions of the Instrument establishing the Framework Administered Account for Technical Assistance Activities (Decision No. 10942-(95/33)), as amended, the Fund hereby approves the establishment of the "Australia-the Fund Scholarship Program for Asia Subaccount," which shall be used by the Fund to administer resources to be contributed by the government of Australia, as described in EBS/96/81 (5/29/96).

Decision No. 11271-(96/55), adopted
June 5, 1996

7. 1996 ANNUAL MEETINGS—OBSERVERS

The Executive Board approves the proposal to invite observers to the 1996 Annual Meetings of the Board of Governors of the Fund and the Bank, as set forth in EBD/96/63 (5/17/96) and Supplement 1 (5/31/96).

Adopted June 5, 1996

8. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 94/111 and 95/65 are approved.

9. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director and by Advisors to Executive Directors as set forth in EBAM/96/89 (6/4/96) and by an Assistant to Executive Director as set forth in EBAM/96/90 (6/4/96) is approved.

APPROVAL: April 28, 1997

REINHARD H. MUNZBERG
Secretary