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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 97/107

10:00 a.m., October 29, 1997

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Decisions Taken Since Previous Board Meeting

Executive Board Attendance

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

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A.A. Al-Tuwaijri	S.M. Al-Turki
	R. Fernandez
T.A. Bernes	C.X. O'Loghlin
	W.-D. Donecker
	W. Merz, Temporary
	N. Coumbis
	F. Mercusa, Temporary
	L. Pinzani, Temporary
	J. Mafararikwa, Temporary
D. Kaeser	W. Szczuka
A. Kafka	H.F. O'Brien
	J.C. Estrella, Temporary
W. Kiekens	J. Prader
	V. Rigász, Temporary
	B.S. Newman
	S.D. Melese-d'Hospital, Temporary
A. Mirakhor	M. Daïri
	A. Vernikov
	J. Shields
A.S. Shaalan	Y.Y. Mohammed
	H.B. Disanayaka
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E. Srejber	B. Andersen
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J.J. Toribio	J. Guzmán-Calafell
	A. Lucenti, Temporary
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Y. Yoshimura	S. Fukushima, Temporary
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R.H. Munzberg, Secretary
W.S. Tseng, Acting Secretary
P. Cirillo, Assistant
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Post-Program Monitoring, Including in Cases of Very High Access
Staff representatives: Leddy, PDR; van der Willigen, PDR; Gianviti, LEG

Republic of Yemen—1997 Article IV Consultation; Extended Arrangement; and Enhanced Structural Adjustment Arrangement
Staff representatives: Jakubiak, MED; Puckahtikom, PDR

Also Present
IBRD: M.G. Ghattas, Middle East and North Africa Regional Office. European I Department: M.C. Deppler, Director. European II Department: J. Odling-Smee, Director. External Relations Department: S.J. Anjaria, Director; R.R. Brauning. Legal Department: F.P. Gianviti, General Counsel; W.E. Holder, Deputy General Counsel; R.C. Baban, R.B. Leckow, L.E. Nordgaard. Middle Eastern Department: P. Chabrier, Director; M.A. El-Erian, Deputy Director; R.E. Daumont, K. Enders, S.N. Erbas, H.P.G. Handy, H.E. Jakubiak, A.H. Mansur, K. Nashashibi, C. Sassanpour, S. Sheybani. Policy Development and Review Department: T. Leddy, Deputy Director; D. Burton, S.B. Creane, J. Gold, T. Nishizawa, R.H. Nord, C. Puckahtikom, S.B. Schwartz, L.E.S. Teo, T. van der Willigen. Secretary's Department: P. Gotur, B.R. Hughes, K.P. Moran, A. Mountford, M.J. Papin. Treasurer's Department: J.E. Corr, K. Kenney, M.G. Kuhn. Western Hemisphere Department: E.R.J. Kalter, P.M. Young. Office of the Managing Director: M. Russo, Special Advisor; B.V. Christensen, J.A. Clément. Advisors to Executive Directors: W.F. Abdelati, R.F. Cippa, M.H. Elhage, L.J.F. Erasmus, S.S. Farid, P.M. Fremann, C.M. Gonzalez, K.M. Heinonen, G.M. Iradian, A.R. Ismael, M.F. Melhem, H. Ogushi, T. Turner-Huggins. Assistants to Executive Directors: N.R.F. Blancher, J.G. Borpujari, M.A. Brooke, D. Chen, M.A. Cilento, H.W. Cocker, D.A.A. Daco, C.K. Duenwald, J.C. Estrella, H. Kaufmann, E. Kouprianova, T.-M. Kudiwu, J.P. Leijdekker, D. Merino, J.A.K. Munthali, L. Palei, H. Paris, S. Rouai, U.Y. Tilyayev, M. Vismantas, A.G. Yakub, Zubir bin Abdullah.

1. POST-PROGRAM MONITORING, INCLUDING IN CASES OF VERY HIGH ACCESS

The Executive Directors considered a staff paper on post-program monitoring, including in cases of very high access (EBS/97/153, 8/18/97).

Mr. Guzmán-Calafell made the following statement:

The paper prepared by the staff contains a balanced approach to the issue of post-program monitoring for those members with very high access to Fund financing, and for others where the institution's resources are thought to be at an unusual risk. The concerns that have been expressed on different occasions regarding the need to monitor carefully the capacity to pay of member countries falling in these two categories are understandable, and I believe that in general the staff's proposals provide an adequate framework to soothe these concerns.

The first issue that arises in delineating a scheme for post-program monitoring in cases of very high access is of course how to define "very high access." This in turn has two components: 1) whether to base the definition on credit outstanding or on the Fund's holdings of a member currency; and 2) where the corresponding threshold has to be set. It is not very difficult to agree with the staff on the first of these components. Since it would make little sense to concentrate post-program monitoring only on users of GRA resources, it is clear that the definition of "very high access" has to be based on credit outstanding.

The specification of a threshold involves a degree of arbitrariness and therefore may be the subject of more discussion. The staff proposes to set the threshold on the basis of an indicator of what the Fund considers to be "normal" maximum access to its resources, which leads to the cumulative access limit of 300 percent of quota. Taking "normal" maximum access as the basis for determining the threshold makes a lot of sense. However, we must not lose sight that the Board has been divided on the issue of the appropriate cumulative access limit, and thus the specification of a "normal" maximum access is not as clear cut as it would appear to be. Some Directors have made on other occasions a convincing case that under the present conditions of the world economy in which a larger demand on Fund resources is to be expected, and given the drawbacks that would accompany a frequent activation of the exceptional circumstances provision, the cumulative access limit should be set above the ceilings on annual access. I sympathize with these views, and therefore I believe that for purposes of the application of post-program monitoring a threshold above 300 percent should be considered, perhaps 375 percent as suggested by Mr. Shaalan during our discussion of this issue at the end of last year. I agree with the staff that the threshold must be subject to review, and that the consideration of access limits is the most appropriate occasion for this.

The next question is how to implement the policy of post-program monitoring. The report evaluates two possibilities. The first is to use the existing limitations on Fund's holdings of a purchasing member's currency and the waiver that can be provided on this under Article V, Section 4 of the Articles as a basis for establishing a requirement for monitoring. The staff provides a good number of reasons why this option would not be recommendable. I fully agree with the staff's views and I do not need to repeat them here. But I would like to add one comment. Article V, Section 4 of the Articles was originally conceived to be consistent with a cumulative access limit of only 100 percent, since this was the ceiling existing at that time on the use of Fund resources under Stand-By Arrangements. This is the reason why this Article calls for a waiver whenever a member's purchase causes the Fund's holdings of its currency to exceed 200 percent of its quota. Thus, even if it is legally possible to use the granting of this waiver as a basis for establishing a requirement for post-program monitoring, this would be inconsistent with the original spirit of this Article to the extent that cumulative access limits exceed 100 percent. For all these reasons, the approach proposed by the staff—to adjust and harmonize consultation clauses in Fund arrangements, combined with a report by the Managing Director to the Board if a country fails to comply with post-program monitoring, and with due consideration of noncooperation in this area when deciding on a request for use of Fund resources—is clearly a better option. I believe this approach should also dispel the concerns on the potential effectiveness of this policy, arising from the fact that no additional use of Fund resources is involved.

The staff proposes to apply post-program monitoring automatically to very high-access members, and to consider it on a case-by-case basis for others if their situation is deemed to be excessively risky. Indeed, there may be countries in which, regardless of the level of indebtedness with the Fund, their capacity to pay may be subject to question marks, and where the pros and cons of post-program monitoring must be adequately weighed. However, I have two comments in this regard. First, it is important to have a clear understanding of the circumstances that would trigger the monitoring provision in these cases; i.e., to have as much clarity as possible in the second part of post-program monitoring policies described in paragraph 25 of the paper. Second, in one of the reports prepared for our previous discussion on safeguards (EBS/96/182), the staff did not favor the application of special monitoring on a case-by-case basis, since this could be read by markets "as a sign of special concern" (para. 26). This view was echoed by a number of Directors. It would be useful to hear the staff's comments on the extent to which these concerns remain valid in the case of their current proposal.

The paper notes that the present consultation clauses would be used to apply post-program monitoring in existing cases of very high access. Thus, according to the staff "members that have outstanding credit under an arrangement at the time the policy is adopted will be taken to have indicated their willingness to engage in monitoring through the consultation clauses contained in their arrangements." The interpretation that these clauses represent acceptance of a policy which was not known when the arrangements were signed is not straightforward, and in fact this gives rise to doubts on whether this staff proposal represents a retroactive application of a new policy. This issue needs further clarification.

I would only like to make two additional comments. First, footnote 20 in the report suggests that it would remain possible in individual cases to "require a member's agreement to post-program monitoring as a condition for the waiver under Article V, Section 4, if this requirement were considered to be warranted." I am surprised by this suggestion in view of the number of disadvantages that the staff sees in a course of action based on the authorization of a waiver. In addition, its application would raise questions regarding uniformity of treatment in the implementation of post-program monitoring. Second, footnote 22 explains that for members failing to cooperate in post-program monitoring "consideration could also be given to making a failure to consult under an earlier arrangement grounds for suspension of purchases under a subsequent arrangement." I would imagine that if the Fund approves a subsequent arrangement for these members, it will be because the institution is satisfied that a cooperative relationship has been restored. I fail to understand how a decision on a specific issue can be subsequently reconsidered and affect a new arrangement. For instance, we could face a case in which a member is meeting all requirements under a program, and still be subject to suspension of purchases on account of a previous instance of noncooperation which in the view of the Fund had already been solved. Obviously, if the member were not cooperating under the new arrangement the proper corrective measures would need to be adopted, but this is a different story.

Mr. Shaalan made the following statement:

The case for post-program monitoring for countries where there is a high exposure of total Fund credit is both compelling and timely. The proposed threshold of 300 percent seems appropriate and it could be reviewed and adjusted from time to time. The automatic application of post-program monitoring mainly to countries exceeding this threshold limit will ensure that staff resources are not unduly diverted from other areas where enhanced surveillance is desirable.

We also can see the rationale for a mechanism that would allow for post-program monitoring for countries below the threshold where the Fund has special concerns about balance of payments projections or the capacity to service obligations to the Fund. In any case, we cannot say that the risk to Fund resources is necessarily higher for countries reaching the 300 percent limit than, for example, for those in the 200 percent range. While we can, in principle, support the application of post-program monitoring in cases below the threshold so long as this follows some clearly spelled-out objective criteria, we have some reservations on its application as outlined in the staff report. First, we have a general concern about the effect on the market of a case-by-case decision to apply post-program monitoring. This was mentioned by many Directors during last year's discussion on safeguards. Second, in terms of implementation of the policy, we would favor Board involvement in the selection of the countries to be monitored. Also on implementation, it is not clear what conditions would need to be met in order to discontinue post-program monitoring; the exit mechanism should be clearly specified along with the application criteria.

With respect to the legal basis for post-program monitoring, I concur with the staff's preference for the use of consultation clauses rather than Article V Section 4. Having said that, however, I want to raise some points that need further clarification.

First, the staff presents a compelling argument in paragraph 23 regarding the declaration of ineligibility for failure to cooperate given the considerable degree of stigma associated with it. Yet, the preferred method described in paragraph 31 seems, for all practical purposes, to give management the right to apply the sanction of ineligibility. The distinction between the two options is unclear both in terms of access to Fund resources and in terms of the related stigma.

Second, the paper is not clear on what would constitute failure to comply with program monitoring. There is an apparent inconsistency in the definition of post-program monitoring contained in paragraph 33 and the contents of paragraph 37. In paragraph 33, cooperation is limited to provision of data and availability for discussion, and there is no requirement or expectation that the member should come to a common understanding with the staff or Fund. Paragraph 37, however, describes a more extensive quantified financial framework and specification of quantitative structural benchmarks on a quarterly or semiannual basis. This kind of monitoring does not seem very different from that under a staff-monitored program. It is also not clear who will decide that a country has failed to comply and what will be the Board's role in this regard. It is therefore essential that the staff clarify a member's requirements under post-program monitoring and the process for determining noncompliance.

Finally, since this policy will be applied to countries other than those exceeding the higher access threshold, it raises the question of whether the same objective cannot be achieved under the Fund's policies for enhanced surveillance.

Mr. Yoshimura made the following statement:

We had an opportunity to discuss the possibility of post-program monitoring when we took up the issue of safeguards for Fund resources last December. It is welcome that we have another chance today to discuss post-program monitoring in more detail. I appreciate the staff's efforts in preparing a well-documented paper to serve as a basis for our discussion.

As was seen in the cases of Mexico in 1995 and Thailand more recently, it was more than likely that the Fund will face the need to provide financial support with very high access in the near future. Against the background of highly globalized international financial markets in which developed capital flows are playing more and more a significant role, it is important that we have a chance to discuss how to find better safeguards for the Fund's resources at this juncture. After reading this paper, it appears to me that amending the Articles so that we can have a solid legal basis for post-program monitoring is the most correct way to establish a truly effective post-monitoring program. Of course, I know this is not realistic in light of the many other urgent issues that the Fund needs to address.

While I, therefore, think that the framework of post-program monitoring that this paper proposes may be the best we can get at this stage, I am not entirely convinced that we should introduce post-program monitoring as it is proposed in this staff paper. The paper makes clear that a member country's commitment under the proposed framework is to provide data and information and to make itself available for discussion. This commitment does not include accepting a program of economic objectives and policies and managing the economy in line with the program. I thus understand that the Fund does not have authority to require a member to accept the program and manage its economy in line with the program. Based on this understanding, I wonder whether the Fund could be accused of a nontransparent use of its authority if there were cases where the Fund secured the effectiveness of post-program monitoring by making the future use of its resources conditional on whether the member accepted an economic framework or on how well the member managed its economy in line with the framework. I would think, however, that if under the proposed framework the economic performance of the member did not affect the future use of Fund resources, the proposed post-program monitoring could not be effective. This leads me to wonder whether we can spare both members and Fund resources to carry out increased consultation activities that would be required to hold Board meetings twice a year to implement a relatively ineffective post-program monitoring. I know these are difficult issues to solve and I think we need to examine further a proposed framework for post-program monitoring, and I would like to hear the other Directors' view on this matter.

Ms. Pinzani made the following statement:

We support the staff suggestion of designing a specific policy in order to strengthen Fund surveillance by means of post-program monitoring. We think that a new policy which can be revised from time to time is the most flexible instrument which the Fund can use to smooth one of the most delicate phase of member development, namely that of starting to rely on their own resources after having been subject to external support. Moreover, the new policy is the most appropriate to deal with the risk which the Fund is bound to face given the member's right of choosing multiple lines of credit.

With respect to the legal instruments currently available to the Fund, the new policy, as it is suggested by the staff, has the advantage of creating a uniform approach for different starting situation. In particular, we support the idea of setting a threshold beyond which post-program monitoring would automatically apply. This is an objective criteria which has also the advantage of limiting the application of the post-program monitoring to a small number of countries. Indeed, we see the case for limiting the automatic application of post-program monitoring since we are aware of the need that our policies are cost effective, both in terms of financial and human resources. In this latter respect, we share the concern expressed in both preliminary statements about the application of the suggested policies on a case-by-case basis to members with outstanding use of Fund resources below the threshold. We see the need of such a flexible approach since it would permit to calibrate surveillance according to members' status as a user of Fund resources. However, we do see some risk in missing to find some specific criteria in order to discriminate among members which are not very high users of Fund resources. The risk is that post-program monitoring becomes a routine, adding a big burden of work to the staff and Board. We want to join Mr. Shaalan in the request for, if not objective criteria, at least for some explicit lines of reasoning which may lead to post-program monitoring in cases of not very high use of Fund resources.

Finally, let us underline two other points which we think deserve a second analysis. As Mr. Shaalan said in his statement, the exit mechanism from a post-program monitoring has to be better specified. It is not clear what are the conditions which need to be met in order to discontinue the post-program monitoring. In addition, like Mr. Guzmán-Calafell, we very much doubt that the existing consultation clauses may be easily interpreted as an acceptance of a policy which was not known when the arrangements were signed.

Mr. Kiekens made the following statement:

I do not object to the staff's proposals for creating an additional policy in the form of so-called "post-program monitoring," which at worst can lead to a marginal waste of resources in a few exceptional cases. But I am not particularly attracted to the idea either, since it may introduce a superfluous new policy. The proposal, and earlier statements, seem to indicate that we are afraid of using our existing policy instruments, especially that of ad hoc Article IV consultations in cases where the Fund has concerns about the sustainability of a country's external position. Indeed, the proposed new Fund policy relies heavily on automaticity rather than on a judgmental decision to hold additional consultations, trying in this way to avoid the stigmatization that may be wrongly associated with ad hoc consultations.

It is argued that the new policy is needed to minimize the risks of large Fund exposure to a particular country, and to ensure that members will be able to service their obligations to the Fund. But the only realistic way for the Fund to achieve these goals is to help the country preserve, or regain, a sustainable balance of payments position. When the Fund does this, by post-program monitoring or other means, the group of beneficiaries extends far beyond the Fund itself to include the country itself, its other creditors, its trading partners, and many other players in the increasingly globalized world economy. In other words, there is no compelling reason to introduce specific policies aimed exclusively at preserving the Fund's claims, other than preserving the Fund's preferred creditor status.

The staff suggests that quantitative and structural benchmarks to monitor the progress toward intermediate and final targets should be established. But if we look more closely at the proposal, it appears that there is no requirement or even expectation that the country and the Fund should reach an understanding about a program. The member's commitment would be limited to the provision of data and other information; readiness to consult with the staff on policy matters; and agreement that the results of these consultations would be formally submitted to the consideration of the Executive Board.

Because it involves no requirement for policymakers to reach consensus with the Fund about program targets and benchmarks, and no threat of losing access to Fund resources, and because it is predominantly forward looking in nature, the proposed post-program monitoring policy resembles an Article IV consultation more than it resembles the monitoring and review of a Fund-supported program.

Instead of introducing this new policy, I suggest that if there is a broad consensus with post-program monitoring, we should amend the Board's decision on surveillance over exchange rate policies to introduce a presumption that members whose outstanding debt to the Fund is above 300 percent of their quota would switch to a six-month Article IV consultation cycle. The same would apply to members whose debts to the Fund exceed a certain percentage of the Fund's precautionary balances. But I can live without such an automatic rule, and urge instead that we should make more active use of ad hoc consultations each time the Management or the Board has serious concerns about a country's economic policies, the behavior of its exchange rate, or the sustainability of its external position.

But above all I would plead here for a more active promotion of precautionary Stand-By Arrangements for countries that face serious challenges of correcting a malfunctioning economy or of persevering with needed policies, even in the absence of an imminent threat to their external positions. Too often still, policymakers regard obtaining Fund supported program as a surrender of national sovereignty. To correct this attitude, we should promote precautionary stand-by programs as a mark of excellence that bring about strong and visible rewards. Such programs foster, within governments and societies at large, a degree of ambition otherwise unattainable. They enhance the international visibility and credibility of a country's program and improve its access to the financial markets.

If a country with less than excellent credit standing and facing economic policy challenges, is unable to enter into a precautionary Stand-By Arrangement with the Fund, I fear that the new policy of automatic post-program monitoring will add little to our existing repertory. But this is not to say that the international community should give up encouraging such countries to adjust their policies, including, if needed, by organizing ad hoc Article IV consultations, irrespective of the level of their outstanding debt to the Fund.

Mr. Fernandez made the following statement:

As others, I welcome the opportunity to discuss the modalities of post-program monitoring for cases of very high access, following previous discussions. We support the proposal of creating such a post-program monitoring, the need of which had been identified in 1995 when we concluded the biennial review of surveillance in the light of the Mexican crisis.

The purpose is to strengthen the Fund's surveillance for countries where outstanding Fund resources exceed a certain threshold. It is not to create a weaker form of staff-monitored program.

In this regard, I consider the proposed procedure appropriate. I support the proposed threshold of 300 percent, as well as the possibility to call for post-program monitoring in some cases where the use of Fund resources does not reach the threshold. It is nevertheless clear that precise justification will need to be given in these cases.

I consider that in both cases we are activating the policy for supplemental surveillance provided for in our Surveillance Decisions, which have not been fully used. I see merits to using a quantified framework, in order to have an orderly discussion on clearly formulated policies, but I think the staff should be extremely careful not to give the impression that this is a shadow staff-monitored program which would send very ambiguous signals about the level of the Fund endorsement. To prevent any ambiguity, I would therefore prefer that this policy be called post-program strengthened surveillance and not post-program monitoring.

Finally, I would like to use the opportunity of this discussion to reiterate that this chair supports the creation of higher charges in cases of very high access as a matter of equity and as a signal of collective discipline.

Mr. Disanayaka made the following statement:

We thank the staff for preparing this paper in response to a request made by the Board when it discussed the preliminary paper on Safeguards for the Fund in Cases of Very High Access in December last year. The preliminary paper discussed several possible ways of safeguarding the Fund resources in cases of very high exposure and post-program monitoring was one of the mechanisms proposed. The present paper has developed this latter aspect further and made some very useful proposals toward formulating a policy for effective use of post-program monitoring as an effective tool.

We are in general agreement with the broad thrust of the recommendations contained in the paper. We would favor the alternative path taken by the staff toward developing a policy for post-program monitoring, in preference to waiver procedure provided for under Article V, Section 4 in view of certain limitations and the rather punitive character of the latter. These are well discussed in para 24 and I do not intend to elaborate on them. I would furthermore see no need to invoke provisions under this article in parallel with the alternative approach, as the staff seems to suggest in footnote 20 on page 12. Besides other concerns, it would raise questions of uniformity of treatment.

The two-tier structure proposed policy for post-program monitoring put up by the staff requires a little more clarification. Why should the second part of the policy be amended from time to time to indicate various circumstances to trigger the mechanism. Why can't it be specific on the basis of the outstanding amount above the threshold limit? If it is varied from country to country it will be treated as discriminatory. However, in the case of a perceived risk the Managing Director can always ask for consultation with the country and this can also be added as a suitably worded general clause rather than allowing a degree of vagueness and an impression that in regard to a policy we will make a case to case approach. We could support the view that different types of consultation clauses presently existing under various arrangements should be harmonized and a uniform set of consultation clauses evolved. This would make the monitoring process more transparent and equitable. We were however worried about the provision that the consultation clauses would apply to individual borrowers only in respect of their outstanding obligations to the Fund arising from such individual arrangements. We wondered whether this would not weaken the intended general provision to make consultation clauses applicable on the basis of a cumulative threshold of outstanding obligations of a borrower. In our discussions with the staff however, we were assured that there would not arise such a conflict and that all borrowers would be bound by the general provision of a cumulative threshold if such an element were to be incorporated into the Fund policy.

I have also some difficulty in understanding footnote 22 on page 13 of the paper, like Mr. Guzmán. I am not sure how practical this suggestion is going to be. The staff may clarify.

As regards automaticity in respect of applicability of post-program monitoring if a country's outstanding obligations go beyond a particular cumulative threshold, we have no objection to specifying a benchmark such as the 300 percent of quota suggested by the staff. Incidentally we presume that the 300 percent of Fund credit referred to in para 11, page 6 would in fact mean 300 percent of outstanding cumulative obligations of a member. However, as the paper points out, Fund credit could be at risk even below this threshold depending on the particular circumstances of individual borrowers as well as developments on the global scenario. The monitoring policy should therefore incorporate a facility for case-by-case review if circumstances so warrant. In the same vein I might add that even though monitoring could normally be phased out with the country's outstanding obligations going below the specified threshold, such monitoring may have to be continued even after that date for countries which may need closer supervision and assistance by the Fund to keep their adjustment programs on track. We believe that the most effective way of safeguarding Fund resources extended to a member is the member's own ability to maintain a strong and steady track record of macroeconomic adjustment well beyond the program/programs supported by the Fund and other creditors. It is the only way to achieve sustainability of growth and thereby the ability to service one's obligations. Viewed against this background, we could support the modalities for post-program monitoring suggested by the staff in Section V of the report. We have, however, some difficulty in agreeing with some comments made in paragraph 33, wherein it is stated that the only responsibility of the member during the post-program monitoring is "to provide data and information and to make itself available for discussions with the staff. There would be no requirement or expectation that the member should reach a common understanding on a program with the staff or the Fund." This is somewhat confusing when we read later on in the same section that monitoring would be conducted on the basis of a program containing quantitative and structural benchmarks. While we would not expect, at the post-monitoring stage, a formal well-structured program such as that supported by an arrangement, yet we would like to see a broad framework of such a program being formulated by the member (perhaps with Fund assistance) which should as far as feasible be monitorable as the staff has suggested. We should have an expectation that the member would make all efforts to continue with such an adjustment program and on our part we should give it all the support and guidance in the course of our post-monitoring discussions with the member.

Finally to avoid an undue burden on scarce staff resources as well as to make this a more effective exercise, we should try to focus the post-program monitoring sharply on a few selected cases that most warrant such monitoring. Keeping the threshold of outstanding cumulative obligations at a rather high level—say 300 percent of the quota (as suggested by the staff) would be one way of achieving this. But as this exercise should be extended to other cases as well that might require post-program monitoring, they have to be very carefully chosen, not the least in view of the sensitivities expressed by some members at our last discussion in December 1996.

Mr. Szczuka made the following statement:

On the discussion on safeguards of Fund resources in case of very high access, this chair took a rather skeptical stance with respect to the post-program monitoring. The doubts we had at that time have not been completely diverted by the paper on post-program monitoring, including cases of very high access. More specifically, we remain not fully convinced that the post-program monitoring in the form outlined in the staff paper is the safeguard for the Fund's outstanding resources. As we already noted in the last year's discussion, we do not see how such extended monitoring could incite a country to adopt sound macroeconomic policies more effectively than normal surveillance under the Article IV consultations. Since there is no additional resources to be extended, there is no carrot. And since the proposed framework provides no sanctions in case of inappropriate macroeconomic policy there is no stick, either. The staff paper offers very few new arguments or insights in this respect or the staff even admits directly that by no means this kind of post-program monitoring is a sufficient condition for minimizing the risk related to extending the Fund resources (pages 3–4). Therefore, it remains difficult to understand how post-program monitoring could make a significant contribution to the objective of safeguarding the Fund's resources. We continue to believe that the best policy for the Fund to avoid undue credit risk is prevention. This is to be achieved by ambitious programs with strong conditionality and the avoidance of very high access in the first place. Moreover, we have some serious concerns about the implied cost of such a post-program monitoring exercise in terms of resources diverted from other surveillance activities. The staff paper only mentions that there is indeed a risk that such a diversion could take place, if post-program monitoring were routinely applied. Where exceptions and the routine begins is an open question. In our view, a diversion of resources would be inevitable even if post-program monitoring is done in only a few cases.

As to the framework for post-program monitoring proposed by the staff, we note that many important questions remain open. For example, the conditions which would justify a call for post-program monitoring in cases of members with outstanding credit below the threshold are yet to be specified. It is not clear to us who will finally have the right to decide if the post-program monitoring is to be applied. In the paper, the staff proposes that the Managing Director would inform the Board if he wished to call for monitoring of members below the threshold. Does this mean that the Managing Director could call for post-program monitoring without the Board approval? We also note that the frequency of staff visits and Board consideration is not presented in a very precise way. All these uncertainties make it difficult for us to fully support proposed framework on post-program monitoring. So, for this reason we would rather prefer to refrain from introducing this post-program monitoring in the form proposed in the staff paper. Instead, we would support the views expressed during today's discussion which go in the direction of strengthening the use of existing mechanisms based, first of all, on the Article IV consultations and on the unused possibilities expressed in the guidelines on conditionality from 1979, which say that there is clearly a case for ad hoc consultations and this sort of de facto post-program monitoring. In this context, we would urge the staff to stick to a 12-month cycle for Article IV consultations. In particular, the consultation should not be delayed by program negotiations.

One other comment relates to the question of harmonizing consultation clauses. We do not see an urgency in doing this, but if other Directors favor harmonization, it seems more appropriate from a credit risk standpoint to take into account all outstanding Fund credit of a borrower rather than just purchases or adjustment under a particular arrangement. Thus, we would propose to modify the consultation clauses of a Stand-By Arrangement and to use them for all other arrangements.

Summing up, I would like to stress that we fully appreciate the need for creating proper safeguards for Fund resources. The question is, first of all, whether we are going to institutionalize a special policy for cases which we consider exceptional, so the question we are going to discuss today cannot be discussed separately from the question of the access policy. If we are to establish a principle of high access, then a more specific policy would be needed. But if we are going to establish a very specific policy of post-program monitoring for cases which we consider very exceptional, we also risk creating a mechanism institutionalizing these sort of exceptions.

The other question is the effectiveness of the mechanism, so the question is whether the mechanism proposed by the staff would really prove to be efficient and could really reach the objective we are aiming at, or whether instead we could focus and make sure that this is fully confirmed with the legal basis as was also indicated by Mr. Yoshimura, that it would be maybe more appropriate to use the existing Article IV consultation, plus use ad hoc consultations which are provided either by the guidelines on conditionality or by the consultation clauses in the arrangements and other Fund facilities.

Mr. Newman made the following statement:

Our discussion of possible modalities for post-program monitoring is an outgrowth of the Executive Board's assessment of Fund surveillance following the Mexican crisis and recent consideration of methods to safeguard Fund resources. While it clearly has implications in the current situation, consideration of post-program monitoring is neither a result of the financial problems in Asia nor directed at the countries in the region. Moreover, I think it would be a mistake to consider post-program monitoring solely as a means of protecting Fund resources, particularly in high access cases. Implementation of such a program will also benefit the borrowing country by providing increased confidence that sound macroeconomic and structural reforms will continue, thus speeding up the country's return to full market access.

The staff paper presents two alternative approaches to post-program monitoring which differ primarily in terms of potential country coverage and the scope of possible sanctions for lack of cooperation. In one case we have what might be called the nuclear bomb approach that would be applied to only a few countries but that would have significant sanctions. In the other case, we have one that would apply more broadly, but as Mr. Kiekens and others have noted, would be largely an empty box in that there would be no consequences for failing to cooperate or to engage in post-program monitoring.

I would be interested in knowing if there is something in between the two that would rely primarily on consultation mechanisms, but that if we find out a serious problem does surface with regard to a country's policies, that the Fund might have some recourse, possibly in the context of our policies with regard to expectations of early repurchase, which I note we are considering in the not too distant future, whether this would serve as a mechanism to provide both an incentive and a safeguard, if we find out that the country's policies are going well off track after a program is completed.

This said, however, we recognize that post-program monitoring could represent a marked departure from traditional Fund program in that practice, in that it goes well beyond even intensified surveillance in terms of country coverage and program detail. It is in effect a precautionary Stand-By Arrangement but without the commitment of money. In these circumstances, we believe it is preferable to begin modestly by encouraging country participation rather than by making it an obligation. Therefore, we could support the staff proposal for post-program monitoring based on revised consultative procedures for countries with outstanding Fund credit above a threshold, and without explicit sanctions for noncompliance.

However, we do have some reservations regarding the staff's proposed threshold. The level of the threshold involves a trade-off between coverage and cost in terms of staff resources. The staff proposal of a cut-off of 300 percent of quota on outstanding Fund credit effectively limits post-program monitoring to high access cases and in general would exclude SAF and ESAF borrowers as well as those countries that have only 200 to 300 percent. This could create a perception that the benefits of post-program monitoring accrue only in cases of large exposure of quota resources, although the staff points out that the need for such monitoring may well be greater for countries with lower access but weak track records. While the Managing Director would be able to request monitoring in cases of concern, this would be based on a high degree of subjective judgment that would inevitably—and in fact has already—raised questions about uniformity of treatment, and questions about sending signals to markets. Therefore, it seems to me an alternative and possibly cleaner approach might simply be to reduce the threshold to some lower number, and here I would be open to suggestions, but possibly something in the range of 250 or 275 percent might be preferable, in that it would avoid perceptions that only high access cases were covered, or that there was a need for difficult case-by-case judgments in most situations. Another alternative, but I think a less preferable one, would be to have two different thresholds, one for General Resources Account-financed programs and another for SAF-ESAF programs.

We can agree with the basic modalities proposed by the staff regarding the content of post-program monitoring, although like other Directors we would appreciate some clarification whether the standards being considered are those of the upper credit tranche conditionality, precautionary arrangements, or staff-monitored programs. Exactly what does the staff have in mind?

Moreover, in view of the potential positive impact of post-program monitoring on the markets' perception of the country's commitment, it might also be useful if the traditional press release on a program indicated whether provision had been made for post-program monitoring. We would see this as being voluntary, where the country itself could decide whether it wanted to be included, much like we have done with regard to Press Information Notices or like we do with regard to our data standards.

As the staff notes, the consultation approach does not involve an obligation of members to agree to and abide by post-program monitoring. It relies primarily on the recognition by the borrower that post-program monitoring can support its adjustment and reform efforts and that the goodwill of the Fund is beneficial. Only time will tell whether this consensual approach will succeed. Therefore, it would be useful to review our experience with post-program monitoring in, say, two years—possibly in connection with the next biennial surveillance review to see if more drastic or fundamental changes are necessary.

Mr. Al-Turki made the following statement:

The staff has provided a very helpful follow up to the Board's discussion last year of safeguards for the Fund in cases of very high access.

The importance of the issues is underscored by the recent and prospective large recourse to Fund resources.

I am willing to go along with the staff suggestion for automatic triggering of post-program monitoring whenever a member's outstanding Fund credit exceeds 300 percent of its quota. The suggested threshold does have the merit of limiting the proposed automatic application of post-program monitoring to a relatively small number of countries where the Fund's exposure is relatively high. The budgetary implications of this choice are indeed self-evident. That said, let me add two brief remarks.

First, in the past, this chair suggested that the threshold for determination of large access should be set in relation to access limits rather than a fixed figure. It remains unclear why the threshold should not be set to automatically follow any change in the access limit. Staff comments will be welcome.

Second, the staff refers to special concerns for which the Managing Director could call for post-program monitoring even if a member's use of Fund resources is below the threshold. Here, it is critical that any such monitoring be evenhanded and transparent.

Regarding the suggested policy on post-program monitoring, the staff raises issues that require further clarification. For instance, paragraph 31 suggests that a member's failure to comply with post-program monitoring could be taken into account in subsequent requests for use of Fund resources. The Fund of course operates on the presumption that a country that performed poorly in the past can perform better in the future. It is thus inappropriate to presume that a past record of poor cooperation on post-program monitoring necessarily implies that the country is an excessively risky candidate for future use of Fund resources. Staff comments will be welcome.

Finally, I remain of the view that post-program monitoring will likely be of marginal help in ensuring repayments to the Fund. Indeed, we already have the mechanism of Article IV consultations. Furthermore, the staff makes additional visits to various countries as needed. This chair therefore continues to believe that a better approach to a further safeguarding of the Fund's resources would be to give greater attention in the future to guidelines for early repurchases and introduction of prepayment clauses.

Mr. Donecker made the following statement:

First, I want to thank the staff for a comprehensive and short paper on the modalities of this proposed new post-program monitoring policy. In principle, we certainly welcome a close monitoring of countries with high Fund credit, too. However, the establishment of a new policy for such selective close monitoring must take into account cost/benefit- and effectiveness-considerations. Among those are that additional costs will be unavoidable since the staff will need more time for travel, will have to produce additional post-program monitoring papers, and we will have to deal with these papers on an already very full agenda. In this context, I would appreciate a rough estimate by the staff of the additional resources expected per year for one country for such an envisaged post-program monitoring policy.

The additional benefits of this policy would be fairly limited. Member countries already are required to submit economic data, and their economic situation is analyzed and also discussed in the Board during the annual Article IV consultations; the staff remains aware of the economic and political developments of each member in between the normal consultation visits. Also, the Board is kept informed or should be kept informed about critical cases during the informal country matters sessions.

Thus, although this post-program monitoring policy may have a certain, positive signal function, its overall effectiveness is restricted. It contains no economic program and no direct sanction mechanism. The fact that the failure to comply with post-program monitoring can be considered when reaching a decision about further use of Fund resources is also not a serious effective sanction, since such decisions are in any case based on the track record of the respective country.

We wonder, therefore, if such a new policy may not give wrong and misleading signals. We are not sure if such a new post-program monitoring policy may rather encourage the staff and the Board to provide extraordinary large use of Fund resources with weaker conditionality than necessary to achieve a viable balance of payments position, always having in mind that we have this post-program monitoring policy to strengthen things later on, but later on may never come.

So, I wonder if this would be the best way to ensure timely repayment of Fund credits. To sum up, like Mr. Yoshimura, Mr. Kiekens, and others, I am not entirely convinced about the usefulness of the proposed approach and I hesitate to support the proposed new policy. In any case, if the majority of the Board were to support the establishment of such a post-program monitoring policy, the following should be clear.

First, the threshold should be very high; i.e., 300 percent of the quota as proposed by the staff. I would not support an even higher threshold as proposed by Mr. Guzmán-Calafell. Such a level would only be reached in very exceptional cases and would raise, therefore, the question why such a procedure should be introduced at all. In any case, the threshold should include, as suggested by the staff, total "Fund credit outstanding."

Second, the Managing Director should have the discretionary possibility to trigger the post-program monitoring when the threshold is not exceeded, but Fund resources appear to be at particular risk.

Thirdly, and most importantly, it should be very clear that the post-program monitoring policy would not be meant to encourage higher access to Fund resources or a weaker conditionality, but the one necessary to achieve the target of every Fund program, i.e., the resumption of a viable balance of payments position in the medium term.

Fourthly, before we finally decide on whether to introduce a post-program monitoring policy, we would like to see a proper decision text on this issue provided by our Legal Department.

Finally, I support Mr. Kiekens' and Mr. Szczuka's position that the Fund should make more use of the ad hoc consultations under the conditions described by Mr. Kiekens. I believe this would be a more pragmatic, more efficient, and more cost effective way to safeguard the Fund's resources and we should concentrate on strengthening the use of existing mechanisms and instruments.

Mr. Zoccali made the following statement:

The staff paper analyzes the issues pertaining to the application of post-program monitoring, excluding arrears cases, in a constructive manner. Despite some drawbacks, such monitoring could serve to enhance the quality of the policy dialogue between the Fund and members with very high access to Fund resources or which are thought to be at unusual risk and, hence, its capacity to foster stability in the system.

Regarding the issues for discussion, Fund resources are exposed to risk whether purchases have taken place under an arrangement or under another facility. At the same time, extending special monitoring to a very broad set of cases could unduly divert resources from other more productive activities, including the prevention of new crisis. Thus, we consider a threshold based on Fund credit outstanding, which captures the notion of very high access, useful to operationalize a post-program monitoring policy. The threshold of the current "normal" maximum access of 300 percent of quota proposed by the staff as a trigger for post program monitoring strikes the right balance between operational efficiency and concern about a member's capacity to service obligations to the Fund. We would also agree that the threshold be subject to review periodically.

Extension of post-program monitoring to countries where use of Fund resources was below the threshold, could perhaps be made more effective if it remained focused on those cases where an increase in Fund exposure above the threshold was envisaged or where there was evidence of debt servicing difficulties. In this regard, we share the general concern expressed by Mr. Shaalan regarding the signaling effect to markets of a case by case decision to apply post program monitoring and of the need to clearly spell out objective criteria for application, exit and noncompliance. Similarly, clarification regarding the extent of the requirement or expectation that a member should come to a common understanding with the staff, not only on the provision of data and availability of the authorities for discussion, but also on the quantified financial framework and specification of structural benchmarks is deemed, necessary to avoid misunderstandings down the road. The important issue is not only to protect Fund resources, referred to by Mr. Newman, but also to preserve the consistency of the member's policy mix, greatly benefiting the countries concerned and the system as a whole. In this regard, I would concur with the views of Mr. Kiekens and others regarding the desirability of a stronger promotion of "precautionary" arrangements given their incentive effect to enhance in an "ex-ante" fashion the confidence of members and hence its chances of concluding the complex and protracted process of structural reforms which lie at the core of successful adjustment.

Having said this, giving effect to the intentions to apply post-program monitoring should, in any event, continue to privilege ownership in policy design and implementation strategy thus enhancing the chances for improved cooperation between the authorities and the Fund. In this context, a post-program monitoring policy based on the harmonization of present consultation clauses in arrangements and a clear procedure for Board consideration of non compliance triggered by a report from the Managing Director would, in our view, be more effective than the alternative under Article V, Section 4.

In addition, since the staff proposes that this procedure apply to countries other than those exceeding the higher exposure threshold, it is not readily apparent why the same objective could not be satisfied by the flexibility afforded Management under Article IV enhanced surveillance procedures, to follow up with "ad hoc" supplementary consultations, as needed, in cases where there is concern about the consistency of a member's policy mix and hence of excessive risk to the Fund's resources.

Finally we concur with the staff that if post-program monitoring is adopted Board consideration of the particular member's situation should normally take place at six-monthly intervals and concluded on a lapse of time basis if the staff's appraisal is positive. Generally, we would also favor providing for a review of the policy on post program monitoring after gaining sufficient experience with the approach, perhaps in the context of the next biannual review of surveillance.

Ms. van Geest made the following statement:

I support the concept of post-program monitoring; we think that an automatic trigger is important. I am in broad agreement with the policy proposed by the staff. I have a few points to make.

Like others we have wrestled with the question how PPM would fit into the existing array of forms of cooperation between the Fund and member countries. We already have full-fledged programs, precautionary arrangements, staff-monitored programs, enhanced surveillance and supplemental surveillance to regular Article IV surveillance. In some cases an exit strategy via a precautionary arrangement might be preferable. In others a monitored program could be more tailored to the situation, or more acceptable to the authorities for whatever reason. Post-program monitoring, which is something of a hybrid of other forms of cooperation, for countries with high access as an additional mode. Perhaps we should consider this more fully, once we revisit the topic, as would seem the obvious outcome of the discussion of today.

> A numbers of Directors have referred to surveillance in this discussion. This brings me to another point: the PINs. Transparency in the relations between members and the Fund have my full support. It would be desirable—and I believe in their own interests—for countries involved in PPM to release information on the program and to agree to a PIN. Indeed, I feel that a summing up of the Board discussion should be an essential element of the PPM approach. A PIN could help to provide markets with confidence concerning the performance of countries with PPMs.

Mr. Newman asked those Directors who had expressed a preference for a more vigorous use of precautionary arrangements whether such arrangements would be expected or required if a member's access reached a certain level.

Ms. van Geest responded that it was important to have good cooperation between the Fund and countries with high access, and a precautionary arrangement was the ultimate illustration of that. The country could opt voluntarily for such an arrangement, which would take care of the post-program monitoring. If countries did not want a precautionary arrangement for whatever reason, the Fund would have to think about other ways to ensure appropriate post-program monitoring in a hybrid form.

Mr. Kiekens pointed out that precautionary Stand-By Arrangements, as well as other kinds of enhanced surveillance, would need to be decided on a case-by-case basis, and could not be decided several years in advance.

Mr. Zoccali said that his ideas were closer to those expressed by Ms. van Geest. While a case-by-case approach needed to be applied, it was important to ensure a successful adjustment process; if that meant giving confidence to members in the context of precautionary arrangements, then that would be appropriate.

Mr. Donecker considered that his approach did not differ very much from that advocated by Mr. Kiekens. It would be inappropriate to aim automatically in the direction of precautionary arrangements in such situations, because it was conceivable that, after a three-year arrangement, a country's economic situation could deteriorate to the point where a precautionary arrangement would be unacceptable to the Fund. In that situation, the only course of action would be an instrument like the ad hoc consultation suggested by Mr. Kiekens. In any event, such cases should be decided on a case-by-case basis to determine the appropriate course of action.

Mr. Vernikov made the following statement:

> If you would allow me to add a couple of words on this very issue, I do not think that precautionary arrangements are a substitute for post-program monitoring, because this qualification "precautionary" is something which is not legally binding on the member. This is something the member wants the arrangement to be, but this decision can be reversed at any point in time. Secondly, it does not cover the whole range of situations. We are looking at different kinds of arrangements, not only to the use of quota resources but also on the SAF/ESAF. So, I do not see precautionary arrangements as an immediate substitute for what we are discussing today, the procedures for post-program monitoring.

I hope that today's discussion of post-program monitoring will allow us to streamline some important approaches. Of course, my preference would be to have fewer cases of very high access than more, but the recent turmoil in emerging markets probably indicates the need to have clear policies and procedures for these types of situations.

Like a number of other speakers today, I am not entirely convinced that the issue is best addressed by formalizing the post-program monitoring. Maybe we indeed need to strengthen the use of existing mechanisms. I noted that Mr. Donecker said that the economic effectiveness of post-program monitoring is likely to be very restricted. If, nevertheless, this Board decided today that we need to go ahead with the procedure of post-program monitoring, let me develop some observations. First, I would like to indicate my preferences on the questions raised by the staff; and second, to make a few comments related to the role of the authorities and the Fund under the proposed policy.

Firstly, I would insist that it is reasonable to tie the activation of post-program monitoring to the total Fund credit outstanding and not only to the Fund's holding of the member's currency. After all, we need to safeguard all Fund resources, not only the quota resources. So, I do not see how we could reasonably explain why the SAF/ESAF part should be beyond the scope of our analysis.

As to the threshold, I have some doubts. After all, it is not any given threshold itself that poses or increases the risk to Fund resources. It is also true that the Fund may have special concerns about the balance of payments projection or about the capacity to repay to the Fund for countries with different amounts of holdings. The preference of this chair has always been that the capacity to repay should be more thoroughly analyzed before a program is approved than post facto. So, maybe we would have avoided some problems if we paid more attention to a member's capacity to repay at a stage preceding the approval of the program.

The figure of 300 percent seems appropriate, although I must recognize that I found some logic in the points Mr. Guzmán-Calafell developed in this regard. It is also true that the threshold should not be made too low, because if we have an excessive number of these situations, then it will pose an incredible burden on the staff, on the Board, and the sense of exceptionality of this procedure will be lost. I think this is not what we are looking at.

As for the modalities of post-program monitoring, I would like the policy to spell out the responsibilities of the authorities and the Fund unambiguously to the maximum possible extent. If I understand the staff's idea of the modalities correctly, the authorities must prepare their own program within the quantitative framework normally used in the Fund's programming.

In the case of Fund arrangements, if there are differences in view between the authorities and the staff, this Board does not discuss the problem. What will happen in similar situations under the proposed post-program monitoring, I do not understand very well. Echoing Mr. Shaalan, it is not clear who will decide that a country has failed to comply and what will be the role of the Board in this regard.

We are witnessing the power of expectations in today's financial markets. This is why the call for the Fund's discretion in these situations, without automatic triggering of monitoring, deserves special and careful consideration. If we want to give management the power of discretion, then Mr. Guzmán-Calafell's proposal for detailed description of the accompanying circumstances is well placed. I see the need to minimize potential for misunderstandings caused by the decision to initiate post-program monitoring in special cases.

Mr. Shields made the following statement:

I think post-program monitoring is a useful addition to the instruments and mechanisms that the Fund has available to safeguard its own resources and to help members. But I do agree that often in circumstances when there is a large amount of credit outstanding and programs come to an end, there may be better ways of carrying out these requirements, so certainly precautionary arrangements will often be appropriate.

I think post-program monitoring provides a sort of catch-all provision. It is useful in the sense that it will be clear both to members and to markets when large arrangements are determined, or additions to existing arrangements, that there will be this continued close contact between the Fund and the member after the program is finished, even if things in many cases seemed to be going reasonably well or a precautionary program is not relevant. So, I think it is a useful addition.

I can see what Directors are saying about the limited number of occasions and being precise about the differences between this and ad hoc surveillance. It is certainly true that our sanctions are quite limited, but I think trying to formalize the arrangements for additional surveillance could be helpful—for example, when this is automatically triggered, and I think the proposals for an automatic trigger if total Fund credit outstanding is over 300 percent sounds sensible to me.

The question of whether it should be triggered below that, some Directors were worried about the effects on market confidence of a decision to go for post-program monitoring. I think it could go either way. It could actually sometimes be very helpful to the markets to show that this cooperation is going to be put into effect. How we display that in terms of decision or whether we go for regular reports on our procedures is an interesting question. I think that may actually turn out to be very useful, because as far as the markets are concerned this would simply be a more frequent Article IV procedure, but hopefully there would be a bit more content than some because we hope there will be some framework agreed by the country which could be mentioned and commented upon.

On the criteria for determining whether to put countries under this arrangement, I think Directors' concerns are right: if the Managing Director is going to have this discretion, then there have to be clear guidelines for him to operate under, and clearly he will need to consult carefully with the Board about what happens in these circumstances. It is not just a question of reporting to the Board afterwards, but I think he will want to take soundings with the Board and it would be useful to know the criteria that he would use.

I think Mr. Donecker is right to say that we need to have information about the costs of this enhanced policy. It is difficult to know how many countries are going to be involved, and so forth, but just some general idea about what it would demand for an individual country in terms of additional resources over a year would enable us to see this in a clearer light.

Finally, on the proposals themselves, I think it is a good idea that we review how these are going before too long, and encompassing them within the review of surveillance seems right. Also, I think one useful side effect of this policy will be that the consultation clause and arrangements will be harmonized.

A couple of people have referred to the other questions that we were looking at in the context of members with very high access, and I certainly would like to see us developing our considerations on charges on large-scale use of Fund resources. We continue to think there are very good arguments for this. Also, guidelines for early repurchase may also look at negative pledges and prepayment clauses, so I look forward to further discussions in these areas.

Mr. Barro Chambrier made the following statement:

I welcome today's discussion on the safety of Fund's resources in cases of very high access and the need to preserve the revolving character of the Fund's resources.

As Directors would recall, during the previous discussion on this issue in December 1996, this chair sees merit in introducing post-program monitoring in cases of very high access to Fund's resources, to provide additional safeguards. While recognizing that the primary safeguards for the Fund's resources should remain the strength of the member's adjustment program, however, the many challenges ahead under the changing globalized environment call for increased vigilance in the replenishment of the Fund's resources. Like Mr. Zoccali, I believe that our ultimate objective is to reinforce the countries adjustment process.

I also note that a continuing dialogue between the Fund and the member country should remain critical to the Fund to encourage member to pursue appropriate policies, and thereby, strengthen its capacity to repay the Fund. The introduction of PPM should not preclude our ability to strengthen our existing ad hoc consultation procedure.

On the main issues I would like to offer the following comments.

First, for the cases where there is a high exposure of total Fund credit, I can go along with the proposed threshold at 300 percent of quota, the equivalent of the cumulative access limit. Like other speakers, I also think that the review of this threshold could also be considered from time to time, when the situation warrants it.

Second, for members below the proposed threshold, taking into account the strengths and the weaknesses of each country, a case-by-case approach should continue to prevail.

Third, concerning possible new approaches to reinforce the basis for the Fund to conduct post-program monitoring, of the two approaches suggested in the report, I would favor the one related on the use of consultation clauses, combined with a report by the Managing Director to the Board in case where a member country fails to comply with post-program monitoring rather than the other based on the Article V, section 4 of the Articles.

Fourth, on modalities of post-program monitoring, I would like to reiterate that a continued dialogue between the staff and the authorities will remain essential to the success of this process. Once again, the country involved in post-program monitoring with the Fund should demonstrate its willingness to cooperate with the Fund. With regard to the Fund position on a country's performance under the post-program monitoring, I have no objection that the Board's views be normally expressed in a summing up, whatever the degree of performance achieved by a member country.

Mr. Qi made the following statement:

This chair supports the establishment of a threshold beyond which members should automatically become subject to post-program monitoring and this threshold would be subject to review at the time of the review of access limits. We also agree that for the time being, the threshold could be set at 300 percent of quota, with the measurement of total Fund credit outstanding.

Against the same rationale—to ensure members' ability to service their obligations to the Fund— we can go along with the staff suggestion that the Managing Director call for post-program monitoring of users of Fund resources below the threshold on a case-by-case basis, if special concerns in this connection arise. However, we share the view that market reaction in these cases should be taken into account.

On the post-program monitoring policy, it is agreeable to us that there should be consultation clauses in all arrangements and post-purchase monitoring for outright purchases, and we support using this opportunity to harmonize the present consultation clauses. On the monitoring discussions, it is hoped that the quantified framework would accommodate the characteristics of the post-program stage which might be different from those of on-program stage.

Finally, we support Mr. Shaalan's suggestion that the exit mechanism should also be clearly specified.

Mr. Andersen made the following statement:

We agree on the need for a strengthening of the safeguards for the Fund in case of very high access, but would also like to stress that the strength of a member's original program remains the primary safeguard for the Fund resources. We also agree that it seems reasonable that countries with very high cumulative access should be subject to closer monitoring than that provided for annual Article IV consultations after the expiration or cancellation of a program or when a program has gone off track, with a view to minimizing the risks associated with Fund exposure and, more generally, to assist in ensuring that the member will be able to service its obligations to the Fund.

I therefore welcome today's discussion and the short paper on possible modalities for post-program monitoring, although we think that a decision on a new policy in this area would justify much more clarity on certain aspects, as noted by others, including the envisaged design of the monitoring, as well as on the consequences of lack of cooperation with the Fund. I would also be interested in some further clarification on the comparative advantages of the post-program monitoring approach as compared to a strengthened use of existing instruments, where more frequent consultations and/or more frequent use of precautionary arrangements could have some merits. In addition, I agree with those that have pointed that the additional benefits of post-program monitoring seem quite modest, to say the least, which warrants some further thinking before we agree on a new policy.

With these general caveats, I would, nonetheless, like to offer a few comments on the suggested modalities.

First, on the choice of a specific threshold, while we can agree that the approach to apply post-program monitoring automatically to very high access members and to consider it on a case-by-case basis when otherwise justified is a reasonable approach, if we go ahead with a new policy here, we would prefer that the main emphasis would be on automatic monitoring in the form of a somewhat lower threshold than the suggested 300 percent of the quota. So, here I am much closer to Mr. Newman than to Mr. Disanayaka.

Second, we find it important to have more clarity on the resource implications. The document is not quite clear on how much additional resources the staff expects post-program monitoring will require, and I think we need to make sure that the modalities are set in a way so that post-program monitoring does not unduly divert resources from other pressing issues. Moreover, we find that the resource implications of post-program monitoring must be significantly lower than for normal Fund programs, and think that intensive use of resident representatives could prove to be very beneficial in that regard.

Third, we agree that failure to comply with post-program monitoring should be taken into account when assessments are made for a new program.

Finally, on the implementation, we feel that the modalities should be established in a way that gives this Board a clear say on when such monitoring is called for. We find that the Board should make the final decisions in the selection of countries to be monitored under the case-by-case provisions of the policy. So, it is rather important that the Managing Director in fact consult with this Board and not only inform the Board ex post, as just remarked by Mr. Shields. Maybe the country matters sessions could be used more intensively for the staff and the Board to signal informal views on the need for special monitoring in particular cases. Of course, we will have to rely on the staff and management's assessment, and it is important to ensure that we have a smooth decision-making process.

Mr. Taylor made the following statement:

I will try to avoid repeating what many other people have said. If this idea were to proceed in its present form, I think it would be imperative to avoid retrospectivity, as pointed out by Mr. Guzmán-Calafell and a number of others, and the figure below in which there would be no automaticity should be no lower than 300 percent.

However, I can only think of two instances where we should feel concerned. The first is where there is a real fear that the policies in the country concerned are so bad that a real risk of default or delayed repayment arises. Now, that would be quite rare and would come to notice quite readily through Article IV or through resident representatives and a number of other ways, and I think an ad hoc approach rather than an automatic approach would be called for in special circumstances.

The only other instance that I can think of is where there would be the capacity to repay early, which all members should feel at least a moral obligation if there is a capacity to repay early, but I think that is better addressed, as several others have suggested, through early repayment clauses or higher charges for longer and larger use of resources.

The other point is that Mr. Kiekens seemed to assume that not much would be achieved but not much would be wasted, either, so that is not a big problem. The summing up on the last occasion this was considered recorded some concern about resource use, and indeed the staff paper indicated that the staffing implications of a move of this kind would need to be considered. I think this could be clarified. I presume that there has been some estimation made of the additional use of resources, and it would be useful to have that this morning.

I noticed, however, that several colleagues who represent borrowing countries are in favor of proceeding with this idea or something similar to it. Against that background, I recall how Mr. Yoshimura began this discussion. I think he was saying that the principle is something that could be supported, but this particular idea may—I think to use Mr. Newman's term—prove to be an empty box. And, like Mr. Yoshimura and I think also most recently Mr. Andersen, I wonder whether it would be better to suspend our discussion, think some more about what has been said this morning, and come back to it at an early occasion. I frankly do not think that there is a basis through this morning to proceed with this particular idea, but I also do not think we are in a position to discard it entirely.

Mr. Daïri made the following statement:

Like other Directors, we have doubts about the need for a specific policy on post-program monitoring. First, we should be careful not to alter the nature of Fund arrangements. A member's obligation can only derive from the Articles of Agreement. All policy measures spelled out in Fund arrangements are intentions that need to be fulfilled to be able to make purchases and to not create obligations other than those provided for in the Articles. Some clarification by the Legal Department on this issue is welcome.

Second, the risks for Fund resources does not depend on the size of the arrangement or the Fund's exposure. These risks should be assessed at the time of the decision to support members' programs, and the Fund should refrain from such support if the risks are deemed unreasonably high, whatever the size of the arrangement. I do not agree with the proposal that Fund relations with members should be affected by the size of their exposure.

Third, any post-program monitoring should not be seen as a sign of a lack of confidence of the Fund in members' policies, but rather as a voluntary endeavor by the member to maintain the transparency and credibility of its policies after the end of the arrangement.

Fourth, I do not see the usefulness of monitoring the implementation of the authorities' policies if such policies are not considered by the Fund as consistent with a member's objectives or if the objectives are deemed inadequate. This is the current position taken by the Board when discussing the issue of staff-monitored programs. Unless there is a clear understanding on a program designed on the initiative of the member and of a quality that can be monitored by the Fund, any post program monitoring would have to be limited to the monitoring of economic and financial developments. In such a case, I wonder whether specific policy for post-program monitoring would be of any use.

Fifth, objective criteria for deciding when to apply post-program monitoring are difficult to identify, which may raise the issue of uniformity of treatment of members referred to by several Executive Directors, as well as the signaling effect to markets of a case-by-case approach referred to by Mr. Shaalan.

Finally, I do not support an imposition of surcharge on large users. I think this is not in fact an issue under discussion today, but I just wanted to mention this.

Mr. Estrella made the following statement:

There seems to be a wish on the part of the Board to institute post-program monitoring in a formal way. The basic, but not exclusive, idea seems to be that the Fund should monitor members that remain in debt to it beyond a certain threshold. Members may be obliged to submit to post-program monitoring by the Fund if the Managing Director considers that necessary, irrespective of the size of their debt to the Fund. Furthermore, the Fund can require so-called supplementary surveillance.

Hence, it seems questionable that formal, along the lines of the staff papers, post-program monitoring is necessary or even useful. This is particularly the case since the Managing Director, according to the staff proposal, is to be authorized to call for post-program monitoring in irrespective of whether a threshold has been exceeded.

In principle, we can see the case for a case-by-case decision to be applied in post-program monitoring, but this decision should be taken by the Board at the request of the Managing Director. Also, as Mr. Shaalan said in his statement, we are not clear what are the criteria and mechanism for exceeding post-program monitoring. Therefore, our first reaction to the suggestion contained in the two staff papers is rather on the negative side.

If it were, nevertheless, desired to give effect to the intention expressed in the staff papers, the Fund could adopt a policy (1) providing for consultation clauses in all arrangements and for post-program monitoring for outright purchases, and (2) specify circumstances that would activate the consultation clauses or monitoring provisions.

A member's participation would not be an obligation. However, not cooperating could, in some ways, be held against the member when it approached the Fund for some purpose. The legal basis for post-program monitoring can be found in Article V, Section 4, which requires a waiver whenever a country wishes to become indebted to the Fund in excess of 200 percent of its quota. This requirement continues until the amount in excess of 200 percent of quota has been fully repurchased.

The problem with this approach would be that it would be applicable only where GRA resources are used. An alternative approach would rely on the use of consultation clauses, which are already included in one form or another in various arrangements. The staff does not seem to favor this approach, for reasons which are not clearly stated. The Fund could, however, establish a policy on post-program monitoring which would have two parts.

One part would be to require consultation clauses in all arrangements and post-program monitoring for outright purchases, and here we could agree to the harmonization of consultation clauses. The second part of the policy would specify those circumstances that would activate consultation clauses or monitoring provision. However, whether in any particular case monitoring should be imposed would remain a matter of judgment.

The purpose of establishing such a policy is not clear to us. Moreover, what would be the case if a country fully cooperated with the Fund but continued to implement its own macroeconomic policy regardless of Fund advice? In those cases, perhaps post monitoring could not safeguard Fund resources. Therefore, post-program monitoring would not be an efficient way to safeguard Fund resources.

Since there is no obligation to submit to consultation except to the extent already specified in the Articles, the sanctions—if one can call them that—for not cooperating would necessarily be limited. The fact of noncooperation could be brought to the Board's attention, and it will be possible to apply somewhat informal sanctions, such as refusal to recommend a purchase, etc.

Finally, as other Directors have said, we would like to see some estimate of the costs and benefits, in dollar terms, of this new post-program monitoring proposal, since, as we all know, there is a clear determination across this Board to reduce costs in this institution. Altogether, it seems that sufficient powers already exist for the Fund to attempt to induce a country to submit to post-program monitoring. There does not seem to be any need for any new form of persuasion.

The Deputy Director of the Policy Development and Review Department pointed out that some of the surveillance instruments—including ad hoc Article IV consultations—suggested by several Directors were directed essentially at exchange rate policies, and were not well designed for the cases the staff had in mind. Clearly, if a member entered into a precautionary arrangement, an alternative monitoring framework would be unnecessary. However, it was important to recall that a member still retained the right to make purchases under precautionary arrangements, and the member would need to meet the standards of upper credit tranche conditionality.

The staff considered that there was a gap in existing monitoring instruments and in existing consultation clauses, at least in the sense that they did not apply to outright purchases that could give rise to high levels of Fund credit, the Deputy Director continued. Accordingly, it seemed desirable to have greater clarity for members, the Board, the staff, and management about how such cases would be handled.

The staff-proposed policy—whose effectiveness some Directors had expressed misgivings about—was based on a cooperative approach, the Deputy Director noted. It was important to point out that, in any event, there was already staff monitoring in cases of very high access and where there was a serious concern about the balance of payments and capacity to repay the Fund. The proposed policy would seek to involve the Board more closely, which would strengthen the staff's efforts. The proposed policy could move forward on an experimental basis, and the Board could consider whether it was effective and whether it needed modifications at a later date.

On the circumstances and criteria for the application of the case-by-case monitoring, the staff had attempted to outline the relevant general considerations, such as balance of payments developments and the prospects for the member's capacity ro repay, the Deputy Director stated. However, it was difficult to be precise because each case would be a matter of considerable judgment, which underlined the importance of the suggestion that the Managing Director initiate the process and that the Board be closely involved in its implementation.

On the issue of signaling, the Deputy Director pointed out that the earlier staff paper ("Safeguards for the Fund in Cases of Very High Access—Preliminary Considerations," EBS/96/182, 11/27/96) had approached the issue of monitoring on the assumption that there would be a very few, selected cases, which had raised questions of the possible adverse signaling effect, particularly to financial markets. A number of Directors had suggested that a somewhat broader framework was needed, and the staff had responded with the current proposal that attempted to address those concerns. Nevertheless, such concerns would continue to be treated carefully.

A number of Directors had asked about the meaning of cooperation in the proposal and the consequences for noncooperation, while Mr. Shaalan had considered that there was an inconsistency between paragraphs 33 and 37, the Deputy Director said. However, he did not see a difference or inconsistency between the two paragraphs. In the proposal, paragraph 33 stated that the member was expected to supply the necessary data and to engage in discussions with the staff on appropriate policies. There was not an expectation or an obligation that the member would reach agreement with the staff or reach agreement on a program that could be presented to the Board. Paragraph 37 indicated how the staff would articulate the results of the discussions to the Board in such a way as to allow for Board monitoring. Ideally, the staff and the member would reach a comprehensive agreement, but, in any event, the results of the discussions would need to be quantified and translated into benchmarks that could provide a basis for Board monitoring of performance and developments under the program. The failure to cooperate would not, as suggested by Mr. Shaalan, lead to a declaration of ineligibility, which was a formal expression of disapprobation on the part of the Fund. Rather, the proposed policy suggested that the Managing Director not bring a request for use of Fund resources to the Board until a cooperative relationship had been restored, which was not much different from the current practice.

On the need for an exit mechanism, once the proposed policy was initiated, the duration of the procedure would be indicated, the Deputy Director pointed out. It could also be provided that the procedure could be terminated at any time if developments in a member's position and prospects so warranted.

The determination of the level of the triggering threshold was necessarily arbitrary, the Deputy Director agreed. The staff considered that the relationship to the cumulative access limit had some logic as a starting point. However, if the staff were to recommend an alternative to the 300 percent of quota threshold, it would probably recommend a somewhat lower figure rather than a somewhat higher figure.

Mr. Yoshimura considered that it was important to have strong sanctions to encourage members to comply with any policy on post-program monitoring. However, he questioned the effectiveness of the sanctions in the staff-proposed policy.

The Deputy Director of the Policy Development and Review Department noted that the proposed policy was not based on sanctions, but on a cooperative approach. He reiterated that one should not underestimate the effectiveness of the Board's involvement in the monitoring process in influencing the course of a member's policies. Accordingly, the proposed policy would represent a substantial step beyond the normal staff-monitoring procedures.

With respect to the costs associated with the proposed policy, it was not possible to give precise estimates because much depended on the frequency with which the policy was used, the Deputy Director noted. Also, irrespective of whether the proposed policy were accepted, staff monitoring would be intense in cases of very high access or where the staff considered that there were serious developments in the balance of payments or capacity to repay the Fund. The incremental cost of specifying benchmarks, preparing a relatively brief paper for Board consideration—either in a Board meeting or on a lapse of time basis—might be minimal, because in the most serious cases, such things as staff visits would occur irrespective of whether a formal post-program monitoring policy were put in place.

Mr. Shaalan reiterated his concern that there appeared to be a difference between the messages in paragraph 33 and in paragraph 37. Paragraph 33 explained that the process of monitoring would involve the provision of data and information, and the availability of the country for discussions with the staff. There would be no requirement or expectation that the member reach a common understanding on a program with the staff or the Fund. But paragraph 37 noted that the staff's discussions with the member in the course of monitoring would focus on the formulation of the member's program of economic objectives and policies, and on their consistency.

On the question of ineligibility, Mr. Shaalan said that he agreed with the Deputy Director that, if a country did not cooperate, legally it would be still eligible for use of Fund resources. But if management took the view that because the country did not cooperate, resources would be withheld in the future, that could be characterized as a declaration of ineligibility for some time.

The Deputy Director of the Policy Development and Review Department said that, in the event that the staff and management determined that a member was not cooperating, it would be reported to the Board, which would then have the opportunity to assess the situation. However, if the Managing Director were confronted with a situation in which a country would not even discuss policies, but wanted access to Fund resources, the Managing Director might consider it inappropriate to present that request to the Board. Moreover, there was not an inconsistency in the staff paper, because the member was expected to enter into discussions on its economic policies and prospects, and then the staff would present the results of those discussions to the Board as a basis of the monitoring exercise.

Mr. Szczuka said that he agreed with Mr. Shaalan. There was a difference between providing data and holding discussions with Fund staff, and establishing and implementing benchmarks, which resembled more closely an actual Fund-supported program that had to be accepted by the member in advance. In order to gain access to Fund resources in the context of a program in the first place, a member would need to accept certain benchmarks that applied after the end of that program. Also, he agreed with Mr. Andersen's suggestion of having a type of comparative analysis of the effectiveness of the proposed policy versus the various existing monitoring instruments.

Mr. Vernikov said that he agreed with Mr. Shaalan that there was an apparent inconsistency between the two paragraphs in the staff report. The point of the current discussion was to consider monitoring after the completion of a program. However, many of the elements of the proposed policy resembled a type of shadow program, which was not what the Board had intended. Existing instruments, such as precautionary arrangements, were described in the Articles of Agreement, so it was not clear what the proposed policy added. He said that he agreed with Mr. Taylor that the current discussion should be suspended and more consideration given to what precisely was desired.

Mr. Daïri said that he agreed with Messrs. Shaalan and Vernikov.

Mr. Donecker said that he shared the concerns expressed by Messrs. Szczuka and Vernikov. There was much room to strengthen and harmonize the consultation clauses under the existing arrangements. The issue of outright purchases was less worrying, because there had not been such purchases around the 300 percent of quota point. Rather, when access reached 300 percent of quota, very close consultations should be required, even after the program period, as was the case with Stand-By and Extended Arrangements.

Mr. Newman stated that he did not quite understand Mr. Shaalan's concerns. The proposed policy was a type of staff-monitored program after a formal program. While Mr. Shaalan was concerned that management might abuse its powers in that regard, the possibility for abuse was no greater than it had been at any other time. Setting specific guidelines in terms of when the proposed policy would be applied—and he preferred a bright-line rule, rather than an ambiguous guideline that allowed management full discretion—would establish a rule encouraging countries to enter into a staff-monitored program once completing a high-access program, however defined. Such a policy was acceptable, particularly if the country was not obligated to do so. If the country disagreed, then the sanctions would be modest, centering on a question of the Fund's or the management's goodwill, which, nevertheless, was always an issue of some importance for countries confronting the institution.

Mr. Yoshimura asked whether the Board had agreed on a policy for staff-monitored programs.

The Deputy Director of the Policy Development and Review Department responded that there had been Board discussions of various kinds of monitoring arrangements, but not a formal decision on staff monitoring. The staff had been asked to prepare a paper discussing the circumstances and procedures applied to staff monitoring, but there were no Board decisions on the matter.

The General Counsel made the following statement:

> This paper was prepared not at the initiative of the staff, but in response to a request from a number of Executive Directors who wanted to explore the possibilities of strengthening post-program monitoring.
>
> In preparing this paper, the staff had to take into account the existing tools and mechanisms that are available to the Fund. First of all, in at least some arrangements—Stand-By, Extended and ESAF Arrangements—there are consultation clauses, which are not identical and not very precise. For example, there is no particular threshold (except for the reference to outstanding upper credit tranche purchases in Stand-By Arrangements) and no particular

guidance for the Managing Director, who is given complete authority in these consultation clauses. Therefore, in this respect at least, the current paper would delineate the scope of that authority to a greater extent. In contrast, there is no similar clause for SAF arrangements or for outright purchases, which creates both a vacuum and inconsistencies.

Second, consultation clauses are not the only basis that may be envisaged for post-program monitoring. For example, while there is no Board decision that establishes rules or procedures for staff-monitored programs, there is a decision on enhanced surveillance, which involves the Executive Board, not just the staff. However, both enhanced surveillance and staff-monitored programs are at the request of the member and essentially to assist the member in its negotiations with other creditors. They are not related to the use of Fund resources, but rather to repayments of loans to other creditors.

Third, under Article IV surveillance procedures, provision is made for supplemental surveillance, which may be initiated by the Managing Director and may involve the Executive Board if an ad hoc consultation is conducted. But again, these procedures are not related to the use of Fund resources, but rather to economic or financial developments that may affect exchange rate policies or the behavior of the exchange rate of the currency of the member.

It has been suggested by a number of Executive Directors that, instead of resorting to consultation clauses, a more adequate basis for post-program monitoring would be the approval of precautionary arrangements. The problem with the so-called precautionary arrangements is that they are actual arrangements. They cannot be approved without a request by the member and they create commitments of resources. This means that, when they are requested by a member which is already at a high level of use of Fund resources, the Fund has to apply high credit tranche policies and high conditionality. In all cases, the Fund must be prepared to give effect to a request for a purchase since the arrangement is a binding commitment. There is no such thing, in other words, as an arrangement without financial resources from the Fund. Therefore, precautionary arrangements are not an adequate instrument if the purpose is only to monitor the member's policies pending the discharge of its liabilities to the Fund.

Another instrument mentioned in the paper is Article V, Section 4, which gives the Fund the power, in case of access above 200 percent of quota in the General Resources Account, to impose certain conditions to safeguard its resources. These conditions may include the imposition of certain obligations, on a case-by-base basis. However, as explained in the paper, there are a number of disadvantages to this approach. For instance, the paper notes that Article V, Section 4 does not apply to SAF/ESAF loans and that the imposition of sanctions may not be the most adequate response when a member fails to cooperate in the monitoring process.

Therefore, the approach proposed by the staff in the paper is to use objective, uniform criteria, similar to the consultation clauses in extended arrangements.

A question has been raised by Executive Directors concerning what they called the "retrospective" application of the new policy to present large users of Fund resources. This is a policy question, not a legal problem. It would be for the Executive Board to decide whether to apply this new policy, if there were to be a new policy, to present large users of Fund resources, and this decision would not violate the prohibition against retroactivity. The principle is that, unless otherwise specified, a decision of the Fund has an immediate effect. If the Fund adopts a new policy that is based on the level of holdings of a member's currency in the General Resources Account, this policy will normally apply on the basis of present holdings. For instance, a decision to increase the rate of charge in the General Resources Account will apply to present holdings of the members' currencies, unless the Fund decides to postpone the effective date of the increase. Because of the generality of this principle, only exceptions need to be specified in the Articles. The precise exception is Article V, Section 7(f): a decision of the Fund to shorten repurchase periods under a policy does not apply to existing holdings. This exception, which was introduced at the time of the Second Amendment to give the member the benefit of the longer repurchase period that existed before it was changed, confirms the principle that new policies apply on the basis of present holdings of a member's currency at the time of the decision.

A question was raised concerning footnote 22, which contains a somewhat cryptic sentence that perhaps requires clarification. Footnote 22 reads as follows: "Consideration could also be given to making failure to consult under an earlier arrangement grounds for suspension of purchases in a subsequent arrangement if this consequence were clearly provided for in the consultation clause." First of all, the paper does not make any proposal but raises an issue for consideration. Second, it would be legally possible to adopt a policy allowing the Fund, in the case of a failure of a member to engage in post-program monitoring, to suspend disbursements under the arrangement in force at the time of the suspension. Third, the standard clauses in arrangements would need to be amended to make it clear that, if the member fails to engage in post-program monitoring, then disbursements under the current arrangement will be suspended. In the absence of such a clause, disbursements could not be suspended. As is the case with any other performance criterion, this condition would have to be specifically mentioned in arrangements.

Another question was raised concerning the power of the Fund to impose obligations under the Articles. There is no doubt that the Fund's powers are limited by the Articles. The Fund has no powers except those conferred by the Articles. However, under the Articles, some obligations are established directly by the Articles while other obligations are established by the Executive Board or the Board of Governors pursuant to the Articles. For instance, the rate of charge is not specified in the Articles, but there is an enabling provision which allows the Executive Board to establish the rate of charge. Thus, there are two types of obligations under the Articles: those that are already specified and those that are adopted pursuant to the Articles. In the case at hand, the latter are envisaged.

Mr. Daïri said that he understood the General Counsel's explanation, but that, with respect to Article V, the Fund did not have the right legally to impose any obligations on members that were not directly available and fulfilled before the disbursement was agreed. It was inappropriate for the Fund to impose legal obligations that might raise an issue of sanctions to be maintained after an arrangement had elapsed.

The General Counsel pointed out that a distinction needed to be made between the date of creation of an obligation and the date of its effectiveness. He agreed with Mr. Daïri that no obligation could be imposed by the Fund ex post. In other words, it was at the time of the arrangement, when granting the waiver, that the Fund had to make clear to the member that specific obligations would have to be met, which would be specified in the arrangement, but the effectiveness of these obligations would be delayed. For instance, the Fund could decide that, as a condition for granting the waiver, the member would undertake to repurchase during a shorter period than three to five years. That obligation was incurred at the time of the arrangement, but became effective, say, two years later. In that case, there would be an establishment of the obligation at the time of the arrangement, but the obligation would become effective only after the end of the arrangement. The obligation would have been established up-front, not ex post, and that was consistent with Article V, Section 4.

Mr. Daïri considered that, if the General Counsel were correct, then the Fund could impose any obligation on members. However, the Fund could only impose obligations that were consistent with the Articles of Agreement and that were known in advance. For example, during a recent Board discussion on capital account liberalization, the General Counsel had stated that national parliaments needed to know precisely what kind of obligations would be created under an amendment to the Articles on the matter.

Mr. Taylor considered that Mr. Daïri had noted a valid point. In any event, retroactively applying the proposed policy to countries with high access to Fund resources was unacceptable.

The General Counsel cautioned that such a policy might have serious implications on the process of changing the rate of charge.

Mr. Taylor said that the General Counsel had raised a fair point, but that the policy on the rate of charge was a well-established practice and the proposed policy on post-program monitoring would be a new procedure.

The General Counsel, in response to Mr. Daïri's point, stated that national parliaments or other competent bodies would be fully aware of all elements of an arrangement at the time of its approval. If a condition to consult with the Fund after the end of an arrangement were imposed, then it would be part and parcel of the arrangement.

Mr. Guzmán-Calafell said that he agreed with the points raised by Mr. Daïri and also with the point mentioned by Mr. Taylor regarding the undesirability of a retrospective application of a new policy. He wondered whether the Fund had retroactively applied any new policies in the past. Also, it did not make sense to suspend purchases under subsequent arrangements on the grounds that a member had failed to consult with the Fund under an earlier arrangement, an approach contained in the staff paper. If a subsequent arrangement were approved, it could be assumed that a certain degree of cooperation had been restored.

The General Counsel remarked that the staff had not proposed that approach. It had been included in response to earlier questions raised by Directors.

Mr. Szczuka said that he agreed with Mr. Guzmán-Calafell that any new policy on post-program monitoring should not apply retroactively. The practice of changing the rate of charge was not relevant in the current case because that was a normal practice when using variable interest rates.

Mr. Donecker said that he agreed with the General Counsel that certain obligations could be created when the Fund activated Article V, Section 4. In any event, he considered that the goals of post-program monitoring could be achieved through the appropriate strengthening of consultation clauses.

The Acting Chairman made the following concluding remarks:

> This has been a useful and detailed discussion. However, in light of the many questions raised at today's meeting, it would seem preferable not to conclude with a formal agreement on the new policies.
>
> On the one hand, there is substantial support for a policy on post-program monitoring. On the other hand, a number of Directors have stated that they could not agree to the proposed policy or are not yet convinced of its usefulness. Some of these Directors pointed to other mechanisms that they might prefer, although it is not clear whether such mechanisms would be applicable in the circumstances envisaged.
>
> I would note that there is general agreement not to rely on Article V, Section 4. Moreover, there is broad support for a threshold of 300 percent of quota and the comprehensive definition of Fund credit given in the paper. There is also agreement on inclusion of a review, perhaps after two years of experience.
>
> While there is broad support for a policy on post-program monitoring, several questions were raised by Directors supporting the policy and also by those who are not convinced of it in its present form. I would like to suggest that the staff look carefully at the record and attempt to address the questions in a short follow-up paper, which could also contain a draft of the guidelines for the new policy.

After adjourning at 1:10 p.m., the meeting reconvened at 2:30 p.m.

2. REPUBLIC OF YEMEN—1997 ARTICLE IV CONSULTATION; EXTENDED ARRANGEMENT; AND ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1997 Article IV consultation with the Republic of Yemen and its requests for an Extended Arrangement in an amount equivalent to SDR 264.7 million and for arrangements under the Enhanced Structural Adjustment Facility (ESAF) (EBS/97/172, 9/9/97; Cor. 1, 10/2/97; Cor. 2, 10/27/97; and Sup. 1, 10/29/97). They also had before them a policy framework paper for the period

1997–2000 (EBD/97/101, 9/2/97), together with a background paper on recent economic developments in the Republic of Yemen (SM/97/235, 9/19/97), as well as the authorities' letter of intent (EBS/97/169, 9/2/97; Cor. 1, 10/27/97; and Cor. 2, 10/27/97).

Mr. Shaalan made the following statement:

Since 1995, the Yemeni authorities have embarked on a very comprehensive and broad-based stabilization and adjustment program. Under the just-expired Stand-By Arrangement, macroeconomic performance exceeded a number of program targets, and consistent with the authorities' desire to accelerate the pace of reform when feasible, the 1997 program targets have been revised to even more ambitious levels. Annual inflation in 1997 is expected to be much lower than programmed, and the annual target for reserve accumulation was attained in the first half of the year. Far reaching structural reforms were also implemented with respect to the tax system, the reorientation of public expenditures, domestic price liberalization, financial sector modernization, the trade and exchange regimes, and privatization. These achievements were attained in spite of both administrative and political difficulties—such as those encountered with respect to wheat and energy price increases and in the establishment of special commercial courts—thereby attesting to the resolve of the newly appointed government. In these and other instances, the authorities pushed ahead with the reforms, cognizant that clear signals are needed to rebuild private sector confidence, maintain the support of the international community and boost investment in order to improve per capita income growth and establish external viability.

The turnaround in the fiscal area was indeed remarkable. The primary cash balance has shifted from a deficit exceeding 14 percent of GDP in 1994 to an expected surplus of 1 percent of GDP in 1997, and the overall cash deficit was reduced to 2.5 percent of GDP. Tax revenues nearly tripled in the past 3 years reflecting tax measures and tightened administration as well as oil-related revenue increases following reforms to the exchange system. Additionally, current expenditures were contained with nonsubsidy current spending declining by nearly a third (as a percent of GDP). Subsidies, which had increased to 17 percent of GDP in 1996 with the move to full accounting transparency, are expected to decline to 11 percent of GDP in 1997 following energy and wheat price adjustments. As part of the reorientation of expenditure toward priority sectors, there has been a six fold increase in public investment spending—to 7 percent of GDP—and a marked increase in social expenditures. In spite of expenditure reductions to meet lower than anticipated revenues, social expenditures are expected to be increased to 7.1 percent of GDP, compared to 4.7 under the Stand-By Arrangement program. Of equal importance, the authorities eliminated dependence on domestic bank financing for the budget and there has been a gradual reduction of government debt to the banking system.

Monetary expansion was arrested in tandem with the strong fiscal adjustment, and real interest rates became significantly positive with the rapid deceleration of inflation. Following elimination of the official exchange rate and shift to a free floating market rate, recent exchange rate stability improved confidence and contributed to stability of the nominal exchange rate, which in turn supported disinflation policies. In spite of some real appreciation, the current account deficit in 1997 is half the size anticipated under the Stand-By Arrangement.

An ambitious agenda of structural reforms has been pursued over 1995–96 in the fiscal, monetary, trade, exchange system, privatization, regulatory reforms, and social safety net areas. Not unexpectedly, technical difficulties slowed down reforms in a few specific areas, such as civil service reform and the privatization of 16 medium-sized enterprises. Legal and administrative constraints are being addressed to move forward with civil service reform and its implementation will require considerable technical assistance. Labor redundancy costs and the potential for conflicting property claims proved to be obstacles to privatization of public enterprises. Nevertheless, 30 percent of all public enterprises were privatized, and although small in relative size and economic weight, this has demonstrated the authorities' resolve to limit public involvement to social sectors and basic infrastructure.

As outlined in the policy framework paper and memorandum of economic and financial policies, the authorities are committed to consolidating their recent stabilization gains and to a broadening and deepening of their structural reform agenda with the objective of raising real per capita income, improving social indicators, and avoiding the dependence on exceptional finance. To achieve these goals, their strategy under the ESAF aims at targeting an increase in non-oil sector growth averaging 6 percent, an inflation rate below 5 percent, gradually increasing social expenditures, and maintaining a high ratio of saving and investment to GDP, a current account deficit of 2 percent of GDP and foreign exchange reserves equivalent to 4.5 months of imports.

The program before us today should be viewed in the context of the severely deteriorated economic environment that prevailed only two years ago as well as the constrained implementation capacity. Following the exceptionally successful implementation of the Stand-By Arrangement, Yemen now is embarking on a still more ambitious program. To use the staff's words, the reforms under the Stand-By were "far-reaching" and those under the proposed ESAF/EFF arrangement are "demanding . . . and will challenge the nation."

As in the past two years, fiscal policy is at the heart of the adjustment strategy consisting of a combination of expenditure and tax measures and strengthened budget management procedures. The budget deficit is to be maintained at 2.5 percent of GDP without recourse to domestic bank financing. Treasury bill proceeds are to be used to reduce government debt outstanding to the central bank. Revenue mobilization is to be improved through income tax reforms, a broad-based general sales tax, further reform of customs administration and enhanced administration of corporate profits, income and excise taxation through the introduction of taxpayer identification numbers and elimination of exemptions. Expenditure Reorientation is being accelerated in order to maintain high and rising public investment in basic infrastructure and to increase outlays for priority social sectors. Accordingly, petroleum subsidies are to be eliminated within the next 15 months, and wheat subsidies by the beginning of 2001 at the very latest. An alternate strategy is under consideration for accelerating wheat subsidy removal and its replacement by a cash transfer to low income groups through the Social Welfare Fund. If found to be feasible, the authorities may be able to considerably shorten the time frame for elimination of wheat subsidies.

To strengthen budget management and expenditure control, a program will be implemented in the next two years to improve budget formulation, reestablish central control by the Ministry of Finance over expenditures through monitoring and vetting of line items, enhance central accounting system, and collect quarterly financial records from key public enterprises.

Civil service reform proved more difficult than had been anticipated and required a number of administrative preparations. The authorities are committed to a far-reaching civil service reform program which they consider to be an essential prerequisite for a durable fiscal consolidation. The revised work program entails completion in the next 9 months of: legislative reform to eliminate tenure rights, complete a survey of public sector employees, including position, grade and qualifications of each employee and establishment of a national civil service grade structure. Establishment of the Labor Redundancy Fund and defining criteria for provision of retirement and buy-out benefits are currently under way. Although this is a more clearly defined and more technically feasible agenda than attempted under the Stand-By Arrangement, its implementation will be challenging and will require the timely provision of technical and financial support.

The authorities are targeting substantial improvements in social indicators and broadening of the social safety net, recognizing that significant improvements are essential to foster prospects for per capita income growth which, in turn, is crucial for public and political acceptability of the ambitious reform program. The Social Welfare Fund will be strengthened and augmented in order to act as the central government agency for administering the cash transfer programs. In the next three years, budgetary outlays for social sectors are programmed to increase by an average 2 percent of GDP annually and will reach nearly 10 percent of GDP in 1998.

The continued tight fiscal stance will be supported by a continued prudent monetary stance. Indirect monetary controls are to be implemented in 1998, following the phasing out of the benchmark deposit interest rates. This should enhance the efficiency of financial markets. Cognizant of the non-oil growth and export considerations, the authorities intend to monitor competitiveness indicators and to continue the policy of gradually phasing down the benchmark interest rate in line with the expected reduction in inflation.

Wide-ranging financial sector policies are already well under way. A number of policy and structural measures are intended to enhance reintermediation in the banking system. Preliminary indications are that the notification system—under which banks are required to report to the central bank on delinquent borrowers—is working effectively in exerting pressures on delinquent borrowers and limiting banks' ability to extend credit to refinance nonperforming loans. It may be too early to determine the effectiveness of the special courts established under the Stand-By Arrangement to pursue nonperforming private sector credits, but the acceleration of bank lending in the first half of the year may be an indication that these two initiatives are having their intended effect. In any case, the authorities stand ready to reinforce these activities if the need arises. By end-1997, the government will have purchased all outstanding nonperforming loans from the two public sector commercial banks, thereby facilitating privatization of these two banks. Also by year-end, agreements will have been reached on the schedule of capital increases and provisioning in order to achieve the minimum Basle capital adequacy standard. Prudential supervision of banks is to be enhanced through a strong and extensive program to be implemented in 1997 supported by an IDA Financial Sector Adjustment Credit.

Reductions in the maximum tariff rates and in the rates for most inputs and goods prone to smuggling, removal of the few remaining duty surcharge and remaining import bans, and the introduction of duty drawback for exports are expected to contribute to economic efficiency and growth.

A number of measures are under consideration to enhance the effectiveness of domestic product markets and strengthen the regulatory framework. Although not actively enforced, the authorities are committed to canceling an existing law that allows the government to enforce price controls in the private sector and to maintain certain external trade monopolies. In the context of facilitating the removal of wheat subsidies, the authorities are considering means to encourage private sector milling capacity so as to replace imported flour with cheaper wheat imports. Additionally, the authorities intend to eliminate the domestic trucking cartel and address bottlenecks causing costly delays at the port authorities during the first year of the program. With respect to privatization, the authorities have identified a list of small and medium enterprises to be privatized under the first annual arrangement, leaving the remainder of enterprises to be privatized in the following two years. The World Bank is providing assistance in formulating a strategy to privatize the largest enterprises.

The Yemeni authorities are committed to improving external creditworthiness through a reduction of external debt and normalization of payment relations with creditors. External debt obligations are excessive, however, and cannot be met through Yemen's foreign exchange earning capacity and available external financing. Outstanding debt to the Russian Federation and late interest charges, constitute the largest part of outstanding arrears and debt service obligations. The government intends to request multiyear debt relief on Naples terms from the Paris Club, and at least comparable terms from other creditors. But even with the requested debt relief, and potential support from the Fund and World Bank, Yemen will require exceptional financing of about $100 million from donors for each of the next three years. Thereafter, if a government request for a stock-of-debt operation on Naples terms is granted in the year 2000, it is expected that Yemen would not have a need for exceptional financing, and its debt indicators would improve significantly. The strength of the program would merit the support of the international community.

The bulk of actions under the First Annual Arrangement have already been completed, as seen from the list of prior actions outlined in paragraph 61 and Appendix I, and as updated in the staff supplement. Nevertheless, the program encompasses a formidable reform agenda that will generate new challenges. The authorities are mindful that the population is awaiting clear signals of improved welfare through increased and more effective budget expenditures and an orderly civil service reform, and that at the same time, the domestic private sector and international community are looking for decisive actions in deepening privatization and accelerating financial sector reintermediation.

On behalf of my Yemeni authorities, I wish to express appreciation for the efforts of Fund staff and management in helping to overcome the severely deteriorating economic conditions of the early nineties and to move toward a stable and more diversified private sector–led dynamic economy. The authorities also acknowledge the technical assistance received from the Fund and bilateral sources, without which implementation of their reform agenda would not have been possible. In this regard, the authorities place a high degree of importance to their request for a resident representative position in Sana'a. A Fund resident representative would play a critical role at this stage in the reform program.

Mr. Al-Tuwaijri made the following statement:

I congratulate the Yemeni authorities for the impressive results of their comprehensive adjustment and reform program. The wide-ranging measures implemented since early 1995 have produced strong results. Output has rebounded, the underlying inflation rate has declined sharply, and gross reserves rose substantially.

These achievements notwithstanding, the reform measures taken so far need to be reinforced to attain sustainable high growth rates. Therefore, I welcome and fully support the authorities' request for an ESAF/EFF program.

Turning to the details of the program, a vigorous structural reform effort is appropriately central to the authorities' strategy. In the fiscal area, commendable progress has been achieved in strengthening the budgetary position. The fiscal deficit declined from some 17 percent of GDP in 1994 to an estimated 2.5 percent this year. Efforts are rightly focused now on strengthening the structure of the budget by improving the elasticity of revenues and enhancing the efficiency of expenditures.

On the revenue side, I welcome the efforts to broaden the tax base, improve tax administration, and create a revenue structure that is geared toward private sector growth. In this regard, the importance of introducing the GST on schedule should be emphasized.

On the expenditure side, the focus on reducing administrative inefficiencies in the civil service and on streamlining subsidies is encouraging. This should allow for the resources needed to finance the infrastructure investments required to enhance growth prospects while maintaining a tight fiscal stance.

On monetary and exchange rate policies, I am encouraged by Mr. Shaalan's statement that the authorities will maintain a prudent monetary stance and will continue their shift to indirect monetary controls. At the same time, however, maintaining interest rates at too high a level is not costless. In this connection, I welcome the authorities' intention to monitor competitiveness indicators and to continue to phase down the benchmark interest rates.

In the banking area, the increased ability of commercial banks to collect on bad debts is reassuring as it reduces risk premiums and increases intermediation. I also support the focus on improving supervision and prudential regulations and on increasing minimum capital requirements of banks. These measures should strengthen confidence in the banking sector and facilitate the planned privatization of public sector banks.

In addition to structural reform in the fiscal and monetary areas, achieving the objectives of the program hinges crucially on promoting private sector investment. In this regard, implementation of the privatization program and early passage of the privatization law are critical. Success is also dependant on further progress in deregulating the economy and promoting competitive markets.

To conclude, Yemen's economy has made impressive progress over the past couple of years. Those results could not have been achieved without the commendable efforts and cooperation of the authorities and the staff. Continued cooperation, and further provision of technical assistance, including the posting of a resident representative in Yemen, should enhance implementation of the program. Support by the international community for Yemen's efforts are also essential.

With these remarks, I wish the authorities further success in managing the economy.

Mr. Daïri made the following statement:

The Republic of Yemen has made remarkable progress over the past two years under an ambitious macroeconomic and structural reform program. Performance under the Stand-By Arrangement program has been outstanding and in some areas has exceeded considerably program expectations. Non-oil real GDP growth averaged 5 percent in 1995–96, more than offsetting the contraction of output induced by the political turmoil of 1994. Inflation decelerated sharply from 71 percent in 1994 to less than 4 percent in 1997. The ambitious agenda of structural reforms, implemented over 1996–97, included tax reform, price adjustment, trade and exchange liberalization, and accelerated privatization. The Yemeni authorities' strong ownership of their adjustment and reform process has indeed produced impressive results and has prepared the ground for a multiyear program to be supported by ESAF/EFF. I commend the staff for the excellent papers and concur with the thrust of their appraisal.

Despite these positive developments, the economy continues to be confronted by formidable challenges. The balance of payments' situation is precarious and the economy continues to be under pressure from excessive external debt obligations. Moreover, the living standard of the majority of the population is very low both in absolute terms and in relation to neighboring countries. To face these challenges, the authorities need to increase prospects for private sector led growth, improve employment opportunities and social conditions, and achieve external sector viability. I support Mr. Shaalan's call for exceptional financing for Yemen over the next three years, in addition to regular project financing from multilateral sources and the application of multiyear debt relief on Paris Club Naples terms by all bilateral creditors.

Fiscal policy is key instrument under the proposed adjustment strategy. The authorities have achieved significant fiscal adjustment to date and have reduced the overall cash budget deficit from 17 percent of GDP in 1994 to 2.3 percent in 1996. Strong fiscal adjustment over the last two years has also contributed to a rapid deceleration in monetary expansion. While I welcome fiscal policy measures to mobilize revenue, reorient expenditures, and strengthen budget management and expenditure control, I recognize that progress in fiscal consolidation is subject to certain risks. Despite large administered price step increases for wheat and energy, the budget is still vulnerable to exogenous developments in world oil and wheat markets. To limit risks to the budget, I encourage the authorities to pursue a strategy for earlier elimination of the subsidies and to liberalize the markets for these commodities. I certainly hope to see substantial recovery in the non-oil activity, especially in the agricultural sector where there are potentials for import substitution and export promotion.

The authorities have adopted a stringent monetary policy aimed at reducing inflation and ensuring real positive deposit rates. This has helped in mobilizing financial savings. The program's emphasis on enhancing financial intermediation, improving prudential supervision, and adopting measures to ensure bank soundness are timely and appropriate. I note the authorities' intention to gradually phase down the benchmark interest rate in line with subdued inflation and exchange rate stability. The Cabinet's recent authorization to settle all outstanding public enterprise nonperforming loans from commercial banks will pave the way for the resumption of banks' credit to the private sector. Similar approach in enforcing loan contracts and recovering nonperforming credits to the private sector will help ensure the soundness of the banking system.

I agree with the authorities that freely floating exchange rate regime with the limited central bank's participation to smooth short-term fluctuations, is most appropriate. Nevertheless one should not loose sight of negative impacts of an excessively appreciated currency on diversification and non-oil sector growth. Therefore, I support the authorities' intention to closely monitor external competitiveness indicators and the real effective exchange rate.

The authorities' commitment to privatization is highly commendable. The privatization program needs to be supplemented by the improvement in financial performance and corporate governance, in particular for enterprises that are not expected to be privatized soon. Given the government's plan for privatization of small and medium-sized enterprises during the program period, I would like to seek clarification from the staff on the estimated amount of privatization receipts and the authorities' plan regarding the use of these receipts.

In conclusion, I support the request of Yemeni authorities for a three-year arrangement under ESAF/EFF. I also support the authorities' request for a resident representative position in Sana'a, which is highly needed at this stage of the adjustment and reform process, and strengthening of Fund's technical assistance. I hope the authorities will seize this opportunity to build on recent achievements by progressing with their sound economic policies and reform agenda.

I wish the Yemeni authorities all success in their endeavors.

Mr. Vernikov made the following statement:

First of all, let me praise the staff for the excellent set of papers provided for today's discussion. Overall, I think that Mr. Jakubiak and his team have done a good job on Yemen.

I welcome the progress achieved by Yemen over the past few years. The achievements are nothing short of impressive and, in some cases, have exceeded expectations. The growth has picked up against a background of macroeconomic stability, and a strong boost to structural transformation has occurred. Now, there is a need to sustain the positive results achieved, and the Yemeni authorities' request for a Fund arrangement appears timely and appropriate. I am glad that all envisaged prior actions have, at last, been completed.

We endorse the thrust of the staff appraisal. Overall, I consider the program to be well focused and comprehensive. The envisaged measures are ambitious but within the authorities' reach. Allow me to comment on a few policy issues

The success of Yemen's transformation depends critically on the external viability and on the efforts currently undertaken to ensure future financial assistance from the international community. I am very glad to hear from Mr. Shaalan that the authorities are committed to improving external creditworthiness through a reduction of external debt and normalization of payment relations with creditors.

The Russian Federation is continuing negotiations with the Yemeni authorities, and stands ready to step forward in solving the issue. Being by far the largest external creditor of Yemen, Russia is mindful of the heaviness of the debt burden. My authorities are prepared to offer a substantial up-front discount on the face value of the claims on Yemen, based on the official USSR Gosbank ruble exchange rate of 0.6 rubles per US dollar. As a participant of the Paris Club, Russia will treat the resulting debt within the framework of the Club. As for the late interest, it may be included within the scope of the consolidation.

Tight financial policies need to be maintained in the coming period. One of the immediate tasks on the revenue side is strengthening non-oil sector revenues. Improvements of the tax and customs administrations are also urgently needed. On the expenditure side, I welcome the authorities' plan to eliminate the wheat subsidy earlier than previously planned. Understanding the sensitivity of this issue, I encourage them to proceed cautiously and make social safety net arrangements fully operational to minimize the effect of subsidy elimination on the general population. Reorientation of expenditures toward the social sphere, and restraint of the wage bill and other nonessential current outlays are also steps in the right direction. I especially welcome the authorities' intention to increase expenditure on education and health. Given the limited administrative capacity of the country, it is extremely important to put more emphasis on education, so as to increase the quality of the labor force in both public and private sectors.

Regarding the exchange rate policy, I noted an enviable stability of the rial for quite a lengthy period of time. Recently, however, there was a slight devaluation vis-à-vis the U.S. dollar, which I believe was quite appropriate and allowed to avoid the problems faced by currencies worldwide pegged to the dollar. The staff report features Yemen's exchange rate regime as free float. Still, it may seem that there is also something else behind the free float. Could the staff please elaborate a little on the intervention policy of the monetary authorities and on the advice the staff has given to them on the issue of exchange rate level and regime?

Two brief comments on the structural policy. The fact that understanding between the Fund and Bank staff and the authorities has been reached on the civil service reform strategy, is very encouraging. The civil service reform remains a priority. Without the efficient civil service, future implementation of the reform measures will slide. I urge the authorities to vigorously implement all envisaged actions on this front, as the reform will positively impact the process of institution building in Yemen.

On privatization. The authorities' intention to submit a Privatization Law to the Parliament by end-1997 represents a first step to enforce privatization, as it will establish the necessary legal background for this process. However, in our view, privatization needs to be accelerated, and emphasis should be placed on its quality. The efforts aimed at increasing the efficiency of state enterprises which the authorities plan to undertake in the coming period, are encouraging.

Finally, the strong commitment of the authorities to the reform process, and comprehensiveness of the program measures to be implemented in a medium-term framework deserve our support. I would urge the authorities to implement their program measures without delays, and to continue maintaining a good track record in their relationship with the Fund. I support the proposed decision. At the same time, I was slightly puzzled by the rationale for involving the GRA resources under an EFF arrangement because those may be too expensive for a country like Yemen with per capita GNP of only $260, i.e. where the use of ESAF resources seems perfectly appropriate. I would like to hear a few words from the staff about the need for the ESAF/EFF blend.

If I am correct, Yemen is the first country in Mr. Shaalan's constituency to request an ESAF arrangement, and actually I am not sure whether we should congratulate him on this occasion or not. In any case, we strongly wish the Yemeni authorities success in their endeavors.

Mr. Shields made the following statement:

I join the congratulations of my colleagues who have spoken already this afternoon to the Yemen on what has been an outstanding performance over the last two and-a-half years in which they have been putting the reforms and stabilization programs into effect. It was just before and during staff monitored and during the Stand-By Arrangement itself. They have really come a very long way in that time. They stuck to the task, to the surprise of many just how they have managed to cope with difficult decisions facing them, often when it looked like they were about to go astray. They came back and nevertheless performed the strong actions.

The results demonstrable now. Performance has often been, indeed, better than expected. We see a situation with low inflation, and the makings of the good growth performance. Indeed, I had taken the stability of the exchange rate for a period and then the small devaluations as a sign of success, but Mr. Vernikov does raise interesting questions. I would be interested to hear from the staff how free the rate has been. I saw it was for awhile when that stability was in place. I would be interested to know if there had been some change in policy. Basically it has all made good sense, and clearly there has been a restoration of confidence.

Congratulations are due to the staff team here, who have contributed greatly to both the understanding of the authorities and their ability to put these measures into effect.

Despite all these gains and commendations, the fact is that nevertheless there is a very large structural reform agenda which still remains to be completed. In particular, the public sector still has a pervasive role in Yemen.

As long as this continues it will limit the country's potential growth rate. So, it is right that the medium-term policy strategy which we are talking about today is focused on providing an environment which is conducive to private sector activity. Because of this what I call the core elements of the program and the detailed measures, this chair is happy to support Yemen's request for a combined ESAF and EFF.

I did nevertheless have a couple of queries about access under these programs, like this question of the blend. And the second which obviously associated with that is the total amount of support that has been provided to the Yemen. This is a very large program, a very large program indeed. It seems to me given the strength of the measures which have been suggested it is probably appropriate. I do not want to suggest that is wrong. It probably would have been useful if we had a bit more explanation in the papers about access with, perhaps, a little bit of background about similar programs in the past and conventions under ESAF, so on. This looks at the high end of ESAF, plus the EFF on top of that. So, when these things are proposed, it probably is a good idea if we see some justification for this on paper beforehand. At the moment, I will wait to hear from the staff, I have not necessarily got any worries about it, but nevertheless we need to keep an eye quite carefully on both sides and precedent.

Looking at the content of the program itself, the areas that I would place particular emphasis on, as others mentioned, civil service reform, in particular, also the final elimination of subsidies, very important deepening of the privatization process, and strengthening of budget management procedures, improvements in the performance of the banking system. And also significantly increasing budget expenditures for the social sectors. Other Directors have already commented on all of these elements individually. But, I just would like to bring out from within that in particular the public sector aspects of it, and also the fact that in order to put this agenda in place there is going to be a considerable strain put on administrative capacity in various areas, so reflecting this I certainly welcome the extension and the broadening of the technical assistance program by the Fund and UNDP.

This technical assistance work will have to focus particularly on improving the government's very weak budget procedures, budget management is crucial. Much better budget management is crucial. Also, the transparency of the fiscal account needs to be significantly improved. A clear requirement is that all government activities, see and be seen to be on budget. Are we able to understand where money is being spent?

Associated with this, there is this problem, and I do not want to single out Yemen in particular, but nevertheless it shares this problem with a number of countries, and that is the problem of corruption in the public sector. To a large degree these problems emanate from the excessive size of the public sector and rather blurred boundaries between the public and private sectors, including in the security sector. There is still in Yemen a very fertile ground for private rent seeking by officials in the public domain. But it is good the government of Yemen clearly recognizes this and is facing up to it. I noted the speech by the president at the end of September in which he called upon the government to, "Combat corruption everywhere." That is very important. The civil service reform and the privatization program play an important part in this fight against corruption. It would be important to make sure that the boundaries between the public and private sectors are clearly specified and also to enact and enforce conflict of interest legislation. Reflecting these concerns about the budget and about governance, I hope that future program reviews will be able to recommend implementation of many of the good fiscal practices that were outlined in the recent paper by the Fiscal Affairs Department on transparency in government operation.

Finally, tight monetary and fiscal policies have delivered an impressive reduction in inflation in Yemen. Going forward, monetary policy should continue to focus on the achievement of low inflation in order to protect Yemen's competitive position and a tight fiscal policy is going to be an essential element in the strategy to establish debt sustainability. I was encouraged by the debt sustainability analysis that was in the report, but clearly risks do still remain. Mr. Vernikov has been able to reduce some of those from his side, but nevertheless it is going to be crucial that policy remains steadfast. That is the best protection.

Mr. Fernandez made the following statement:

I would be short as I concur with the thrust of the staff appraisal and most of what previous speakers have put on the table. I would like to commend the Yemeni authorities for having embarked on such an ambitious program. Indeed, if very challenging tasks still remain ahead, progress made so far on the Stand-By Arrangement on fiscal, monetary, and structural policies bode well for the future. So I will just make two brief comments on the structural policies and debt issues.

In the structural field, I would only point out that enhanced civil service reform must be a high priority, as previous speakers have emphasized. This is a condition for the success of this program. This chair can only once more insist on the necessity of urging the strengthening of Yemen's administration.

Furthermore, I agree with Mr. Vernikov that a lot relies on the capacity of the Social Welfare Fund which has to handle efficiently the difficult transfer of a subsidy system to a cash transfer program targeted at low income groups. The success of this task is essential to provide support throughout the population and it is essential to the success of the program itself. Every effort in technical assistance will be needed in this area.

Turning to debt issues, it is clear that Yemen's debt burden remains considerable. The perspective of a Paris Club agreement under Naples terms in November is therefore a positive sign which I welcome. I would just point out that figures relative to Russian claims on Yemen are subject to discussion, and that the reconciliation process will be critical on this matter.

Finally, like Mr. Vernikov and Mr. Shields, I would be very interested in hearing from the staff how this blend EFF-ESAF program has been earmarked for access to Fund resources.

Mr. Merz made the following statement:

I broadly agree with staff's analysis and recommendations. Therefore, I support the proposed decision for arrangements under the ESAF and the EFF.

As outlined in the statement of Mr. Shaalan and mentioned by previous speakers, Yemen has indeed achieved remarkable economic progress in the last years. After the severe political crisis in the fist half of the nineties and its negative macroeconomic impact the country has regained political stability since 1995 and was able to improve its macroeconomic performance considerably. Core inflation has come down to a one-digit level mainly based on a strong reduction of fiscal deficits. Real growth rates are satisfactory. The authorities are committed to pursue important reforms and have presented a comprehensive adjustment and reform package. Further positive indications are that the authorities were able to normalize the country's relations to its external creditors. We also welcome that greater independence of the central bank is envisaged for 1998.

Progress on the fiscal front will be sustained by planned reductions of subsidies. In this context I would encourage the authorities to choose the option of an accelerated reduction of wheat subsidies. Their concern that additional administrative measures are needed to provide transfers for the needy should not be exaggerated. They will gain additional administrative resources by the abolishment of price-fixing and price-control and will also have positive allocation effects due to a lessening of price-distortions.

Despite the progress mentioned above, there still remain areas of concern. Let me focus on those few which we consider particularly important:

On the macroeconomic side, the staff projects a further worsening of the current account position, especially as regards the "own current account" which excludes the transactions of foreign oil companies. Thus, I wonder if the proposed program and adjustment path is adequate and sufficient to reach a sustainable balance of payments situation in the medium term.

With regard to public sector reform, the originally intended substantial reduction of staff is still delayed. A further reduction in the medium term is also not overambitious since the completion of this reform is targeted for early 2000. The authorities should therefore consider stronger actions in this area until the medium-term review of the program.

The pace of privatization doesn't seem very ambitious either. Privatization is focused on small enterprises in the first two years of the program, on medium-sized companies in the final year. Larger enterprises will be addressed only in 1999.

The economy depends upon a high level of oil exports and remains therefore vulnerable to external shocks. The diversification of the economy (e.g., in the area of tourism and transportation) should therefore be more firmly anchored in the program. In this context the planned liberalization measures for foreign trade, the construction of a container-harbor and the establishment of a free-trading zone in Aden are encouraging steps.

Let me conclude with a more technical point, also addressed by Mr. Vernikov and Mr. Shields. As in other cases before the proposed decisions contains a blend of EFF and ESAF resources; Yemen is nevertheless a typical ESAF candidate in light of its low per capita income. I would welcome the staff's comment on which criteria have guided the staff to propose this particular blend of EFF and ESAF resources. Turning to the revised proposed decisions, I would suggest to mention the total amount for the ESAF credit explicitly in Decision B as it is done for the EFF Arrangement in Decision A.

Mr. Fukushima made the following statement:

It is welcome that the Yemeni authorities have made a substantial progress. At the same time, however, in view of the remaining heavy debt burden and the economic deterioration of just two years ago, the authorities need to make more effort to consolidate their achievement.

In this regard, the adjustment program agreed is correctly designed for achieving sustainable growth and improving external viability. Let me make some remarks on specific policy issues for emphasis.

The core of fiscal policy is to eliminate subsidies. The authorities have indicated that they will eliminate subsidies on petroleum and on wheat. Given that the positive impact of the elimination of subsidies on agricultural production and the balance of payments, however, it would be preferable to accelerate the process. In this regard, I am pleased to know that the authorities are considering an alternate strategy for earlier elimination of the wheat subsidy by a one-step price increase in mid-1999. This strategy involves the expansion of the social safety net by replacing the wheat subsidy with a cash transfer to low income groups through the Social Welfare Fund. The staff notes that such a rapid and substantial expansion of the social safety net poses a significant administrative challenge. I would appreciate it if the staff would comment further on the prospects for this alternate strategy. I would also appreciate their comments on what technical support the Fund will provide for eliminating the subsidies.

On the revenue side, it is important to increase non-oil revenue. I agree with the staff's proposed revenue enhancing measures.

Regarding structural reform, in view of efficiency as well as its positive effect on the budget balance, civil service reform has to be implemented, even though it will be difficult. In this regard, it is an important first step that the authorities have determined to establish a High Commission for Civil Service and Administrative Reform as well as the Oversight Committee. I hope that the authorities will continue their effort for the civil service reform under the initiatives of these groups.

On banking sector reform, we are pleased to learn from Mr. Shaalan's helpful statement that special courts and the notification system are having their intended effect on solving the nonperforming loan problem. In addition, we would note the importance of implementing by the end of this year measures including government purchase of all outstanding nonperforming loans of the two public sector commercial banks and agreements on a schedule of capital increases and provisioning to achieve the minimum Basle standard.

Finally, Yemen's large external debt has been an impediment to sustainable growth and external viability. In order to improve the debt situation, both debt reduction by external creditors and the authorities' commitment to the adjustment program are necessary. In this regard, I am pleased to note that Yemen's debt will be sustainable after 2000 according to the baseline scenario prepared by the staff. It is also welcome that the staff announced that all eight Paris Club creditors will reach agreements by the next Paris Club meeting in November.

With these remarks, I wish the authorities every success.

Mr. Watal made the following statement:

The Yemeni authorities are to be congratulated without reservation for the impressive macroeconomic achievements. They have implemented the requirements of what we had felt was an ambitious program entailing high social costs despite persisting structural weaknesses. The performance has been better than what was prescribed under the Stand-By Arrangement in terms of growth, inflation, budgetary, monetary and external sector targets. We feel that the time is apt to take full advantage of the stabilization gains and to further accelerate the momentum that has been gathered in the reform process.

We congratulate the staff and the authorities for the understandings they have reached in listing the prior actions. We are equally impressed that all the twelve actions mentioned in para 61 have already been implemented. We are also in broad agreement with the thrust of the very well written and clear staff report.

Having said this we would like to make a few comments in connection with the proposed arrangements. The financing arrangements proposed are now higher than the access that was provided under the Stand-By Arrangement. We had always felt that Yemen deserved a higher level of financial support in view of the demands being placed on the authorities because of a strong program. We feel that under the proposed financial package of the arrangements the Yemeni authorities will have greater maneuverability to pursue the strong policy measures with confidence. Our chair would also associate itself with Mr Vernikov's observation regarding the rationale for an ESAF, Extended Arrangement blend and would seek the staff's reaction.

The prior actions and the staff report indicate that the focus of the reform is now going to be on the structural side. These are areas which will pose the biggest challenges to the authorities in the coming months. For instance it is obvious that the privatization process has been moving forward rather slowly. The authorities are still targeting the sixteen industrial enterprises for privatization or liquidation by mid 1998. As the staff has pointed out that this process will be facilitated by the privatization law. The private sector has yet to be rid of laws which mandate prices. Externally fixed prices have only encouraged inefficient use of scarce resources and this does not make economic sense. There is yet a lot of work to be done in the surface transport sector and also the management of public enterprises and public utilities. We would encourage the authorities to work closely with the Bank and the Fund staff in these areas of sectoral reforms.

The civil service reform is another major challenge and the authorities will have to surmount the obstacles in downsizing the numbers and reforming the cadres with political deftness. The program requirements to have a proper job classification, filling of posts according to functional needs and eliminating absentee employees or multiple job holders are going to be a formidable tasks. Apart from this the authorities must also put in place a viable pensions system.

We support the way the authorities intend to reduce explicit and implicit subsidies. The steps contemplated by the authorities to dismantle the system of high subsidies by phasing out subsidies related to petroleum and wheat prices and making the subsidy provisioning to be more transparent by its replacement by a cash transfer to low income groups are moves in the right direction. Dismantling of the distortionary subsidy system must simultaneously have in place efficient Social Safety Net programs. This is important Yemen is a low income country where the poor people have depended heavily on state subsidies. Rapid changes toward a market system does affect the poorer and vulnerable sections of society. We support the governments intention to have all direct cash support routed through the Social Welfare Fund. The involvement of NGOs in the IDA funded Social Fund for development projects is also a welcome development. Education, Health and SSN allocations for 1998 mentioned in the latter section of para 45 will be higher than the 1997 ratios. Mr Shaalan's helpful statement mentions that in the next three years budgetary outlays for social sectors are programmed to increase by an average 2 percent of GDP annually and will reach 10 percent of GDP in 1998. In this context would the staff comment on the quality of performance of the Welfare Fund and in the areas of education and health?

The staff report mentions that Yemen will have to achieve a national savings/GDP ratio of 22 percent to achieve the target of 6 percent growth in the non-oil sectors in the medium run. This would require higher productivity in agriculture, manufacturing, construction and service sectors. The growth in these sectors would broaden the revenue base and facilitate better budgetary management. Hence diversification away from oil dependence will remain an equally important but not insurmountable challenge.

The external financing gap for 1997 is still substantial and the external debt position continues to be a vulnerable area of Yemen's economy. It stood at $9.1 billion at the end of 1996. A major portion of it is due to the Russian Federation. The financing needs of Yemen that would be required to close financing gap have been projected at $100 million for the next three years. Hence the success of this program would be crucial for Yemen to merit the support of donors for exceptional financing. The Debt Sustainability Analysis (DSA) shows that Yemen debt indicators are likely to improve significantly. This will be an encouraging development but it is a projection which has its risks even though bilateral agreements with the creditors are likely to be finalized.

In conclusion, we would say that Yemen is poised to make a successful economic breakthrough. The authorities' commitment to the reform process and their ownership of the recently concluded Stand-By Arrangement makes it clear that their efforts must be supported and encouraged. Therefore our chair would like to endorse the proposal made by the staff to support the arrangements. Our chair also wishes the Yemeni authorities success in their future policy endeavors.

The staff representative from the Policy Development and Review Department elaborating on the reasons behind the proposed access and blending under the program, noted that the program proposed for Yemen was relatively strong—appropriately so. In view of the comparatively large balance of payments need, comparatively large access to Fund resources was warranted. The proposed Fund combined access would be equivalent to about 5 percent of Yemen's total gross financing needs over the three-year ESAF/EFF period. That was measurably smaller than the average Fund contribution of 7 percent in other ESAF cases in the past two years.

As Yemen was an ESAF-eligible country, it was natural for the staff to consider the ESAF in the first instance, the staff representative indicated. Given the circumstances, the staff felt it appropriate to bring ESAF access to the top access granted thus far in ESAF cases—150 percent of quota. Zambia represented the only exception to this top rate of access under the ESAF, and its larger access had been required to take account of the rights accumulated under Zambia's rights accumulation program. The staff had been hesitant to exceed the limit of 150 percent of quota, in light of the Board's and staff's concern about the need to conserve ESAF resources. The Board had signaled that the ESAF access limit of 190 percent of quota should not be viewed as an entitlement, and ESAF resources should be conserved by careful ESAF access policy management. It should be noted in this context that ESAF commitments thus far in 1997 and projected for the rest of the year would amount to SDR 1.6 billion—well above the figure of SDR 1 billion projected when the Board had last discussed ESAF financing requirements. That was the second reason for the staff's concluding that exceeding the 150 percent of quota under the ESAF would not be prudent.

The staff considered it appropriate to top up the ESAF access with a modest access under the EFF, the staff representative continued. That would be in keeping with the Board's view, expressed in the most recent discussion on continuing ESAF financing, to retain the option of using blended cases similar to Yemen's. The Board suggested that such an option should be kept open for countries with capacity for nonconcessional debt servicing. As Yemen now enjoyed limited access to nonconcessional financing, the staff had concluded that limited EFF access would be consistent with Yemen's capacity to service debt.

Mr. Shields, noting that the combined access amounted to 250 percent of Yemen's quota, inquired how that compared with programs for countries using only an Extended Arrangement.

The staff representative from the Policy Development and Review Department replied that the combined access for Yemen was slightly higher than the other high EFF access.

Mr. Shields remarked that the staff's comparison suggested that the program was exceptionally large, and, consequently, it behooved the Board to assess carefully the program's strength, and the potential precedent-setting implications of its decision.

The staff representative from the Middle Eastern Department said that he attributed the stability of the exchange rate to tight financial policies. Inflation had been brought down rapidly; interest rates had become significantly positive, and the willingness to hold the currency had improved dramatically. The central bank had intervened in the currency market only sparingly, and only to counter speculative movements. In late August, in response to a sudden move in the exchange rate, the authorities had sold a relatively small amount of U.S. dollars. In addition, the prime minister had met with the business community to explain the government's exchange rate policy and provide information on the size of foreign exchange reserves. Subsequently, the exchange rate movement had been reversed.

Privatization program receipts would be difficult to forecast, as the market value of public enterprises was uncertain, the staff representative indicated. Most of the first eight enterprises were not marketable—they had been returned to their original owners, or their assets had been sold and the land leased. Only two enterprises had been leased and continued to operate. Of the 60 small enterprises, some had been returned to prenationalization owners, and others had been turned over to their workers. Only the sales of the largest enterprises—such as the airline, the refinery, and the banks—were expected to generate net proceeds. The Privatization Law contained a provision stipulating that any net receipts over and above the costs of the privatization would be used to reduce the government's debt to the central bank.

The staff was confident that the budget coverage was comprehensive, encompassing all government operations, the staff representative stated. There were no indications that transactions were conducted outside the budget.

The envisaged replacement of the wheat subsidy by a cash payment system was an ambitious goal, the staff representative remarked. It would not be free of difficulties. Yemen was a large, mountainous country with 14 million people, and small villages scattered through the mountains. In order to implement an effective cash payment system, identification and payments systems were required. It would likely be a costly undertaking, because outside consultants would need to be hired to assist with establishing the systems and their computerization. Nevertheless, the authorities remained determined to eliminate the wheat subsidy as quickly as possible.

At the time when the world wheat price had been $6 or $7 a bushel, an early subsidy elimination would have offered fiscal benefits that were less clear now at the current price of

$3.80 a bushel, the staff representative continued. The staff would need to take a close look at the gain to the budget. Specifically, was the gain to the budget through the accelerated pace of the subsidy removal worth the risk that the cash payment system might not operate effectively in compensating the poor for their loss of purchasing power? That issue was expected to be addressed in the next round of discussions, coinciding with the first program review in mid-November.

The staff was impressed by the minister and the staff in charge of the Social Welfare Fund, the staff representative indicated. The minister maintained high standards for operating the fund, insisting on social workers interviewing recipients of cash transfers to ensure that leakages in the system were strictly limited. Also, he was concerned about a rapid expansion of fund operations, which could result in the deterioration of its quality; thus, the quality of the operations of the Social Welfare Fund had been good.

The quality of health and education services was not so good, however, the staff representative continued, which was why the staff had been looking forward to the government's agreeing with the World Bank staff soon, perhaps by the end of 1997, on reform programs for the health and education sector to improve the quality of services.

Mr. Lucenti made the following statement:

> I would like to commend the staff for the well-written set of papers for today's discussion on the Republic of Yemen. I also would like to commend the Yemeni authorities for the impressive achievements reached on the economic adjustment program. The experience of the Republic of Yemen on the stabilization front tells us that it is feasible, in a short period of time, to implement a program that places the economy on the path of growth, one digit inflation and important structural reforms. This has been done in spite of civil war and strong imbalances the country faced at the beginning of the 1990s, and, of course, due to the authorities willingness to stabilize the economy using a sound set of policies.
>
> Since I fully share the staff's appraisal, this chair supports the proposed decision. I will not go over the details since it would be a repetition of what is already on the staff's report, Mr. Shaalan's statement and what has been said by previous speakers. Therefore, just for emphasis, I would like to briefly comment the following two points.
>
> Notwithstanding the importance of oil production and the comparative advantage the country has in producing oil, it is important to diversify the real sector, and further increase non-oil exports. This would help protect the economy from the negative impact of international oil prices volatility and also, help stabilize the balance of payments current account. In this regard, I welcome the authorities' medium term macroeconomic strategy to promote accelerated private sector–led growth and investment.
>
> The other point of some concern is the significant external financing gaps that Yemen will face over the medium term, specially the one for 1997. I concur with the staff on the importance of a timely availability of financial

assistance from the international community and in particular, the assistance that may be given by bilateral and multilateral creditors.

With these comments I wish the authorities every success in their future endeavor.

Mr. Qi made the following statement:

I am very much impressed by both the achievements made by Yemen last year and the ambitious reform agenda for the authorities ahead. The successful implementation of tight fiscal and monetary policies has brought down the inflation rate and maintained the GDP growth momentum, which allows more room for structural reform and adjustment. Since I broadly agree with the thrust of the staff's appraisal, I would like to make brief comments on three issues for emphasis.

First, the sustained economic growth. The real GDP growth rates are projected to be 5–6 percent between 1997 and 2002, which is essential for the adjustment program to get continued support from the general population of the country. The development of the oil and gas sector, which accounts for 40 percent of GDP, lends crucial influence in this regard. The authorities' policy for attracting more foreign investment in this sector is heading in the right direction to avoid any shortfalls of oil output. It is also encouraging to see that the budget is now more biased to infrastructure investment and priority social sectors such as health and education, which may lay a solid foundation for long term economic growth.

Secondly, the debt burden. Yemen has very high debt ratios, although it is not a HIPC. The liberation of more resources from the heavy debt and debt service burden for use by priority sectors and reforms, will greatly benefit this country and its people, it will therefore be welcome if Yemen's major bilateral creditors could grant substantial debt relief.

Thirdly, the social safety network. The comprehensive reform program is indeed ambitious and challenging. A well established social safety network might cushion the hardship faced by the general people and minimize the social cost. I concur with the staff in supporting the expansion of the Social Welfare Fund operations and the establishment of the Labor Retirement Fund. It might also be considered to increase some amount of the government transfers to these funds.

Finally, we think it is quite necessary for multilateral institutions to extend financial support to Yemen. I therefore support the proposed decision and wish the authorities every success in carrying out their reform agenda.

Mr. Presečan made the following statement:

Following the initial stabilization program from the early 1995, the Yemeni authorities have continued to take courageous steps to restructure their economy and to provide the environment conducive to sustainable growth and external viability.

Progress with respect to economic growth, a reduction of inflation and the budget deficit as well as an improvement of the external position has continued during the course of 1997. In addition, some important structural reforms were implemented such as the start of operations of the special courts, tax reforms and the freeing of bank fees and charges. Nevertheless, further structural reforms are still needed with respect to private sector development, social policy, the budget process and structure and the financial sector. The set of policy measures described in the staff papers gives an adequate answer to most of these issues and also reflects the recommendations of the Public Expenditure Review that was presented earlier this year. This refers in particular to restructuring the budget toward priority areas such as the social sectors, operation and maintenance and infrastructure, to improving the tax base and continuing the processes of civil service reform, privatization and rationalization of the public sector.

Within the context of the budget process it is not fully clear how the relation and coordination between the development budget [Ministry of Planning] and the recurrent budget [Ministry of Finance] will be improved. Having in mind that the UNDP/the Fund technical assistance program covering 1998–99 is expected to be approved shortly, could the staff comment on whether this issue is addressed within the program and if so, to what extent?

The staff emphasizes that Yemen's external position will remain fragile in the mid term, despite the current prudent policy stance of the authorities, rather comfortable present level of the gross international reserves of the Central Bank of Yemen and the program measures that are to be undertaken. Moreover, the entire program is rather sensitive to developments in the area of external relations. Could the staff provide further comments on the downside risks of the balance of payments projections that have been provided in the papers on Yemen for this session? What are the respective contingency measures in case of adverse developments in the balance of payments?

Having all that in mind, we could support the proposed decisions.

Mr. Melese-d'Hospital made the following statement:

I want to second the remarks of other Directors in commending the Yemeni authorities for the strong progress they have made on reforms. Notwithstanding certain relatively minor problems including recent difficulties implementing increases in diesel prices and electricity tariffs, I remain very impressed with the authorities' continued commitment to the reform process and with their flexibility in addressing deficiencies as they arise. I would also note that they have taken some rather substantial risks in pushing through reforms. These qualities of commitment, flexibility and a willingness to take risks can be expected to serve them well in executing the ambitious medium-term program of reforms we are considering here today. As many of the points

I wanted to raise have been raised by other Directors at this point, I can be brief.

Despite very positive recent developments, Yemen's economy still suffers from a precarious medium-term balance of payments situation which can only be resolved through a combination of debt rescheduling and reduction and a fundamental reorientation of the economy toward private sector growth. The important progress made to date by Yemen in its relations with creditors bodes well for the future, however, it cannot be overemphasized that Yemen is not yet fully out of the woods. Timely implementation of measures to which the authorities have committed themselves under the proposed blended program and continued imagination and flexibility in finding ways around the roadblocks which will inevitably appear will be key in achieving the authorities' goals of a substantially reduced debt burden and a reinvigorated private sector. In particular, I think the staff are right on target when they state in the staff appraisal that the quality of implementation will provide a clear signal to the private sector regarding the government's commitment to the private sector–led growth strategy.

I also strongly support the view expressed by the staff that clear signals would be sent by decisive actions in reforming the civil service, deepening privatization, accelerating reintermediation, and significantly increasing budget expenditures for the social sectors as subsidies are withdrawn. The failure to complete programmed retrenchments in the civil service has been a disappointment in the past, although I recognize that the legal framework compounded the problem. In this light, the targeted reduction of 20 percent in payroll recipients by the year 2000 is a crucial element of the reform program, and I would like to query the staff whether there is perhaps even room to further strengthen the program in this area. I would also like to know whether legal restraints on layoffs have been or will be eliminated.

As regards privatization (and in line with the comments made by Mr. Merz), I would note that the program will focus on small enterprises in the first two years, typically the easiest privatizations to do, and that we will only get privatizations of medium enterprises in the third year. Further, it is not clear to what extent the authorities envision full privatization of large-scale enterprises versus just restructuring and perhaps selling a minority share. Put alternatively, it is not clear exactly which enterprises will remain in the government's portfolio at the end of the program period. This is another area where I would encourage the authorities to work closely with the staff and the World Bank on strengthening the program in the out-years, with a view to substantially removing the state from the economy by the end of the program period.

As regards financial reintermediation, I was encouraged to note in the staff supplement that credit to the private sector had increased by 36 percent, although it is of course still small relative to the money stock at 2.8 percent. On the face of it, such growth seems to ratify the approach which has been taken so far, including establishment of the special courts and the notification system, and I would only encourage the authorities to stay the course in this sector and soldier on with reforms, including notably in areas of bank soundness covered by the World Bank FSAC and in the area of indirect monetary controls. Given the current very low levels of intermediation and in the context of very significant unexploited assets, including excellent harbors and concomitant opportunities for the development of trade-related industry, financial reintermediation could be of crucial importance in unlocking the productive potential of Yemen's private sector.

Mr. Rigász made the following statement:

I would like to express our chair's full support for the proposed decision. By implementing all the prior actions despite the possible political costs, the Yemeni authorities have shown a strong commitment to continuing their stabilization and structural adjustment programs and merit today's approval of their request for both programs.

Since I generally agree with the staff report, I would just like to seek clarification on two points.

First, in Table 2, on page 8, the staff predicts significantly smaller crude oil production for the period 1998 until 2000 than has been reported in news reports. I wonder whether this discrepancy reflects an intention of the authorities not to exploit the existing capacity fully, though this would seem inconsistent with their drive to expand production and exports, or results from conservative assumptions by the staff, or is there some other explanation?

Second, I could find no reference in the staff report to the establishment of a stock market. Establishing a stock market, in addition to increasing intermediation in the economy, would also promote the government's privatization program, especially in the next few years, and would increase the general public's participation in this process. Could the staff tell us anything of the government's plans in this area?

The staff representative from the Middle Eastern Department indicated that the comprehensive budget management reform, included in the UNDP-IMF program, would take at least two years to complete. Its objective was to improve the Ministry of Finance's control over the budget, increase the efficiency of budget operations, and by effective monitoring of expenditures, tighten the relationship between development outlays and subsequent associated current outlays.

The most significant downside risk in the external sector concerned oil export revenues, the staff representative suggested. A substantial drop in oil prices would necessitate adjustments in the budget. An increase in cereal prices would also have a negative impact on the budget, but, following the subsidy reduction, the government was not expected to be as vulnerable as in the past.

The feasibility of trying to achieve a civil service retrenchment of over 20 percent was not clear, because the exact size of the civil service was not known, the staff representative indicated. One of the first goals of the civil service reform to be undertaken with the assistance of the World Bank was to obtain reliable information on the number of civil service positions.

Unlike the previous attempt at retrenchment of the civil service—which had been premature given the institutional circumstances—the current reform held greater promise of success. The cabinet was committed to civil service reform. The former minister of finance was in charge of the operation and was taking his new responsibilities seriously. He enjoyed the support of a strong team among cabinet ministers, as well as considerable assistance from the World Bank. In addition, the government possessed the resources necessary to finance the Labor Retrenchment Fund, and the 1998 budget would allow sizable transfers to the civil service pension fund. A Fiscal Affairs Department expert was expected to take up residence in Yemen to assist with the pension fund's restructuring, and its reform would facilitate the movement of workers out of the civil service.

Although the privatization got off to a slow start, eight enterprises had been privatized, the staff representative indicated. The psychological barrier had been breached with the privatization of the first wave of enterprises, and the second phase was expected to proceed on time. The minister of planning wished to move quickly. The Fund and the Bank had agreed with him on the list of enterprises to be privatized in 1998 under the auspices at the Technical Privatization Office. It was worth noting that the minister of planning's list had been more ambitious than the list suggested by the Fund and Bank staffs. Larger enterprises would be targeted toward the end of the process, as they required extensive preparatory work.

The oil production forecast of 360,000 barrels a day had been prepared by the Ministry of Petroleum, the staff representative remarked. Although the forecast might be conservative, the staff did not have any reason for questioning it.

Mr. Rigász noted that the information released by Yemen's oil minister suggested that by early 1998 production could reach up to 420,000 barrels a day.

The staff representative from the Middle Eastern Department said that it still remained to be seen whether or not a recent oil discovery would prove to be commercial. It was a somewhat delicate topic, because foreign oil companies—from which the Ministry of Petroleum data originated—faced restraints placed on them by, among others, the Securities and Exchange Commission in the United States about what constituted a commercial find. While the staff did not wish to rule out the possibility that production figures might be revised, it did not possess more recent data than those provided by the Ministry of Petroleum.

The IFC was planning to work with the government in developing a capital market, but the process would not be easy and would take some time to complete, the staff representative said. Over the course of its reform efforts, the Yemen government's view of how economies should be run had evolved. The authorities had become committed to price and trade liberalization and reliance on the private sector.

Ms. Mercusa made the following statement:

> The Yemeni economy has experienced a tremendous recovery since peace was restored and since the adjustment program was launched. The recovery, however, still has a long way to go, as the size of the economy is still well beyond the level of the late 1980s. This recovery has been heavily financed by external borrowing from multilateral institutions, overall amounting to one-eighth of the country's GDP. The exceptional performance is thus linked to exceptional financing. We have to make sure that the massive inflows of

resources drive the economy to a path of self-sustained growth, helping to reshape the productive as well as the administrative sector.

The economy is endowed with substantial oil fields that constitute by far the main source of the economic activity, both external and domestic activity. Recent recovery of output is due to larger oil sector activity and is spurred by oil-related exogenous factors, like prices of oil, new fields, and things like that. However, the benefits coming from the oil sector should not overshadow other activities and substitute for reforms. In this respect, it is worrying to notice a decline in non-oil sector revenues as a percentage of GDP from the already-low level of 10 percent to 9 percent recently. We strongly sustain, therefore, the tax reform in revenue mobilization planned by the government and urge for measures to improve compliance.

To reduce the risks of shocks related to the price of oil and to assure a more balanced economic growth, a diversification of the economy is crucial. Currently, the economy is narrowly based, but we were struck to learn that Yemen's economy used to be self-sufficient on wheat production. The current level of subsidies to wheat import has led local production out of the market. Is the planned timetable of increases in the price of wheat to reduce subsidies by the year 2001 enough? Can the staff comment on the consequences of the increase announced a couple of weeks ago, I believe, by Mr. Shaalan of 84 percent increase in the price of wheat.

Finally, on the external position of the country. As many speakers noted already, prospects in the external position of Yemen did substantially improve lately, in light of the recent agreement with Paris Club debtors. We thank the staff for the timely update on the subject. Recent membership of the Russian Federation to the Paris Club, of course, favors a major reassessment of the debt situation, as two-thirds of debt overhang of the Yemen Republic are owed to the former Soviet Union. If the staff has any specific information on possible prospects of former Soviet Union debt rescheduling, in light of what Mr. Vernikov said earlier, is there a chance that this will be reconciled by the meeting in November? We support the request for both programs.

The staff representative from the Middle Eastern Department noted that Yemen's tax performance had been quite strong. Non-oil revenues had tripled between 1994 and 1997. The reason behind the decrease in the ratio of non-oil revenues to GDP was the effect of the very large exchange rate depreciations on nominal GDP in the context of exchange system unification. The exchange rate used to value oil and foreign transactions in the national accounts had moved from YRls 12 per US$1 to YRls 125.

The price increases effected in early 1997 covered petroleum products, wheat, and electricity, the staff representative explained. The wheat and electricity price increases had been quite large—85 percent and 50 percent, respectively. The electricity price increase had eliminated any direct subsidy to the public electricity utilities, although a small implicit subsidy remained as the fuel oil price and the diesel price had not yet reached world levels.

Mr. Shaalan noted that in 1995 Yemen had initiated wide-ranging reforms aimed at restoring macroeconomic stability and introducing a comprehensive structural reform program. Prior to 1995, the economy had been stagnant, fiscal and external sector imbalances had abounded, and the economy had suffered from rapid inflation and very high unemployment. Against that backdrop, Yemen's progress over the past two-and-a-half years was impressive. The extent of accomplishments was all the more surprising, in view of the administrative difficulties inherent in implementing such wide-ranging and comprehensive reforms.

Since early 1995, Yemen had introduced increases in petroleum product prices, partial exchange rate reform, treasury bills, the freeing of all interest rates, and elimination of concessionary loans by the banking system, Mr. Shaalan emphasized. The initial reforms had been reinforced in 1996 when the wheat and flour subsidies had been reduced sharply, petroleum products and electricity prices increased, and monetary policy tightened. Growth had picked up, inflation had declined from 66 percent to about 12 percent, the budget deficit had been reduced from 17 to about 2½ percent, the wage bill and the defense bill had declined in relation to GDP, and the current account deficit had narrowed.

Structural reform goals were ambitious, Mr. Shaalan continued. Although privatization had proceeded more slowly than expected, one should not lose sight of the difficulties inherent in the process of privatization. To an extent, it was a learning process, and it picked up steam as it moved on. All the achievements showed the authorities' commitment to reform. The prior actions and the plan for the next three years had been adequately detailed in the program. The authorities realized that much remained to be done to reap the full benefits of the reform. The policy objective for the forthcoming period was to accelerate growth, increase employment, and create an environment conducive to private sector activity. Improving the social indicators remained the government's high priority, reflected in the increasing outlays on health and education.

Savings needed to finance the accelerated economic growth would be mobilized through the strengthened budgetary stance, Mr. Shaalan indicated. That would be achieved through cuts in nonsocial expenditures, a widening of the tax base, and accelerated reduction in subsidies. At the same time, the wheat subsidy would be replaced by a cash transfer early in 1999.

Financial sector reform was also receiving the authorities' attention, Mr. Shaalan said. Bank intermediation was being enhanced, and a greater role for indirect monetary instruments was envisaged. The government's intention remained to privatize the two public sector banks, although that would likely take time. Bank soundness would be enhanced under a reform program with the World Bank.

The country's heavy debt burden represented an impediment to carrying out the reform and attaining higher growth, Mr. Shaalan emphasized. A reduction of the burden would be critical to the reform strategy's success. The assignment of a resident representative and provision of technical assistance should be accorded high priority by management, as Yemen was one of the countries that, over the years, had consistently followed the Fund's advice. Furthermore, those actions would facilitate the implementation of the complex program.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the impressive implementation of the economic program for 1996–97. As a result, macroeconomic performance in terms of growth, inflation, and fiscal, monetary and external sector developments had exceeded or been in line with program expectations. Directors also commended the authorities for implementing a far-reaching structural reform agenda, notably unification of the exchange system, adoption of the floating rate regime, tariff and trade reforms, and a start at privatization. Directors noted that the authorities' ownership of the reform program was a key factor in its successful implementation.

Notwithstanding these achievements, Directors observed that Yemen's economy continued to face formidable challenges, particularly a vulnerable external position. Therefore, they welcomed the authorities' adoption of a comprehensive medium-term structural reform program aimed at realizing the goals of higher growth, raising per capita income, expanded employment opportunities, improved social indicators, and external sector viability. They encouraged the authorities to persevere in their macroeconomic stabilization efforts and to implement the program fully.

Directors noted that fiscal policy was central to the stabilization and reform strategy. While observing that commendable progress had been made in reducing the fiscal deficit, Directors stressed the need to continue to pursue a firm budget stance, incorporating measures on both the revenue and expenditure sides, as well as strengthened and clear budget management procedures. Directors urged the authorities to implement the substantive tax and expenditure reforms envisaged for the program. On the revenue side, they emphasized in particular the importance of measures to broaden the tax base, including the introduction of a GST, and to improve tax administration. On the expenditure side, Directors called for the early elimination of subsidies, in order to provide increased scope for expenditures in the areas of education and health, cash transfers to be administered by the Social Welfare Fund, and infrastructure investment, while maintaining fiscal consolidation.

Directors welcomed the authorities' continued commitment to tight monetary policies and enhanced monetary management, including the development of indirect monetary instruments.

In the area of structural policies, Directors called for decisive implementation of the envisaged financial sector and civil service reforms and the privatization program. With regard to privatization, it was suggested that the authorities work closely with the staff of the Fund and the World Bank to accelerate the timetable, with a view to substantially reducing the role of the state in the economy.

Directors stressed the importance of attaining the medium-term goal of external sector viability as this would significantly enhance creditworthiness and thus the environment for foreign private investment and economic growth.

Given the key role played by non-oil export growth and diversification, they recommended that competitiveness be kept under close review. Noting that realizing the external viability goal would also depend importantly on a significant reduction of the external debt burden, they noted the need for multiyear debt relief on appropriately concessional terms from the Paris Club and other bilateral creditors.

Directors observed that, as administrative capacity needed to be strengthened, substantial technical assistance would be required.

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

The Executive Board then took the following decisions:

Extended Arrangement

1. The government of the Republic of Yemen has requested an Extended Arrangement in an amount equivalent to SDR 105.9 million for a period of three years.

2. The Fund approves the Extended Arrangement set forth in EBS/97/172, Supplement 2.

Decision No. 11594-(97/107), adopted
October 29, 1997

Enhanced Structural Adjustment Arrangement

1. The government of the Republic of Yemen has requested a three-year arrangement under the Enhanced Structural Adjustment Facility and the first annual arrangement thereunder.

2. The Fund notes the policy framework paper of the Republic of Yemen set forth in EBD/97/101.

3. The Fund approves the arrangements under the Enhanced Structural Adjustment Facility set forth in EBS/97/172, Supplement 3.

Decision No. 11595-(97/107), adopted
October 29, 1997

3. EXECUTIVE DIRECTOR

The Acting Chairman bade farewell to Mr. Kaeser on the completion of his service as Executive Director for the Azerbaijan Republic, the Kyrgyz Republic, Poland, Switzerland, the Republic of Tajikistan, Turkmenistan, and the Republic of Uzbekistan.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/97/106 (10/27/97) and EBM/97/107 (10/29/97).

4. THAILAND—REPRESENTATIVE RATE FOR THAI BAHT

The Fund finds, after consultation with the Thai authorities, that the representative exchange rate for the Thai baht under Rule O-2(b)(i), against the U.S. dollar, is the average interbank market rate as ascertained and reported by the Bank of Thailand. (EBD/97/120, 10/22/97)

Decision No. 11596-(97/107) G/S, adopted
October 27, 1997

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 96/106, 97/16, 97/35, and 97/51 are approved.

6. EXECUTIVE BOARD TRAVEL

Travel by Assistants to Executive Directors as set forth in EBAM/97/162, Supplement 1 (10/22/97), EBAM/97/168 (10/22/97), and EBAM/97/169 (10/23/97) is approved.

APPROVAL: May 11, 1998

REINHARD H. MUNZBERG
Secretary