February 23, 2004
Approval: 3/1/04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 03/114

10:00 a.m., December 15, 2003

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Decisions Taken Since Previous Board Meeting

Executive Board Attendance

S. Sugisaki, Acting Chair
A. Carstens, Acting Chair

Executive Directors	Alternate Executive Directors
	A. Alazzaz
	F. Vermaeten, Temporary
	C. Gust, Temporary
	G. Meissner
	F. Meyerhoefer, Temporary
	B. Reichenstein, Temporary
	M. Reddell
	S. Boitreaud
	L. Duriez, Temporary
S. Indrawati	I. Alowi
	R. Karki, Temporary
	T. Segara, Temporary
N. Jacklin	M. Lundsager
	A. Baukol, Temporary
W. Kiekens	I. Ábel, Temporary
	J. Sipko, Temporary
G. Le Fort	J. Costa, Temporary
	C. Pereyra, Temporary
A. Mirakhor	M. Daïri
	T. Farhadi, Temporary
	S. Vtyurina, Temporary
	I. Zakharchenkov, Temporary
D. Ondo Mañe	L. Rutayisire
	E. Menye, Temporary
L. Martí	P. Moreno, Temporary
	R. Calderón-Colín, Temporary
	J. Santos, Temporary
	D. Lombardi, Temporary
	L. Rizzotti, Temporary
M. Portugal	C. Cobos, Temporary
	A. Tombini, Temporary
B. Misra	R. Jayatissa
	R. Gauba, Temporary
	D. Prasad, Temporary
	M. Brooke
	A. Stuart, Temporary
	P. Williams, Temporary
	O. Kanaan
	S. Bakhache, Temporary
	H. Morsy, Temporary

	G. Campos, Temporary
	J. Mafararikwa, Temporary
	B. Mamba, Temporary
	H. Ge
	W. Zheng, Temporary
J. Kremers	L. Croitoru, Temporary
	M. Abbing, Temporary
	T. Miyoshi, Temporary
	S. Naka, Temporary
F. Zurbrügg	S. Antic, Temporary

S.J. Anjaria, Secretary
A.S. Linde, Acting Secretary
Z.R. Ahmed, Assistant
A. Tarantino, Assistant
O. Vongthieres, Assistant

Also Present
IBRD: A. D. Craig, Country Director; P. Hansen, Lead Economist; M.L. Masutti, Country Officer; Z. Partow, Country Economist; C. Wood, Senior Economist. African Department: D. Donovan, Deputy Director; C. Briançon, N. Carvalho, M. Katz, N. Kirmani, M. MacFarlan, L. Schmitz, C. Steinberg, A. Tahari, J. Williams, K. Yao. Asia and Pacific Department: R. Kronenberg. External Relations Department: A. Gaviria, L. Mboto-Fouda. Legal Department: F. Gianviti, General Counsel. Monetary and Financial Systems Department: F. Fischer, Y. Yokobori. Policy Development and Review Department: M. Allen, Director; L. Aylward, W. Brown, D. Desruelle, M. Fetherston, M. Fisher, J. Hicklin, T. Lane. Secretary's Department: P. Cirillo, M. Da Costa, L Hubloue, J. Stotsky. Statistics Department: W. Alexander, L. Fernando, D. Kar, L. Laliberte, A. Pellechio, J. Rosales. Western Hemisphere Department: A. Singh, Director; R. Benelli, A. Cheasty, J. Franks, M. Rodlauer, R. Sab, J. Thornton. Senior Advisors to Executive Directors: C. Duriyaprapan (ST), K. Kanagasabapathy (IN), T. Moser (SZ), D. Vogel (AG). Advisors to Executive Directors: D. Ayala (AG), M. Barootchi (MD), O. Basdevant (FF), L. Cao (CC), P. Dohlman (UA), A. Dupont (BE), G. Francis (AU), P. Inderbinen (SZ), J. John (UA), N. Joicey (UK), K. Kpetigo (AF), S. Maherzi (MD), T. Nguema-Affane (AF), R. N'Sonde (AF), M. Sidi Bouna (AF), S. Wolff-Hamacher (GR),Y. Wu (CC).

1. STRENGTHENING EFFECTIVENESS OF ARTICLE VIII, SECTION 5—PROPOSED DECISIONS

Documents: Strengthening the Effectiveness of Article VIII, Section 5—Proposed Decisions (SM/03/386, 11/26/03; and Cor. 1, 12/9/03).

Staff: Gianviti and Leckow, LEG; Fetherston, PDR

Length: 3 hours, 10 minutes

Mr. Misra submitted the following statement:

The staff paper seeks to take approval of the Board on two proposed draft decisions: (i) to expand the categories of information under Article VIII, Section 5 and (ii) to establish a new framework of procedures and remedial actions to address cases in which members have breached their obligations under said Article. Our comments and views are provided respectively on these draft decisions.

Decision No.1

In our view, the proposed Decision does not adhere to the spirit of Board discussion last June, but stick to the letter. Second, it deviates from the well-established and healthy practice of following a consensus approach, but has attempted to impose the will of a simple majority. Third, technically Decision 1 should be an integral part of periodic discussions on Data Provision to the Fund, coming up for discussion in early 2004, which is not far away. This should obviously take into account the related discussion and conclusions of May 2002. Finally, the proposed decision does not in any way strengthen the effectiveness of Article VIII, but has some risk of effectively weakening the provisions.

Let us first consider the spirit of last Board discussion. All Directors expressed their strong support for the voluntary and co-operative approaches underlying the Fund's relations with members. Directors noted that the voluntary cooperation of members in providing the information is working well. As a result, members provide extensive and quality information as and when necessary to the Fund that far exceeds requirements of Article VIII, Section 5. Since the list is thus, more illustrative in nature, by adding a few items to this list now, practically serves no purpose, except to create some apprehensions about the spirit of voluntariness and members' co-operation.

A majority of the Board agreed no doubt that it would be useful to adopt a decision of a general applicability, expanding the coverage, but underscored the need to preserve the voluntary nature of existing data dissemination standards, and to continue efforts to preserve co-operative approaches to resolving data reporting problems. Though the proposed decision excludes those items that do not appear as part of the SDDS, the inclusion of some of the items coming under the SDDS, which is voluntary, as part of the expanded coverage would effectively mean making the provision of such data mandatory.

Apart from the above, the proposal creates an awkward situation inasmuch as the Board has no authority to review and amend the categories already listed in Article VIII, Section 5. The existing list is not only limited but is also outdated. The proposal is only to add to the existing list. This creates problems in two ways. First, there are items like production of gold, gold imports and exports according to countries of destination and origin, official and nonofficial gold holdings, etc., which do not appear relevant to consider them as part of 'minimum necessary'. Secondly, the proposed additions by the staff overlap the existing list in several respects:

Item (vii) exports and imports of goods and services, is not much different from the existing item (v) total exports and imports of merchandise etc., and services being effectively covered as part of existing item (vi) international balance of payments including (1) Trade in goods and services.

New Item (vi) External Current Account Balance is already captured under existing item (vi).

Existing item (vii) in a broader sense and in a significant way also captures the proposed item (viii) international reserve assets and reserve liabilities.

Existing item (viii) national income is not different from the new item (ix) gross domestic product or gross national product.

Existing item (ix) price indices etc., in its very elaborate form is much broader in scope and coverage than the new item (x) which captures only the consumer price index.

The data provisions are not defined precisely in terms of periodicity, underlying methodology, coverage and scope, etc. further complicates the overlapping issue. Apart from general applicability, case-by-case differences also will be enormous. For instance, illustratively:

There are substantial differences in the way in which reserve money and broad money are defined and applied for policy purposes. One important point of deviation will be the treatment of non-resident liabilities and several non-banking money market assets.

The composition of financing government balance in terms of foreign, domestic bank and the domestic non-bank sources on a continuing basis will be difficult with active secondary market in securities, repos and derivatives in securities and integration of domestic and global markets. Another issue relates to the initial maturity versus residual maturity, complicated further by call/put options.

Balance sheet of the central bank is given annually and so are the balance sheets of banks. Only a statement of affairs on a continuous basis will be possible on these items.

Barring the overlapping items, the items that appear to be new are only (i) reserve or base money, (ii) broad money, (iii) interest rates, (iv) revenue, expenditure, balance, etc., (v) balance sheet of the central bank, and (xii) consolidated balance sheet of the banking system. These items are no doubt necessary for facilitating Fund's activities, but are extensively and publicly available already through IMF publications like International Financial Statistics. Since the accuracy of data as also harmonization for comparative analysis under these items are well established through such documents, the value addition of the proposal is practically nil.

In view of the above, if the new items are at all to be added, they must be harmonized with the existing items by leaving out overlapping items, and adding only really new items. Ideally, redundant and not so relevant items also should be technically removed from the list. Furthermore, since Decision No.1 is effectively a modification to Article VIII, Section 5, and as per Article XXVIII, 'any proposal to introduce modifications in this agreement, whether emanating from a member, a Governor, or the Executive Board,' should follow the procedure laid down in that Article, the issue should preferably be taken to the Board of Governors. We request that this position may be clarified.

The best proposition to avoid all the above complexities in our view, is to go for an amendment to Article VIII , Section 5, and take the matter to the Board of Governors. Alternatively, it could be advisable to leave Article VIII as such (after all it remained so since the inception) and to strengthen data provision through periodic reviews and carry forward the discussion to early 2004.

In short, it is our view that the Board of Directors is not mandated under the Articles of Agreement to make any substantive changes and amendments to the text, which lies clearly in the domain of the Board of Governors. What cannot be done directly should not be attempted to be done indirectly. Even if the proposal is to be taken before the Board of Governors, the text would need substantial revision.

Decision No. 2

Since Article VIII is the central pillar of data provision, a legal framework for remedial action in the case of non-compliance with the Article and clarifications of procedure are useful, though handling of these procedures will continue to remain delicate. The draft decision appears to take into account carefully the nuances of Board discussion in implementing a new framework. We suggest however, the following minor modifications to the draft:

Paragraph 1, last sentence is to be amended to capture the additional points in italics:

Failure to provide information includes both the nonprovision of information in relation to member's capacity and the provision of inaccurate information, deliberately in an attempt to take advantage.

Rationale: Without these qualifications, members' interests cannot be adequately protected.

Paragraph 2, add an additional sentence at the end of paragraph on the following lines:

Differences between provisional and final data due to methodological changes and the statistical discrepancies will not be construed as provision of inaccurate information.

Rationale: All statistical information is accurate within the parameters of error properties. There cannot be in principle absolute accuracy or inaccuracy. Many a time, provisional and final data differ by high margins for obvious reasons.

Paragraph 4, deletion of the following part:

"…before making a formal representation to the member, the Managing Director shall inform, and enlist the co-operation of the Executive Director for the member"

Rationale: Since the Managing Director acts on behalf of the Board, and the Executive Director being a part of the Board, the Executive Director's function on behalf of his/her authorities cannot be separated from his/her role in the Board in collective decision making. In any case, an Executive Director's co-operation is very much implied in his/her functioning as a bridge between the Board/management and staff and the authorities.

In general, we would urge that these procedures should in practice be treated as enabling provisions and limited to exceptional situations where safeguarding of Fund's resources are involved and particularly in relation to performance criteria in program countries. In practice, if this legal framework is taken to the last letter, it may end up only in proliferation of verbal battles and in totally unproductive diversion of scarce human resources, at both the Fund level and across the membership. Therefore, while publishing these documents, the intention of bringing about clarity to the legal framework must be clearly elaborated to avoid generating serious doubts about voluntary and cooperative nature of the data provision to the Fund.

Comments on the draft PIN

It is stated in the last paragraph of the section on Background (page 14 of the document), that exclusion of some key categories of fiscal and monetary information hindered the IMF's effectiveness in the conduct of its activities. This does not reflect the discussion in the last Board meeting. This may be deleted or suitably modified.

In the context of the need to limit the scope of application of Article VIII, one sentence talks about avoiding a proliferation of nuisance cases. To our understanding, practically, the nuisance cases were only a few as reported in the staff paper. And yet another related question is nuisance to whom—to the Fund, to the public at large or to the concerned members. We suggest that this part may be reworded to mean something like 'in the interest of safeguarding use of Fund's resources'.

Ms. Jacklin and Mr. Baukol submitted the following statement:

Key Points:

We support Decision No. 1, including the phase-in of the requirement to provide data.

We have some suggestions regarding decision two to provide more structure to the framework for remedial action.

The Board in June emphasized the importance of accurate, timely, and comprehensive information for every aspect of the Fund's activities, including surveillance and financial assistance. Members need to collect high quality and timely data of sufficient scope for the development and maintenance of sound and sustainable economic policies, and the Fund needs access to a robust set of data to conduct effective surveillance and perform its program functions. As emphasized in the IEO report on capital account crises, Fund staff and the Board are unable to conduct effective surveillance if adequate data are not provided by the member.

Before turning to the decisions, we note the intention to implement data requirements flexibly in the context of a member's capacity to provide the information. It is important that the relationship between the Fund and member continue to be based on cooperation and dialogue. Such assessments of compliance will invariably involve a measure of judgment, with the member receiving the benefit of the doubt.

Data List Decision

We support Decision No. 1 concerning the list of data that members should provide to the Fund. This list is consistent with the results of the Board discussion in June and reflects a good balance between the need to provide comprehensive data to the Fund while avoiding data that are difficult to collect or rarely collected. The list conforms closely with data included in the SDDS. We suggest that the Board review this list periodically going forward, including consideration of 'encouraged' items in the SDDS.

Procedural Framework Decision

We support the broad framework underlying Decision No. 2, but have some specific changes to recommend, consistent with our proposal in the June discussion. In our view, Decision 2 includes too much ambiguity on the timeframe for Board consideration for warnings and sanctions and leaves too much discretion to Management without clarifying how such discretion should be used. While we would expect to rarely, if ever, reach the final stages, clarifying the timeframe and framework could help focus the authorities' attention and help lead to corrective actions at an earlier stage in the process. In particular:

The decision does not provide guidance for the notional timeframe that the Board should give, in normal cases, to remedy the situation after the Board finds the member in breach of its obligations and issues a 'statement of concern' (paragraph 10c). We suggest that 90 days would be a useful guide, recognizing that the Board has flexibility to adjust this time period, case by case. We think 90 days would be sufficient in most cases to remedy the situation, given that the Board will have concluded that the breach of obligation is not due to an inability to provide the data in a timely manner. In other words, it is not a capacity problem.

The decision indicates that the MD 'may recommend' action at the expiration of the period specified by the Board in its 'statement of concern' (paragraph 10d). In the event that the member has not remedied the situation, we think the MD 'shall recommend' one of the three actions cited in paragraph 10d. One of the three actions will be needed in any case.

The decision indicates that the Board must give a second warning and timeframe to a member before adopting a declaration of censure (paragraph 11). In our view, the Board will have already given this warning and timeframe in its 'statement of concern' (paragraphs 10b and 10c, changing 'may' to 'shall' in 10c), so a requirement of an additional warning only undermines the force of the initial statement. We recognize that the Board could always decide to give a second warning, on a case-by-case basis.

The decision indicates that the MD 'may issue' complaints to the Board to initiate and follow through on sanctions if the member is still not compliant after the declaration of censure (paragraphs 13, 14, 15). We suggest that the MD 'shall issue' such complaints. Again, the Board has discretion whether to impose the sanctions or not, and we would expect to rarely, if ever, reach the final stage in the process.

Mr. Ge submitted the following statement:

At the outset, let me thank the staff for their considerable efforts in providing us with the paper for today's discussion.

Before touching on the proposed two decisions in detail, I wish to stress our preference for a voluntary approach on data provision to the Fund—strongly supported by a number of chairs during our discussion last June. Such an approach has served the Fund well and played a positive role in enhancing the cooperative spirit with its member countries. The rapid progress made on the GDDS, SDDS, and other data provision initiatives demonstrates that member countries fully realize that it is in their own interests to improve their statistical capacity and data transparency and as a result now have a tremendous incentive to move forward. For those countries lagging behind, their lack of capacity is the major obstacle. The key to strengthening data provision to the Fund for surveillance purposes lies in enhancing member countries' capacity building, not in expanding the mandatory data categories and clarifying the sanction procedural framework. In other words, the substitution of enhanced technical assistance and cooperation for the proposed reinforced sanction power is a better means of helping member countries provide more qualified data for surveillance purposes. We therefore welcome the references in the proposed decisions to some member countries' inability to provide the required information and their demand for technical assistance in this regard.

On the technical issues related to the proposed decisions.

Decision No. 1

First, subsections (a), (b) and (c) under Article VIII, Section 5 form an integral part the rules governing member countries' data provision to the

Fund—(a) and (b) define the circumstances for compulsory data provision to the Fund from member countries while (c) defines how the Fund can obtain further information beyond the mandatory requirement. To our understanding, provision of any data exceeding the mandatory list should require member countries' agreement in keeping with subsection (c). Therefore, the expanded list should only become effective after it has been added to Article VIII, section 5(a) with the approval of 85 percent of the Board of Governors or will be provided on a case-by-case basis with agreement from every member country. We would like to hear the staff's view on this.

Second, if there is a consensus on the need to update the data categories under Article VIII, Section 5(a), the data requirement should serve as a "lowest threshold"—to be met by as many member countries as possible. A rule with too many exceptions is deemed not to work well. Since the staff is only taking out the elements that go beyond the requirements of the SDDS, we wonder whether some elements in the proposed list go beyond the GDDS requirements, such as central government stocks and central government-guaranteed debt. Is the proposed list a real "lowest threshold" for member countries? The staff's comments are welcome.

Third, once the expanded list is decided upon, it should not overlap with the original list and should have the same legal power under Article VIII, Section 5. But, as Mr. Misra raises in his insightful preliminary statement, the proposed additions do overlap with the existing list in several aspects. If the expanded list is to be separate from the original one and only needs a 50 percent majority to be adopted, how can we be assured that it has the same legal power as the original one which was approved with an 85 percent majority of the Board of Governors together with other items in the Articles of Agreement? Again, we invite the staff's comments.

Fourth, though we can see the merit of not defining data requirements in detail such as exact definitions, coverage and timeliness, in view of the statistical definitional discrepancies across member countries, it may be valid to argue that, without a benchmark, the Fund may have difficulty in measuring the accuracy of data provided by member countries and then adopting sanction measures.

Decision No. 2

With regard to the procedural framework for the application of Article VIII, Section 5, we have reservations about the public announcement of all relevant Board decisions. To encourage closer cooperation between the Fund and the member country in breach of its obligation, it may be desirable to allow the member country to request technical assistance and be given time to make the required improvements without disclosing this Board decision to the outside world. If such a remedial effort is ignored by the country, escalated measures can then be considered and the Board can consider making the case public.

In short, it seems premature to make such decisions at the current stage while some technical issues still need to be addressed.

Mr. Mirakhor submitted the following statement:

This chair made its position clear during our last Board discussion, and it remains unchanged. Proposed Decision No. 1 is not needed as the Fund has more appropriate means to obtain data necessary to perform its surveillance responsibility. More importantly, the decision is an amendment of Article VIII by other means, and the Board has neither the mandate nor the jurisdiction to amend the Articles of Agreement via its decisions. Mr. Misra's thoughtful statement, with the advantage of "a fresh-pair-of eyes perspective," explains eloquently why the proposed decision "does not in any way strengthen the effectiveness of Article VIII, but has some risk of effectively weakening the provisions."

We could support Decision No. 2, with the following modifications:

We agree with the proposed modification suggested by Mr. Misra for the last sentence of paragraph 1, but suggest the following formulation:

"Failure to provide information includes both the provision of information in relation to member's capacity and the deliberate provision of inaccurate information."

It is understood that the burden of the proof for the failure in both instances falls on the Fund.

We support Mr. Misra's suggestion of adding a sentence at the end of paragraph 2 with the following modification:

"Differences between provisional and final data due to methodological changes and statistical discrepancies will not be construed as a deliberate provision of inaccurate information and/or misreporting.

We support paragraph 4 as is and believe that requiring the Managing Director to "inform, and enlist the cooperation of the Executive Director for the member" is both appropriate and necessary. The time line for this purpose needs to be specified.

We also agree with and support Mr. Misra's comments on the draft PIN.

Mr. Yagi and Mr. Miyoshi submitted the following statement:

As we stated at the previous Board meeting last June, we are of the view that the Fund should legally require members to report at least the minimum of information that is necessary for the effective discharge of the Fund's current duties, including surveillance and the provision of financial assistance under appropriate conditionality, by adapting the scope of information subject to Article VIII, Section 5 to the changes in circumstances since the Articles of Agreement were promulgated in 1944.

At the same time, we pointed out that the Fund should also be careful in making a judgment about the appropriate scope of additional information because the breach of the obligation under Article VIII, Section 5 would have legal consequences in the form of sanctions, and we requested that the staff provide an analysis of the impact of requiring additional information, including the number of countries that do not provide the Fund with information that is to be required in the proposed expanded list of data; how long it will take such countries to be able to provide such information; and the extent to which requests for technical assistance are expected to rise. This chair therefore reserved its support for the staff's proposal or an alternative proposal.

In this respect, we are uncomfortable with the current staff paper because it only proposes an expanded list of data that is in line with the SDDS and does not provide any analysis of its costs and benefits. As Japan subscribes to the SDDS, we do not think that our authorities would have any problem if the extended list of data were to include those data required in the SDDS. However, the existence of discretion against a background of legal sanctions could create increased uncertainty for members with limited institutional capacity as well as excessive pressure on these countries. Moreover, while the staff proposes a transition period of one year after the Board decision, the paper includes no discussion on whether members that do not currently provide information at the SDDS level would be able to provide such information in such a short period of time.

Under such circumstances, this chair is not in a position to support the proposed decisions, as information about the implications of the decisions is insufficient. We would therefore suggest that the information that members are legally required to provide to the Fund should be limited to core indicators, which the Board has specified members should report to the Fund. This chair would also like to make it clear that it would not be prepared to provide financial support for increased technical assistance in this area, even if Decision No. 1 is adopted today.

Mr. Bennett submitted the following statement:

Timely, accurate, and comprehensive information is essential to the IMF fulfilling its core surveillance mandate. We, therefore, welcome the proposed decisions which, in our view, do not impinge on the cooperative nature of the Fund's operations; rather, it simply reflects the fact that in this, as in any organization, there are basic responsibilities of membership.

We endorse the first decision on the required list of data and the proposed phase-in. This list should be reviewed regularly, say every 2 or 3 years, in keeping with Article IV, Section 3(b).

While we broadly support the procedural framework underlying Decision 2, we agree that the process could be structured further, both to increase and safeguard the important principle of uniformity of treatment in its application across members.

In that context, Ms. Jacklin and Mr. Baukol make some pragmatic suggestions that we fully endorse. To clarify:

- It makes sense for the Board to issue a statement of concern and articulate a set of remedial actions upon reaching agreement that a breach of obligation has occurred. The proposed 90-day timeframe to remedy non-capacity related breaches seems reasonable as a working guideline (recognizing, of course, that the Board retains the flexibility to adjust this time period case-by-case).

- If the situation is not remedied in the agreed timeframe, the Managing Director should recommend one of the three actions cited in paragraph 10(d). I see little merit in issuing a "statement of further concern" before taking a decision to adopt a declaration of censure if this course of action is recommended.

- There should be a presumption that the Managing Director issue a complaint to initiate and follow through on the sanction process if the member remains in non-compliance. As noted above, this presumption is rooted in the essential character of the information at issue in terms of the Fund fulfilling its core mandate.

Mr. Brooke and Ms. Stuart submitted the following statement:

As we highlighted in the discussion in June, the provision of inadequate information to the IMF can significantly impede the Fund's ability to undertake its surveillance and crisis prevention responsibilities. Recognizing this, the Articles of Agreement rightly requires members to furnish the Fund with such information as it deems necessary for its activities.

We strongly support establishing a clear framework of procedures and remedial actions to address cases in which members have breached their obligation under Article VIII, Section 5. We are confident that in adopting this policy the staff and the Board will use their best judgment to ensure that the framework of remedial actions would only be initiated when the Board judges that the non provision of information or the provision of inaccurate information is not due to the inability to provide the information required and where the Managing Director's dialogue and offers of technical assistance have failed to yield progress.

We welcome the staff's proposals. We support the coverage of data set out in Decision No. 1. However, we feel that that the procedures set out in decision 2 could be made more effective by clarifying timeframes and making the procedure more analogous to the procedures on arrears. We support the suggestions to strengthen the procedures as outlined in Ms. Jacklin's and Mr. Baukol's preliminary statement. In particular:

We believe that there should be an expectation that the requirements are met within a particular length of time and that a time frame of 90 days should be specified in paragraph 10(c) .

We would prefer to strengthen the framework by making it analogous to the framework on arrears so that the issuance of complaints by the Managing Director would be the presumption in the event of lack of cooperation by a member. We therefore support Ms. Jacklin's and Mr. Baukol's comments on paragraphs 10(d), and 13-15.

We also support their suggestions on paragraph 11.

Ms. Indrawati submitted the following statement:

As previously stated in our preliminary statement issued for the June 9, 2003 Board meeting on Strengthening the Effectiveness of Article VIII, Section 5, we would like to reaffirm our stance that we remain strongly supportive of the spirit of Article VIII, Section 5, which defines members' responsibilities as not an absolute obligation, but rather as a conditional obligation, as the technical and institutional capacity varies across the membership. Hence, members should not be considered in breach of Article VIII, Section 5 for their failure to report information that they are unable to provide due to capacity constraint. In this respect, we continue to believe that assessment of member countries' capacity should be based on a combination of judgment and reference to the best statistical practice and experience, with benefit of doubt given to member countries.

On the draft proposed Decision No. 1, while we recognize the importance of the Fund to have access to information that is complete and accurate as possible in carrying out its duties, we would like to reiterate that we remain in favor of maintaining the voluntary framework in meeting the Fund's data requirements as this has been working well. Therefore, we do not support the proposed Decision No. 1. Like Mr. Misra, we are also concerned that expanding the list would practically serve no purpose, but will rather than create some apprehensions about the spirit of the voluntariness and members' cooperation. Once the Board agree to expand the coverage of required information, it would effectively mean that making provision of such data is no longer voluntary but rather than mandatory. In addition, the obligation to provide additional data would put undue pressure to the member countries whose lack of institutional capacity.

In addition, we are of the view that the proposed Decision No.1 still needs further discussions, particularly on the issue of the transitional period (paragraph 2). We have strong reservation that this measure will apply to data commencing six month from the date of adoption of the decision, which implies that the actual transition period given to the members will be only six months. In this case, in order to allow members to improve their capacity and perform all necessary work to prepare the additional required data after the decision take effect, the period of six months might not be adequate. We are concerned that some members may need more time for dealing with technicalities as the additional information reporting requirements would add burden to them despite their ability to provide the information. Hence, to ensure the member's compliance with the Article, we would like to suggest that the measure should apply to data for the relevant periods commencing from the effective date of obligation.

We believe that the staff is fully aware that for certain countries some data, such as international reserves, are market sensitive. In this respect, in the event the Board agrees with the extended list, we strongly urge the staff to treat the market sensitive data as confidential, based on the member's circumstances.

With regard the draft proposed Decision No. 2, if the Board agrees to adopt this proposed decision, we view that the Board's judgment in determining whether a member is in breach of its obligation under the Article is very crucial, as the sanctions imposed under Article XXVI remain severe. An excessive sanction such as compulsory withdrawal from membership would create adverse toward the Fund and would also create unnecessary pressure upon member countries. It is also very crucial that the remedial action recommended by the Board should be supported by the technical assistant provided to the member. In addition, we support the proposed modification suggested by Mr. Mirakhor and Mr. Misra for paragraph 1 and paragraph 2.

On the procedures for making public Board actions relating to breaches of obligations under Article VIII, Section 5, we continue to believe that it is the prerogative of the member countries to decide whether to publish or not. In addition, we see no merit in making public cases on non-compliance of Article VIII, Section 5 during the intermediate stages of consultation before the imposition of sanctions under Article XXVI.

Mr. Usman submitted the following statement:

The IMF Executive Board had discussed the subject matter extensively during its meeting of June 9, 2003.

We are broadly in agreement with the thrust of the recommendations and will limit our intervention to a few issues pertaining to the proposed procedural framework. We support the proposed time line and sanctions procedures as they are tailored to the existing Fund framework including periodic notification of the Board and seeking its intervention on these matters.

We support the staff's proposal in dealing with Article VIII, Section 5 issues in a flexible manner that would treat cases on their individual merits. We however, view the issue of information reporting crucial to the Fund's surveillance work and accordingly countries need to be urged to take this matter seriously. The Fund however, has to recognize the inherent difficulties faced by many developing countries in terms of constraints in human and financial resources in their efforts to improve data availability to the Fund. In this connection, we believe the proposed decisions should take into consideration these constraints and the different levels of development and capabilities of these countries.

Like other Directors, we view the relationship between the Fund and its members as an on-going and dynamic process. In that respect, even for surveillance purposes, this relationship needs to be reviewed from time to time with a view to accommodating changes that serve to enhance the quality, reliability, and timeliness of data.

We are encouraged by the Fund's commitment to provide technical support for the purposes of building and strengthening capacity in member states to improve data dissemination to the Fund. In this respect, we are encouraged by the increase in the number of countries joining the GDDS and the SDDS.

The General Counsel (Mr. Gianviti), responding to questions and comments from Executive Directors, made the following statement:

> I will take up some of the major issues and also specific legal points that have been made in the preliminary statements.
>
> First of all, several Directors have argued in favor of having an amendment of the Articles of Agreement rather than a decision of the Executive Board. Of course, it would be possible to take the route of an amendment, but the point we have been making in this paper and earlier papers is that this is not necessary.
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> In Article VIII, Section 5(a), there is a list of minimum information that members are required to provide to the Fund. In addition, the same Article VIII, Section 5(a) allows the Fund—that is, the Executive Board—to expand that list by requiring additional information, which in the judgment of the Board is necessary for the Fund to perform its activities. The staff is now proposing that the Executive Board exercise that power by adopting a general decision that will be binding on all members, pursuant to Article VIII, Section 5(a) and require additional information from members.
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> The point has been made by at least one Executive Director that any information that is not specified in Article VIII, Section 5(a) should only be requested by the Fund under Article VIII, Section 5(c). Article VIII, Section 5(c) deals with the voluntary provision of information by a member to the Fund. However, as I just said, the Fund does have the power to require information. Thus, there are two different possibilities. One is to exercise the power to require information—that is the power vested in the Board by Article VIII, Section 5(a), which is what we are suggesting the Executive Board should do. The other would be to ask members whether they are willing to provide information. That is always possible, but this is not the approach being proposed by the staff, and it is not necessary to take this approach since the power exists in the Articles to require additional information.
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> With respect to the provision of information, the issue of sanctions and remedies arises, and the point has been made that the power to impose sanctions should be limited to cases where either a member fails to provide information at all or deliberately provides wrong information. This is not the first time that this issue comes up in Board discussions, and as Executive Directors remember, the staff has consistently been of the view that the condition that the provision of information be deliberately wrong should not be insisted upon by the Board. Why? First, if sanctions could only be imposed in the case of deliberate provision of wrong information, then the Executive Board and the staff would have the burden of proof. Those who are familiar with the rules on the burden of proof know that it is always extremely difficult to prove intent.

The second problem would be that it is not clear whose intent would have to be established. Would it be sufficient to prove the intent of a junior civil servant who misled his authorities? Would it have to be the intent of a senior civil servant, of a minister, of the cabinet, or of the head of state? All these questions would have to be discussed, and they would be extremely difficult to settle in a uniform and effective fashion. Thus, we have always said that it should not be a condition to prove that the intention was deliberately to mislead the Fund. However, in cases where the Board comes to the conclusion that there was concerted action by the authorities to mislead the Fund, this element can be taken into account in determining the level of sanction that is imposed by the Board.

I should add that there is no breach of obligation under Article VIII, Section 5 if the member does not have the capacity to provide information. So the only cases that may arise are those where the member had the capacity but failed to provide accurate information. One can agree that in such cases something wrong has happened in the mechanics of an administrative reporting system for which the member is responsible, and that should be sufficient for the Board to take action against the member. Again, the determination of the level of sanction would take into account all relevant facts.

With respect to the procedures that have been suggested by the staff, a number of counter proposals have been put forward, which need to be addressed.

The first one is about the imposition of remedial actions in paragraph 10(c) of the proposed decision. This paragraph discusses the various options that are offered and states that the Executive Board will specify a deadline for taking any remedial actions under paragraphs 10(a) and 10(b). A proposal has been made by some Executive Directors that there should be a deadline, a no-show deadline that can be exceeded on a case-by-case basis, say, 90 days. The problem with this deadline is that the remedial actions under paragraph 10(c) are of two different natures. There are remedial actions aimed at improving the data collecting system of the member—having more statisticians, collecting more information, reporting on a more regular basis, and so forth. It is difficult to see how a 90-day deadline could be imposed in this case.

In contrast, the other remedial action that can be specified by the Board would be simply the provision of information, to which a 90-day deadline could be applied. A shorter period could also be imposed if we know that the member has this information and is just refusing to provide it. Why should we wait 90 days? It seems to us that there should be flexibility because there is a range of actions that can be taken by the Board, and depending on the nature of the action, the deadline could be 30 days, 90 days, or 6 months.

We should not have a uniform deadline that would be a one-size-fits-all type of approach.

With respect to the Managing Director's recommendation in paragraph 10(d) of the proposed decision, the draft text states that the Managing Director may recommend and the Executive Board may decide on the three options—to extend the period, to call upon a member to take additional remedial actions, or to issue a declaration of sanction. These measures are optional both for the Managing Director and for the Board because there is always a fourth option, which is not to do anything. In other words, the Managing Director could recommend not taking any action, and the Board could agree with him. If we say that the Managing Director shall recommend one of the three, then we do not have an option for the Managing Director to recommend no action at all. That is why we have used "may." Similarly, we believe that the Executive Board should have the option to adopt any of these actions; it should not be an obligation to adopt any of these actions.

There were also questions about the multiple warnings that precede a declaration of sanction. On that, we recognize that it is a matter of choice. The reason why we have proposed a small steps approach is that, if I may refer to our recent experience, the Board has not been willing to enforce the obligation to provide the information listed in Article VIII, Section 5. So it seems that persuasion should be more the appropriate type of approach the Board would be willing to take and having a number of small steps may be more of an incentive to lead the member to comply rather than having a short sequence with definite steps.

Finally, there is a question of optional versus mandatory complaints by the Managing Director. This is a difficult question. There is a proposal by some Executive Directors to make the complaint by the Managing Director against the member that fails to comply mandatory rather than optional as we proposed. Again, it is a matter of choice. One could go either way.

Perhaps, however, I should put the issue in perspective. Under the Articles of Agreement, there is no reference to who makes a complaint against a member that is not in compliance with its obligations under the Articles. The practice of the Fund has developed three different possibilities. One is for the Managing Director to be the complainant, and, in principle, it is optional for the Managing Director to make a complaint. It is not mandatory; he may make a complaint. What the Managing Director has to do is to make a report. He must report to the Board any case of breach of obligation that comes to his attention. He must inform the Board. Making a complaint is something else. Making a complaint means asking for a sanction to be imposed, and that is optional for the Managing Director in principle.

There is one exception pursuant to a Board decision of November 1985, concerning the case of arrears. Arrears are an objectively defined, well-circumscribed breach, and the Board has decided that the Managing Director shall make a complaint if the member remains in arrears for two months. That is the exception. The question is whether, in this case, one should follow the principle or the exception.

In addition to the Managing Director making a complaint, any member of the Fund, through an Executive Director or directly, can make a complaint against a delinquent member. There was in the past the case of Czechoslovakia, which is a well-known episode of the history of the Fund where an Executive Director on behalf of his authorities made a complaint against Czechoslovakia for breach of Article VIII, Section 5. This is still possible. If an Executive Director feels that the Managing Director should make a complaint but fails to do it, the Executive Director can, on behalf of his authorities, make a complaint.

Finally, the Executive Board collectively could make a complaint against a member. Perhaps that is not a good system because the Board, after making a complaint, will sit in judgment of the member. But, still, it is possible under the practice of the Fund for the Board itself to make a complaint.

Why, in this case, are we proposing to make the complaint optional rather than mandatory for the Managing Director? First of all, as I just said, there are other possibilities. Second, at the time the complaint may be made by the Managing Director under this procedure, it is possible that the breach of obligation itself has been cured. Once a breach has occurred, it is always possible to make a complaint even if the breach has been cured. In such cases, the reason for the complaint should be that the member that was found in breach has failed to take all the corrective or remedial actions specified by the Executive Board. Perhaps, however, not only has the breach been cured, but most of these actions have also been taken, and what still needs to be done by the member is, in the Managing Director’s judgment, of minor importance. Why require the Managing Director to make a complaint if, in his judgment, there is no need to impose a sanction? It would put the Managing Director in an awkward situation of having to ask for a sanction which, in his judgment, is not justified. That is our view and that is why we are proposing to make the Managing Director’s complaint optional rather than mandatory.

Mr. Mirakhor thanked the General Counsel for his eloquent response to Directors’ questions. The differences of views among Directors were somewhat nuanced. He himself was convinced that Article VIII, Section 5 gave the Fund the authority to ask for whatever additional information it needed in order to carry out its surveillance responsibilities. If that was the case, it was unnecessary to adopt the proposed decision, one that had raised a number of thorny questions. Mr. Kiekens had always argued that this decision was not necessary, and the General Counsel had also suggested an alternative of simply asking members to provide the information the Fund needed to carry out the surveillance activity.

The question then was why the Board had to take this decision instead of simply asking members to voluntarily provide the additional information needed, Mr. Mirakhor asked. The experience so far had been that the membership had not resisted, with only one or two exceptions, which did not provide enough justification for adopting a general decision. All of the membership acting together in cooperation could produce a favorable response, provided that a coordinated and forceful action was taken. The voluntary approach, which was the hallmark of the Fund, should continue for at least a year. The exceptional cases, those that did not respond favorably, should be brought to the Board for an assessment of the extent of the problem.

Ms. Jacklin said that, given the importance of good data and good statistics to the core mission of the Fund and to the design and implementation by its members of sound policies, it was important to keep trying to raise data standards, which was the objective of the proposed decision and had been agreed at the last Board discussion. The General Counsel had confirmed that the decision was sensitive to capacity issues, as it did not require that every country comply with the standards, regardless of its current level of capacity. Rather, it set an important goal for the development of data necessary at the present time for countries to implement good policies and for the Fund to perform its surveillance role.

With regard to paragraph 10 of Decision No. 2, Ms. Jacklin said that she accepted the General Counsel's point on paragraph 10(c) that the implementation of improvements in the statistical systems referred to in paragraph 10(a) might take more than 90 days. However, a firmer guideline should be imposed on the provision of the required information in paragraph 10(b). She would be happy to revise her proposal to apply a 90-day presumption to paragraph 10(b).

In respect of the General Counsel's comments on paragraph 11, it was of concern that the small steps approach might reduce the incentive for the member country to take remedial action as quickly as possible, Ms. Jacklin noted. That would undermine the whole purpose of adopting these guidelines, which was to encourage the member with the capacity to provide the data to take remedial action as quickly as possible. The circumstances where the stage of sanctions would be reached were expected to be very rare. Under the proposed small steps approach, the country was given as many as four chances to take remedial action. First, the staff and the Managing Director would discuss with the country about the problem. A second chance was given after the Board considered the issue based on the Managing Director's report. A third chance to remedy the problem was provided under paragraph 10(d), whereby the first two options could be taken, giving the country more time to respond. Finally, paragraph 11 gave the country a fourth chance. The first two steps were expected to be ineffective, as the country was given four chances in all. Three graduated steps should be sufficient to fix the problem. Dragging the process out too long might be counterproductive.

Mr. Mirakhor said that he agreed fully with Ms. Jacklin that good statistics and good data were important to the work of the Fund. He had no objection to raising the standards and believed that the membership would comply with the higher standards of data provision as they had done so in other areas. The question was whether a Board decision to raise those standards was necessary or simply asking the membership to comply with the data requirement would be sufficient for the Fund to carry out its surveillance activity. That was still an outstanding question to which the staff had not provided an answer.

If it was determined that Article VIII, Section 5 was inadequate and a decision had to be adopted to correct its inadequacy, that process was indeed an amendment regardless of how it was called, Mr. Mirakhor continued. That unnecessarily raised a legal problem, as the Fund could simply request the membership to provide the information needed without going into a gray area. It would also set a precedent if the contents of the Articles of Agreement could be changed simply by decisions of the Board. The Board could feel tempted to go further to amend the shortfalls in other Articles.

Mr. Misra said that he wished to thank the General Counsel for explaining some of the doubts that he had. Still, he wished to reiterate the first point made in his preliminary statement regarding the amendment of the Articles of Agreement. The General Counsel had opined that an amendment was not necessary, pointing to the phrase “the Fund shall decide.” The term “the Fund” was not defined, however. Was it the Board of Governors, the Executive Board, management, or the staff? The staff report explained that the Fund meant the Executive Board, not the staff or management. He was, however, strongly of the view that the Fund was the Board of Governors.

Article VIII, Section 5(c) stated that the Fund might arrange to obtain further information by agreement with members, Mr. Misra continued. It should be reminded that a section of the Articles of Agreement could not be read separately from the rest of the Articles of Agreement. In this case, Article VIII, Section 5(b) stated, “In requesting information, the Fund shall take into consideration the varying ability of members to furnish the data requested. Members shall be under no obligation to furnish information in such detail that the affairs of individuals or corporations are disclosed. Members undertake, however, to furnish the desired information in as detailed and accurate a manner as is practicable and, so far as possible, to avoid mere estimate.” While the Board had generally agreed to the changes in the required data categories, it was clear from the minutes of the last Board discussion that the provision of data should be done in a cooperative fashion, not by means of a sanction. As pointed out in his preliminary statement, some of the proposed expansion overlapped with the existing items listed under Article VIII, Section 5(a). Contrary to the General Counsel’s view, an amendment was necessary. However, any change to a particular Article had to be made by the Board of Governors. Governors would likely agree on the need to expand the categories of information required of the membership.

With respect to the issue of deliberation, the General Counsel had raised the question of whose intent would have to be established, Mr. Misra recalled. In fact, the timing—when the request for data was made—was relevant. In the period close to elections, no one in the government would provide data to the Fund, as that could cause the government’s party to lose the elections. Most of the data being proposed were already provided to the Fund by members. If a change were to be made to the list of information required by the Fund under Article VIII, Section 5(a), that was in effect an amendment.

The Acting Chair (Mr. Sugisaki) remarked that the General Counsel had provided a clear answer to the question of whether an amendment of the Articles of Agreement was needed.

Mr. Portugal made the following statement:

> I would like to return to the point made by Mr. Mirakhor and Mr. Misra now and to have some further questions to Mr. Gianviti. Mr. Mirakhor asked why this decision is needed, and Ms. Jacklin is trying to respond to him by saying that it is because we want to set the standard for the data that the Fund needs for performing its activities. But I am not convinced by that answer because, in fact, the Fund already receives more data from member countries than those specified in Article VIII, Section 5. That is said in the decision that is proposed. If the purpose was really to obtain additional information or to obtain data of better quality, then Mr. Misra's suggestion to deal with these in the upcoming review of data provision to the Fund would make all sense. In fact, we already have a standard, the SDDS and the GDDS, which is much more complete than the first decision. So, to my mind, the real purpose of that decision is not about getting data or improving the quality of data. Rather, we are discussing here about establishing a framework for punishing members. This is the real issue that we are after. This I also find disquieting because, as Mr. Mirakhor said, the case was not made by the staff that the current system is not working well. There are only a few exceptions. We have been dealing with them in cases of misreporting. The case has never been made by the staff that the existing system is not working well.
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> Then there is a question of whether we could do this by a decision of the Board or an amendment to the Articles of Agreement is required? Mr. Mirakhor says that it is a gray area, and I agree with him and Mr. Misra that it is a gray area. Mr. Misra raised the question of who is the Fund. I could accept that perhaps the Executive Board is the Fund. But what about the types of data that are included in the decision and are also included in Article VIII, Section 5? For those categories that overlap, in fact the decision would imply amending the Articles of Agreement. If we are adding to the existing list of categories, it would be one thing, but if we are repeating a category that already exists in a different way, then, to my mind, we are, in fact, trying to amend the Articles of Agreement by this decision. As Mr. Misra has said, and I agree, what cannot be done directly should not be attempted indirectly.
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> Then I would like to go to Mr. Gianviti's response to the question of why, in cases of reporting wrong information, we should not look into intent? He gave two reasons. The first reason is that the burden of proof would be upon the Fund, and the second reason would be whose intent it would be. I do

> not accept the first reason because if we are going to punish a member, the burden of proof should really be with the Fund. So, this is not a reason for not putting the word deliberate there.
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> As for the second point that Mr. Gianviti raised, whose intent would it be? We could say it would be the intent of any one official involved in the provision of the data. We do not need to specify if it is the intent of the minister or a clerk. If it is the intent of anyone involved in the provision of data, then that would be sufficient. But there has to be the intent of at least someone and not a pure error. I would like Mr. Gianviti to comment on this and on how he sees the case where the same category of data is already included in the Articles of Agreement. This, to me, is an amendment.

Mr. Misra added that Article XXVIII, Amendments, paragraph (a) stipulated that any proposal to introduce modifications in this Agreement, whether emanating from a member, a Governor, or the Executive Board, shall be communicated to the chairman of the Board of Governors. It referred to any modification, not only an amendment. That also needed an interpretation. An interpretation clause was provided in Article XXIX.

Mr. Brooke, responding to Mr. Portugal's comments about the scope of data currently provided by the membership, called the Board's attention to the previous staff paper for the June 2003 discussion. In Box 1, the staff set out clearly a number of important examples of countries that had reported inaccurate information or had failed to report information to the Fund over a prolonged period. Turkmenistan was one of the most obvious examples over which the Board had been unable to exercise surveillance because of lack of information.

That pointed to the need for taking the proposed decision, Mr. Brooke commented. However, he accepted Mr. Portugal's view that the vast majority of members already provided much more information than that required under Article VIII, Section 5. Unfortunately, there had been a few exception cases where the existing procedures had proved frustrating. At the Board discussion in June 2003, a clear majority of the Board had recognized the need to change the procedures and had agreed to adopt the decision. The Board was currently at the point of deciding what decision to implement.

On the question of whether to include text on deliberate misreporting, he agreed with the General Counsel that it would be difficult for the Fund to prove the intent of any authority or member of the authorities, Mr. Brooke continued. Including that text in the decision would effectively make it inoperable. Hence, he would have grave reservations about that approach.

Ms. Jacklin had rightly commented on the elongation of the steps and the number of opportunities that the authorities would have to take actions, Mr. Brooke related. He, therefore, agreed with her that there would be a good case for removing the final element in paragraph 11. Like Ms. Jacklin, he accepted the General Counsel's point on the timing issues in paragraph 10(c). It was hoped that the staff could come up with more tightly worded expression in paragraph 10(c) to reflect the differences between the treatments under paragraphs 10(a) and 10(b).

Mr. Mirakhor wondered whether the problem with Turkmenistan remained unresolved or the case had been handled within the existing framework. There was no reason to change the existing framework, which seemed to be working well. Mr. Brooke considered that, given the seriousness of the problem, the decision favored by a majority should be adopted. The problem, in fact, was that such an attempt to amend the Articles of Agreement through a Board decision would continue to haunt the Board. Perhaps an amendment could be made by other means to easily handle the cases within the present framework, or to strengthen the sanctions as suggested.

Mr. Kiekens made the following statement:

> The purpose of today's Board meeting is to implement what the Board agreed in June in principle, but all Directors need to be comfortable with the decision we take today. So, if there is a need to explain further the rationale, we should go through that process, although we have had discussed all that in June.
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> Let me explain my view. The decision that is proposed today clearly does not amend Article VIII, Section 5 of the Articles of Agreement. It merely intends to implement that Article in a clear, explicit way. Article VIII, Section 5 obliges the members of the Fund to provide information to the Fund for the discharge of its duties. It says that, at a minimum, the members need to provide the data that are listed in Section 5(a). However, that is a minimum. The Fund may request more information depending on the peculiarities of the case, the complexity of the economy, the complexity of its problems, and the ability of the country to provide more information than the minimum. Over 55 years, the Board has never taken an explicit decision to ask all members additional information. Even so, the Fund has been exercising surveillance over members by asking many of them to provide additional information, the most relevant one being fiscal data, which, quite surprisingly, were not included in the data list that was established in 1945.
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> Mr. Mirakhor and others have observed that that system has worked satisfactorily over 55 years. I would agree that it was broadly satisfactory, but not fully satisfactory because some countries did not provide, for instance, fiscal data in a timely manner or in an accurate manner. That led to a discussion, after some awkward instances of misreporting on fiscal data, on the question of whether that country has failed to comply with its obligations to provide data to the Fund as required for surveillance.
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> We all agree that providing fiscal data to the Fund for surveillance is necessary, but there was an interpretation problem. One interpretation was that, since the Board had never taken an explicit decision that fiscal data must

be provided, there was no obligation for any member to provide these data. Thus, if there was a shortcoming in the data or misreporting of the data, it was not a breach of obligation. That was the interpretation that was subscribed to by the vast majority of the Board and also by the General Counsel. I personally had another interpretation, but I recognize that this was not the view of the majority. My view is that, over 50 years, the Board, at least implicitly, had delegated the power to the Managing Director to ask each country individually the information that the Fund needs for surveillance purposes; that was the practice. When a Fund mission goes to a country, it sends in advance a questionnaire and asks for a whole list of data, which often go beyond the minimum data. And, in almost all instances the countries have provided these data, indeed voluntarily, probably because the Governor and the Minister are of the view that indeed it is reasonable to give these data to the Fund who conducts surveillance. This practice did not raise any serious problems.

But then when there was a misreporting case, a majority of the Board was of the view that, since the Board had not explicitly required the country to provide fiscal data, there was no breach of obligation. Hence, the proposal to have a more explicit list, to clarify the situation in a particular way and to establish an additional list that countries are expected to provide, is very clear, provided they have the ability to do so. We cannot require the countries to provide those data regardless of their ability, because otherwise we would indeed be amending the Articles of Agreement. That is not the intent. So, the proposed decision is a clarification of how the Fund, and that is the Board, applies Article VIII, Section 5. In principle, I am in agreement with the decision that is proposed, and I firmly believe that there is no need for an amendment.

To Mr. Mirakhor, my principal interpretation was that we did not need this whole list, but this was based on my reading that the Board agreed to delegate the power to the Managing Director to require from each individual country what data it should provide to the staff and hence to the Board. If the member provides such data, it is because it believes it is obliged to do so. If the member would be of the opinion that this was excessive, it could always ask the Managing Director or its Executive Director to bring the case before the Board, and then we would have to take a decision on whether the Managing Director, i.e., in the name of the Fund, is requesting data that the Fund needs for the discharge of its duties or is asking too much data. However, this is a view that is not taken by the Board. I agree with the proposed decision because it is an implementation of a decision taken by a vast majority of the Board.

I have some detailed comments on the proposed decision, but I will make those comments later.

Mr. Mirakhor said that his understanding of Mr. Kiekens's position was precisely as he had described it. As with the implementation of other provisions of the Articles of Agreement, the Board had given the authority to the Managing Director and the staff to ask countries to provide as much information as needed in order for the Fund to carry out its surveillance function. He continued to hold the view that a Board decision was not necessary. Nevertheless, if there remained a problem with interpretation, that could be brought to the Standing Committee on Interpretation, to which any Executive Director could refer in order for the decision to be made whether the proposed approach was consistent with the Articles of Agreement.

Mr. Kanaan said that he supported the points made by Mr. Mirakhor, Mr. Portugal, and Mr. Misra. On the issue of intent, the General Counsel had argued that it was difficult for the staff to prove the authorities' intention not to provide the information, and had thus dismissed the notion of intent altogether. In most cases, however, the staff did not have to prove it but to pass judgment on whether a country had had the technical ability needed to provide the data and on whether the authorities had deliberately chosen not to provide the information. As in the case of sovereign debt restructuring, the staff was asked to provide its judgment, not to prove, whether the country concerned had made good faith efforts to engage in private debt negotiations. The same concept could be applied to the provision of data to the Fund. The General Counsel might wish to react to that point.

In cases of misreporting and nonprovision of information, the staff should at least make a judgment on the intent of the authorities, Mr. Kanaan continued. In a number of past cases of misreporting, it could be seen clearly that the authorities had not deliberately provided wrong or inaccurate information. Abiding by the strict definition of misreporting had caused, and would continue to cause, problems; that issue should be reconsidered.

With regard to the General Counsel's second justification for not considering intent, Mr. Portugal was right in suggesting that the intent of any one official involved in the provision of data should be a sufficient reason, Mr. Kanaan agreed. There was no need to ascertain who exactly was responsible for the nonprovision of data.

Ms. Gust said that she supported the comments made by Ms. Jacklin, Mr. Brooke, and Mr. Kiekens.

Mr. Ge said that he fully supported Mr. Mirakhor's comments. While data provision was important for the Fund to conduct its surveillance over the member countries, he considered it unnecessary to adopt the proposed decision, as cooperation between the Fund and its member countries in the area of data provision had proceeded well and the voluntary approach was welcome by most countries.

Ms. Indrawati said that she fully agreed with Mr. Mirakhor's statement. The current mechanism whereby the Board delegated the authority to the Managing Director and the staff to request data from country authorities had worked well so far, while the cooperative nature of the institution had been preserved. Within the strengthened surveillance framework, including the SDDS and the GDDS, if the staff felt the need for further information or verification of data, they could always contact the authorities and discuss with them in a cooperative manner.

Adopting the proposed decision for the purpose of implementing Article VIII, Section 5 would not help the Fund to obtain more data or improve the quality of data in any significant way, Ms. Indrawati continued. On the contrary, it would be counterproductive, with all the negative consequences that Mr. Mirakhor had noted. Also, as mentioned by Mr. Portugal, country authorities could react negatively to the strengthened punitive framework if that was perceived to be the case. The countries in her constituency had felt that the decision proposed for adoption was biased toward punishing countries for not providing the required data rather than strengthening the incentives to provide the data voluntarily.

Mr. Meissner remarked that the continuation of the June discussion took him by surprise. The summing up of that Board discussion stated clearly that a majority of the Board had agreed that it would be useful to adopt a decision of general applicability expanding the coverage of Article VIII, Section 5 to bring it more closely into line with the Fund's data needs. Based on that, the proposed decision could have been adopted on a lapse of time basis. On Decision No. 2, he was also prepared to support Ms. Jacklin's proposal.

The General Counsel (Mr. Gianviti), responding to additional questions and comments from Executive Directors, made the following further statement:

> First of all, on the general approach of these two proposed decisions, it should be clear that, on the one hand, what is being proposed in accordance with the summing up of the June Board meeting is to expand the list of information required under Article VIII, Section 5(a). On the other hand, it is also to provide those member countries that were concerned about the expansion some comfort in having more precisely defined procedures and the assurance that sanctions would not be taken without first considering all the elements or the corrective measures that could be taken. In fact, if one looks carefully at the proposed procedures under Decision No. 2, these steps depart substantially from what the Fund could do in the strict application of the existing rule on sanctions. Under the current framework, there would be no need to issue a statement of concern or a declaration of censure; the Managing Director would report to the Board on a breach of obligation and could make a complaint; and the member could be declared ineligible and could be sanctioned. The proposed procedure delays this and tries to find a mutually satisfactory solution between the Fund and the member. This has to be taken into account.
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> With respect to the powers of the Executive Board, I am actually surprised to hear Directors expressing doubts concerning the authority of the Executive Board to exercise the powers of the Fund under the Articles of Agreement. That is an important issue on which we have to be very clear. Article VIII, Section 5(a), which is the provision under consideration, confers powers on the Fund; it is the Fund that may require information. It does not

say that members only have to provide the information listed in Article VIII, Section 5, but that the Fund may require, as Mr. Kiekens said, as a minimum the data listed in Section 5(a). Therefore, the minimum has to be understood as something beyond which the Fund can require additional information.

Who exercises the powers of the Fund? The Articles of Agreement are very explicit. Under Article XII, Section 2(a) of the Fund's Articles of Agreement, and I quote, "All powers under this Agreement not conferred directly on the Board of Governors, the Executive Board, or the Managing Director shall be vested in the Board of Governors." Therefore, the powers of the Fund not conferred on other organs by the Articles of Agreement are vested in the Board of Governors. However, Article XII, Section 2(b) authorizes the Board of Governors to delegate its powers to the Executive Board other than the powers conferred directly on the Board of Governors by the Articles of Agreement. This delegation has taken place. According to Section 15 of the By-Laws, the Executive Board is authorized by the Board of Governors to exercise all the powers of the Board of Governors except those conferred directly by the Articles of Agreement on the Board of Governors. Article VIII, Section 5 does not say the Board of Governors; it says the Fund. Therefore, pursuant to Section 15 of the By-Laws, the authority to require additional information is vested in the Executive Board. The delegation stops there, and this is where Mr. Kiekens and I have a difference of views. There is no sub-delegation from the Executive Board to the Managing Director, because the powers of the Fund may not be delegated beyond the scope specified by the Articles of Agreement. Therefore, the power conferred by Article VIII, Section 5 rests with the Executive Board. It is for the Executive Board to decide what additional information is required and what is not required. In fact, in individual cases, the Executive Board has already exercised that power. When the Board approves a stand-by arrangement or an extended arrangement under which a member has to provide information with respect to performance criteria, it is specifying information pursuant to Article VIII, Section 5, and failure to provide this information could lead, on the one hand, to an application of the decision on misreporting, and, on the other hand, if the member had the capacity to provide information, to sanctions for breach of Article VIII, Section 5 obligations. That has been the practice of the Board over the years. To say now that it does not have that authority seems rather strange.

Therefore, this power is vested in the Executive Board, and the only question is whether the Executive Board should, in the future, operate on a case-by-case basis—in other words, different data for different members—or through general decisions, or a combination of both. What the staff is proposing here is to have a general decision that applies uniformly to all members. It follows the principle of equal treatment. It does not prevent the Executive Board from requiring more information in individual cases. There is no conflict with Article VIII, Section 5 because this is additional to Article

VIII, Section 5. The two lists have to be read together as providing a comprehensive system of information. The concept of information necessary for the Fund's activities has evolved. Mr. Kiekens has mentioned fiscal data. Clearly, when the Articles of Agreement were written, it was not envisaged that the Fund would be looking at fiscal data. The focus was mostly on reserve assets, exchange controls, balance of payments, gold production, and so forth. Given the evolution in Fund activities, the purpose of the list is to provide the corresponding information. The adoption of this list does not require an amendment. It is within the powers of the Executive Board to require this information.

With respect to the question of intent, I just want to clarify that, first of all, and the point has been made by Executive Directors, if inaccurate information is provided by a member as consequence of a mistake made by Fund staff, there is no breach of obligation by the member. We have always been very clear on that. It has also happened that staff made wrong calculations, in which case there is no breach of obligation by the member.

If there were a requirement that intent be established, the question would be: whose intent? Information is provided by members through their governments, and those who are familiar with criminal laws applicable to juridical persons will know that there is no such thing as the intent of a juridical person. One has to look at the intent of individuals, of human beings. So, which human being is responsible for the provision of inaccurate information? It is close to impossible. We know that different people worked on the information, but who did what? If we do not know who was responsible for generating false information, how can we determine intent? Judgment could be exercised, but that is not really proof; it is only suspicion. All we can say to the best of our ability is that there is conclusive evidence that the information is inaccurate. In some cases, there is evidence or recognition by the authorities of their intent to mislead the Fund. The Executive Board will be informed. To say, however, that proof of intent is a condition for finding a member in breach would imply that members have no responsibility for ensuring the provision of accurate information to the Fund to the best of their ability. It would be a major loophole in the application of Article VIII, Section 5.

In the context of the use of Fund resources, the Board has agreed that the guidelines on misreporting do not require the establishment of intent. The finding of misreporting is based on purely objective criteria. In other words, if inaccurate information is provided with respect to a performance criterion, we do not have to establish intent. The fact that the information provided is inaccurate is sufficient. So, it is important to maintain the principle that the staff or the Board does not need to establish intent in those cases.

The staff representative from the Policy Development and Review Department (Mr. Fetherston) said that, on the problem with Turkmenistan, it might be interesting for the Board to know that, during the visit to the country in September 2003, the mission chief of Turkmenistan had showed to the authorities the summing up of the June discussion on Strengthening the Effectiveness of Article VIII, Section 5. It had been reported that that had produced quite a salutary effect on the level of cooperation from the authorities.

Mr. Kanaan noted that the staff had made it clear that a mistake by the Fund staff would not give rise to a misreporting case. Nevertheless, the process leading to the provision of information was often a cooperative effort, involving input from both the authorities and the Fund staff. It might not be that easy to determine whether the staff or the authorities should be held responsible for providing wrong or inaccurate data.

Mr. Misra, reacting to the General Counsel's reference to a juridical person, stated that a country should not be regarded as a criminal but as a sovereign, who must subject itself to some degree of discipline in the matters pertaining to the agreements it had signed.

With respect to the Articles related to amendments and interpretation, Article XXVIII provided that any proposal to introduce modifications in the Agreement was to be communicated to the Board of Governors, Mr. Misra reiterated. Article XXIX(a) stipulated that any question of interpretation of the provisions of the Agreement arising between any member, not members, and the Fund or between any members of the Fund shall be submitted to the Executive Board for its decision. Article XXIX(b) provided that "[i]n any case where the Executive Board had given a decision under (a), any member might require, within three months from the date of decision, that the question be referred to the Board of Governors whose decision shall be final. Any question referred to the Board of Governors shall be considered by a Committee on Interpretation of the Board of Governors. Each Committee member shall have one vote." The decision was currently at the Executive Board level, but the Board did not comprise representatives of all the members of the Fund. It was sovereign governments that were parties to the Articles of Agreement, and they were represented in the Board of Governors. A whole host of procedures had been set up to protect members that were not entitled to appoint an Executive Director, as referred to in the latter part of Article XXIX (a).

All the data sought had already been provided to the Fund, with very few exceptions, which might have been caused by the countries' incapacity to provide those data, Mr. Misra noted. He did not object to the objective of obtaining more data, but would caution against the approach taken, as that brought about substantial changes to Article VIII, Section 5—the power that did not rest with the Executive Board. The amendment clause and the interpretation clause were described in great detail in the Articles of Agreement, for a good reason. The Articles of Agreement were not a country law whereby a disagreement case could be brought to the Supreme Court, and they could not be challenged in the International Court of Justice. There was a strict provision in the Articles of Agreement that should be considered carefully.

Mr. Zurbrügg made the following statement:

My understanding of last summer's discussion was exactly as Mr. Meissner pointed out. So I am going to be brief and just build on what we decided last time.

First, on the categories of information, at our last Board meeting, we would have had a preference to limit the list to core indicators. But, for the sake of compromise, I could go along with the staff proposal because it balances the different positions that were expressed at the time.

Second, on the procedural framework, the limitations regarding the application of Article VIII, Section 5, as specified in paragraph 3, are reasonable, and the proposed procedures for addressing breaches of obligation are flexible. Mr. Gianviti made an important comment that the existing sanctions are very severe and that is one of the reasons why we are supportive of these procedures. Perhaps Ms. Jacklin finds the steps too small, but there are more gradual steps in approaching the member to deal with this issue. Most importantly, they allow for informal reactions and solutions and take into account country-specific circumstances. I also see good reasons for giving the Board and management more options in the case of information requirements than in the case of arrears before going to these severe sanctions.

On Ms. Jacklin's proposals to change the wording from "may" to "shall" in several places, I was going through that and replacing the words, but after listening to the other comments, I think that "may" is probably more appropriate, particularly since the expectation is, as Ms. Jacklin pointed out, that we do not expect to reach this stage of sanctions. This is something really in extremis, and this is exactly a good reason for leaving that last "may" before the sanctions. I do not think that we want to be in the situation the European Union is with the Stability and Growth Pact because they are suddenly forced into an issue of sanctions, which nobody actually wants but has to do to preserve credibility. I would like that little escape clause at the end. Again, the idea is that we do not want to be there. We want to do this in a consensual fashion in small steps, so we hope to resolve it on the way there.

As pointed out by Mr. Fetherston, in the case of my constituency member, the fact that the staff and I emphasized was this publication issue. To say that we would like to soften the sanctions and have it more gradual was actually quite a persuasive argument.

Finally, on the question raised by Ms. Indrawati on the transitional period, I think that she makes a fair point because the idea was to have an effective one-year transitional period. I could thus support her proposal. On the other hand, it is important to point out that the lack of capacity would enable the country to be out of the loop anyhow. If a country can make the case that the capacities are still lacking for these new data categories, they would be automatically excluded. From that point of view, it is not as binding as it would seem.

The Acting Chair (Mr. Sugisaki) thanked Mr. Zurbrügg for his useful clarification and asked that other speakers follow suit to the extent possible and make their position clear on the two draft decisions.

Mr. Al Azzaz made the following statement:

I remain of the view that the voluntary cooperation of members in providing the information the Fund needs to conduct its operations is working well. Therefore, it is unfortunate that we are shifting from this proven and successful approach to a legalistic one that imposes additional obligations on the membership. It is important to stress that, in view of the proposed substantial additional data that need to be provided pursuant to Article VIII, Section 5, it is essential to allow members sufficient time to ensure compliance. In this connection, I still prefer a transitional period of two years to allow for addressing capacity constraints. Here, the importance of providing the needed technical assistance cannot be overstated. It is also important to put in place an outreach program to explain the changes that have been adopted and their implications.

In addition, I would like to stress that while assessments of members' capacity to report the required information would always involve an element of judgment, it is essential to give the member the benefit of any doubt.

On the proposed procedural framework, I agree with the staff that "the timeframe for the implementation of remedial measures by the member be established on a case-by-case basis rather than specified under a standard timeline." I also agree that "the issuance of a complaint by the Managing Director for the imposition of sanctions under Article XXVI be optional under this framework." These two proposals will help provide the necessary flexibility to address any gaps in the provision of data to the Fund while taking full account of each country's particular circumstances.

Extending his remarks, Mr. Portugal made the following further statement:

I have already expressed my view on the first decision. As I said, I think that it is not needed. As Mr. Kiekens has said, the system we have of 55 years is working broadly well. Mr. Brooke called my attention to the staff paper earlier discussed. I looked back into that paper and found that there are seven cases reported. Out of the seven cases, as it is written in the report itself, six have been solved and dealt with either by applying the misreporting guidelines or by applying Article VIII, Section 5 as it is. So, I still have the view that Decision No. 1 is not needed.

I noticed that Directors were either surprised or disappointed that we maintain our view. But the fact is that this issue is being discussed in the Board again, and in spite of the majority having taken a different view, I still hold to my view, and I express it when the issue comes to discussion. This is perhaps one of the costs for taking decisions by majority rather than by consensus.

Regarding Decision No. 2, I could accept it, but I think that it is important to make some modifications to it. The first modification is in the second sentence of paragraph 1. Article VIII, Section 5(b) establishes that, in requesting information from members, the Fund has to take into consideration the varying ability of members to furnish that information. This is not mentioned in the second sentence of paragraph 1. Moreover, the requirement for the provision of accurate information, which is mentioned there, goes a little further than what is written in Article VIII, Section 5(b), which establishes a requirement for providing information "as accurate as practical," which is different from accurate. These two essential qualifications have to be included in Decision No. 2.

Thus, in line with what Mr. Misra and Mr. Mirakhor proposed, I would suggest that the second sentence of paragraph 1 should read, "Failure to provide information includes both the nonprovision of information for which the member has the capacity to provide and the provision of information that is not as accurate as practical." The issue of capacity is partly recognized in paragraph 2, but the issue of accuracy is different from that of capacity, and the obligation is to provide information as accurate as practical. Even if a member has the capacity to provide certain information, we have to decide what the accuracy level we are talking about. Are we going to ask precision to the several decimal points after the comma or not? We should stick to the language that is in Article VIII, Section 5(b), which refers to accurate information but as accurate as practical.

I also support Mr. Mirakhor's suggestions to include at the end of paragraph 2 a phrase that the differences between provisional and final data and data revisions due to methodological changes and statistical discrepancies should not be construed as provision of inaccurate information.

It is also important to add to the second paragraph a phrase stating that, in assessing the member's capacity to report the required information, judgment is needed, and the members should be given the benefit of any doubt. In fact, this phrase appears specifically in the summing up of the June decision, and some Directors noted this point in their preliminary statements. I saw this mentioned in the preliminary statements of Ms. Jacklin and Mr. Baukol and of Ms. Indrawati.

> I also support Ms. Indrawati's and also Mr. Al Azzaz's suggestions about the length of the transition period. Mr. Misra raised an important issue about what should be the quality, the timeliness, and the lags with which this information should be provided, which we have not discussed yet, and which the staff has not addressed. These are important issues that we have to decide. For instance, what would be the periodicity that would be required for data on the revenues, expenditures, balance, and composition of financing of the central and local governments? Would that be monthly or annual? With which lag should that information be provided? I would like to hear the staff comment on how they intend to deal with these issues of the timeliness and lags in the provision of information to decide whether a member has breached the obligations under Article VIII.
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> I still have the view that we should consider including the word "deliberate misreporting," as Mr. Mirakhor and others have suggested. I am still not convinced by Mr. Gianviti's suggestion. He asks intent of whom. But I would ask him back, with a very good example that Mr. Kanaan gave, when the staff is judging whether there is good faith negotiation with private creditors, could you please tell me whose good faith you would look at? It seems to me that this is the same problem. If you are able to apply some judgment on one case, I do not see why we could not apply that in the other.
>
> I am not able to support Ms. Jacklin's and Mr. Baukol's proposal for changing the word "may" to "shall" in the case of the discretion given to the Managing Director. Because of the great diversity of capacity among members and probably the diversity of problems that will have to be solved, we would need discretion, and the Board has some discretion to decide. I cannot see why the Managing Director would not have the same discretion.
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> Finally, I support Mr. Misra's suggestions for the PIN.

The Acting Chair (Mr. Sugisaki) asked if the General Counsel could respond to Mr. Portugal's suggested changes to the draft Decision No. 2.

The General Counsel (Mr. Gianviti) replied that it would be useful to have those changes in writing. The staff had no objection to the mention of the benefit of the doubt being given to the member, but would need to look at other suggestions more carefully.

Mr. Mirakhor complimented Mr. Portugal for making an excellent intervention. It seemed to him that some of the proposed modifications had already been submitted in writing.

Mr. Portugal again read out his suggested changes to paragraph 1 of Decision No. 2, and reiterated that the proposed changes were consistent with the language of Article VIII, Section 5(b). "Accuracy" was a too stringent requirement for data and was not a requirement established by the Article. Rather, the Article established the requirement of "as accurate as practical." That was a different issue from capacity, as a country could have the capacity to provide information with the accuracy of several decimal points, but that might not be practical or necessary.

The Acting Chair (Mr. Sugisaki) said that the Secretary would prepare the text as amended by Mr. Portugal and circulate it to the Board.

Mr. Brooke asked that, when commenting on the proposed amendments, the General Counsel also clarify whether such language was already covered in the first and second sentences of paragraph 2. It was stated that a member was not in breach of obligation if it was unable to provide the required information.

Mr. Portugal said that the issue of capacity could be covered in paragraph 2, but not the issue of the degree of accuracy required for the provision of information.

Mr. Lombardi made the following statement:

> First, I would like to thank Mr. Gianviti and Mr. Fetherston for providing further clarifications.
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> Turning to the decisions before us today, we support Decision No. 1, as it brings the data provision requirements closer in line with the SDDS.
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> Regarding Decision No. 2, we agree with the suggestions put forward by Ms. Jacklin and Mr. Baukol and supported by a number of other Directors. In this respect, we believe that having a clear and more structured framework would be appropriate. All in all, the suggestions would strengthen and safeguard the principle of uniformity of treatment in its application across members, as emphasized by Mr. Bennett.
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> We also support the proposal made by Ms. Jacklin and Mr. Baukol and Mr. Bennett for the Board to periodically review the list of items, to bring them in line with the evolving practice in the Fund's surveillance function.

Mr. Rutayisire made the following statement:

> During the last Board discussion, our chair expressed a position that we would like to reiterate. Particularly we requested flexibility in the application of the proposed decisions. In requesting information, the Fund may need to take into consideration the varying ability of members to furnish the data requested. In this context, like Ms. Indrawati, it is important that members be not under obligation to furnish information in such detail for which members have not adequate capacity.
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> We are of the view that the voluntary cooperation of the Fund members to ensure the provision of information essential for the Fund to

discharge its mandate has so far served well our common institution. Therefore, like Mr. Mirakhor, Mr. Misra, and others, we do not see the need for the proposed decisions.

However, if the decisions are to be adopted, we see the broader issues of interpretation of Article VIII, which Mr. Misra has raised, as pertinent. We also support the amendments suggested by Mr. Portugal.

Mr. Boitreaud made the following statement:

First, we support the coverage of data set out in the proposed Decision No. 1. Like Mr. Kiekens, we believe that this proposal would clarify the modalities for the implementation of Article VIII, Section 5, as it explicitly lists data that are necessary for the Fund to fulfill adequately its surveillance mission.

In that regard, and like others, we also suggest that the Board review this list periodically. As was said during the last discussion, these changes should be accompanied by the provision of sufficient technical assistance to help countries with limited capacities deal with them, as Mr. Rutayisire has just suggested.

Second, regarding the procedures set out in Decision No. 2, we share some of the concerns raised by Ms. Jacklin and Mr. Baukol. Indeed, clarifying the time frame of this decision would make it more effective and would strengthen the procedure. Thus, we are ready to agree on the following suggestions. First, we agree with the idea of a 90-day time frame for the member to provide the information required under paragraph 10(b). Second, we think that the additional warning suggested in paragraph 11 of the proposed decision should not be granted automatically but decided upon by the Board on a case-by-case basis.

However, as for the other proposals made by Ms. Jacklin and Mr. Baukol, I think that the Managing Director should retain the flexibility to react to any situation, particularly to unforeseen situations. I, therefore, support the wording proposed in the decision regarding paragraphs 10(d), 13, 14, and 15. And, to reassure Mr. Zurbrügg, this decision has nothing to do with developments in the European Union.

Finally, on the notion of deliberate intent, we fully support Mr. Gianviti’s comments.

Mr. Egilsson made the following statement:

We supported this effort last summer, and our support has not changed. We would thus like to go ahead with the decisions.

I noticed that Decision No. 1 on the provision of information is only one and a half pages long, while Decision No. 2 on the procedural framework and sanctions is almost seven pages long. Perhaps the appearance of what we are discussing here is not an example of good marketing.

If the decision on the procedures for the application of Article VIII, Section 5 were to be adopted without taking Decision No. 1, we would still be speaking about something similar. If a member is determined not to submit to the Fund the information deemed necessary for surveillance, then in the end we would want to come to some kind of a conclusion like that specified on page 12. Even if we were not looking at Decision No. 1 in the same context, we would still think that it would improve the functioning of the Fund to have some kind of a framework outlined in Decision No. 2.

For Decision No. 1, as has been said by many Directors, it is only fair that the Fund, in some way, defines every now and then what kind of information is considered as the minimum necessary, because the necessary part in the Article is an open-ended requirement. I think that, first of all, for transparency reasons, it is good to have these requirements spelled out every now and then. Second, if one would look at it in a more positive light, it is really guidance about priorities for technical assistance as has been mentioned both by Mr. Boitreaud and Mr. Rutayisire. It is not necessary to look at this in such a negative light. We have on the table the requirements that are necessary now and for the next two years, and if a member is not able to submit this information, there is a clear reason to give priority in technical assistance to that member to try to improve its capacity.

So, we should look at the decisions in a positive way, even though the seven-page sanctions do not look attractive. I would rather see them as a long and difficult road that the Fund would have to take in order to get to the final sanction on page 12, which is the compulsory withdrawal from the Fund. I could very well live with both the proposals that were made by Ms. Jacklin. What Mr. Portugal was suggesting was not unreasonable, that it has to be explicitly clear that, on this road to compulsory withdrawal, the Fund is not going after members that do not intend to submit the wrong information. I think that it has to be dealt with in the context of the capacity of the members, and, of course, it has to be a cooperative process. Only when the member is persistently determined not to submit the information, then the Fund should be sanctioning them.

Mr. Kremers made the following statement:

I think that the proposed decisions are a good reflection of what the Board concluded during the June meeting. I agreed with them then and I agree with them now as well.

I have two remarks. First, on the first decision, like others, I have doubts whether the transition period of one year applying to data commencing six months after the decision will be a realistic deadline for all member countries. Therefore, we should stand ready to assist any country that would have capacity or implementation problems when trying to deliver these data within the required time frame.

On the second decision, I think that it is fine as it is, but it could be improved with the suggestions made by Ms. Jacklin and Mr. Baukol in their preliminary statement. So, I am sympathetic to them. Also, having listened to Ms. Jacklin's comments here in the Board, I think that they will provide a somewhat clearer and more predictable framework for remedial action.

Mr. Kiekens made the following statement:

I can broadly agree with the proposed decisions, because they reflect the principal decisions reached by the Board in June. To my colleagues who believe this decision was not necessary, I would like to point out that we initially have the same view, be it, as I have explained before, for different reasons. I can assure you that this decision, as it is proposed today, enhances the legal protection for countries compared to the former stance, which was to say that the Managing Director, by delegation of the Board, determines what data the country needs to provide, and if the country does not challenge this request, it accepts that it was an obligation.

So, I repeat, we had the same starting point. It is the practical consequences from our separate interpretations that are quite different. The proposed decision is clearly giving more legal protection to countries, because it is the Board who clarifies what is required and not the Managing Director.

I have two comments on the first decision. The first comment is on item (iv): the specification, which is probably the most important one, that the country is required to provide information on revenue, expenditure, balance, and composition of financing. Then it clarifies what the composition of financing is: foreign, domestic bank, or domestic nonbank financing. The notion of foreign financing is not clarified. We all know that the currency composition of public debt is probably one of the most important aspects to determine the fiscal vulnerability and sustainability and the external vulnerability and sustainability of a country. But it is not clear what is meant by foreign financing. I refer then to data item (xi) where the country is requested to provide gross external debt. For external debt, there is a definition in a footnote. External debt is a debt owed by a resident to a nonresident, irrespective of the currency composition. For the composition of the financing of public debt, another word is indeed used; it is foreign debt. But it is not clear whether that is distinct from external debt. I repeat, external debt is clearly defined as that owed by a resident to a nonresident. Foreign debt does not necessarily refer to the currency composition of the debt because domestic debt can be denominated in foreign currencies. The point is that, in my opinion, we need more detailed information and data about the composition of the debt. Mr. Geithner in his comments to the Board had made a similar observation: he doubted that the composition of public debt was detailed enough for appropriate surveillance. I would like to see, as a minimum, the composition of the public debt in the currency in which this debt is expressed. It is not sure that the data that are requested in our decision allows for that.

This brings me to another important practical decision or question. Who has the authority to determine what these data mean in practice? It is good to say that countries need to provide data on expenditure, revenue, and balance. But we can have many methodologies for providing them. When there is doubt about how exactly to interpret what it means—the foreign debt or the external debt of a country—who has the mandate to tell the authorities that they have to provide the data in that particular way or that they have to interpret that pragmatically in such and such manner. We have no delegation of power; my assumption is that it is the Board. But here again, in practice, I am sure that the staff will clarify to the Minister of Finance how to provide the data for the reason that all other countries do it. But we probably do not have data standards for all categories established by this Board. Thus, we should clarify where the authority is in a pragmatic way. These are my comments on Decision No. 1.

On Decision No. 2, I can broadly agree with what is proposed. I think that there is a good balance in the powers or the duties of the Managing Director and of the Board. It is preferable to also give the Managing Director discretion by inviting him in that decision to act and to give an opinion. He may initiate procedures, but he is not obliged to do so. I think that that is a balanced approach. However, I would like to stress the clarification that the General Counsel has already provided, that the Board can act without the Managing Director acting. Paragraphs 11, 12, 13, and 14, say that the Managing Director may issue a complaint and recommend to the Executive Board to declare the member ineligible. In all these decisions, it is stated that the Managing Director may initiate an action, and then the Board can act. But the Board is not limited to act by the Managing Director's action, which is discretionary. I agree with the General Counsel on that interpretation. However, the decision does not reflect this clearly. I wonder whether it is necessary to clarify it in the decision or in the summing up, or if the records of this Board meeting will suffice. Indeed, the Board can act as an entity or an organ of the Fund, and any Executive Director individually can bring the issue to the agenda of the Board and any member state can act and ask its Executive Director to bring a complaint or whatever action to the Board in order to proceed with the degrees of sanctions that we provide for in Decision No. 2.

> My second comment is an assurance to Mr. Portugal that paragraph 2 of Decision No. 2 can never be interpreted against the Articles of Agreement. Articles VIII, Section 5(b) obliges the members to provide information in as detailed and accurate a manner as is practical. That is their obligation under the Articles of Agreement. No decision by the Board can go beyond that. So, nothing in paragraph 2 of Decision No. 2 can be interpreted as going beyond, over and above what is in the Articles of Agreement.

Mr. Portugal said that he agreed with Mr. Kiekens that no decision could be interpreted as against the Articles of Agreement. His only suggestion had been to use the same language that was in the Articles of Agreement to avoid any confusion.

Mr. Mirakhor, supporting Mr. Portugal's proposal, said that he was not comforted by Mr. Kiekens's assurance and could not go along with his interpretation, which seemed to differ from the view expressed at the last Board discussion.

Mr. Kiekens added that the purpose of the current Board discussion was not to reopen the whole discussion of last June, but to implement what the Board had decided at that time. In that spirit, he could go along with the decision, as it was an accurate reflection of the Board's decision in June. The interpretation that he had presented at the last Board discussion remained valid. However, the Board had taken a decision that would give more legal protection and certainty to member countries.

Mr. Mirakhor argued that the idea was not to open up the discussions of last June but to clarify the procedures for taking decisions based on the majority of the Board rather than on consensus. It would always be helpful to obtain as much clarification as possible how decisions should be taken in those circumstances for future references. Mr. Kiekens had raised a similar point in his intervention. The current discussion provided the opportunity for the clarifications to be made by the staff and Directors, which otherwise would have been absent from the record. For the future generation of Executive Directors, the discussions might prove considerably helpful. It was not necessarily a bad idea to have discussions for clarification purposes. Besides, every Executive Director had the right to raise any question anytime, and to express views as long as he or she wished.

Ms. Indrawati added that she supported Mr. Portugal's suggestion to include a reference to practicality in the second sentence of paragraph 1 of Decision No. 2, and she also supported Mr. Misra's comments on the PIN. In addition, she fully shared Mr. Portugal's and Mr. Mirakhor's views regarding the nature of the decisions currently proposed. Board discussions always provided the opportunity for Directors to present the views of the authorities in their constituencies and to raise questions and comments as they seemed fit.

The Acting Chair (Mr. Sugisaki) said that the issue currently under consideration was difficult and the Board might not be able to reach a consensus. Nevertheless, he intended to acquire as large a majority as possible on the decisions.

Extending his remarks, Mr. Kanaan made the following statement:

During the discussion of this topic last June, a large number of Directors expressed serious misgivings about the decision that was proposed then. We are disappointed that the revised proposal does not take into consideration those concerns. Since we expressed our views in detail at the June meeting, we shall be brief and associate ourselves in particular with the points made in Mr. Misra's and Mr. Ge's preliminary statements, as well as the interventions made earlier by Mr. Mirakhor, Mr. Portugal, and Ms. Indrawati.

As many Directors pointed out, the current proposal is not consistent with the well-established practice of following a consensus approach in our deliberations and decisions. This is a serious matter, especially given the concerns raised by Directors representing the vast majority of the membership about the technical and administrative constraints and burden arising from expanding the legal obligation to produce and provide such a wide range of data across the membership. We do not believe that adopting major decisions by a simple majority and without an adequate effort to build consensus would serve the institution well or contribute to a good relation between the Fund and its members. We also remain convinced that the current voluntary and case-by-case approach in dealing with data issues is more efficient and more appropriate in general than the new proposal. We, therefore, urge that any amendments of the obligation to provide data be based on a wider consensus, fully taking into consideration the concerns of member countries, be as realistic as possible in expanding the data set, and accord management and the Board sufficient flexibility in exercising judgment and not impose on them overly rigid guidelines or time limits.

We would like to emphasize the need to ensure that the institution's relations with its members continue to be guided by a cooperative approach, that our efforts to improve data should focus on the provision of adequate technical assistance, and that any benefit of the doubt be given to the member. As several Directors have mentioned, we do not find the proposed public announcements of all Fund decisions on individual cases to be appropriate. Data deficiencies are usually the result of capacity constraints. The Fund's effort should, therefore, be geared toward helping members improve their technical and institutional capacity, as underscored in Mr. Ge's preliminary statement.

Adverse public statements are a matter of particular concern in view of the definition of misreporting that is currently used by the Fund, which, in our view, is both misleading and can result in a large number of nuisance cases, which will not be excluded under the provision in the current proposal. We believe that the shortcomings of the current definition should be addressed by, for example, excluding cases where breaches are not material or would not alter the assessment leading to a conclusion of a program review. The current definition of misreporting should also be amended to take into account the authorities' intention as well as their effort to address data deficiencies within their capacity and resources.

I would like to reiterate the points I made earlier with regard to determining the responsibility for nonprovision of data or with regard to making an assessment as to whether or not the nonprovision of data was deliberate. I see an inconsistency in the proposal suggested by Mr. Gianviti. On the one hand, he explained that, if it is clear that the staff was involved or if a mistake was made by the staff in the provision of data, then the staff would not consider that misreporting has occurred. On the other hand, if the staff clearly sees that the nonprovision of data was not due to the fault of the authorities but for example to a technological or computer error, then misreporting would be declared and reported to the Board without the staff mentioning specifically that in its own judgment there was no deliberate effort to provide inaccurate information.

On the second point of Decision 2, Section 1, I agree with Mr. Portugal that it should be amended so that the last phrase would read: "the provision of information should be as detailed and as accurate as is practical in line with the Articles of Agreement." In this connection, I remember a recent case where a country provided some data on in-kind public investment with a long time lag. At the time the data were provided, the authorities and the staff considered that the data were complete and accurate, but ex post, after a while, it was the judgment of the staff that the data were not complete and therefore not accurate, in view of new information that had become available only after a long time lag. The original data can be considered "accurate" at one point but, after a certain period of time, it could be considered "inaccurate" as new data become available to staff and the authorities. As it stands, the proposed clause that says "the provision of inaccurate information" is too strict. It should be qualified by a reference to what is practical.

Finally, we do not support the suggestions made to further tighten the time frame and impose additional limitations on the discretion to issue public statements about relevant management and Board decisions with regard to possible breaches of Article VIII.

Mr. Martí made the following statement:

I will try to be brief. Let me pick up from where Mr. Mirakhor left off. This chair has a different view from the meeting of June. We were in favor of trying to make the most of the cooperative approach by the Fund, but we saw that the majority was on the other side, and we accept the decision without further comments. Our preference is clear and it is still the one that was stated previously.

Second, on Decision No. 1, I have a point of substance, which, to my surprise, has not been mentioned by other Directors. Perhaps Mr. Kiekens made a comment and I already commented on it last June. One of the data requirements in item (iv) is public debt held by residents and nonresidents respectively, including currency and maturity composition. None of the countries in my chair, including my own, is in a position to provide this information, which normally is held by markets only. This is a difficult piece of information to provide. I asked in June for a lighter wording. What we can provide only sometimes is some information on the holders of public debt. I do not know if Directors remember that we have had recently a case with Nicaragua in which this question was basic to establish the position of this Board and of the Fund related to the publication of part of the information included in the staff report. This is a serious question, and I would request that some additional thought be given to it, for instance, by rewording "currency and maturity composition," and, if possible, removing references to residents or nonresidents of the holders of debt.

Third, the language on capacity and accuracy, which is of great concern to this chair, is sufficiently well-established, but I still could easily support Mr. Misra and Mr. Portugal on their requests. If this is the way ahead in our wish to achieve a consensus, I think that it is worthwhile to clarify things. For some of the countries in my constituency, it would be much clearer if the suggested language was included in our decisions. So, I can basically support those proposals.

On Decision No. 2, in most, if not all, of the cases, the situation has to be handled at the stages prior to the report to the Executive Board. I think that this has been handled very well by the area departments and I congratulate them. It would fall on us to make the case and argue in such a way that we can actually prevent the Managing Director and the Board from getting into a more formal procedure. The only point I would like to make is that we have the same procedure in the Maastricht Treaty, and it does not seem to have worked well. So, this should encourage us to do our best if those cases come to the Board.

As to the formal procedure, I can fully support Ms. Jacklin's suggestions, as amended by herself at the beginning of the discussion. Once the Executive Board has taken the decision to issue a declaration of censure, the Board just cannot be held expectant whether the Managing Director will or will not decide to recommend the adoption of a declaration of censure; that step should follow. I could also consider different language, for instance, the Managing Director shall submit a statement to the Executive Board spelling out what his proposal or his recommendation is. He can propose to the

> Executive Board that further steps be taken in the direction of the censure, or , of course, backtrack because a satisfactory response is received, and this is already covered in the paragraph. So, in short, substituting "shall" for "may" is all right in this and the following paragraphs.

Mr. Portugal, observing that both Mr. Martí and Mr. Kiekens had referred to Footnote 2 of Decision No. 1, wondered why the staff had included the two footnotes in the decision and whether that was appropriate. Footnote 1 defined the general government, while Footnote 2 defined gross external debt; both terms were already described in other Fund documents. If the staff saw the need to provide definitions in footnotes, then all data categories should be defined in the same way, not only those two. In his view, the two footnotes should be removed from the decision.

The Acting Chair (Mr. Sugisaki) said that that issue could be addressed later.

Ms. Vtyurina made the following statement:

> Despite the fact that I have lost a bet to Mr. Mozhin on the length of this meeting, I will still be extremely brief. The brevity of my statement, however, should not be interpreted as a lighthearted approach to this delicate issue. We thank the staff for producing a set of well-balanced decisions after taking into consideration Directors' suggestions. This Chair's position did not change since the June meeting and we support the two proposed decisions. We can also go along with the suggestions of Ms. Indrawati and Ms. Jacklin and would be interested in the staff's comments on Mr. Kiekens' inquiry on the external debt issue for clarification.

Mr. Costa made the following statement:

> We thank the staff for the proposed decisions that faithfully reflect the main conclusions of our June 9 discussion on the Strengthening of the Effectiveness of Article VIII, Section 5 aimed at a greater clarification of members' legal obligations regarding the provision of information to the Fund as well as the procedural framework for addressing non-compliance with obligations under such Article. From the outset, we would like to express our support for the proposed decisions.
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> With respect to Decision No. 1, we have found Mr. Misra's statement, as well as the views of Mr. Portugal, Mr. Mirakhor, and others—in particular their view that it does not appear to be any major need for it—persuasive. For the same reason, however, it does not appear to be any major harm in adopting this decision. On the contrary, it may be helpful, to the extent that it clarifies legal obligations on the part of members regarding the provision of data, in the few cases that may arise in the future in which a member may fail to provide the required information or the information provided is inaccurate. It is important not to lose sight of the fact that we are discussing here legal matters

rather than the more broad issue of Data Provision to the Fund, which will be discussed separately early next year.

We share Mr. Misra's objection, however, to the statement in the last paragraph of the background section of the PIN saying that the present exclusion of key categories of fiscal and monetary information from Article VIII, Section 5, hinders the Fund's effectiveness in the conduct of its activities. We consider this statement to be both inaccurate and counterproductive since, in most cases, such information has been readily available. A clearer and more balanced view on the reasons for this enlarged listing of obligations to provide information should be presented in this section.

Regarding Mr. Misra's questioning about the Board's capacity to actually introduce these changes to the Articles of Agreement, we have found Mr. Gianviti's arguments convincing and share the view that there is no impediment for the Board to proceed on this matter.

Regarding the procedural framework, Decision No. 2, we share Mr. Kiekens's view that, in fact, it provides greater legal protection to members. In particular, we consider the intention to involve the Executive Director in circumstances of an apparent breach of obligation as appropriate. Similarly, giving the member time to demonstrate that it was unable to provide more accurate information and a time frame for acting on the Managing Director's report and for implementation of remedial measures on a case-by-case basis rather than under a standard timeline are also adequate safeguards. Given the importance of judgment in assessing whether a country has breached its obligations under Article VIII, Section 5, however, the importance of giving the member the benefit of any doubt should also be underscored in the decision and not just mentioned in a footnote of the text. In the same vein, we share Mr. Portugal's suggestion that the reference to accurate information be completed with the expression "to the extent that it is practical."

On the effectiveness of the decision, notwithstanding our preference for a two-year transitional period, we can agree with the proposed timing of one year after the Board approval of the proposed decision, with application to data for the relevant periods commencing six months from the date of adoption of this decision. However, given the broadening of the information members would be required to provide to the Fund and the somewhat short transition period, we should be aware of the challenge that many members may face and the likely impact that this may have on the demand for Fund technical assistance going forward. We suggest that the Public Information Notice for this meeting contains an explicit reference to the willingness of the Fund to meet the needs that may arise regarding this issue.

Mr. Reddell made the following statement:

We do not feel particularly strongly about the issues raised in this paper, but we do support both decisions. I would associate myself with the comments made earlier by Mr. Zurbrügg.

The only other point I would endorse is one that Mr. Martí raised on the resident/nonresident splits and holders of government debt. Having spent a lot of time earlier in my career trying to sort out those data on my own country, I know how extremely difficult it is to get even remotely accurate data, given serious methodological issues. Compared to other kinds of data that are listed in the proposed decision, there is much more difficulty and subjectivity involved in collecting the data in item (iv). So, it may be worth revisiting.

We could go along with the consensus on a variety of minor changes, including the transition period and the wording changes proposed by Mr. Portugal with respect to the practicality. We do not feel strongly about any of those suggestions.

Extending his remarks, Mr. Miyoshi made the following statement:

At the Chairman's request, I would like to clarify our position, but, before that, I would like to request the staff's answers to the questions we raised in our preliminary statement, particularly on the number of countries that do not currently provide the Fund with the information required in the proposed expanded list of data, on how long it would take those countries to be able to provide such information, and on the extent to which requests for technical assistance are expected to arise. I would like to have at least some sort of indication from the staff on the implications of the proposed decisions, particularly Decision No. 1. We need that information in order for us to give some thought on the transition period suggested by Ms. Indrawati and Mr. Alazzaz, and our views on Decision No. 2.

On technical points, I am wondering what the difference is, if any, between the information specified as required in the SDDS and the proposed decision. For example, for item (xii) of Decision No. 1—a consolidated balance sheet of the banking system—I remember that different words are used in the SDDS, that is, an analytical account of the banking system. Thus, I would like the staff to clarify whether there is any difference between these two.

I would also like to know the difference between item (iv) in paragraph 1 and the fiscal data that are required in the SDDS. I know that the issue here is the question of coverage, not the timeliness of data provision, but I would like to have some clarification on that.

Mr. Kiekens suggested that one sentence from the summing up of the last Board discussion should be added to Decision No. 1 for clarification, although it was not strictly necessary to do so. That sentence was: "A majority of the Board agreed that those data requirements that would be applicable to all members could be supplemented by specific data requirements for individual members if warranted by the specific circumstances of the member." The Board did not have to decide on that, as it followed from Article VIII, Section 5. That clarification could be added as paragraph 3 of Decision No. 1 and reworded as follows: "The Fund can request from individual members additional data not specified in paragraph 1 if warranted by the specific circumstances of the member." That was almost a literal reflection of what had been agreed at the June discussion.

He could support Ms. Jacklin's suggestion on paragraph 10 of Decision No. 2 to impose a 90-day deadline for the member to provide the additional data, Mr. Kiekens added.

Mr. Portugal, disagreeing with Mr. Kiekens's proposal to add paragraph 3 to Decision No. 2, said that he preferred not to include the proposed sentence that was already in the summing up. At the last Board discussion, the Board had agreed to adopt a general decision that applied to all members, and to take a decision on each specific case when the need arose. It was thus not necessary to include that in the proposed decision, as Mr. Kiekens had also admitted. Otherwise, the last part of that sentence from the summing up should also be repeated in the decision, namely, "while cautioning that the Board should refrain from excessive case-by-case specification to ensure uniformity of treatment of members."

Mr. Misra requested further clarification on the points that he had raised in paragraph 2 of his preliminary statement regarding the overlap between the new list of items and the existing one. For example, price indices specified as item (ix) of the existing list were much broader in scope and coverage than item (x) in the proposed list, which captured only the consumer price index. There were four other categories of data that were repeated in the new list, but in different terminology. The reason for changing the terminology was not clear.

Ms. Jacklin wondered whether the clause "the Managing Director may" in paragraphs 11, 13, 14, and 15 of Decision No. 2 meant that the Managing Director was always required to report the event to the Board but that it was within his discretion as to the subsequent action he would recommend. If that was the case, the language should be clarified. As currently drafted, the language suggested that it was the Managing Director's discretion to even report the state of facts to the Board.

The General Counsel (Mr. Gianviti), responding to additional questions and comments, made the following further statement:

> On the "may" versus "shall" issue, I note that we are not departing from Rule K-1, which is the general rule that binds the Managing Director. It is a rule which requires the Managing Director to report to the Executive Board any case in which it appears to him that a member is not fulfilling obligations under the Articles of Agreement, other than obligations in the

SDR Department. With respect to obligations under the Articles of Agreement, including Article VIII, Section 5, he has a duty to report.

There is a difference between informing the Board through a report that there is a breach of obligation and asking the Board to impose a sanction that requires a complaint. We are proposing to rely on the duty to report the breach of obligation under Rule K-1, and making it clear that it is optional for the Managing Director to make a complaint. It is the general principle that complaints are optional. The only exception is in the case of arrears to the Fund.

Mr. Portugal asked a question about paragraph 1 of Decision No. 2, suggesting adding "as practical as possible" as a reference to the Articles of Agreement, Article VIII, Section 5(b). Perhaps we should have realized that. We thought that the decision was self-explanatory, but maybe it is not. The proposed procedural framework deals with different types of situations, some of which involve a breach of obligation and articles, and some of which do not involve a breach of obligation because the member is unable to provide information or to provide information that is fully accurate. Paragraph 1 defines the broad scope of the decision. This decision deals with all failures to provide information, and that is explained to mean both nonprovision, not ready for it at all, or provision of inaccurate information.

We turn to cases of breach in paragraph 2. But there are other provisions in the draft decision that deal with cases where there is no breach of obligation. For example, in paragraph 6, if the Managing Director concludes that the nonprovision of information is due to a member's inability to provide adequate information—which means that there is no breach—he may so inform the Executive Board, and the Board may then, under paragraph 9, ask the member to take corrective actions. There is no obligation here, and there could also be technical assistance. So, it is important for us in the introductory paragraph to have a broad definition because we are covering both cases of breach of obligation and cases where there is no breach of obligation. That is why I do not agree with Mr. Portugal's suggestion, as it would limit the whole decision to cases of breach; the provisions that deal with other cases where the member is being asked to take corrective action without finding a breach would disappear.

Mr. Portugal remarked that the General Counsel had argued that, in addition to paragraph 2, a member's lack of capacity to provide information was also referred to in paragraph 6. However, the question of accuracy was not dealt with anywhere in the decision. The phrase "the provision of inaccurate information" in paragraph 1 went beyond the Articles of Agreement, as the latter only required member countries to provide information that was "as accurate as possible," not fully accurate. Thus, paragraph 1 of Decision No. 2 should be revised accordingly. It was doubtful who was to decide on the degree of accuracy. A country could have the capacity to provide information to the third or fourth decimal point but it might not be practical to do so. The definition of "failure to provide information" should not go beyond the obligations under the Articles of Agreement, namely, Article VIII, Section 5(b).

The General Counsel (Mr. Gianviti) clarified that Article VIII, Section 5(b) referred to "as accurate as practicable," which was different from "as accurate as practical," as it related to a question of capacity. Article VIII, Section 5(b) dealt with a member's capacity to provide information. Decision No. 2 not only provided for sanctions but also addressed cases where there was no breach of obligation, that is, where a member provided inaccurate information due to the lack of qualified staff or financial resources. In that regard, the proposed remedial framework aimed to help the member improve its data collection system, which was a constructive approach.

Mr. Portugal said that he agreed with the General Counsel on the use of the term "practicable." Nevertheless, that was still different from capacity, which was referred to in the first sentence of Article VIII, Section 5(b), namely, "In requesting information the Fund shall take into consideration the varying ability of members to furnish the data requested...." That provision also noted the level of detail and the quality of information that should be provided. It indicated that members should "furnish the desired information in as detailed and accurate a manner as is practicable."

The Acting Chair (Mr. Sugisaki) took note of Mr. Portugal's point and confirmed that, as Mr. Kiekens had pointed out, Article VIII, Section 5(b) would still apply to those cases. The decision did not have to repeat the language that was already covered by the Articles of Agreement. The requirement to furnish the desired information in as detailed and accurate a manner as practicable, as stipulated in Article VIII, Section 5(b), certainly applied to the data listed in the proposed Decision No. 1.

The staff representative from the Policy Development and Review Department (Mr. Fetherston), responding to questions and comments from Executive Directors, made the following statement:

> There was a question about requirements on timeliness and periodicity. The drafters of the Articles of Agreement, in their wisdom, did not specify any such requirements for the existing list in Article VIII, Section 5, and the staff is following the same approach with regard to the proposed expansion of the list. Thus, there will not be such requirements, in contrast to the SDDS, which is a fully comprehensive statistical standard covering periodicity and timeliness. In strengthening the legal framework, the provision only refers to the dimension of coverage.
>
> There were some questions about foreign debt and foreign financing. First, I would note that there was a concern about capturing the currency composition of debt. In the fourth line of item (iv) in Decision No. 1, there is a reference to the currency composition of the stock of central government and central government-guaranteed debt. The reference to the composition of

fiscal financing earlier in the same item is consistent with the framework that is used in the SDDS; it refers to foreign financing with the notion of residency.

There was also a concern about difficulties in determining residency of the stock of debt. This difficulty is recognized in the SDDS, which calls for dissemination of data on domestic and foreign debt "as relevant". That may mean a case where there is no foreign debt or it could also refer to situations where, for the kinds of reasons that Directors have mentioned, it is technically difficult to determine the residency of debt. This provision, as all the others, would continue to be governed by the capacity clause that has been discussed at some length.

On a question about the overlap with the existing list, one key consideration here is to provide some additional clarity in what is required. The existing list refers to gold and foreign exchange holdings; it does not refer to international reserves as such. There have been some cases where it was not clear whether a breach of obligation had occurred because of that difference in wording. The staff from the Legal Department could explain further on that.

In terms of the overlap between consumer prices and other price indices, I do not see it as an overlap, as it is an additional item. As we set out in the earlier staff paper for the June Board discussion, the staff's approach was, first of all, to focus on the list of core indicators, which includes the consumer price index. We, therefore, felt that it should be included.

As regards the number of countries that currently can provide the data in the proposed expanded list, there was some discussion on this issue in the last meeting. The staff mentioned in that meeting that, currently, about a third of the membership provides information on the general government for the Fund's statistical publications. There is nothing to update on that point.

I would mention in that context that it would not necessarily be a sensible use of scarce resources to provide technical assistance to bring countries up to the requirement, for example, on the general government in a case where this is of little significance. For many of the countries that do not provide data on the general government, this is unlikely to be an issue because the local governments are of no great significance or may not even exist.

As regards the balance sheet of the banking system, I am assured by my statistical colleagues that the proposed item is equivalent to that in the SDDS, namely, the analytical accounts of the banking system.

Mr. Portugal thanked the staff for his answer to the question on periodicity and timeliness, and for his confirmation that the staff had followed the same approach as in the Articles of Agreement. It remained unclear, however, how that would be applied in judging whether a country had breached the obligation of data provision. If the periodicity and the lag were not specified in the decision, a country might still be found in compliance with the obligation to provide information, for example, on base money or on state and local governments, even though that information was provided only every five years and with a long lag. One alternative would be to specify that members were to provide the information with the same lag and periodicity that were envisaged in those voluntary data initiatives participated by each particular member. That would provide some framework with respect to timeliness and periodicity.

The staff representative from the Policy Development and Review Department (Mr. Fetherston) explained that the proposed decision was meant to provide some protection to the member countries. The staff was cognizant of the view frequently expressed by some Directors that the Fund's data standards were voluntary. Consequently, in expanding the list of data under Article VIII, Section 5, the focus had been only on the coverage issue, to avoid giving full legal force to the currently voluntary initiatives, such as the SDDS. In applying such an approach, the case of Turkmenistan came to mind. In cases where a member provided data on a regular basis for some considerable period of time, that country had demonstrated that it had the capacity to provide the data. If it stopped providing such data, there was clearly an issue for the staff to investigate, and that was the approach taken in the case of Turkmenistan.

Mr. Kiekens, agreeing with the staff, added that the guiding rule was pragmatism and good faith. The staff was expected to apply that approach pragmatically and countries were expected to cooperate in good faith. In the end, it was the Board who would decide whether a breach of obligation had occurred, and only after a lengthy procedure. A detailed set of rules could be spelled out, but the staff had duly exercised restraint in proposing the decision for Board approval, given the intention and the calls by the Board to stress more the voluntary nature and cooperation in undertaking an essential duty, namely, Article IV consultations. On the issue of timeliness, the practice of annual consultations was in place whereby countries were required to provide the data at least on an annual basis. If an interpretation problem arose, it was the Board who would exercise wisdom and judgment.

Mr. Reddell said that he was not convinced by the staff's argument that the composition of fiscal financing in item (iv) was consistent with the framework used in the SDDS on grounds that the SDDS was entirely a voluntary standard. As the staff had pointed out, the guidelines stated where relevant or where material. The proposed decision established as a legal obligation on all countries, and thus needed some additional specificity. In areas where the data were nonmaterial or irrelevant for some countries, perhaps such data should not be in the list that would be applied to all members.

Mr. Kanaan said that Mr. Portugal had made an important point on the need to take into account the lags in providing data. In practice, data were continually being updated and revised. In cases where the data, which had been judged to be accurate at the time of the provision, had been revised after a certain lag, it was not clear how an assessment on the accuracy of data could be made and how would those revisions be treated in the proposed decision.

The staff representative from the Policy Development and Review Department (Mr. Fetherston) replied that, without going too far in the purely legal aspects of Mr. Kanaan's question, he wished to call Directors' attention to the discussion on that particular point in the June Board discussion. Data revisions and their treatment in the proposed framework had been discussed in detail in the staff paper for the June discussion, the bottom line being that any benefit of the doubt would be given to the member.

On the question about the relationship between data provision requirements and the SDDS, in drawing up the list, the staff had felt the need to have a list of required fiscal information that was considered sufficient to provide the necessary protection to the Fund in those rare cases where the framework needed to be applied, the staff representative continued. The staff paper for the June discussion provided a more detailed specification covering the general government and its subsectors. In light of Directors' preference not to go beyond the coverage requirements of the SDDS, the staff had revised the proposal for the current discussion to refer to government operations as general government operations and central government operations without requiring the data on all the lower levels of government to be provided separately.

The Acting Chair (Mr. Sugisaki) recalled that a suggestion had been made that the list of data be reviewed in three years' time. Also, Mr. Kiekens had suggested adding a new paragraph 3 referring to the possibility of requesting data that were not specified in paragraph 1, if warranted.

The staff representative from the Policy Development and Review Department (Mr. Fetherston) replied that the proposal to review the proposed list of data in three years' time was reasonable. The current discussion had focused on the need to update a list, which, in the staff's view, had become outdated. It was, therefore, appropriate to review the list on a periodic basis as some Directors had proposed.

Mr. Kiekens's suggestion for an additional sentence about the Fund requesting additional information was also a good suggestion, the staff representative agreed. However, he wished to defer to the General Counsel on the legal implications.

The General Counsel responded that some Directors had expressed reservations about that suggestion and preferred a more complete reference to the language in the summing up. In his view, there was not a need for such a provision in the decision.

The Acting Chair (Mr. Sugisaki) asked Mr. Miyoshi to clarify his authorities' position.

Mr. Miyoshi, responding to the Acting Chair's request, made the following statement:

> I would like to thank Mr. Fetherston for his comments on part of the points raised in our preliminary statement. I was at the June discussion, and I had looked at the minute of that discussion before I drafted this statement. I understand that he answered to the question of how many countries are

currently providing information on the basis of the staff proposal. I think it was Box 4 in SM/03/166. I would like to know the change in the number of countries complying with the staff proposal this time from that provided by the staff at the June discussion.

I do not think that the staff's response to our comments on the expected rise in technical assistance requests is satisfactory either and I would like to put that on record.

Nevertheless, I would like to clarify our chair's position now. My authorities instructed us to go along with the staff proposal on Decision No. 1, provided it is a consensus of the Board, and with some exceptions. With regard to the transition period, I agree with Ms. Indrawati and Mr. Alazzaz on the need for a longer period of perhaps two or three years to ensure pragmatism in the application of this provision.

With regard to Mr. Bennett's and other proposals on the periodical review of the scope of the expanded list of data, it is an interesting idea and we can support it. But, again, I think that a longer period would be necessary. I would prefer a longer period, not two or three years. Perhaps at least five or ten years would be appropriate.

On Decision No. 2, we broadly support the staff's proposed decision. Personally, I tend to agree with Ms. Jacklin and Mr. Baukol on the mandatory second warning before a declaration of sanctions (paragraph 11). But, on balance, I think that the proposed decision is well-balanced, and I particularly associate myself with Mr. Zurbrügg on this point. We should err on the conservative side in considering applying these sanctions and perhaps a longer period and greater flexibility would be appropriate.

With regard to the question of whether the Fund should take intent into consideration, I agree with Mr. Brooke that it is close to impossible to prove the intent of the government or the authorities. It would be inoperational if the Fund is to take account of a country's intent. That is also part of the reason why we think that more flexibility or a more conservative attitude is needed in the application of Article VIII, Section 5. I agree with Mr. Kiekens about the discussion on practicable and practical. Since this decision is covered by Article VIII, Section 5 itself and Article VIII, Section 5(b) basically mentions the practicability of data provision, I do not think that the additional words in the proposed decision are needed.

The Acting Chair (Mr. Sugisaki) proposed that the Board reconvene after lunch to consider the revised draft decisions. With regard to Decision No. 1, the following points had been highlighted. First, on item (iv) in paragraph 1, although the staff had already made some clarifications, Directors might still wish to comment on the question of data coverage. Second, on paragraph 2, the issue was the timing of the commencement of the periods for which the data were to be provided after the date of adoption of Decision No. 1. On this point, Ms. Indrawati had proposed one year rather than six months. Third, Mr. Kiekens had suggested adding paragraph 3, on which the General Counsel had already commented. Fourth, the review clause for the coverage of data seemed to have received fairly wide support.

With regard to Decision No. 2, Mr. Portugal had suggested two changes, one on paragraph 1 and the other on paragraph 2, the Acting Chair continued. The proposed change on paragraph 1 with respect to the provision of inaccurate information had been discussed and responded to by the General Counsel. On paragraph 2, Mr. Portugal had proposed additional language at the end of paragraph 2 to read: "In assessing the member's capacity to report the required information, judgment is needed and members should be given the benefit of any doubt."

Ms. Jacklin had made various proposals in her preliminary statement, the Acting Chair added. With regard to her proposal on the 90-day deadline for taking remedial actions in paragraph 10(c), that had been amended to apply to remedial actions under paragraph 10(b) only. Ms. Jacklin also suggested changing the word "may" to "shall," which applied to the actions by the Managing Director in paragraphs 10(d), 13, 14, and 15.

Ms. Vtyurina suggested that, as a majority of the Board was in favor of adopting both decisions, it might be more practical to give the staff more time to revise the decisions and circulate them for Board adoption on a lapse-of-time basis.

Ms. Jacklin agreed to consider those changes on a lapse-of-time basis and added that she had made a third suggestion regarding a second warning in paragraph 11, which she believed had been broadly supported by the Board. If that was the case, that paragraph should also be changed in the next version.

The Acting Chair (Mr. Sugisaki) replied that the Secretary would look at the record on that point.

Mr. Nijsse said that he supported a lapse-of-time procedure.

The Acting Chair (Mr. Sugisaki) agreed to circulate the revised decisions for Board approval on a lapse-of-time basis.

2. PARAGUAY—STAND-BY ARRANGEMENT

Documents: Request for Stand-By Arrangement (EBS/03/165, 12/8/03; and Cor. 1, 12/12/03).

Staff: Franks, WHD; Fisher, PDR

Length: 1 hour, 45 minutes

The staff representative from the Western Hemisphere Department (Mr. Franks) submitted the following statement:

> Since issuance of the staff report (EBS/03/165), the following additional information on recent developments has become available. This information does not alter the thrust of the appraisal.
>
> Inflation edged higher. Monthly consumer price inflation in November 2003 was 1.3 percent, bringing the 12-month rate to 9.9 percent. In October, producer prices rose by 2.5 percent, causing the 12-month rate to reach 16.9 percent.
>
> The guaraní has continued to appreciate against the dollar, closing at 6,050 per dollar on December 9 (up 16 percent for the year).
>
> Net international reserves were US$884 million on December 9. Although some decline may be expected in the second half of December owing to government debt service payments, reserves are likely to remain well above the program target for end-December. These additional reserves will provide an important cushion against any adverse shocks during the program.
>
> Tax revenues increased by 39 percent in November, continuing the sharply higher trend since August. Revenues in the first 10 days of December continued at roughly the same pace.
>
> Asset quality of the banking system has begun to improve. The average nonperforming loan ratio declined from 23.2 percent in September to 22.7 percent in October 2003.
>
> The 2004 budget will be approved in the coming days. A final vote in the Chamber of Deputies was taken on December 9, and the final Senate vote is expected soon. Early pressures in Congress to increase spending sharply have been defeated, and congressional leaders have assured the staff that the final version will be fully consistent with program targets.
>
> The Senate and Chamber of Deputies have both passed the Public Pension Reform Law. Slight differences in the version approved mean the law returns to the Senate for reconciliation. Passage of the law is a condition for the first review under the program.
>
> Paris Club creditors have indicated their willingness to consider granting forbearance to permit the clearance of arrears to its members in line with the program.

Mr. Le Fort and Mr. Ayala submitted the following statement:

The authorities are fully committed to address the long-term fiscal and financial weaknesses, by implementing a far-reaching economic program based on deep reforms, covering the tax system, public expenditure management, the pension fund, the state bank, and the financial system. The authorities are strongly committed to combating corruption and increasing transparency. Full implementation of the new public procurement law is included in the program agenda. The government has achieved broad political support for the economic strategy, clearly demonstrated by the full adoption of the prior actions under the program. A new Banking Resolution Law and a new Regulatory Framework for banks' assets classification and provisioning were introduced. The monetary authorities will target single digit inflation and a prudent level of official reserves. Fiscal reforms are aimed at restoring discipline, and the central government is projected to post a small surplus in 2004.

On behalf of the Paraguayan authorities, we thank the staff for a well-focused report and for its valuable advice and assistance in the design of a comprehensive reform agenda. Last year, the lack of social and political consensus made it impossible to pass key legislation, thus hindering the possibility of reaching an agreement on a Stand-By Arrangement. However, and as mentioned in our statement for the last March Consultation, Paraguay is now facing a more conducive political environment that has allowed the necessary political consensus to implement with strong ownership the authorities' economic program. Thus, after 46 years, and for the second time in the country's history, Paraguay is in a position to request the Fund Board for financial support for its economic program, this time in the form of a 15-month Precautionary Stand-By Arrangement.

Adversely affected by severe external and domestic shocks, in 2002 the Paraguayan economy experienced a significant fall in real GDP, by nearly 2½ percent, thus aggravating the already high poverty levels. Moreover, inflation jumped to 14 ½ percent, the guaraní lost 34 percent of its value and the Central Bank reserves declined to US$ 641 million, the lowest since 1993, while large domestic and external payment arrears were accumulated by the public sector. All these resulted in the downgrading of Paraguayan foreign currency debt to Selective Default. Even more, such results came after nearly 2 decades of economic stagnation and poor macroeconomic performance, owing, inter alia, to structural impediments to growth, banking sector weaknesses, governance problems, and inefficient public enterprises.

There has been a slight economic recovery in 2003, particularly owing to improvements in the global and regional conditions, a good harvest in the agricultural sector, an improved political outlook, and the first steps toward the implementation of the authorities' program. In addition, the guaraní has appreciated against the U.S. dollar by nearly 15 percent so far this year, official reserves have risen over 36 percent since end-2002, inflation rate has declined to single digit, and real GDP is projected to grow around 2 percent. However, the authorities recognize that these improvements will not be sustained unless key structural weaknesses are promptly addressed.

Since the new government took office, the authorities have focused their efforts on addressing long-term structural weaknesses and implementing adjustment measures toward economic recovery. They propose to reverse the deterioration of public finances and to improve the soundness of the financial system. It is important to mention that the government and all political parties agree on the main measures that should be taken to address the long-term weaknesses. Indeed, the agreement signed by the main political leaders backs a series of legal reforms toward the rationalization of public expenditure in the Budget of 2004, restructuring the state pension fund, modification of the tax regime, introduction of a new customs code, restructuring of the public debt, reforming state banking, and reforming publicly owned enterprises. This cross-party agreement opened the way toward defining a strong-ownership reform program. The full observance of the prior actions agreed under the program with the Fund is proof of the political support and the authorities' strong determination.

Thanks to the prudent monetary policy implemented by the new authorities, annual inflation has dropped to 9.9 percent in November, after peaking at 21 percent last April, and the guaraní has partially recovered its value after the sharp depreciation in 2002. Our authorities share the staff's concerns about inflation risks if monetary policy is not conducted appropriately, but they have taken a series of reform measures to make their operations more transparent and independent. The goal is to maintain a single digit annual inflation rate over the program period. At the same time, intervention in the foreign exchange market will be limited, mainly to avoid erratic fluctuations and to achieve the program's NIR targets. The Central Bank is developing the 2004 monetary program, and the government has agreed to coordinate the management of public sector deposits with the Central Bank to avoid generating disturbances in monetary policy or to financial institutions. In addition, the monetary authorities' will request the Fund's technical assistance for the design and implementation of the inflation-targeting regime.

Important steps have been taken to reform the financial sector and address its vulnerabilities. A Banking Resolution Law and a new Regulatory Framework for banks' assets classification and provisioning, both prior actions for the program, were recently approved by Congress and the Central Bank respectively. The law establishes clear procedures for bank intervention and resolution, creates a bank recapitalization fund to provide additional financial support to banks in difficulty, develops legal tools to allow quick transfer of deposits to other financial institutions during bank resolutions, and introduces a deposit insurance fund, among others. At the same time, new regulations on banks' assets classification and provisioning have improved prudential norms advancing to international standards. The gradual and consistent implementation of these new regulations will undoubtedly place the financial sector in a better position to confront domestic and external shocks, reinforce confidence, and improve financial intermediation. These measures will also give the supervising authorities additional tools to enhance control and more flexibility in responding to an eventual crisis.

Meanwhile, the Superintendency of Banks has been receiving considerable technical assistance from the Fund and other specialized institutions to strengthen its oversight capacity and adapt to changes taking place in the financial system. The monetary authorities are also committed to build the basis for lowering the current high lending spreads, as well as facilitating financial intermediation and the development of credit to the private sector. The authorities are confident that once macroeconomic stability is restored as a consequence of implementing a sound and credible economic policy strategy, an improved investment environment will stimulate financial intermediation by banks, thus contributing to economic recovery. The government has also requested an FSAP review mission for next year in order to improve the diagnosis and better define the financial system reforms going forward.

Regarding the Public National Development Bank (BNF), the authorities are committed to implement next year a restructuring plan supported by a US$50 million sectoral loan from the IDB. Likewise, the draft public banking law was submitted to Congress at the beginning of this month, and its approval by mid-2004 is a performance criterion under the program. It incorporates the consolidation of several public lending institutions into a retail bank for micro enterprises and small farmers, and a second tier bank to on-lend resources from bilateral and multilateral development lenders. In addition, our authorities intend to continue with additional measures in the short term to strengthen the overall financial system further, including the largest financial cooperatives.

The authorities are promptly confronting the difficult financial situation of the public sector. They have already avoided a widening of the central government deficit that, in absence of measures, would have exceeded 2 percent of GDP and resulted in the accumulation of additional arrears. The authorities' fiscal strategy is already succeeding at containing the central government deficit this year, and the program is targeting a surplus in 2004, an ambitious target that confirms the authorities' determination to restore fiscal discipline. The debt to GDP ratio, which has risen to nearly 50 percent, is to be gradually reduced beginning in 2004 as a result of the fiscal adjustment and stronger growth.

The measures already adopted in 2003 include a 6 percentage point increase in the excise tax on diesel fuel, and administrative measures to reduce tax evasion and fight corruption in the public sector, including enhancing tax audits to large companies, strengthening customs procedures and reducing the number of customs officials at border crossing, and developing a strong public campaign encouraging people's compliance with tax obligations. These measures, along with the improved economic activity, have contributed to a significant increase in tax revenues. According to preliminary data, in September, October, and November of this year, government revenues rose sharply by 36 percent, 53 percent, and 39 percent respectively, as compared to the same month in the previous year, while nominal GDP is projected to expand about 16 percent in 2003.

To confront the financial difficulties for 2003 and 2004, the authorities have successfully rescheduled with local banks and private creditors US$138 million of domestic public debt. Under the signed agreement, debt maturities due in 2005 were extended to 2008, and interest rates reduced, resulting in a slight NPV reduction. The restructuring of public debt was approved by Congress the first week of December. The Stand-By Arrangement with the Fund will contribute for the disbursement of the World Bank's and the Inter-American Development Bank's loans for US$30 million each before the end of this year. The authorities intend to clear all public external debt arrears during the program and all domestic payment arrears that go beyond a normal float. Moreover, the authorities' commitment goes beyond to assess and negotiate any disputed debt and to settle arrangements with eventual creditors. It is important to mention that at the beginning of this month, the authorities addressed a letter to the Paris Club asking for special consideration to any existing arrears, and expressed their firm commitment that, as per the program, the arrears will be gradually cleared during 2004.

Major reforms are envisaged in the public sector, including the overhaul of the public employees pension plan (the "caja fiscal"), which currently generates a cash deficit of around 1.9 percent of GDP. Draft legislation was presented to Congress this past October, and has already been approved by the Upper House. This bill will contribute to reducing the existing cash deficit and consolidate its financial position over the medium-term by, among other actions, achieving higher contribution rates, increasing retirement age, and indexing benefits to projected inflation rather than to salaries.

Draft legislation has also been sent to Congress to modify the tax regime, aimed at raising revenues, simplifying the tax structure, widening the tax base, and eliminating tax distortions. The introduction of a new customs code was also submitted to Congress this past November. It intends to enhance customs administration by simplifying import and export procedures, improving control procedures, reformulating the employees' career system, and applying the SOFIA computerized import system in full, which will help reduce corruption and improve revenues. In addition, our authorities are committed to taking further measures in 2004 to improve the efficiency of the public sector, increase transparency, and combat corruption; proof of such determination is the authorities' firm commitment to implement the procurement law fully in all public agencies by mid-2004. Our authorities have expressed their commitment to strengthen good governance. In this connection, they are making strong efforts to combat money laundering, counterfeiting, and drug trafficking in Paraguay.

The government will also expand coverage of the government's financial statistics system to all levels of government to standardize accounting practices and to establish a timely and quality information system. Public enterprises and the Social Security Institute will provide monthly financial information to the staff with a lag of no longer than 30 days after the end of each quarter. In addition, these enterprises will publish their external audit reports to enhance transparency and improve management.

In sum, the Paraguayan authorities are confident that their policy framework addresses the many challenges that the country faces. Moreover, the broad political and social consensus for implementing the envisaged reforms underlines the strong ownership of the program. The authorities request the support of the international community to complement their efforts in overcoming today's economic difficulties, reinforcing confidence, and laying the basis for high and sustained growth and poverty reduction.

Mr. Kanaan and Mr. Sakr submitted the following statement:

A combination of adverse shocks and inadequate policies has resulted in a lackluster economic performance in Paraguay over the last two decades. This performance weakened further in 2002 as reflected in a contraction of real GDP, a marked rise in the inflation rate, a depreciation of the exchange rate, an increase in unemployment, and a loss of access to capital markets. In response to this situation, the new administration initiated a positive shift in policy implementation in 2003, which, along with the regional recovery and the good harvest, led to some improvement in economic conditions, including a resumption in growth, and an increase in reserves and bank deposits. The economic situation, however, remains fragile and calls for perseverance in reform implementation in the context of the proposed arrangement.

We are pleased to note that the authorities' reform program is appropriately focused on advancing macroeconomic stabilization, while initiating important structural reforms in a number of areas that are crucial for consolidating the recent fiscal improvements and addressing the weaknesses in the financial sector. Mr. Le Fort and Mr. Ayala's insightful statement highlights the authorities' commitment to the program, which is reflected in the front-loading of key reform measures. We, therefore, support the request for a Stand-By Arrangement, and urge them to make timely progress in implementing the program to pave the way for an increased focus on other structural reforms that are essential to improve the country's growth prospects and reduce poverty. The authorities should guard against any backtracking or slowing of the fledgling reform momentum as this could raise the risks to the program and lead to a reversal of the gains achieved thus far.

The strong fiscal reforms embedded in the program are expected to result in a substantial consolidation, which would bring about a small surplus in the overall public sector balance as early as 2004 and, thus, facilitate the clearance of arrears and a reduction of public debt. It is reassuring that this consolidation, if fully implemented, is likely to be sustained in the longer run as it is based on measures that have lasting effects. We welcome in particular the measures aimed at reversing the declining trend in the efficiency of tax and customs administration, which contributed to the deterioration in the revenue-to-GDP ratio in 2002. In this connection, it is encouraging to note that the already implemented reforms of tax and customs administration have started to yield a significant increase in collection, and hope that these improvements will be sustained. The planned widening of the tax base by phasing out the VAT preferential treatment and tax holidays and introducing taxes on vehicles and personal income would go a long way in enhancing revenue in both the short and medium terms. The authorities are, therefore, urged to adhere strictly to this plan, as well as to their commitment to adjust fuel and utility prices regularly to reflect changes in costs.

With regard to expenditure, it is regrettable that financing constraints have led to a marked decline in the much-needed capital spending from its level a few year ago. To allow for a gradual increase in essential public investment, it would be necessary to further phase out non-priority outlays, including by eliminating ghost workers and launching a comprehensive civil service reform with a view to streamlining and improving the efficiency of the public sector. The reform of the pension system, which appears to be overly generous and subject to abuse, would also be crucial to improve the fiscal outlook. In this connection, we welcome the draft new public pension law that aims at raising the early retirement age and reducing the replacement rate. We encourage the authorities to spare no effort in securing approval of this law by Congress.

Adhering to the fiscal program would allow an increase in private sector credit, which has been declining over the past four years, while, at the same time, facilitating a further reduction in inflation. The latter objective should be the focus of monetary policy in the period ahead. To reduce inflation while maintaining exchange rate flexibility, it would be essential to strengthen the monetary policy framework, and secure an improved coordination with the Ministry of Finance and other public institutions, particularly with regard to the movement of public sector deposits. The latter appears to have complicated the conduct of monetary policy and posed risks for the banking sector over the last year. It would also be important to sterilize any significant unprogrammed accumulation of foreign exchange reserves in a timely fashion in order to prevent an excessive growth of money supply.

Paraguay's financial sector has suffered from successive banking crises since the mid-1990s. It is important to take steps to reduce the sector's vulnerability, especially in view of the recent increase in non-performing loans, the persisting weaknesses of the National Development Bank and a number of small finance companies, and the reduced engagement in the local market of three international banks. The unfortunate default on government bonds held by banks in late 2002, and the movement of public deposits to influence the exchange rate in early 2003 served to weaken confidence further. While these problems should diminish with progress in implementing the fiscal and monetary sector components of the program, determined reform efforts are also needed to improve the health of the financial sector. We therefore welcome the approval by Congress of the Bank Resolution Law and the recent strengthening of the management of the ailing National Development Bank, as well as the planned introduction in 2004 of a legislation aimed at facilitating the consolidation and restructuring of development banks. We are also reassured by the authorities' commitment to extend the central bank's regulatory supervision to cover the cooperative financial sector, and to strengthen prudential regulations and supervision in general. In this connection, we welcome the recent central bank resolution to improve banking supervision, and look forward to a timely approval of the new comprehensive banking system legislation.

With these comments, we once again congratulate the authorities on their commendable start in implementing the reform program, and urge them to persevere in their efforts to put the country on a sustainable path of growth and poverty reduction.

Mr. Mirakhor submitted the following statement:

The discussion of the long awaited program for Paraguay is welcome. Given the hopeful signs of modest recovery, declining inflation, currency appreciation, increase in reserves, and improvement in global and regional outlook, the time is propitious for Paraguay to embark on implementation of a comprehensive adjustment and reform program. It is highly encouraging that political consensus has emerged on a much needed and urgent set of measures to stabilize the economy.

Restoration of fiscal sustainability and reversal of rapidly growing stock of public debt are crucial to macroeconomic stabilization and to creation of a basis for sustained growth and poverty alleviation. Accordingly, fiscal consolidation and improvement in public debt management are the centerpiece of the authorities' program. Given the dire state of public finances, the combination of expenditure-reducing and revenue-increasing measures is appropriate and realistic. It is hoped that the agreement signed between the government and congressional leaders will provide a strong basis of support for a swift passage of legislations that are essential elements to the proposed arrangement. The passage of these laws will be an important signal of the strength of the agreement and of ownership as well as political commitment to implementation of policies contained in the program.

The program also includes a realistic strategy to strengthen public debt management. Limits set on contracting external debt by nonfinancial public sector entities and the commitment to no new arrears rule and to clearance of all public external and floating domestic arrears represent a healthy start on the road to establishing sound public debt management. It is also encouraging that the authorities are committed to exercise caution in considering contracting or guaranteeing new external debt.

Measures to restore effectiveness of tax administration, broaden the tax base, and introduce taxes on personal income and on vehicles are welcome. While deficit reduction efforts are necessary, Mr. Kanaan and Mr. Sakr are correct in their regret regarding the decline in capital spending, especially in view of the fact that "improving the country's infrastructure, particularly in rural areas," is a government priority. It is hoped that once the imperative of closing the financing gap is alleviated, capital expenditure will be restored to levels commensurate with the need to improve infrastructure.

Monetary policy is set to continue the prudent posture held recently, as a result of which disinflation appears firmly in place. Better focused monetary policy, in close coordination with fiscal policy, and reforms that render monetary policy more independent and transparent, including through containment of public sector's domestic borrowing, should ensure achievement and maintenance of the objective of price stability. A clear, solid, and focused monetary policy framework will also help the authorities to carry through their commendable commitment to exchange rate flexibility.

Given the high level of dollarization in Paraguay and weaknesses in the banking system, maintaining a healthy level of reserves as cushion against external shocks is prudent. Therefore, the program's objective of strengthening reserves further is appropriate. The commitment of the Central Bank to limit its intervention in the foreign exchange market should help the achievement of the reserve target of the program.

While the banking system has demonstrated a degree of resilience to repeated bouts of crises over the last decade and banks are generally liquid and well capitalized, serious weaknesses and vulnerabilities remain. The long-awaited passage of the Banking Resolution Law by Congress and the approval of the regulatory framework for banks' assets classification and provisioning are welcome. The package of further legislative and regulatory measures designed to facilitate strengthening of the banking and financial systems is well described in the staff report, the comprehensive and helpful statement of Mr. Le Fort and Mr. Ayala, and the authorities' Memorandum of Economic and Financial Policies. The passage, approval, and faithful implementation of these measures should lead to better supervised and regulated as well as much strengthened banking system. Combined with a much-improved fiscal position, these reforms, once in place, will result in emergence of an efficient, highly resilient financial sector.

Considering the focus of previous Board discussions on privatization, there is a paucity of information in the documents before us on this subject. Given the political sensitivities and potential feasibility of privatization, it is understandable that the proposed arrangement should focus primarily on achieving macroeconomic stability. The authorities have made commendable commitment to strengthen the financial position and transparency of operations of public enterprises. The staff report indicates that the authorities are studying ways and means of allowing participation of private capital and management in public enterprises. Is this strategy an alternative to privatization? If so, it is a welcome development, and it is hoped that, with the assistance of IFIs, the authorities will be able to design a framework for these enterprises to become well managed and efficient with operational transparency and private sector participation. While privatization may still be a valuable long-term goal, it is a long-held view of a number of Directors, including us, that the agency question should not be the primary focus of Fund advice, but rather efficiency, transparency, financial discipline, and economically sound pricing policy, particularly in countries, such as Paraguay, where immediate privatization is politically not feasible.

To conclude, the proposed arrangement supports a well-designed program with reasonably manageable risks, promising resolution to the many problems Paraguay faces. Resolute and unwavering implementation of policies it contains will ensure achievement of macroeconomic stabilization and lay a firm foundation for sustained growth. Best wishes for the program's successful implementation.

Mr. Reddell submitted the following statement:

It is encouraging that political change in Paraguay means we can consider a program today. Nonetheless, there are very real challenges ahead, and translating good intentions into continued ongoing consolidation and reform represents a huge challenge. We wonder about the logic of frontloading the program, when it is avowedly precautionary. On the other hand, using the available resources to clear domestic arrears might have had material payoffs. We are curious about the reasons for staff's concern at the possibility of the central bank engaging in excessive unsterilized accumulation of foreign reserves.

We wish, first, to record our disappointment that this paper, for a precautionary arrangement, is being considered by the Board only a week after the paper was made available.

After the setbacks of the last couple of years, it is most heartening that Paraguayan politics has moved on sufficiently to enable a credible program of stabilization and reform to come to the Board. The people of Paraguay, and the newly-elected government, face monumental challenges in rebuilding a moribund economy. While the work will mostly have to be done by the Paraguayans themselves, the international community and financial institutions have a useful supportive role to play.

We support the proposal before us today, to enter a Stand-By Arrangement with Paraguay (apparently its first program since 1957), and will confine our remarks today to a few points.

First, it is well to remember that it is still early days. As we have seen in all too many countries, the ability of reforming politicians to take the public with them in support of difficult and painful measures is often limited. We are encouraged by the measures taken to date, and by the expressed intention of the authorities to treat this arrangement as precautionary only. Nonetheless, the government does not command a majority in the legislature, there appears to be scope for the judiciary to delay reforms, and the power of vested interests, including those within the governing party itself, cannot be underestimated. None of these comments should be taken as skepticism about the case for the program itself, but they do suggest that the international financial community should tread carefully, and continue to monitor developments in Paraguay very closely.

With this in mind, we would welcome some staff comment on the way in which the program's disbursement schedule has been set up, with 60 percent of the total amount available on approval of the program. On the one hand, this can be seen as something of a "reward" to the authorities for the encouraging measures already implemented. However, as one of the main purposes of the program seems to be to unlock World Bank and IDB financing, we wonder why such frontloading was necessary. As the staff notes, Paraguay's problems are deep-seated and will need to be worked out over a considerable period of time. Moreover, as the recent IEO report on fiscal adjustment found, it has often proved very difficult to secure material fiscal adjustment much after the first year of a program. With all this in mind, and noting that there are very few structural performance criteria (one, to be precise) specified for the final six months of the program, we wonder whether there might not have been a case for making more of the program available rather later, and conditional on a stronger continuing program of structural reforms (we note, for example, that serious action on permanent structural reform of the important public enterprises appears to be beyond the horizon of this program).

If, on the other hand, there is thought to be a compelling case for the proposed frontloading, we wonder why the authorities were not encouraged to draw down the facility, and use at least some of the proceeds to accelerate the clearance of the high level of domestic arrears. Clearing arrears more rapidly would be likely to have had some material confidence-building benefits.

We note that under the program it is a structural benchmark that all banks obtain a credit rating from an international rating agency by the end of 2004. We have several questions about this. First, why is this a benchmark rather than a performance criterion? Second, what experience do the international rating agencies have in Paraguay? Third, what precedent is there for the Fund to make a provision of this sort a condition of a program? Coming from what was, I think, the first country to impose such a requirement, I certainly support the broad direction, but I remain a little doubtful as to just how much benefit public ratings are likely to offer in an environment where governance is weak, corruption is rife, and accounting standards are perhaps not all that they should be.

Finally, we were a little puzzled by the comment in the final "Staff Appraisal" section of the paper, in which the staff expressed concern about "the possibility that the BCP will continue to accumulate excessive foreign exchange to the detriment of the program's inflation objectives. In particular, accumulation of reserves well beyond the targeted amounts—unless sterilized—will give rise to excessive growth of the money supply and generate inflation". We assume that there is some background to this comment, and we would be grateful for the staff's comment. As it stands, however, there is no discussion of this issue in the body of the paper, and no obvious reason why we should suppose that the BCP would be oblivious to the need to sterilize foreign exchange purchases, beyond some point, if inflation is to be kept in check. We note both that inflation has settled back this year, and that earlier this year (in the Article IV) the staff was actually commending the BCP for the pragmatic and effective handling of monetary policy last year.

Mr. Alazzaz submitted the following statement:

I thank the staff for the frank and insightful report on the difficulties still limiting economic prospects in Paraguay. Output expanded this year in the country's continued cycle of modest growth succeeded by offsetting contraction. The resulting overall stagnation has been accompanied by rising inflation, a weak fiscal position, and falling reserves as well as high levels of unemployment and poverty. The staff has already helped to outline the far-reaching macroeconomic, administrative, judicial, managerial, and financial reforms that are essential to reverse the unfavorable economic trends. Indeed, last year's efforts for a stand-by arrangement failed to take effect solely for lack of the required will for action in Paraguay.

Against that background, I am encouraged by the new government's evident determination for a fresh start on a proactive approach to economic adjustments and reforms. I also take note here of the reassurances in that regard in the helpful statement of Mr. Le Fort and Mr. Ayala. While the program risks that the staff underscores are indeed significant, the Fund's support at this stage is critical for the authorities' efforts to succeed. At the same time, implementation of the proposed program is appropriately front-loaded. It is also reassuring that the authorities intend to treat the arrangement as precautionary with the requested Fund access designed to cushion any adverse balance of payments shock.

Turning to the policy priorities, I broadly agree with the staff appraisal. Given full implementation of the agreed policies, the economy would be indeed well placed to realize the expected continuation of growth next year. To that end, close monitoring of the developments and continued effective collaboration with especially the World Bank and the Inter American Development Bank are crucial. In that regard, I support the staff's suggestion for reviews on a quarterly basis. However, notwithstanding signs of an emerging policy consensus, the authorities clearly will need to exert a strong leadership to keep the program on track.

The fiscal front holds the key to overall program success. The goal of a stronger budgetary position through improved tax administration and spending controls is a challenge in view of the country's deep-seated habits of tax evasion and lax spending controls. The magnitudes of the challenge in that regard are well laid out in Box 2 and Box 3. In that connection, the Fund should stand ready to provide further technical assistance that may be necessary to help implement the policies.

On monetary policy, I welcome the authorities' determination to end the earlier ad hoc approach. Lowering the two-digit inflation rate is a priority. At the same time, it is crucial to help sustain the still fragile recovery. The authorities are therefore right to adopt a cautious approach with room for allowing a rise next year in real private sector credit. The key is to ensure policy consistency for achieving the agreed goal of exchange rate stability with reduction of the inflation rate to a single digit over the medium-term. In that connection, while recognizing the usefulness of reserves growth as a cushion against external shocks, I join the staff in stressing the costs of excessive reserve accumulation.

On structural reforms, I welcome the authorities' proactive stance, especially regarding the troubled pension plan. The progress toward reform of the national pension and health systems is therefore welcome. Regarding banking system reforms, addressing the high rate of nonperforming loans is a priority. Therefore, I welcome the progress noted in that regard in the staff supplement. On other structural reforms, the announced agenda for action is ambitious but achievable. Greater attention is also needed for restructuring the inefficient public enterprises and rationalizing the civil service.

With these remarks, I support the proposed decision and wish the authorities success.

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

We thank the staff for the well-focused report and Messrs. Le Fort and Ayala for their very helpful statement. At the outset, we want to express our support for the Paraguayan authorities' request for a precautionary Stand-By Arrangement. It would help unlocking important program loans from the World Bank and IDB, with whom arrears were fully cleared recently. These new program loans are critical not only to complete funding for 2004 and 2005, but to assure that technical assistance is available to an administration that is willing and ready to make good use of them. Moreover, the proposed economic program is a necessary and important first step to bring the country to a path of sustained economic growth.

The new administration enjoys a high degree of legitimacy and public support. Decisive moves against corruption and in the direction of structural reform were already made. In October, the President signed a political agreement with the heads of both houses of Congress and with opposition leaders to pass a series of economic laws. This agreement reflects a nascent partnership of forces in the three main parties to press ahead with stabilization and structural reform. However, the administration faces a heavy agenda, and political commitment should be critical to overcome the barriers that might lie ahead, including considerable opposition from special interests.

Paraguay is emerging from its worst recession in decades. The regional crisis and a poor harvest combined with the collapse of the third-largest bank triggered the accumulation of sizable arrears including with multilateral organizations. Public debt is mainly bilateral and multilateral, and most of it is denominated in foreign exchange (predominantly U.S. dollars), which adds to other structural vulnerabilities. Political instability and serious governance problems have overwhelmed the country in the past, together with high income inequality and widespread poverty. As regional prospects have improved, in particular those of Paraguay's main Mercosur partners, Brazil and Argentina, some progress is already underway. Growth is conservatively projected to rise to around 2½ percent in 2004 and possibly 3½ percent thereafter, while inflation should moderate. The current account should remain broadly in surplus and the capital account is expected to return to positive territory, after the strong capital flight registered in the beginning of 2003.

Looking forward, the proposed Stand-By Arrangement represents a clear opportunity to address long-standing weaknesses of the Paraguayan economy. In our view, the economic program is well-anchored on key structural reforms in the areas of tax revenue collection, expenditure control, including the social security system, and the financial system. Moreover, we strongly welcome the authorities' commitment, as expressed in Messrs. Le Fort and Ayala's statement, to fight corruption and increase transparency of the public sector.

In the first three months of the new administration, tax revenues rose by 42 percent over the previous year. Still, some formidable challenges remain, as tax and customs administration are historically very weak. Reformers with no political affiliation and with reputation for probity were named to head the Departments and deliver the restructurings needed. All auditing officials of the Large Taxpayer unit were removed, so that tax statements can be more intensively scrutinized. Collection processes were streamlined and access to main entry points was restricted to essential personnel. Most important, VAT evasion is being reduced, and all its exemptions are to be eliminated.

Exemptions to the profit tax will also be eliminated, as is the case with the small business tax that will be standardized. Striking distortions should disappear as the land rent tax and the profit tax become uniform. Still on the revenue side, a personal income tax will be introduced. On expenditure, tighter budgets should follow, as the central administration transfers less to autonomous agencies. A census of civil servants and pensioners will take place. As a consequence, the removal of sizable irregularities will be possible, reducing payroll and benefit payments. We also welcome the proposals to overhaul the pension system for public employees (caja fiscal) to bring it more in line with actuarial balance.

The proposed program appropriately focuses on strengthening the banking system. In the past, it has suffered with the absence of adequate regulation and supervision, lack of essential banking skills and fraud. Approval of the Bank Resolution Law, submission of a new Public Bank Law and Central Bank regulation on asset classification and provisioning are all prior actions under the program. Further, comprehensive bank legislation passage is also included in the structural part of the program.

We believe the proposed Stand-By Arrangement is sufficiently strong and represents an important step to stabilize the Paraguayan economy, while laying the basis for a sustained economic recovery. It is key that the Paraguayan authorities take full advantage of this opportunity to build up a strong institutional framework that can help sustain economic growth and alleviate poverty in the years to come.

Mr. Zurbrügg and Mr. Antic submitted the following statement:

The macroeconomic situation in Paraguay has slightly improved as a result of decisive measures taken by the new government. The success of the program depends heavily on how the newly elected government can build confidence in its program. Fiscal consolidation should combine measures with long-lasting effects with rapid improvements in public sector governance. Achieving a sustainable debt profile needs significant primary surpluses over the medium-term. The increased frequency of crises shows the vulnerability of a highly-dollarized banking sector. The approval of banking supervision reform and its envisaged extension to financial cooperatives should create conditions for a sound banking system. We welcome the government's request of an FSAP review for 2004.

We support the authorities' request for a precautionary Stand-By Arrangement. This will allow the authorities to be in the position to implement deep economic reforms that could produce higher growth rates and fiscal stabilization. There is a window of opportunity for a break with the past, which was characterized by low growth rates, repeated banking crises, and serious structural problems.

To implement the program successfully, the new government should garner broader public and political support. It is encouraging to see that the authorities are moving forward boldly in addressing structural and governance problems. The observation of all the prior actions and the rapid move to fulfill some of the structural conditions show that the government has so far managed to capitalize on public support.

This year's elections have helped reduce political uncertainty and enabled the formation of reform-oriented government. However, it seems that the reformist alliance is still fragile. The possibility that some strong factions within political parties that support the government are not fully committed to reform put a question mark on ownership. The strong prior actions adequately reflected the nature of these risks for the program.

The fiscal situation remains a concern, despite the partial reversal of the deterioration that had been taking place. As noted at our last meeting, we are still very concerned about the debt dynamics. Without sustained economic growth and significant primary surpluses, it will be difficult for Paraguay to service its debt. A primary surplus will be needed for several years to achieve a sustainable debt profile by the end of the decade. In that regard, the projected fiscal surplus is relatively low in comparison with the adjustment scenario given at the time of the last Article IV consultation.

We encourage the authorities to pursue reforms, which do constitute only temporary revenue enhancements or expenditure cuts, but will have long-lasting effects. The costly pensions system for state employees recorded a large deficit in 2002, highlighting the need for reform in this area. We welcome the new law that will address this issue.

Governance problems have contributed to Paraguay's poor economic performance. A strategy that combines transparency, accountability, and decisiveness is crucial to attack the problem at its roots. The steps taken in the Tax Department and Customs could have very positive effects for further civil service reform. The public enterprise sector is an appropriate candidate for similar actions.

The authorities are clearly committed to focus monetary policy on price stability. We support this change of policy and agree with the measures outlined in the program. In order for disinflation to continue, special attention will have to be paid on decelerating money growth. This also implies that fiscal policy will have to forego central bank financing. The new orientation of monetary policy needs to be embedded institutionally to make it permanent. Establishing greater independence for the BCP will be a necessary condition.

We welcome the authorities' decision to continue a floating exchange rate regime. Price stability as the foremost monetary objective will leave only a marginal role for exchange rate policy. This can mean a considerable policy limitation in times of marked currency fluctuations for a highly dollarized country like Paraguay. It is thus crucial for the authorities to make progress on all fronts (such as enhancing financial sector resilience, decreasing the debt burden, and improving debt management) to reduce the country's vulnerability to exchange rate movements.

The banking sector is rightfully considered as one of the areas that warrants special attention. It has been considerably weakened by a series of crises, which have occurred with increasing frequency. More macroeconomic stability would definitely be helpful for the banking sector to come to grips with its immediate problems. Nonetheless, this would only set the right stage for the authorities to deal with the structural deficiencies of the banking sector. These are manifold as the long list of measures in the program underscores. We are convinced that the program addresses the key issues. The authorities should implement the measures in a comprehensive and timely manner. Special attention has to be paid to the BNF, which continues to be in a dire situation. We welcome the government's request of an FSAP review for 2004.

To conclude, the program is comprehensive and the structural reform agenda is indeed very ambitious. As the main challenges are of a longer-term nature, we wonder why the staff is proposing an Stand-By Arrangement instead of an EFF. Furthermore, we wonder why the program foresees such a strong front-loading of disbursements.

Mr. Martí and Mr. Calderón-Colín submitted the following statement:

We thank the staff for a succinct paper and Mr. Le Fort and Mr. Ayala for their insightful statement.

While inserted in a region beleaguered by economic distress in the recent years and troubled by profound problems of its own, Paraguay has paid a high price for the lack of consensus in order to adopt structural reforms and solve some of the urgent matters that would position the economy back in the road of sustainable growth and could lead to future reduction of poverty.

For the first time in many years, the elements necessary to change the direction of the Paraguayan economy seem to be gathering. The broad agreement between the President and the heads of both houses of Congress, as well as that with opposition party leaders, to pass a series of important economic reform laws is encouraging and could indeed pave the way for a new start. The authorities have timely proposed an economic program with a very strong sense of ownership in a moment in which there appears to be a slight improvement in economic conditions that could very well signal the appropriate moment to take decisions and carry on with delayed reforms. They should also take advantage of the favorable political climate.

The restoration of fiscal sustainability, improvement of the efficiency of the public sector, strengthening of the banking sector, and improvement of governance and fight against corruption are all elements signaled previously by the Board as essential in a serious strategy toward economic restoration and stabilization, and which are included in the authorities' program. Furthermore, we perceive a strong sense of commitment accompanied by political alliances that could be fruitful. We support the staff's proposal to approve the request for a Stand-By Arrangement.

Not a surprise, the fiscal program is the cornerstone of the economic program. The authorities have ambitious plans that could position the public finances in a more sound position. We have a couple of comments with respect to tax policy. Although tax efficiency declined between 2001 and 2002 around 1 percent of GDP to 9.1 percent, the basic problem is that collections were already in a very low level. In this sense, we welcome the fiscal strategy to increase revenues while minimizing increases in tax rates, but acknowledge this will be a significant challenge. Of particular importance will be the enactment of the Administrative Reorganization and Fiscal Adjustment Law, which, along with the overhaul of tax and customs administration and the increase in excise taxes in fuel will increase revenues in approximately 2.9 percent of GDP. However, we remain cautious of applying an additional round of increase to the excise tax on fuel after having already modified it from 14 to 20 percent last August. We must remember that the political situation is fragile and we would not like to see the government lose support in its policies. The staff's comments would be welcome in this respect as on other options to generate the resources expected to be collected through this measure.

On the expenditure side, the government will face the challenge of closing the financing gap while addressing social needs and not affecting the much-expected return to growth of the economy. In this regard, we welcome the clearance of arrears with the World Bank and the IDB and look forward to the continuation of this action with other debtors. Of particular concern is the sizable deficit of the Caja Fiscal. The approval of the ambitious proposal presented to the Congress will be an important indicator of serious public finances improvement, while an updated and accurate database of pension claims—which should already be showing a decreasing trend with a low impact on the budget—is essential. We notice from the staff that the correct implementation of the fiscal adjustment could set Paraguay's debt to GDP ratio in adequate levels by the end of the decade and we look forward to this achievement.

On monetary policy, we welcome the authority's commitment to control inflation. However, a cautious approach should be followed in order not to fall from a remonetization phase to a monetary expansion one. As we have recommended in other cases, we would advice intervention in the foreign exchange rate markets to be carried out according to rules-based mechanisms. This is important because it would help the authorities to signal the central bank's objective to control inflation and not to target a particular level of exchange rate. Furthermore, we consider that the improvement of the central bank's credibility will depend on its performance and independence, which will benefit from a more clear legal framework.

We welcome the recent approval of the Banking Resolution Law and the new Regulatory Framework for banks' assets classification and provisioning. Such legislations should be useful to improve the current situation of the financial system, which is not very positive. We are concerned with respect to the mounting risks of the banking sector, coming from the high level of non-performing loans, the impact of holdings of domestic bonds, and the highly dollarized banking system. A small comment regarding the latter of these risks: we expected a much more thorough analysis by the staff with respect to risks arising from such a high-dollarized system than the one that appears in the report. Unfortunately, we have failed to see a consistent approach to this issue among the staff with respect to the same problem in different cases and wonder regarding the causes for such differences in analysis.

The economic program proposed by the authorities would not be complete without a profound commitment for progress in structural reforms. Paraguay has made it evident recently that an important transformation of the economy is required in order to guarantee sound and sustainable growth. This is not news for the staff, as this problem has been mentioned previously. However, perhaps a more detailed paper on the sources of growth would be interesting. The staff's comments would be welcome. Additionally, an indication of further structural reforms required would also be useful.

Finally, improvement of governance and administration of public enterprises will also be crucial for a deep transformation of the economy. We notice the authorities' acknowledgement of this problem and determination to improve on these grounds.

With these remarks, we wish the authorities success in their future endeavors.

Mr. Ondo Mañe submitted the following statement:

We appreciate the resolve of the newly elected government to rebuild the Paraguayan economy and thus emerge from a long period of economic and political hardships. Although the measures taken to date toward economic and social stability are encouraging, the economic situation remains vulnerable and notably to external shocks and calls for a vigorous reform program supported by the international financial community. The authorities' commitment to embark on a wide-ranging adjustment and reform program as described in the staff report and in Mr. Le Fort and Mr. Ayala's insightful statement is encouraging. We therefore support the request for a Stand-By Arrangement and will limit our remarks to the following few points.

The authorities have prepared a fiscal policy package to close the fiscal financing gap, pay off arrears, and place the public debt on more sustainable path. We note the improvement of the tax and customs administration along with measures aimed at the widening of the tax base, the elimination of tax exemptions including the phasing out of preferential VAT schemes, the introduction of vehicles tax, the reform of the personal income tax, as well as the increase of tax on tobacco products and alcohol are in line with the authorities' objective to contain the central government fiscal deficit. Recent increase of tax revenue, albeit modest is a sign that these measures are paying off and we encourage the authorities to spare no effort in implementing the program.

On the expenditure side, the authorities intend to improve spending through the setting of annual expenditure targets, and the Caja Fiscal Law including a law aimed at reforming the public employees' pension plan (Box 1). We are of the view that the conjunction of the tax revenue strengthening and tight control of the budget implementation will leave room for the payment of the government arrears as well as poverty reduction related spending.

We welcome the authorities' objective of strengthening international reserves. Limiting the intervention of the Central Bank (BCP) in the foreign exchange market should help reach the program's NIR targets, and cushioning international reserves is a prudent approach to maintain adequate coverage of imports in order to mitigate external shocks.

On monetary policy side, we note the need to further reform the BCP in order to enhance its transparency and efficiency, as well as its ability to conduct a more independent monetary policy. In this connection, reaching the program's inflation target will also require a more coherent monetary policy, an enhanced coordination between the BCP, the Ministry of Finance and other public sector institutions as well as the Fund technical support. However, in order to succeed in the conduct of indirect monetary policy, the authorities will need appropriate securitized instruments. To this end, we welcome measures taken by authorities in order to restore confidence among domestic bondholders by rolling over all domestic debt as new bonds carrying a maturity of 1 to 5 years.

Although the banking sector has shown remarkable resilience in the face of the economic downturn, we share the staff's concerns about the high rate of nonperforming loans and the weakness in banks supervision and in the licensing of financial institutions, and liquidity and efficiency problems of the National Development Bank (NDB). We therefore welcome the banking reform package detailed in the report, notably the Bank Resolution Law, the Public Banking Law, including the interim decision to recapitalize, modernize, and streamline of the NDB.

The government intends to implement the National Strategy of Poverty Reduction designed with the support of the World Bank and the IDB. We commend the authorities for this initiative aimed at fighting rural poverty through the enhancement of social sectors financial support, improvement of basic infrastructures, road, and housing.

Finally, we wish the authorities every success in their future endeavors.

Mr. Usman submitted the following statement:

We thank the staff for producing a comprehensive report, which adequately assesses Paraguay's economic situation and highlights the main challenges and priorities facing the Paraguayan authorities. From the onset, we support the authorities' request for a stand-by arrangement, as we are reassured by Mr. Le Fort and Mr. Ayala's in their informative statement, that the authorities are strongly committed to implement a far-reaching reform program and to combat corruption and increase transparency, and that they have achieved broad political support for their economic strategy.

We are pleased to note that the economic situation in Paraguay after experiencing an adverse recession in 2002, has improved in 2003, as growth has resumed and inflation decreased, while official reserves and bank deposits have risen. We particularly note that, since a new government took office in August 2003, a pro-reform social and political consensus has emerged, which has considerably contributed to improve the business climate and has certainly impacted positively on growth. However, the challenges facing the new authorities remain enormous, as underscored by the need to close the large financing gaps in the public sector and address the fragility of the banking sector, while creating conditions for sustained economic growth and poverty reduction, and tackling the long-standing governance problems.

We are meanwhile encouraged by the authorities' determination to implement a comprehensive and ambitious economic program aimed at stabilizing the fiscal situation and the banking system while initiating needed structural reforms. We are of the view that the program is coherent and the policies are suitable and see as particularly appropriate the fiscal policy package aimed at closing the financing gap, paying off arrears, and placing the public debt on a more sustainable path. In this connection, we believe that the government's fiscal strategy of raising revenues while minimizing increases in tax rates and addressing key issues on public expenditure management is adequate. In addition, we welcome the up-coming enactment of the Administrative Reorganization and Fiscal Adjustment Law, a key measure to broaden the base of VAT and income taxes and to strengthen tax enforcement.

Monetary and exchange rate policies are in line with the program inflation objectives and we welcome the freely floating guaraní with only limited seasonal interventions to smooth fluctuations. We note that the program appropriately establishes targets on net domestic assets aiming at bringing down the growth of money supply and estimates international reserves to increase. In addition, we believe that moving the monetary program to an inflation-targeting regime will be a step in the right direction and support the authorities' request for Fund's technical assistance to develop the necessary technical and statistical capabilities for the design and implementation of such a regime. Furthermore, we welcome the implementation of measures aiming at reforming the Central Bank with the view to enhancing its transparency, efficiency and its ability to conduct an independent monetary policy.

As regards the financial sector, we are pleased to note the important steps that have been taken to reform the financial sector and address its vulnerabilities. We specially welcome the recent approval by Congress of the Banking Resolution Law and the new Regulatory Framework for banks' assets classification and provisioning, and encourage the authorities to continue addressing other key concerns in the sector, including the weakness of the BNF, the high rate of non-performing loans and the large participation of unregulated cooperatives in the market.

The authorities' structural reform agenda under the program is ambitious. We particularly welcome the development of a comprehensive civil service reform plan and the implementation of a customs reform program. However, as staff points out and we concur, these measures are only initial steps in the context of a full modernization of the economy. We, therefore, encourage the authorities to vigorously pursue the process of structural reform, by focusing particularly on improving governance, restructuring the management of public enterprises and reforming the pension system.

With these remarks, we wish the Paraguayan authorities success in their endeavors.

Ms. Lundsager and Mr. Dohlman submitted the following statement:

In its initial months, the Paraguayan authorities have shown strong ownership and capacity to deliver reforms. Their ongoing consensus building efforts with congress and civil society have already helped secure approval of several key fiscal and banking measures as prior conditions for this program, culminating in the proposed Stand-By Arrangement before us today. The program has strong fiscal and structural adjustment and we join colleagues in supporting this request. Nonetheless, Paraguay historically has had difficulty garnering enough domestic support to implement reforms and the staff report lays out the continuing vulnerabilities; the quarterly reviews are thus appropriate in this instance.

My authorities face some difficulties in addressing this requested treatment of arrears by the Paris Club and view a Paris Club treatment on the basis of a precautionary program as highly exceptional. The Paris Club should be considered the financing source of last resort. In addition, the suggestion in the Stand-by Arrangement that bilateral creditors "forebear" on arrears is not acceptable. Financing assurances from bilateral creditors are required for this program to move forward. From our perspective, these difficulties could have been mitigated if Paris Club creditors had received earlier and clearer indications of the authorities' intentions, either from them or from the staff. Going forward, we strongly encourage the staff and the relevant country authorities to engage Paris Club creditors at an early stage in the development of programs that rely on Paris Club treatments.

Generating faster growth will be critical for both achieving sustainable debt dynamics and improving real incomes (which have stagnated). The projected 3.5 percent medium-term annual real growth path—which is initially to be driven by investment—is well above the historical average of 1.9 percent and the zero average growth over the past six years. The high level of dollarization also makes Paraguay especially vulnerable to shocks. To achieve their target, the authorities will have to maintain a strong reform trajectory well beyond the timeframe of this program. It will be particularly important to provide a more stable environment for economic activity and to convince domestic and international investors that Paraguay is a good place to do business.

By all accounts, there is pervasive corruption and weak governance in Paraguay (see Table 2) that places a significant drag on growth. The authorities' governance reform program includes a number of significant measures—including the recent replacement of heads of key agencies and reform of the large taxpayers unit, and a strengthened procurement law next year—that will limit incentives and opportunity to engage in corrupt practices. The early result from some of these measures are remarkable, namely the roughly 40 percent increase in tax revenues during the first four months of the new administration relative to the previous year. Continued progress here will be essential if this program is to succeed.

One useful step would be reform of inefficient public enterprises. This would lower costs to businesses. The authorities' plans in this area are not clear, and we understand that public perceptions toward privatization are generally negative. We recommend an early dialogue with civil society about the clear benefits of greater private sector involvement and privatization. Perhaps the planned study of participation of private sector in public enterprises, a December 2004 structural benchmark, could be sharpened in focus and accelerated. There may also be steps to raise labor productivity that should be explored.

Another key ingredient for stimulating growth will be reform of the weak financial sector. This sector has experienced repeated crises, and currently has high NPLs, inadequate provisioning, high lending spreads, and system-wide currency mismatches. The structural reform agenda in this sector is ambitious, including actual passage of important legislation rather than simple submission or further studies as we often see in other programs. The legislative agenda includes the recently approved bank resolution law and new regulatory framework, both prior conditions for this program, and two other key pieces of legislation over the coming months. The extension of regulatory supervision to financial cooperatives should help avoid further financial sector surprises.

The National Development Bank (BNF) is particularly weak, with more than half its loans non-performing. We therefore welcome the authorities' plans to work with the IDB to definitively restructure this institution. On a related point, we strongly support the authorities' request for an FSAP in 2004—this is a country that could greatly benefit. Taken as a whole, these actions, combined with fiscal adjustment that will reverse crowding out, should help increase the availability of credit to the private sector—a key goal of the authorities, as Messrs. Le Fort and Ayala note—and will reduce incentives for further dollarization of the banking system.

The authorities have an ambitious fiscal reform agenda. This is appropriate both to create room for increased growth-enhancing capital spending and to bring down debt levels. Debt has been rising at a rapid rate over the past six years, and the Annex I analysis shows that fiscal sustainability is highly sensitive to fiscal adjustment. Moreover, access to domestic and external capital markets is likely to be highly restricted given the only recently resolved default on domestic debt.

Overall, the authorities will implement fiscal measures that will generate a projected 2 to 2.5 percent of GDP in adjustment in the context of this program. Half of the fiscal adjustment target has already been achieved through successful implementation of a tax and custom administration regulatory reform—a prior condition for this program. Other planned measures include legislation to address long-standing structural problems in the public pension program, customs, procurement, fuel and utility price adjustments, and other fiscal measures. As important, the quality of the adjustment is high, relying on permanent structural changes, not one-time revenue or expenditure compression measures.

Inflation has been uncomfortably high owing to domestic shocks, weak policy implementation, and currency depreciation. The solidification of a more rules-bound approach to monetary policy—namely an informal inflation-targeting approach backed by NDA and NIR targets and a floating exchange rate—along with fiscal adjustment and exchange rate appreciation, should bring inflation back to comfortable levels. We also welcome plans to address the significant Central Bank operational weaknesses identified in the recent Safeguards Assessment. A strong, independent Central Bank with transparent objectives will be key to achieving sustainable high growth. The continued buildup of NIR over 2004—if appropriately sterilized—should provide a useful additional cushion given the high level of dollar debt and the dollarized financial system.

> We note that the authorities have received significant technical assistance from the Fund in a number of different areas. We urge the authorities to work with the staff to review advice already received, to see what might be taken on board. Finally, we urge the authorities to once again consent to publication of the staff report. This would reinforce the government's efforts to increase transparency and fight corruption.

Extending his remarks, Mr. Le Fort informed the Executive Board that the authorities had consented to the Fund's publication of the staff report under the terms of the Fund's transparency policy.

Extending his remarks, Mr. Tombini pointed out that Table 2 in the staff report on Indicators of Governance was based on a preliminary draft prepared by the World Bank, and that a qualification in that regard should have therefore accompanied the data contained in the Table.

The staff representative from the Western Hemisphere Department (Mr. Franks), in response to questions and comments from Executive Directors, made the following statement:

> In the area of fiscal policy, there was a question that came up on why the projected primary fiscal surplus in the program over the medium term is low in comparison with what the staff presented in the Article IV consultation staff report in March. There are two explanations for this. First, the debt-to-GDP ratio by 2010 in both the Article IV consultation scenario and the one that we are presenting with the program are the same. The only difference is that the situation in 2003 has improved significantly compared to what we envisaged in the Article IV consultation. Specifically, with a more appreciated exchange rate, the debt-to-GDP ratio of the largely dollar-denominated debt is significantly smaller, and there has also been a better fiscal outturn in 2003 owing to higher economic growth and the adjustment measures that are already being undertaken by the authorities. This improvement allows us to reach the same level of debt-to-GDP ratio in 2010 with a lower primary fiscal surplus. Second, the factor affecting the change in the projections since the Article IV Consultation is that interest payments are now forecast to be somewhat lower than what we had forecast them to be, which means that a lower primary fiscal surplus is consistent with a similar overall balance. This is owing to the fact that interest rates have been lower than we had anticipated, but is also owing to revisions in the data provided to us by the authorities.

> The staff was asked about the increase in the excise tax on fuel, in particular, given that one increase has already been implemented from 14 percent to 20 percent, whether there was some concern about adequate political support for an additional increase, and whether this was therefore an appropriate mechanism or whether there are other measures that should be

considered. I should stress two things. First, this additional increase in excise taxes was included in the authorities' 2004 budget, and this element of the budget has been approved already by both houses of the Paraguayan Congress, so there does seem to be congressional support for this issue. While it is true that there is always political opposition to movement of sensitive prices, as is the case with fuel, we do not anticipate that there will be a major difficulty in this area. In addition, this will leave the price of fuel and the taxation on fuels below that of neighboring countries; specifically below Brazil and Argentina. Thus, prices—even after this additional increase—will still be lower at the retail level for these fuels than in neighboring countries. It is for these reasons that the staff thinks that this additional increase in the excise tax is politically viable and also a useful way to improve the taxation profile of Paraguay.

Turning to issues of monetary and exchange rate policy, a question was raised about our expressed concern in the staff appraisal of additional reserves accumulation unsterilized beyond program targets raising the risk for inflation. The way in which the program is structured is such that the reserves target could be exceeded without necessarily breaking the net domestic assets target, and thus there is some risk that there would be a transmission of increased reserves accumulation into the growth of base money. We will monitor that very carefully. While we think it is appropriate for the authorities to try and increase their reserves and maintain a high level of reserves, sterilization will obviously be necessary to keep base money from growing at a level that is not consistent with the inflation targets, and the staff will reexamine this issue in the mission for the second review by evaluating the indicative targets on the monetary side and making them performance criteria for the remainder of 2004.

There was a question about the analysis of risks from the highly-dollarized banking system. I would say that we share Directors' concern that a highly-dollarized banking system, as Paraguay has, and as many other Latin American countries also have, is a factor that increases risks in crisis situations and the risks of adverse impacts from external shocks. Perhaps the staff report could have been more explicit. However, underlying the analysis in the staff report is the idea that the increased prudential regulation of the banking system and the increased central bank reserves anticipated under the program are two aspects of the conditionality of the program aimed at enhancing the resilience of the banking system against these shocks, given its highly-dollarized nature. In addition, we note that the authorities have requested, and the staff is planning to conduct, a Financial Sector Assessment Program (FSAP) mission during the course of the program in 2004, and we think that this will be an opportunity to look at this issue in greater detail and provide additional advice to the authorities on how to mitigate the risks from their highly-dollarized banking system.

On some other financial sector issues, there was a question about the condition in the program for requiring banks to obtain international independent credit ratings during 2004. There were several aspects to this question. One was, is this something that has precedent in Fund conditionality. I am not aware of a specific case where it was a structural benchmark or performance criterion, although there have been other cases where it has been included in Letters of Intent in authorities' plans for banking system reforms. It constitutes an element of international best practices and is a common recommendation by the missions of the Monetary and Financial Systems Department in the banking area for countries that do not do this. In this particular case, the measure was supported by the Paraguayan Bankers Association as well as by the Bank Superintendency, and thus it is not in any sense an imposition of the Fund on the authorities in this area but rather something that is supported both by the regulators and the ones to be regulated in the banking system.

A second part of the question asked about the experience of international ratings agencies in Paraguay. A number of banks in Paraguay are full-service branches of international banks, and as such they already all have international credit ratings. There are other banks, of course, that are not full branches of international banks, and therefore do not have a credit rating. Thus, international rating agencies do have some experience in dealing with Paraguayan issues. Again, the Paraguayan Bankers Association did not feel that there was any need to have additional experience with the international credit rating agencies.

Finally, there was an issue connected to this broad question regarding how international ratings might be affected by the concerns about governance in Paraguay. The staff is of the view that it is precisely in a country where internal governance concerns are very high that an international rating might provide a significant value added by having an international organization that has experience in many countries in carrying out these kinds of ratings to come to Paraguay and look in—using its international methodology—at the internal functioning of the banking system. That might well provide an added measure of transparency that may or may not be available through internal bank regulation and supervision of Paraguay's banks.

There is one other question as to why we chose that this condition should be a structural benchmark rather than a performance criterion. Given that it is a somewhat innovative measure and it has somewhat less criticality to the overall thrust of the program than some others, the staff decided that a structural benchmark in this area would probably be more appropriate than a performance criterion.

Moving to other structural reforms, there was a question about the authorities' stance vis-à-vis the privatization of public enterprises. The current authorities have taken a public view that they do not want to contemplate outright complete privatization. However, they have indicated that they are willing to look at other mechanisms for the participation of private capital in public enterprises; mechanisms such as concession contracts, capitalization schemes, partial privatization, or private management contracts. They have not yet decided exactly how they want to proceed in this area, and during the course of the program—as there is a structural benchmark in this area—they will be developing a plan for permitting private participation in these public enterprises.

There was a question whether a paper on the sources of growth would help to identify structural reforms that would guarantee sound and sustainable growth in the future. In the short run, we anticipate that the main sources of growth for Paraguay in the coming year or two will be continued strong performance in the agricultural sector, especially in the industrialized agricultural sector, which has been growing quite rapidly in recent years. We also anticipate that, with the improved confidence that is being provided by macroeconomic stability, there will be increased domestic consumption and investment as well as increased capital inflows into Paraguay. These capital inflows will also be affected by the better regional environment in which Paraguay now finds itself vis-à-vis previous years. Over the longer term, however, sustainable increases in growth will clearly require an improved efficiency in the banking system—and many of the targets in the program are designed to move Paraguay in that direction, improved public services in the public enterprises that are in key sectors of the economy, a continued effort to improve governance—including areas such as improving the rule of law and improving public sector transparency and efficiency, and finally, efforts to improve human capital in Paraguay via perhaps education reform. Progress in these areas is crucial for sustained growth in the medium and long term.

On the issue of program risk, let me just respond to a couple points and then allow the staff representative from the Policy Development and Review Department to make some comments. There was a question about the modality of the program, particularly whether or not an EFF-supported program would perhaps have been more appropriate. While we recognize that the nature of the structural difficulties in Paraguay might make that an attractive arrangement for the country, we felt that, given Paraguay's lack of track record in Fund programs and history of uneven compliance with sound macroeconomic policies, it would probably be most appropriate to begin our renewed formal relationship with Paraguay via a Stand-By Arrangement. Of course, in the future, if the authorities were interested and the program develops nicely, we could consider some other arrangement or conversion of arrangement in the future.

The staff representative from the Policy Development and Review Department, (Mr. Fisher), in response to questions and comments from Executive Directors, made the following statement:

> Ms. Lundsager noted the need for financing assurances, and of course the staff agrees fully with her in this regard. We have been informed by the Paris Club Secretariat that creditors are willing to provide a treatment consistent with the program assumptions, and thus we believe that the financing assurances have, indeed, been received.
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> Ms. Lundsager also stressed the importance of early and effective collaboration between the Paris Club and the staff. Here, too, the staff agrees fully with her. This close collaboration has served the institution well for several decades, and we must all work to ensure its continued effectiveness.
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> Mr. Reddell and others raised questions about the phasing of the arrangement. Paraguay at the moment has no credit outstanding, and is thus entitled to the first credit tranche. Our policy is that the first credit tranche is available in its entirety and is not phased. The actual proposal for the first drawing is 30 percent of quota, which is just a little bit larger than normal, but in the view of the staff is justified by a combination of the strength of the program and the high degree of dollarization in the economy.
>
> Mr. Reddell also raised a question about whether it would be appropriate to have a Fund drawing and to use that to accelerate the pay down of domestic arrears. The staff's view is that the sustained implementation of the program, including the elimination of arrears to all creditors, will be effective in rebuilding confidence; sustained adherence to the program rather than a one-off shot deal to clean out arrears quickly will be the basis for a restoration of confidence that will allow private sector activity to resume.

Ms. Lundsager asked whether the Fund's policy regarding EFF-supported programs required a member to demonstrate that its balance of payments needs were more related to structural issues rather than macroeconomic ones. If so, had the Fund ever approved a precautionary EFF-supported program?

The staff representative from the Policy Development and Review Department (Mr. Fisher) replied that the Fund had in the past approved precautionary EFF-supported programs. One such program had been approved for Peru in order to provide the resources for the Brady bonds deal. Nevertheless, until that deal was finalized the authorities treated the arrangement as precautionary.

Mr. Le Fort made the following additional statement:

> I would like to add an additional element to the discussion on using Fund financing to clear arrears. As the staff representative from the Policy

Development and Review Department has already explained, the arrears will be cleared during the program span as a result of the systematic implementation of policies and not through the use of Fund resources. Nevertheless, besides that, there is one additional element that is important to have in mind. If the program with the Fund were not to be treated as precautionary, the Paraguayan institution borrowing from the Fund would be the central bank. However, the arrears that have been accumulated are government arrears. Therefore, if the central bank were to borrow from the Fund to clear arrears of the central government, there would have to be credit from the central bank to the government, thus weakening one of the structural goals of the program, which is to develop the independence of the central bank to be able to carry monetary policy on the basis of inflation targeting. This is an important element to be taken into account when considering the design of the program and the treatment of the arrears.

The Acting Chair (Mr. Sugisaki) expressed his appreciation to the Paris Club for providing financing assurances so that the Executive Board could discuss Paraguay's request for a Stand-By Arrangement.

Mr. Boitreaud underscored that the Paris Club's treatment of providing financing assurances for a precautionary program should be considered as exceptional. It was unfortunate that the informal request had come at a relatively late date, which put creditors in a difficult situation. The Club's treatment of Paraguay would be raised at its next meeting in order to ensure that such a situation did not arise again.

Ms. Rizzotti remarked that she shared the concerns expressed by Mr. Boitreaud as well as Ms. Lundsager and Mr. Dohlman on the treatment of arrears and the modalities of the Paris Club's involvement in the case of Paraguay.

Mr. Sipko made the following statement:

Under a newly-elected reform-oriented government, the Paraguayan economy is prone to be turned around. The country is moving from economic stagnation to macroeconomic stabilization. The latest data presented by Mr. Le Fort and Mr. Ayala in their statement are encouraging. Recovery started, revenues improved significantly, and the authorities adopted a comprehensive package of legislation in the fiscal area and in the financial sector. Despite these positive developments, the main challenge for the authorities is the conversion of this legislation into real practice. Acceleration of structural reforms, continuation with fiscal consolidation, and the elimination of arrears are most important for putting the economy on a more sustainable path, which will be a crucial precondition for dealing successfully with still very high and widespread poverty. Let me make some comments on the program itself.

To stabilize the macroeconomy, fiscal consolidation is needed. We welcome the adoption of measures for the tax and customs administration as well as the measures for increasing the tax revenue. We also support the planned widening of the tax base by phasing out the VAT preferential treatment, the tax holidays, and introducing taxes on vehicles and personal income. However, we join Mr. Kanaan and Mr. Sakr and urge the authorities to adhere strictly to this plan and to commit to regularly adjusting fuel and utility prices, and to reacting to changes in costs.

Measures to set expenditures targets should be taken in accordance with revenue measures. In this connection, we urge the authorities to adopt regulations for governance improvement, including the transparency of its operations. The recently approved Public Procurement Law is a step in the right direction. We would like to encourage the authorities to start a civil service reform and prioritizing expenditure.

The progress made in adopting the legislation in the banking sector is encouraging, although, despite certain improvements in this area, the present level of non-performing loans (NPLs) is a matter of concern. Box 4 of the staff paper clearly points out the weaknesses of the banking sector. The situation is even more complicated in the National Development Bank (BNF), and we are pleased to learn from Mr. Le Fort and Mr. Ayala that the authorities are committed to implement a restructuring plan for this bank in the next year. Still, we would like to learn from the staff about the present level and future trends of NPLs in this bank.

The authorities are committed to implement the measures for improving the efficiency and increasing the productivity of public sector enterprises. To do so, we urge the authorities to create conditions for a private capital involvement in public enterprises. In addition, an independent audit for these enterprises is essential.

Deterioration of public debt and the rapid increase in the stock of public debt in recent years, from 20 percent of GDP in 1997 to almost 50 percent of GDP in 2003, is another matter of concern. We urge the authorities to eliminate new arrears in the public sector and commit to clear all public external debt arrears during the program. However, in order to realize this strategy, improvement in public debt management is greatly needed. Concerning the treatment of arrears, we associate with comments made in Ms. Lundsager and Mr. Dohlman's statement.

Our last comment concerns the National Strategy for Poverty Reduction, which needs to focus on rural areas. Based on the authorities' agreement with the World Bank and the IDB it is essential to protect social expenditure within an economic program.

Finally, based on the broad political consensus and the authorities' willingness to implement a well-designed, very ambitious, and comprehensive economic program, we support the proposed decision and we would like to wish the authorities every success.

Ms. Reichenstein made the following statement:

We support the request for a Stand-By Arrangement and welcome the authorities' intention to treat it as precautionary. Given the serious governance problems and weak policy implementation in the past, close monitoring with quarterly reviews is appropriate. We broadly concur with the staff's analysis and recommendations, and would like to add the following comments.

Fiscal adjustment is crucial for the success of the program and for the country's debt sustainability, as shown in the debt sustainability analysis. Therefore, we welcome the fiscal adjustment measures that are already implemented, and encourage the authorities to fully carry out the remaining fiscal reforms as shown in Box 2. Here, the modification of the tax regime and the overhaul of the public employees' pension plan are most important. In this connection, we call on the authorities to eliminate all remaining arrears to Paris Club members as soon as possible. We also concur with Ms. Lundsager and Mr. Dohlman's and other speakers' concerns on the treatment of arrears to the Paris Club.

High priority should be given to the reform of the Central Bank. Here, the independence of the Central Bank from political pressures and transparency of its monetary policy operations are of particular importance. Unfortunately, only one performance criterion and two structural benchmarks address this important reform of the Central Bank. In addition, only the beginning of the reform process is addressed instead of continuously monitoring the progress. Regarding the significance of such a reform for the future outcome of monetary policy, here, structural conditionality could have been more specific.

Regarding the introduction of an inflation-targeting regime, in our view, it is premature to discuss this topic now. Monetary and fiscal policies first need to reach more stability before preparations for formal inflation targeting start. In this context, like Mr. Martí and Mr. Calderón-Colín, we think that the document could have addressed the issue of a highly dollarized banking system and the related problems for monetary policy more thoroughly. The requested FSAP review mission will be useful to define the necessary financial sector reforms.

With these remarks, we wish the authorities success in implementing an ambitious reform agenda.

Ms. Gust made the following statement:

As I noted at the time of Paraguay's Article IV consultation discussion earlier this year, the staff deserves to be commended for such a well-written report. We are willing to support the request for a Stand-By Arrangement, and agree not only with the priorities for the program, but also the staff's assessed risks to the program. Consequently, I have nothing further to add on that count. Let me join with Ms. Lundsager, Mr. Boitreaud, Ms. Rizzotti, Mr. Sipko, and Ms. Reichenstein in noting that the treatment of arrears by the Paris Club is highly exceptional. Having said that, of course, my authorities certainly agree to go along with this treatment. I would like to comment on some emerging best practices contained in the staff report, and encourage their inclusion in other reports, as well as comment on Paraguay's banking sector and request for an FSAP review mission.

First, the staff report does an excellent job of describing the political difficulties that prevented the Stand-By Arrangement request from being brought to the Board before now. When we have asked in the past for more information on political economy issues, I think the information contained in the Paraguay staff report is exactly what we had in mind. I am starting to see more analysis of political economy issues; this was certainly the major theme of the informal country matters session last Friday. If the staff is looking for an example of the type of analysis that we find helpful, I would certainly recommend looking at the Paraguay staff report. As noted last week at the Board meeting on Mozambique, political stability is an important precursor for growth, and it seems to me that understanding the political situation in a country is an important job for the Fund.

Second, the focus in the program on improving governance is welcome and appropriate in light of perceptions about Paraguay's governance problems. Notwithstanding Mr. Tombini's comments on Table 2 in the staff report, I actually found this quite useful and I think that the important thing that the World Bank studies have emphasized is that it is important to look across countries, across time, and see the relative rankings. That is what one can see in this table; it is not just ordinal or cardinal rankings for Paraguay but provides indicators of some of Paraguay's neighbors, which is something I found useful. Improving governance should help to improve growth prospects and attract investment. Box 1 in the staff report outlining the authorities' planned reforms in tax and customs administration along with the background information on the need for these reforms was also very informative. The staff should consider including more information of this sort in future reports. We had asked at an earlier Board meeting about the staff's use of governance indicators, and I would be interested to have the staff's view on the usefulness and reliability of the International Country Risk Guide that was referred to in the report.

Third, I agree with Mr. Zurbrügg that the banking sector warrants special attention. The program addresses the key issues, and we urge the authorities to implement them in a comprehensive and timely manner. Related to this, we welcome the authorities' request for an FSAP review mission. We were pleased to hear earlier from the staff representative from the Western Hemisphere Department that an FSAP review mission will be undertaken in 2004 as I understand it. Given the weaknesses remaining in this sector and the concerns expressed by Directors about the risks and vulnerabilities related to it, we certainly look forward to the findings of the mission.

Finally, I welcome Mr. Le Fort's remarks that the authorities are to publish the staff report. Given that precautionary Stand-By Arrangements are meant to play a signaling role, publishing the report will benefit the authorities.

With these remarks, I wish the authorities every success in the future in addressing the challenges ahead.

Ms. Rizzotti made the following statement:

Inadequate policies, poor governance, and adverse shocks have limited Paraguay's economic performance in the past decade, and notwithstanding recent improvements, the economic situation remains fragile and the challenges ahead cannot be downplayed. However, it is encouraging that political consensus has emerged on much-needed reforms, and we welcome the authorities' commitment to stabilize the economy in addressing long-term structural weaknesses. We think that they deserve support from the international community in order to capitalize on the new favorable internal and external situation. Therefore, we support the proposed decision, hoping that the program and the close monitoring will help to keep them moving in the right direction in putting their economy on a sustainable growth path. As Mr. Reddell and Ms. Reichenstein, we are encouraged by the authorities' intention to treat this arrangement as precautionary. As we broadly agree with the thrust of the staff appraisal, we have a few questions and comments for emphasis regarding the fiscal area, monetary policy, the impact of regional developments, and banking supervision.

Fiscal consolidation is crucial in terms of debt sustainability. The sensitivity analysis clearly shows that the deterioration in the primary balance is the most dangerous factor undermining sustainability. We welcome the preliminary results of the measures already adopted to improve tax administration and broaden the tax base, and we urge the authorities to complete fiscal consolidation and avoid slippages in this area. Given their very poor past record, we particularly welcome the authorities' commitment to reduce corruption. In particular, we note that the measures undertaken in the tax and customs administration area represent a good signal, and we urge the authorities to continue their efforts in this direction.

The latest inflation data stress the need for a firmly-committed monetary policy and the importance of central bank independence. We therefore welcome the measures devoted to improving the policy framework and the commitment of the government not to interfere with monetary policy management. The fact that Paraguay is a small open economy in a region characterized by relatively high economic and financial turmoil stresses the importance of a regional approach. The staff realizes the risk of external shocks. However, especially taking into account that developments in the most important neighboring countries are subject to risks, we would appreciate it if the staff could elaborate on the expected impact on the economy and the program of a downturn in the major Mercosur countries. We would also like to hear more on the expected behavior of the exchange rate and its driving forces, given the risk added valuation would pose in terms of debt sustainability.

Finally, regarding the banking system, we welcome the focus on strengthening supervision and, in particular, its extension to cooperatives. However, given the relevance of foreign and foreign-majority banks, coordination and exchange of information with foreign supervisory bodies would be important to assess the stability of the system. The staff's comments are welcome.

With these comments, we wish the authorities a successful program implementation.

Mr. Karki made the following statement:

Paraguay's economy experienced a long period of macroeconomic stagnation over the last two decades mainly owing to serious structural weaknesses, severe external shocks, and weak economic policies. This development has resulted in decline in Real GDP, acceleration in inflation and increasing macroeconomic imbalances. However, macroeconomic situation has improved slightly as clearly indicated in the analytical staff paper as well as the insightful statement of Mr. Le Fort and Mr. Ayala. Real GDP is projected to grow by around 2 percent in 2003, while the inflation has declined to single digit and the national currency appreciated by about 15 percent with 36 percent rise in official reserves since end-2002. These developments are primarily owing to good harvest, and improved global and regional situation along with improved domestic political environment. In particular, the President signed in October this year a political agreement with the heads of both the houses of parliament with opposite party leaders to pass a series of economic reform laws. As the staff notes that it is now important to capitalize on this good start by addressing the macro economic imbalances and initiating structural reforms to move to the economy onto a path of sustained growth. In this connection the authorities, after meeting the prior actions as evident of their strong commitment to the program, have requested for a stand-by arrangement with the comprehensive package of economic reform program. Thus, we support the request for a Stand-By Arrangement, and will concentrate our comments on few areas, especially for emphasis.

We are glad to note that there is broad political and social consensus on the reform agenda as Mr. Le Fort and Mr. Ayala state in their statement that the government and all political partiers agree on the main measures and the agreement signed by the main political parties backs a series of reform toward rationalization of public expenditure for 2004, modification of tax regime, restructuring state pension fund and public debt, reforming public enterprises etc. This is a positive development that indicates successful implementation of the program. However, capacity constraint would hinder the smooth implementation of the reform program in Paraguay for which the authorities should give prior attention.

Implementing the fiscal policy prudently and especially improving fiscal situation significantly is a major challenge for the authorities. We are associated with Mr. Mirakhor's view that restoration of fiscal sustainability and reversal of growing public debt are crucial to macroeconomic stabilization and to creation of a basis for sustained growth and poverty alleviation. The government efforts toward this direction are a welcome development. As pointed out by Mr. Le Fort and Mr. Ayala in their statement, the authorities' fiscal strategy is already succeeding at containing the central government deficit this year and targeting to a surplus in next year. However, in order to achieve the targeted result in 2004, the authorities need to improve the tax efficiency and broaden the tax base on the one hand and on the other, they have to control expenditure so as to improve the public debt. In addition, the authorities have mentioned a number of fiscal measures to be undertaken in their MEFP. In light of time consuming of legal processing of these measures and some capacity constraints, the fiscal package looks ambitious. I would appreciate if the staff could elaborate on this.

As the authorities under the new government started to implement the monetary policy prudently, inflation has dropped to single digit recently. Thus, we encourage the authorities to gear the monetary policy with the formal inflation targeting in order the achieve the program objective , while we agree with the staff that the foreign exchange should be market determined with intervention limited to smoothening of seasonal fluctuations so as to maintain competitiveness and respond flexibility to external shocks. However, central banking reform is crucial in order to make the central bank more independent and effective to implement the monetary policy.

Structural reform is the centerpiece of the program. Fiscal, financial, external, public enterprises, social security, governance, each sector needs drastic reform so as to enhance sustainable growth and reduce poverty, and a series of structural reform measures have been designed accordingly. In terms of reform, they have to do a lot which requires time, resources, and capacity. However, they should implement the reform agenda in a steady and phase wise manner in order to get its effectiveness and continue the process of reform even beyond the current program so as to modernize the Paraguayan economy fully.

With these few remarks, we wish the authorities' success in implementing the reform program.

Ms. Stuart made the following statement:

We support Paraguay's request for the precautionary Stand-By Arrangement. As the staff notes, the economy needs to recover from years of weak economic policies, structural rigidities, poor governance, and stagnation. The authorities have recently embarked upon an ambitious policy agenda that attempts to address those weaknesses, and it deserves our support. The agenda rightly focuses on tackling governance issues, improving the fiscal framework, and developing the financial sector. We note that the efforts of the government thus far have had some positive effects, most especially in terms of tax revenues. However, as the staff, we note that these are initial steps, and that the reform effort will need to be deep rooted and sustained well beyond the life of this Stand-By Arrangement, which will be a very difficult economic and political challenge to manage. Given this and the vulnerability of Paraguay to shocks in addition to the high level of foreign currency debt, this is a program that does have high risks. To illustrate those risks, we felt it might have been worth using the debt sustainability analysis and expanding upon the analysis to show the impact of a no-policy-change scenario on the outlook. We felt that the debt scenarios presented in the staff report are more in line with the old template than the new one that we recently agreed to in the summer.

I have a few other specific comments on the report. First, on the fiscal side, the authorities anticipate necessarily ambitious fiscal adjustment efforts, with revenue measures yielding an additional two to two-and-a-half percent of GDP a year and maintenance of strict expenditure restraint. The durable nature of a number of the proposed measures is very welcome. Given that this is such an ambitious adjustment effort, we feel that it could have been helpful to set out in more detail how the staff and the World Bank are monitoring the poverty impact of the reforms and what measures are being taken to ensure that a robust safety net is maintained. More broadly, maintaining close engagement with the World Bank and with the IDB will be especially important as the reform effort moves forward.

Second, on monetary policy, we are concerned about the recent expansion of domestic money supply. We can see that the adjustment earlier in the year might have reflected monetization following last year's crisis. However, going forward, it will be especially important for the central bank to ensure that it adheres to targets and that domestic money growth is kept in check. In that regard, we agree strongly with the staff that it will be very important to monitor the developments of all the monetary aggregates, and we feel that it will be useful to revisit targets early in the new year and, in particular, perhaps to supplement them on the domestic side.

Third, we would like to stress the importance we attach to the recommendations of the central bank's safeguards assessment. The operational autonomy of the central bank is critical for effective management of monetary policy. The accounting recommendations are also especially important to safeguard the use of Fund resources. Thus, we welcome the performance criterion and the structural benchmarks in this area, and given the comments of Ms. Reichenstein earlier, we would welcome further staff comments on the detail going forward.

Fourth, we strongly welcome the publication of the staff report. We feel that this will assist with the outreach effort that is needed to maintain a consensus of public support behind the reform agenda. Thus, the notification that this paper will be published is extremely welcome.

Finally, we sympathize with the comments made in Ms. Lundsager and Mr. Dohlman's statement and by other speakers on the need for close coordination and early engagement with the Paris Club. It is particularly important that the Fund maintain close engagement where financing assurances are being sought.

Mr. Boitreaud made the following statement:

We would first like to thank staff for their comprehensive report, as well as Mr. Le Fort for his insightful statement.

At the outset we would like to underline our support for this Stand-By Arrangement. We welcome this deepening of the cooperation between the Paraguayan authorities and the IMF, and we are confident that it will be the starting point of greater integration of Paraguay in the global economy. The arrangement will have positive effects not only on the economy itself but also on the region, as South America is still very fragile and vulnerable to external shocks. Thus, we hope that having the international community helping the Paraguayan authorities to implement the necessary reforms should also have some positive external effects by reducing uncertainties and strengthening the whole region. We therefore support Ms. Rizzoti's remarks on the regional dimension of the program.

The economy has been deeply affected by a recession in 2002. This has pointed out two main issues: the need for structural reforms and the lack of political and social consensus on the reforms.

Regarding the latter we are pleased to see that the new administration has started building such a consensus, and the presentation of this arrangement to the board is a result, not only of this process, but also of their displayed commitment to sound policies. We would like to insist on that point as it is of paramount importance that there exist a constructive dialogue within the Paraguayan society on the needed reforms together with good cooperation between the authorities and staff.

The staff report rightly emphasizes the great vulnerability of the economy to external shocks. This fragility comes from a lack of diversification of the economy but also from a specialization in low skill intensive activities. It requires further investment in technologies and education, as underscored by Mr. Franks, and a clear view on how best to create comparative advantages in fields that will not only help to enhance growth but also reduce social and regional inequalities.

The report also rightly focuses on strengthening the banking system, which is of course a welcome step. It is of paramount importance to reform the central bank, especially if the authorities are aiming towards adopting an inflation targeting framework though, on this issue, we share the reservations expressed by Ms. Reichenstein.

In our view, the report does not address the issue of dollarization, which is nonetheless a key issue for Paraguay. The forthcoming FSAP review is therefore welcome and we look forward to its main conclusions.

Regarding fiscal policy, we welcome the steps taken to streamline public finances. We strongly support the fiscal reform proposed, that should generate additional financing sources. Nevertheless we are a bit concerned with the fact that this reform should lead to an increase of indirect taxes and more generally to an increase of taxation on the formal sector. It would also be a welcome development if staff could further elaborate how fiscal measures will lead to a 1.8 percent increase of GDP next year, and what are the precise measures that will be taken to rationalize current expenditures.

Finally on the authorities' requested treatment of arrears by the Paris Club, let me underline that a Paris Club treatment on the basis of a precautionary program is highly exceptional and that the Paris Club should be considered the financing source of last resort. Like Ms. Lundsager and Mr. Dohlman, we believe that these difficulties could have been mitigated if Paris Club creditors had received earlier and clearer indications of the authorities' intentions, either from them or from the Fund staff. Going forward, we strongly encourage the staff and the relevant country authorities to engage Paris Club creditors at an early stage in the development of programs that rely on Paris Club treatments.

With these comments we support the proposed decisions, and wish the authorities all the best.

Mr. Miyoshi made the following statement:

Paraguay has suffered from severe economic downturn over the past few years. While this is attributed partly to exogenous shocks, including drought, foot and mouth disease, and the spillover of economic crises in its neighbouring economies, Paraguay's long-standing structural vulnerabilities, such as poor fiscal performance, a fragile banking system and mediocre governance, have exacerbated the situation. Although previous governments tried to address these deep-rooted problems with possible financial assistance from the Fund, their efforts were eventually frustrated by political instability and a lack of consensus about the proper course of action to take.

It seems that the current authorities have finally managed to move on decisively to committing themselves to a credible reform program. Like other Directors, we support the proposed decision and hope that the new Stand-By Arrangement will help the authorities and the people of Paraguay to rebuild their economy and take steps forward toward poverty reduction. At this stage of the discussion, I will limit my comments to a few points for emphasis.

First, it is important for both the authorities and the Fund to bear in mind that the approval of this Stand-By Arrangement is not the end of the story, however long it has taken them to reach agreement. Although the program indeed appears strong, and the current authorities seem to have legitimacy to govern as well as full ownership of the program, its implementation is key, and the Fund needs to monitor developments closely, given the government's lack of majority in congress and an interventionist judiciary.

Second, as Mr Reddell, we would have liked to hear the staff's comments on the reason for the frontloading of disbursements in the proposed arrangement, but I thank the staff representative from the Policy Development and Review Department for his clear explanation. In another context, however, the staff representative from the Western Hemisphere Department stated that a Stand-By Arrangement is preferable to an Extended Arrangement or other long-term arrangements in view of the authorities' poor track record and uneven performance in the past. However, this comment raised the question to me as to the appropriate way to signal the Fund's assessments of countries' economies and policies. On the one hand, if the objective is to see a track record, the staff has an instrument for this purpose in the name of a

Staff-Monitored Programme. On the other hand, another main objective of this arrangement seems to be giving a "seal of approval" to the program to unlock financing from the World Bank and the IDB.

The precautionary Stand-By Arrangement may be seen as a reward to the new authorities for their encouraging initial actions. In this regard, I have the impression that management and the staff increasingly takes political economy contexts into consideration these days in judging whether and how the Fund should support the member concerned, and tends to rely on the momentum of a new government in examining the likelihood of success of the programs. This is understandable, as the feasibility of the authorities' program hinges greatly on the extent to which they can gain a momentum for reform and command strong leadership in building a consensus. Moreover, it is generally the case that the authorities' ability in implementing painful reforms is greatest in their early days. However, I do not think it appropriate for the Fund to generalise this practice easily, as the Fund's political analysis is inevitably limited in my view given the lack of expertise as well as extensive knowledge of local politics. In the extreme, relying on political grounds in making judgement could risk the Fund becoming involved in domestic political disputes and ending up being counterproductive. It could also have an adverse effect in terms of safeguarding Fund resources when the Fund's expectation of strong program implementation is unfounded.

Third, we think that the program adequately addresses key issues to the Paraguayan economy, particularly in the fiscal area. However, we note that improving governance and fighting corruption is another important issue for Paraguay. Governance of the country is one of the worst in the region, and this has significantly impeded investment and growth, both of which are essential for the country to tackle the problem of poverty. In this regard, it seems that the authorities' commitment to improving governance in this program is rather weak: full application of procurement law and development of a plan for civil service reform are only structural benchmarks, while conditionality with regard to judicial reform or anti-corruption initiatives is absent. I understand that this is a Fund-supported program and that these issues may be dealt with under the programs supported by the World Bank or the IDB, but it is not clear from the staff report whether or how these issues are addressed in those programs. We would welcome the staff's explanation on this point.

Fourth, we are somewhat sceptical about a structural benchmark that all banks obtain a credit rating from an international credit agency. This may have been intended as a complement to the authorities' efforts in strengthening banking supervision, but we are doubtful as to what degree this measure would be effective. We are not convinced that international credit agencies have experience that is substantial enough for them to make informed judgement. Nor do we think that the results of the rating will be beneficial to these banks in view of the unfavorable environment surrounding them.

Fifth, we agree with Mr Reddell's view on the staff's comments about the authorities' monetary and exchange rate policy in the staff appraisal. I thank the staff representative from the Western Hemisphere Department for his clarifications at the beginning of the meeting, but remain of the view that reference in the staff appraisal should be substantiated by discussion in the main body of the paper.

Finally, I agree with Ms Stuart's comment about the DSA (debt sustainability analysis). I also felt that the growth projections are still a bit too optimistic, and that there should have been a non-policy scenario as endorsed at the Board meeting on this issue last July.

Ms. Vtyurina made the following statement:

When analyzing the developments in the Paraguay's economy the picture of the past few years looks rather bleak. Therefore, it is fortunate for the country that the new administration has serious intentions of getting the country out of the present difficulties. On paper, the proposed reforms seem promising and, if implemented, could contribute to a rise in otherwise low living standards of the majority of the population. At the same time, the program with the Fund is not a panacea, and, as the staff rightly noted, the country will need to push through aggressively with structural reforms in years to come to achieve the aforementioned objective fully. The road of reform implementation does not look easy, as the opposition to the changes is very strong and will probably be growing as the authorities try to push ahead. We see this by far the most significant risk to the program. I will refer to this throughout my statement.

We do welcome the program, especially as it should meet the expectations of analysts and investors as it is supposed to restore order to the public finances and help avoid imminent default on the government's external debt. The program before us is appropriately ambitious and covers a broad area of marcoeconomically significant reforms. Let me start off with some comments on the modalities of the proposed arrangement. First, we see the Stand-By Arrangement arrangement as appropriate given the fact that Paraguay has no track record with the Fund (while its own reform implementation record is rather patchy) and that it has incurred arrears to other IFIs. At the same time, we are not very comfortable with the proposed enormous front-loading of the program, that is, the first credit tranche of SDR 30 million or 60 percent of the total program funds, but I take point made by the staff representative from the Policy Development and Review Department that this is a normal practice under such an arrangement. Second, we are somewhat concerned that the proposed conditionality, although strong and most appropriate in general, is bound for delays from its birth as four out of seven PCs require approval of legislation by Congress. While we accept that in October the President reached agreement with the legislators on the passage of several laws, the fulfillment of the agreement is not guaranteed and the opposition is likely to become bolder about pressing for its own interests. Therefore, I am surprised that after some debate in the Fund about the need to be very careful about including such actions in the conditionality, Paraguay's program has been much exposed to these self-induced risks. If past is a lesson, then the failure to reach agreements with the staff on two past occasions shows that the implementation of key measures depends heavily on the political opposition. I wonder thus if potential future waivers could have been avoided by making the PCs benchmarks and turning some other important conditions (that are fully in the hands of the authorities) into PCs without weakening the conditionality. We would welcome the staff's comments on these points.

Now, let me turn to some specific issues under the program. On the fiscal side, it is indeed remarkable that the initial efforts to improve tax collection have already led to a marked increase in August collections and more is to come. We do welcome the authorities' proposed measures in this area, and while some of them may seem ambitious, they say, "it is better to try and fail than not to have tried at all." At the same time, these steps entail the approval of controversial fiscal adjustment law and regular adjustments to fuel and utility prices. These measures are essential for the improvement of the fiscal situation, however, the experience shows that these are the ones that are most politically and socially difficult to gather support. In this light, I would ask the staff to comment on the groups that will be most affected by the increases and whether there are appropriate safety nets to mitigate the consequences on the poor. The improvements on the expenditure side also require the approval of some ambitious legislation. While we would like to join the staff in strongly supporting the adjustment effort, which is supposed to be underpinned by the reforms with lasting effects rather than temporary revenue enhancements and unsustainable expenditure compression, we wonder what the authorities' contingency measures are to deal with potential setbacks.

Preserving monetary stability will also be essential for the program success. The period of rapid disinflation helped to bring inflation to more appropriate levels. There could be some pressures on inflation in case of rapid foreign exchange inflows and tax rises, but overall there are good prospects for it to be under control. We note that the staff's inflation projections stand comfortably in the middle of projections by various analysts. At the same time, while we welcome the authorities' commitment to the policy geared toward controlling inflation while maintaining exchange rate stability, we are concerned that without adequate operational independence this may not be guaranteed. In this respect, we note that the reform of the Central Bank is to take place in July of the next year and that it is in fact a SB. We do wonder what such restructuring will entail in terms of the necessary legal provisions for such and how difficult would it be for the authorities to implement such an array of reforms listed in footnote 8. The banking system is in dire shape, and after five crises in the past eight years, I am surprised that there is still a banking system that is functioning. It was, thus, most appropriate to require as prior actions the adoption of two important laws to help revitalize the sector. Continuing action on this front will be necessary and we are content with the proposed reforms under the program. Now, the implementation will be key to success.

Finally, a point on privatization. I note that some of the Directors expressed some discontent with the fact that the plans for it were absent from the program. Actually, we were not at all surprised that this was indeed the case given a missive social discontent with the previous privatization process that was riddled by corruption. To this end, we see the inclusion of the measure to develop options for private participation in the state sector is the best solution at the time being in this particular situation and maybe in other Latin American country cases. We continue to emphasize that privatization without adequate safeguards is not a means to an end as it does not reach its primary objective of lessening the burden on the state and benefiting the population at large.

We wish the authorities success with program implementation.

Mr. Ross made the following statement:

I would like to join other Directors in thanking the staff for its excellent report and Messrs. Le Fort and Ayala for their reassuring statement.

At the outset, I would like to confirm our support to the requested arrangement that will be treated as precautionary. At the same time, we hold a very strong view that all stakeholders should be frank in assessing the related risks. The growth forecast is ambitious and Paraguay's economic and institutional weaknesses are deep-rooted, and more importantly, we have to admit that the track record of the authorities is yet to be established. Thus, while we lend our support to the authorities, we also urge them to adhere strictly to the program conditionality. It should also be underlined that the precautionary nature of the arrangement emphasizes the importance of the signaling role of the Fund's involvement.

On specific issues, I would like to add a few remarks on monetary and fiscal policies, and on transparency.

First, the monetary program holds the key to macroeconomic stabilization. The inflation rate should be brought down. Nevertheless, monetary policy should also create such an environment that would reduce the exchange rate volatility. This is important because the exchange rate is the main risk factor affecting the sustainability of both the budget and the financial sector. The current program envisages the restoration of international reserves to the levels in 1997. Since then, the economy has gone through severe crises, including several runs on dollar deposits and the accumulation of external arrears. These developments clearly underline the importance of the international liquidity cushion for Paraguay.

Against this backdrop, the balance between the domestic and external monetary targets is rather delicate indeed. One can argue that in the current market situation, the authorities could be in a position to reduce the vulnerability by allowing some extra build-up of the reserves (as, in fact, has already happened). On the other hand, we understand the staff's concerns on the possible impact on the money supply. Therefore, we would appreciate additional comments from the staff in this regard, especially against the apparent upward pressure on the real exchange rate. The question is, essentially, whether the main short term risks are stemming mostly from the balance sheet and cash flow mismatches, or from the perceived loss of external competitiveness owing to the higher than expected inflation (that is, if the growth of international reserves is the main factor behind the pressure on the consumer prices).

Second, it is obvious that both the fiscal and financial sector policies are crucial for the success of the monetary program. On fiscal policy, we understand that a better than expected outcome for 2003 and the renewed confidence in the authorities' policies have led to reduction of the targeted primary deficit to around 2 percent of GDP, compared to the 3.5 to 4 percent presented during the latest Article IV consultations. Of course, one can argue that a higher primary balance would reduce the net external debt and create better conditions for inflation targeting. While we broadly agree that the situation has changed, we would recommend maintaining a conservative approach. For instance, if the fiscal performance would turn out better than expected and it seems that the tax income has improved, the higher revenues should be used to increase primary surplus and to reduce external vulnerability. On financial sector policies, we welcome the authorities' request for the FSAP review that would provide the basis for the discussion on the financial stability issues.

Third, success in the fight against corruption and the economic mismanagement in general is a precondition for achieving the growth targets under the program and beyond. The structural conditionality is containing a number of measures that would tackle some very deep-rooted problems. In addition to the explicit benchmarks, we would like to emphasize the importance of publishing the full external audit reports of the public sector enterprises, especially as further privatization of public assets is not envisaged at least under this arrangement. In addition, we understand that the authorities are implementing all recommendations of the safeguard assessment during the first half of 2004, and of course assume that they will consent to the publication of the staff report and the Stand-By Arrangement in full.

The requested program, if vigorously implemented, could become a starting point for Paraguay's economic recovery and the new administration has demonstrated the welcomed initial determination. Indeed, the fulfillment of the prior actions has necessitated in a broader consensus building among the political groups. However, Paraguay's economic problems can be addressed only by strong and sustained policies over the medium term. Therefore, we are very much looking forward to the discussion on the sources of growth and the medium term tax reform during the next year's Article IV consultations.

With these words, we wish the authorities every success.

Ms. Gust supported the views of Ms. Stuart and Mr. Miyoshi on the importance of including a no-policy-change scenario in the DSA as well as the comments by Ms. Stuart and Ms. Vtyurina on the social safety net.

The staff representative from the Western Hemisphere Department (Mr. Franks), in response to further questions and comments from Executive Directors, made the following additional statement:

There was a question by Mr. Sipko on nonperforming loans, particularly in the National Development Bank. The trend in the National Development Bank in recent years has been toward increased nonperforming loans. They rose from about 45 percent of total loan portfolio in the end of 2000 to 58 percent in mid 2003. Thus, there has been a continued deterioration in this area. In mid 2003, an initial round of reform was implemented in the National Development Bank, including a change in management and a recapitalization of the Bank. In the staff's view, that is a nice first step, but it is not sufficient to deal with the problems. Hence, the program's conditionality on a total restructuring of the public development banks. Since the new management team took office in the National Development Bank, there has been some initial additional increase in nonperforming loans for two reasons. First, because lending activities have been sharply curtailed while they try to restructure the bank, and thus the denominator has declined somewhat. Second, because they have been conducting due diligence on past loans. The new technocrats in charge of the bank have been trying to clean out the accounts and in the process they have discovered loans that were previously not registered as being nonperforming and they have registered them appropriately. Thus, even though the ratio has deteriorated somewhat, in the last couple of months it has begun to decline, we think it is reflecting a number that is more reflective of the actual reality in the Bank than was the case in the past.

There was a question about the staff's view of the country risk guide. As with Table 2 in the staff report, we all need to recognize that attempts to quantify governance are inherently going to involve a certain amount of subjectivity, and they are not going to have the same precision that economic data are going to have. We all need to take that into consideration when looking at these types of indicators. It is also true that most of these types of indicators are based primarily on perceptions surveys, and thus they are not representative of what the situation actually is, but instead of what people perceive it to be in some determined survey environment. Having said that, it is important to look at these kinds of indicators as a way of, as Ms. Gust indicated, looking at comparisons across countries and also over time to gauge in some qualitative sense what is happening. While we should all take with the appropriate skepticism any particular indicator, they do provide some indication of the direction of a country with regard to governance issues and how it compares to other countries.

There were a couple of questions from Ms. Rizzotti on the effect of potential future regional downturns on Paraguay and the factors affecting the exchange rate. In terms of the regional downturn, there are several channels through which Paraguay is affected from what happens in the regional environment. Brazil is one of Paraguay's largest trading partners, and so there is a direct effect on Paraguayan exports from Brazil. Imports could also be affected if Brazil were to change its effective exchange rate vis-à-vis Paraguay. There is also a significant amount of Brazilian direct investment in Paraguay, which could also be negatively affected by a downturn. In the case of Argentina, the other large neighbor, the direct trade effects are less significant, but there is a significant component of workers' remittances from Argentina to Paraguay that was in fact negatively affected by the crisis in recent years, and although they have rebounded this year, there could in the future potentially be a risk there.

Beyond those direct effects, Paraguay during the recent crisis was affected in its banking system by the overall confidence effects in the regional banking system. There are Paraguayan banks that are partly owned by Argentine or Uruguayan banks. Thus, there could be a confidence effect that could have an impact on the banking system.

Finally, let me just mention one channel where there is not a large impact regionally, and that is that Paraguay has no outstanding commercial bonds internationally, and therefore it would not be affected by the kind of depression of bond prices and inability to place bonds on international markets in the same way that other countries in the region might be affected by this type of contagion. Paraguay's indebtedness is essentially largely either domestic, multilateral, or bilateral, and as a result is not as sensitive to contagion.

We did a back-of-the-envelope estimate of the impact of a downturn in either Brazil or Argentina on Paraguay, and the results that we get are that the direct effects are relatively small. For example, a one percent decline in the Brazilian growth rate would affect Paraguay on the order of one quarter of a percent. Of course, that does not take into account indirect effects. Likewise, with the case of Argentina, it was somewhat smaller, around 0.15 percent direct decline in Paraguayan growth as a result of a decline of one percentage point in Argentine growth. However, this does not take account of the more indirect confidence effects that could obviously multiply that effect.

In terms of factors affecting the exchange rate, on the export side, Paraguay's export revenues are highly sensitive to international commodity prices on its main agricultural exports, specifically soybeans, cotton, and beef. In addition, they are sensitive to the weather effects that might affect the quantities of those products exported. Thus, those are some of the main susceptibilities on the export side. On the import side, Paraguay produces no petroleum products internally, so it is completely subjected to fluctuations in international oil prices, which can also affect the exchange rate. These are the main factors affecting the exchange rate. Let me make one final comment about the exchange rate, and that is that while the currency has appreciated sharply against the U.S. dollar this year, the appreciation of the guaraní against the dollar is not out of line with the appreciation of the euro against the dollar or the appreciation of the Brazilian real or the Argentine peso. Thus, in trade-weighted real effective terms, the appreciation is not yet something that is a matter of concern for the overall competitiveness of Paraguay.

There was a question about the ambitiousness of the fiscal program. Several Directors have commented that the fiscal program is ambitious, some in a complimentary fashion and others with some concern. Our view is that it is an ambitious fiscal program. There are risks with an ambitious fiscal program, but it is a program that is largely reflecting of the authorities' own drive to improve their fiscal situation, something that we feel that we should support. It is possible that at some point in the future compliance on all items in the program might not be complete, and there might have to be a request for a waiver. However, I think that at this stage it is really important that the staff support the authorities' ambitiousness in this proposal. Given the Independent Evaluation Office's recent report suggesting that up-front fiscal reforms tend to be the only ones that are successful in programs, perhaps it is encouraging that this fiscal adjustment is ambitious and front loaded in that respect.

There was a comment about wanting some additional detail going forward on the safeguards assessment. If I could, I would like to tie that with a question that was raised about central bank restructuring, because those two issues are very closely related. The central bank board has accepted formally the safeguards assessment recommendations of the Fund, and has committed as central bank policy to implementing those recommendations. As Directors will have noted, several of the key recommendations in the safeguards assessment report are included as conditionality in this program. In specific terms, some of the most important aspects are an autonomy agreement, which was to be signed between the central bank and the Ministry of Finance, allowing—within current legislation—greater operational autonomy and budgetary autonomy for the central bank; changes in the central bank's accounting practices, which will bring them into line with international best practices; and the requirement that external independent audits of the central bank be conducted every year.

In terms of other reforms in the central bank, the central bank authorities are drawing up plans for the restructuring of the central bank staff, which will involve several goals. One is to address the issue of overstaffing in certain areas and of the lack of qualified personnel in certain areas in order to try to improve both the quality of central bank staffing and make the central bank staff more efficient. A related issue to this is to increase the staff devoted to banking supervision in the central bank and reducing staff in other areas where there is an excess of personnel as well as to increase technical capabilities within the central bank, which will allow it to begin the process of converting to formal inflation targeting. Those are some of the main areas of central bank restructuring and implementation of the safeguards assessment report.

The safeguards assessment report views that in the medium and long term it would be ideal to change the charter law of the central bank, as that would be a better long-term solution for providing increased central bank independence. As an intermediate arrangement, there is an agreement that will be signed between the Ministry of Finance and the central bank in this regard. It is also contemplated that going forward in 2004 consideration would be given to possibly sending legislation to Congress on amending the central bank reforms, but that is not specifically in the conditionality of the program.

Mr. Miyoshi asked for an elaboration of the governance issues under the program, and perhaps we were not clear in the staff report in this area. The staff's view is that a number of the important reforms in the fiscal area and in the central bank are, in fact, important for governance, and will have a major impact on the governance issue, specifically, the reforms of tax and customs administration, which traditionally in Paraguay have been centers of corrupt activities, a lack of transparency, and inefficiency. Undertaking these important administrative reforms, which are now underway, would have a positive impact on governance. Likewise, corruption has been rife in some areas of the public pension system, and the reforms for that system are designed in part to address the governance concerns there as well as the fiscal impact that they could have. In the central bank, as I mentioned a minute ago, we have strengthened auditing requirements, as well as data publication requirements, and improved accounting standards, which will also improve transparency in that area. Finally, as was mentioned by some of the Directors, there is a comprehensive requirement for external audits of public enterprises, the central bank, and certain key public sector institutions, such as the Social Security Institute, which provides pensions to private sector employees, another area where there are large concerns about governance. The external audits of these institutions will provide a basis for future reforms and will help make the accounts of those institutions more transparent.

There was a comment about the performance criteria (PCs) that require congressional action. I share the view that there are certain risks in having legislative passage of certain laws be conditionality under a Fund program. Our view in this case is that the particular measures that are PCs under the program are absolutely crucial to attain the program objectives, specifically in the area of banking reform and the area of fiscal adjustment. For this reason and given the lack of political consensus in the past, we felt that it was important to put absolute priority in terms of our conditionality on those areas.

There was a question about the fuel tax increases and who could potentially be affected by the fuel tax. The fuel tax is, as I mentioned earlier, lower than in neighboring countries. The increases that are contemplated under the program would still leave them somewhat below neighboring countries. The main areas that would be affected by the fuel tax would be transport and the agricultural sector, especially the mechanized agricultural sector. It is the staff's view that the increase in fuel taxes in Paraguay is not a particularly regressive tax because the consumption of fuels is also highly concentrated in the prosperous mechanized agricultural sector as opposed to the peasant agricultural sector, and is highly concentrated in consumption by private automobiles versus on a per-person basis vis-à-vis the consumption by, say, public transportation systems. Thus, in our view the raising of the fuel tax is not a particular concern from a distributional standpoint. Paraguay is not a country where heating oil, for example, is consumed by people given the climate there, so that is another area where it is not particularly a distributional concern. I will say, though, that we have not done an intensive study of this issue.

Ms. Vtyurina asked whether increases in utility prices would affect the poor disproportionately.

The staff representative from the Western Hemisphere Department (Mr. Franks) replied that increases in electricity prices would affect the poor. However, the public enterprises in the electricity sector and in the water sector had special rates for small consumption in poor areas, and that would continue to be the case under the program.

The staff representative from the Policy Development and Review Department (Mr. Fisher), in response to further questions and comments from Executive Directors, made the following additional statement:

> Mr. Miyoshi raised a question about the possibility of a staff-monitored program (SMP) instead of a precautionary arrangement. The Fund no longer has signaling SMPs. Nonetheless, it would have been possible to have had a track record SMP. However, in the staff's judgment, the authorities' capacity and commitment to implement the program are sufficient to warrant a credit tranche arrangement.
>
> I would also note that there are at least two advantages of having a precautionary arrangement over a SMP. First, making resources available under a Stand-By Arrangement helps give the authorities comfort to sustain the implementation of their policies, and that is of course fully consistent with the purposes of the Fund. Second, Paris Club creditors are generally only willing to provide a debt treatment in the context of another credit tranche arrangement and—with one very special exception—are not willing to provide such treatment in the context of staff-monitored programs.

The Acting Chair (Mr. Sugisaki) made the following statement:

> The current administration in Paraguay has been making remarkable progress. That is the reason why the need for a program is less acute than the previous occasion when we submitted a draft Letter of Intent to the Board that was never discussed, which was last August, because the administration at that time was not able to fulfill the prior actions. The prior actions proposed at that time were similar to the ones we have proposed for this program, and which were all implemented. Thus, compared with the previous administration, this administration has been doing great. The strengthening of tax administration has already produced a sizable tax revenue, which is remarkable. Therefore, the question arises whether we really need a precautionary Stand-By Arrangement or not. While the authorities may have passed the crisis period, but their situation is still precarious. That is the reason why we think the Stand-By Arrangement is appropriate, and given the strong action that will be needed to have an EFF-supported agreement, which should include more elements of structural reforms, we thought that it was up to the authorities to seek an EFF at this stage. Thus, the overall assessment is that the country is doing much better than it was before, and, in my view, the authorities deserve Board approval of this arrangement.

Mr. Le Fort made the following concluding statement:

> First, I would like to thank my colleagues at the Board for their very helpful and constructive statements and especially for their support to my Paraguayan authorities' economic program.

As it was said in the discussion, indeed this Board meeting is not an end in itself. However, it is a very important moment. For many years Paraguay has waited for a moment like this when a strong government with broad political support is firmly committed and convenes in making the necessary reforms to place the country in a stable growth path with macroeconomic stability. We think that this is possible now that the support of the international community is being secured. The authorities' strong determination has already been demonstrated, not only in the commitments undertaken in the program, but also in the deliveries that they have already been able to make in terms of prior actions.

Our authorities are aware that this program is not going to be an easy challenge, but are confident that their economic strategy and their political support will be sufficient for a successful program implementation and to yield the results that are expected from them.

It was asked during the discussion about what would be the authorities' response if there were fiscal overperformance, that is, tax revenues being greater than originally expected under the program. This question is already indicative of what could be expected from the implementation of this program and what the initial results are. However, it is always wise to stick by the notion that it is better not to count the chickens before the eggs hatch, and to be very careful in keeping the momentum and advancing the implementation of the program. I am sure that my authorities are going to be very happy to discuss with the staff what to do in case things go even better than they have programmed.

The government of Paraguay has already expressed its great appreciation to the Paris Club creditors for their understanding and support of the program, and the government is fully committed to respond to their trust.

Finally, on behalf of my authorities, I would also like to express their sincere appreciation to the staff for its permanent support and to management for its involvement in giving advice on confronting Paraguay's problems effectively. Their support and technical advice have been crucial to develop this program, and they already are counting on continuing to receive it in the period ahead.

Likewise, I thank my colleagues for their constructive remarks in today's discussion that, as usual, are going to be conveyed to my Paraguayan authorities. As I said, international support is a key element for the success of this program, and to give the opportunity to this country to establish a path of reforms and discipline toward securing macroeconomic stability and growth.

The Acting Chair (Mr. Sugisaki) made the following summing up:

Executive Directors observed that Paraguay is attempting to emerge from a long period of economic stagnation, characterized by adverse shocks, weak economic policies, and structural rigidities. They noted that improved economic and political conditions present a valuable opportunity to address underlying problems, and they endorsed the objectives of the authorities' program to achieve macroeconomic stability while undertaking structural reforms to raise growth, reduce poverty, and improve governance. Directors commended the government's efforts to forge a broad consensus with the Congress, political leaders, and key elements of civil society around its reform plan.

Directors supported the program's fiscal objectives to achieve a significant improvement in the public sector balance, including a balanced budget in 2004, and to undertake lasting reform of public sector institutions, restructure and reduce debt, and clear all payment arrears, in part by working more closely with the Paris Club. They welcomed the commitment of Congress to prompt enactment of key legislation. It was also considered important to monitor closely, with World Bank involvement, the impact of fiscal consolidation on the poor.

Directors emphasized the importance of strengthening revenues, including through increasing key excise tax rates and enactment of the Administrative Reorganization and Fiscal Adjustment Law, which contains measures to broaden the base of the value-added and income taxes, implement a new vehicles tax, and strengthen tax enforcement. They also endorsed plans to reform the customs administration, which has committed itself to dealing with entrenched corruption.

Directors approved the authorities' plans to support social spending and public investment, while maintaining overall expenditure austerity, and contain losses of public enterprises, through efficiency enhancement and adequate pricing policy for fuel and utilities. They also supported the full implementation of the recently approved Public Procurement Law and the plan to conduct external audits of public institutions.

Directors stressed the need to pursue a monetary policy that is geared toward controlling inflation, while allowing exchange rate flexibility. They cautioned against any significant intervention by the central bank in the foreign exchange market, to allow the exchange rate to float freely and respond flexibly to external shocks. Directors noted that net international reserves have increased significantly during recent months, minimizing the possibility that Paraguay will need to draw on Fund resources. They observed that future reserve accumulation may need to be sterilized if base money growth begins to threaten the inflation objective. Directors commended the authorities' focus on institution-building in the central bank to enhance its transparency and efficiency, and its ability to conduct an independent monetary policy and eventually implement inflation targeting. They welcomed the authorities' interest in an FSAP review, and supported the recommendations of the safeguards assessment.

Directors noted that, although private banks are at present liquid, important banking system reforms must be implemented, and would support the expansion of private credit. They were particularly concerned with the persistent weakness of the public development bank (BNF), the high rate of nonperforming loans in the financial system, and the large participation of unregulated cooperatives in the market. In this context, they expressed their support for the authorities' plan to restructure the public banks, strengthen banking supervision and regulation, and extend supervision and data collection to cooperatives.

Directors welcomed the authorities' ambitious structural reform agenda under the program, emphasizing the particular importance of reforms to tax and customs administration, the public employees' pension plan and Social Security system, the civil service, and the central bank, as well as the opening of public enterprises to private sector participation, as a basis for achieving a lasting improvement in macroeconomic performance and enhancing governance. They noted, however, that continuing efforts to improve transparency and strengthen the rule of law, including through judicial reform, will be essential in the future.

The Executive Board took the following decision:

1. The government of Paraguay has requested a Stand-By Arrangement in an amount equivalent to SDR 50 million for the period from December 15, 2003 through March 31, 2005.

2. The Fund approves the Stand-By Arrangement for Paraguay set forth in EBS/03/165 (12/8/03) and decides that purchases may be made under the Stand-By Arrangement on the condition that the information provided by Paraguay on the implementation of the measures specified as prior actions in the table attached to the letter from the President of the Central Bank of Paraguay and Minister of Finance dated December 5, 2003 is accurate.

Decision No. 13144-(03/114), adopted
December 15, 2003

3. REPORT BY DEPUTY MANAGING DIRECTOR

The Deputy Managing Director, Mr. Carstens, reported on his travel to Senegal.

Length: 12 minutes

The Deputy Managing Director (Mr. Carstens) made the following statement:

> In early November, I visited Dakar, Senegal, to attend the concluding meeting of the Institutional Reform Committee of the regional central bank, the BCEAO. I also used the opportunity to meet with the governor of the central bank and with the Senegalese authorities, as well as the donor community and representatives of other UN agencies in the country. This was my first trip to Africa, and I am grateful to Mr. Ondo Mañe and his authorities for their excellent assistance. I would also like to thank Mr. Bio-Tchané and the African Department staff for their work in the region, on which I received positive feedback.
>
> In my speech at the opening session of the BCEAO seminar, I welcomed the initiative to modernize the monetary institution, which is to include a revision of the existing legal text governing the BCEAO taking into account international standards and, in particular, emphasizing the independence of the central bank. I stressed that a strong, independent institution, free of undue political pressure and interference from member governments and private interests, and with clear assignments of responsibility for formulating and conducting monetary policy, is a key requirement for the success of the monetary union. At the same time, I noted that the central bank must be accountable for the authority delegated to it, and that its operation should be transparent. I suggested that a strong regime of accountability, essential for operative central bank autonomy, should contemplate a structure that would see the institution report to both the executive and the legislative powers.
>
> While welcoming the recent initiative by the central bank to shift government domestic financing from direct advances of the central bank to the issuance of government securities on the regional financial market, I called on the BCEAO to pursue efforts aimed at improving the efficiency of monetary policy instruments. This would require developing a well-functioning interbank market, making the reserve requirements uniform across member countries, using a more flexible interest rate policy, reinforcing the authority of the Regional Banking Commission to ensure the effectiveness of bank supervision, and the adherence of financial institutions to prudential norms.
>
> In my meeting with the Governor of the BCEAO, we examined the economic and financial situation in the member countries of the WAEMU.

We also discussed the status of budgetary convergence in the unions. Because the majority of member countries were not in compliance with the convergence criteria in 2002, the convergence phase has been prolonged to end-2005, but a concerted action by all countries to achieve further fiscal consolidation will be needed over the next two years to ensure convergence.

The Governor and I also discussed the problems besetting the financial sector. We noted that, despite the prevailing excess liquidity in the zone, the banking system did not contribute significantly to the financing of the economy. I affirmed that the Fund stood ready to provide technical assistance in this area, and informed the government that the Fund's African Department will be organizing a seminar on financial sector issues in Africa in Addis Ababa, Ethiopia, in 2004.

In my meetings with the President and the Minister of Finance, I congratulated them on the important milestones that Senegal had achieved during the past year, including, *inter alia*, putting together a program, supported by a new three-year PRGF arrangement, that builds on Senegal's strong record of prudential financial issues, and designing and implementing a comprehensive poverty reduction strategy in broad consultation with domestic stakeholders and development partners.

I also discussed with the authorities, their efforts to promote foreign direct investment in Senegal through the establishment of the Presidential Investors Council and the New Partnership for African Development, the NEPAD. I assured them of the Fund's continued support for both initiatives, our commitment to capacity-building in Africa through the regional centers, the AFRITACs, and our desire to help address deficiencies in Africa's little-developed financial sector. I reiterated the importance of strengthening the financial infrastructure in Senegal, while emphasizing that a strong and healthy financial sector can contribute to growth. The Fund was ready to send a technical mission, if needed, to help the authorities with this important task.

We had a very broad discussion on many other items related to the PRGF-supported program, and in particular two issues related to the investment code and the privatization of SONACOS. I am happy to report that in last six weeks the authorities have made important progress on these items, which will hopefully make it possible to shortly conclude the first review, and to reach the HIPC Initiative completion point by end-March 2004.

There was a lot of enthusiasm from the President in relation to NEPAD, as he was one of the creators of this initiative. I encouraged him to use his experience to help build more international support for this initiative.

During the meeting with donors and representatives of other UN agencies, I gave a briefing on the status of Fund relations with Senegal. I noted that the support, and the following-up of the program of the Fund in the context of the HIPC Initiative by the donor community, was quite comprehensive. Their good understanding of all the aspects of the issues contributed to a frank and interesting discussion.

Overall, I thought that my visit to Senegal was very productive. It was my first trip to sub-Saharan Africa in my position as Deputy Managing Director, and I had a very frank discussion with the authorities. It provided the beginning of a better understanding of the pressing issues in Africa's development. I would also like to underline the good work Mr. Bio-Tchané and, in this particular case, Mr. Schmitz, for their excellent work in Senegal, as I now fully appreciate the difficulties associated with going into the field. The other understanding I gained from this mission is the importance of movements toward further regional integration in Africa; in this respect, the BCEAO is a good example, as it is already a very professional central bank that is looking to further improve its institutional structure.

To conclude, I felt it was a very successful trip and I thank Mr. Ondo Mañe again for assisting in the arrangements, and for his successful efforts to create an environment conducive to good discussions.

Mr. Ondo Mañe, on behalf of his authorities, thanked the Deputy Managing Director for his visit to Dakar and for his participation in the BCEAO seminar, which was important toward strengthening the work of the regional central bank. He thanked him further, on behalf of his Senegalese authorities, for meeting with the President and Minister of Finance. As the Deputy Managing Director only had occasion to visit part of the country, and given the opportunity such trips afford to learn of the challenges facing Africa's development, they encouraged this to be the first of many visits. He also encouraged other members of the management team to make similar trips to Africa so that they might augment, with first-hand experience, their understanding of Africa outside of the context of the staff reports, and fully appreciate the complexity of the challenges in the region.

Mr. Daïri thanked the Deputy Managing Director for his interest in Africa, and noted that this was actually his second visit to Africa, as he had earlier visited Tunisia. Despite their division from their African neighbors in the area department structure of the Fund, owing to geographical, historical, and political realities, the North African countries were also extremely committed to and involved in the development of Africa, including in the context of NEPAD.

The Deputy Managing Director (Mr. Carstens) stated that his comments were delivered in the spirit of his first visit organized under the African Department to sub-Saharan Africa. He reiterated his gratitude to Mr. Daïri and his authorities for contributing to the success of his trip to Tunisia, and expressed his appreciation for Tunisia's African roots.

4. MALI—2003 ARTICLE IV CONSULTATION; EX POST ASSESSMENT

Documents: Staff Report for the 2003 Article IV Consultation (SM/03/380, 11/24/03); and Selected Issues and Statistical Annex (SM/03/381, 11/24/03).

Staff: Briançon, AFR; Fetherston, PDR

Length: 2 hours

Mr. Ondo Mañe submitted the following statement:

Introduction

I would like to thank the staff for a positive and well-balanced Article IV consultation report, and their assessment therein of performance under Fund-supported programs during the last ten years. Appendix I, which is a multi-departmental ex post assessment of ESAF/PRGF-supported programs is also a testimony to the efforts deployed by my authorities to improve the macroeconomic framework, reduce structural rigidities, and promote growth and reduce poverty. The well-coordinated financial and technical assistance from the World Bank and other donors are also highly appreciated by my Malian authorities.

Over the past decade, Mali has made good progress in improving its political and social situation. There is a strong hope that this process will be sustained. At the same time, the authorities made strenuous efforts to build solid economic foundations. During the period 1992-2002, Mali implemented three Fund-supported programs, which have permitted the restoration of macroeconomic stability, laying the foundation for sustainable growth and reducing poverty. Mali reached, in March 2003, the completion point under the enhanced HIPC Initiative. However, Mali is still faced with a number of challenges, particularly limited production and export bases, limited private sector development, a need for financial sector deepening, a decline of gold exports, falling cotton prices, and the crisis in Côte d'Ivoire.

In order to confront these challenges, my authorities are determined to intensify the diversification of the economy so as to promote growth, streamline the regulatory framework, strengthen the judicial system, and maintain fiscal consolidation, in order to enhance private sector involvement. Such actions will help boost private sector investment. To complement this process we agree with the staff that a Fund arrangement would help the authorities to prepare a comprehensive set of policies and measures aimed at accelerating growth and reducing poverty. My authorities are confident that a Fund-supported program would permit them to attract more foreign direct investment, and that such a program will likely ensure that the level of funding on concessional terms is adequate to finance the development program.

The authorities are committed to pursuing a prudent, debt-management policy and will continue their efforts to improve the debt profile.

Recent Developments

Developments in 2002 and 2003 were satisfactory in spite of the adverse weather-related shocks on output, and, more recently, the difficult environment resulting from the crisis in Côte d'Ivoire. The year 2002 benefited from a strong recovery in cotton output, while gold production reached a new record of 66 tons. In 2003, by contrast, there were weather-related declines in cereal and cotton output, and the production of gold fell. Hence, real GDP, which had risen by 9.7 percent in 2002, fell by about 1 percent in 2003.

In order to meet the challenges posed by the loss of access to the sea in Abidjan starting with the third quarter of 2002, my Malian authorities reacted rapidly and diverted to other ports in the region for new sources of supply and exports, albeit at additional costs to them. Despite the official reopening of the Bamako-Abidjan road in May 2003, traffic has not reverted back to its pre-crisis' flow. In retrospect, the impact of the regional crisis was only 0.5 of 1 percent of GDP in 2002-2003, through reduced activity in public works, constructions and trade.

The fiscal impact of the regional crisis was a shortfall in revenue estimated at one percent of GDP in 2002, mainly from lower receipts from import duties and domestic value-added tax. In 2003, due to weather-related difficulties, the government granted exemptions estimated at 0.3 percent of GDP during the first half of the year. Had it not been for international community spending on refugees, the overall impact of the Ivorian crisis would have been quite severe.

Despite the above-mentioned negative exogenous shocks, my Malian authorities had full control over inflation, which declined from 5 percent in 2002 to 1.4 percent in September 2003. The cautious monetary policy, carried out at the regional level and the anchor provided the CFAF by the Euro also helped in containing inflation. The financial situation of large banks has also improved, and prudential ratios have been met.

As stated in the staff report, the external sector in Mali is influenced mainly by developments in the agricultural sector, by the production of gold, and more recently, by difficulties in shipping that resulted from the crisis in Côte d'Ivoire. Nevertheless, the current account deficit has been more than covered by official assistance, including debt relief under the enhanced HIPC

Initiative and private capital inflows, some of this due to businesses moving their financial operations from Côte d'Ivoire to Mali. Hence, in 2003, Mali is expected to record a surplus in the overall balance of payments, thus contributing to the build-up of international reserves of the Central Bank of West African States.

Mali's real effective exchange rate has appreciated by 4 percent since end-2001, mostly reflecting the appreciation of the euro against the US dollar. In addition, other factors such as the evolution of labor cost, and transportation charges owing to the Ivorian crisis have eroded Mali's competitiveness. However, with the help of the World Bank the authorities are currently carrying out studies in order to come up with measures to improve the country's competitiveness.

Moreover, my Malian authorities are determined to reduce the vulnerability of their export sector to domestic and international shocks by diversifying the export base away from traditional exports, lowering production cost through labor training, while keeping labor cost in check, and fostering financial intermediation between banks, as well as within the microfinance sector. They are also committed to implementing the common external tariff within the WAEMU aimed at gradually eliminating barriers to international trade and opening up the Malian economy to the outside world.

My authorities have noted that export volumes grew by 13.5 percent per year, twice as fast as imports, but these positive developments did not always translate into corresponding outcome in the overall balance due to unfavorable environment experienced by cotton export in the international market.

The Way Forward

As stated on page 12 of the staff report, my authorities agree with the thrust of the assessment of the Fund-supported programs. They observe that, after more than 20 years of heavy government intervention in the economy, Fund-supported programs have contributed to the design of sound macroeconomic policies and structural reforms that have reduced external and internal imbalances, and opened the economy to private sector initiatives. My authorities emphasize that the reform agenda is still unfinished, and that they view further support from the Fund as an essential element of their efforts to move the process forward and mobilize foreign financial assistance.

Both my authorities and the staff agree on the key challenges facing Mali as summarized in Box 6, on page 13 of the report, and which I presented in the introduction.

My Malian authorities are in the process of completing the first-year assessment of the PRSP, which will serve as a basis for a donors' roundtable to be organized with the assistance of the UNDP in early 2004. On that occasion, they would count on the generosity of the donor community to increase ODA in favor of Mali. It will also serve as an opportunity for Mali to argue for opening up developed countries' market access to Mali's agricultural products, mainly cotton, in the context of the Doha round of negotiations.

It may be recalled that our Chair has always argued for the maintenance of Fund financial and technical assistance to low-income countries until they are in a position to formulate an appropriate exit strategy. At this juncture, Mali is a good case in this regard. Hence, my authorities welcome the staff recommendation for a successor arrangement, and we would hope that the Board would go along with this recommendation. We would, however, argue that Mali's access not be reduced, contrary to the staff recommendation, as we consider Fund financial assistance very important in the total mix of a financial package.

Conclusion

In concluding, I would like to express my appreciation to the Fund for its technical and financial support, as well as its policy advice over the last decade, which have been invaluable in enabling Mali to establish a long track record of good performance.

Because of the catalytic nature of Fund involvement, the donor community has rallied successfully around Mali over the program periods. We would welcome the pursuit of such efforts in favor of Mali, and we would appreciate a substantial increase in ODA in its favor.

Mr. Reddell submitted the following statement:

Key Points

· The papers would have benefited from the use of cross-country analysis, both in the ex post assessment of Fund-supported programs, and in the Article IV assessment of the issues and challenges facing Mali.

· We were disappointed that the ex post assessment did not contain much evaluative and reflective comment. What lessons, for example, has the Fund learned?

· In view of the international attention given to the adverse impact of cotton subsidies, we were disappointed that the Article IV report did not devote more attention to assessing and highlighting the macroeconomic costs and consequences for Mali of these unjust measures.

· We have an open mind on a possible future program, but would welcome the staff's comments on the strength of local ownership, in view of the number of structural performance criteria and benchmarks that were missed during the period of the most recent program.

· As we broadly share the staff's assessment of recent economic developments in Mali, we wish to focus our brief comments today primarily on the papers themselves, with some concluding comments on the possibility of a further PRGF-supported program.

At the end of a program, and with the opportunity provided by an Article IV consultation, the papers before us today should provide a good opportunity to stand back and think carefully and deeply about the issues and economic challenges facing Mali. The papers go some way in that direction, and contain much interesting material. Nonetheless, they do not go as far as they might have. Two points, in particular, strike us.

The first is the near-complete absence of any cross-country analysis or comparisons. As this Chair has often highlighted, a cross-country perspective should be among the most valuable things the Fund can bring to its surveillance activities—valuable to the Board (as for many of the smaller countries less well-integrated to world markets, cross-country analysis helps fill some of the contextual gap we face in evaluating economic performance and policy), to outside readers, and to the main audience for these reports, the national authorities themselves. The absence is all the more surprising for a country, such as Mali, which is a member of an economic and monetary union. It is all too easy, immersed in the details of a single country's challenges and successes, to take an exclusively national focus almost by default, but a lot of valuable information and perspectives are lost if we do so. In this case, cross-country perspectives would have been enlightening both in the Article IV analysis itself, and—although it would be more difficult to do—in the ex post assessment of the Fund's program involvement in Mali over the last decade. We reiterate that we think it is important that cross-country comparative assessments become a standard part of the Fund's surveillance (and self-assessment) toolkit.

We were also disappointed to find that the ex-post assessment appendix contained little evaluative material. It is a useful description of what has been done in Mali in the last ten years, but it is not clear whether hard questions have really been asked. Hindsight is a wonderfully useful perspective, helping us do things better in future, in this country or in others. And yet, it is not obvious from the assessment that, with the benefit of hindsight, staff see any lessons to be learned or anything that the Fund should have approached in a materially different way if we could re-run the period. Most of us have been national policymakers or advisers long enough to know that life is just not like that. Identifying such lessons is not about second-guessing or criticizing those involved at the time; it is about getting progressively better at what we do. We live in a world of intense uncertainty, and the Fund holds itself out to be a learning organization. But, if we cannot identify valuable lessons out of ten years of program experience in a country like Mali, ex post assessment documents of this sort will serve little purpose. We were interested to note that of the four points raised by the authorities (paragraph 19 of the main paper), only one has a staff response or comment provided. We noted with interest the comment that "the low level of expertise and the weak institutions will require an increase in the level and intensity of technical assistance from development partners to strengthen economic policy design and implementation," and yet were more than a little surprised to see no evaluative comment on the success or otherwise (or lessons to be learned) of the Fund's extensive provision of technical assistance to Mali since 1991 (26 separate items, in a country with no central bank of its own).

For the purposes of the ex post assessment, and in thinking about the possibility of a future program, we would have been interested to have seen a little more reflection on the slightly disconcerting numbers contained in the most helpful table (Box 2) on Mali's observance of performance criteria and benchmarks. First, we were puzzled by an apparent contradiction within the paper. In paragraph 19 of the main paper, the staff responds to the authorities by arguing that conditionality "was streamlined over the last Fund-supported programs," and yet on page 49 it is noted that "streamlining of structural conditionality was limited," and that "prior actions were extensively and increasingly used." That later perspective appears to be accurate: as the table highlights, in the most recent program there were 58 structural measures, compared to 17 in each of the previous two programs. This level of structural conditionality came even though one of the features of the PRGF arrangement is supposed to be a streamlined approach to conditionality, as compared with the previous ESAF. It would have been helpful if the staff could have offered us an assessment of whether, with the benefit of hindsight, that heightened level of conditionality was really necessary (especially as most of the measures, other than the prior actions, were not actually observed). We would also be interested to have learned a little more about what this tells us about the extent of local ownership of the program. Superficially, it might appear that the authorities did just what the staff insisted had to be done to get the program and review papers to the Board and not a great deal more.

The answers to questions of this sort will be helpful in considering the possibility of a further program. It is not obvious that the authorities need the money for macroeconomic stabilization purposes, and indeed the staff comments that the authorities are more interested in having a program than in the amount of money available. If the option were available, this would appear to be a case for considering a precautionary PRGF arrangement. However, we should be cautious about the Fund being used simply as a prop to enable reforms to continue to be pursued. Strong local ownership should be a vital ingredient of any program. Moreover, we should also be open to considering alternative ways to provide intensive policy advice, outside the context of a formal program.

Finally, and changing tack somewhat, we were disappointed to find little coverage of the impact on Mali of the iniquitous cotton subsidies provided by some major industrialized countries. While the Malians need no reminding of the severity of that impact, one useful thing documents of this sort can do is to remind the rest of world of the role policies in other countries play in impeding development in one of the poorest countries on earth—and all the more so in a year when the cotton subsidy issue has achieved considerable attention, among the public and opinion leaders around the world. I am conscious that the staff is subject to a word limit in these documents, but this would have been a highly appropriate topic for a selected issues paper.

Mr. Bennett submitted the following statement:

Key Points

· A low access PRGF arrangement would be the most appropriate form of Fund engagement at this time.

· We would hope that the PRGF-supported program documentation provides a comprehensive assessment of the cotton sector. The reforms need to be well-sequenced, practical, cognizant of its impact on poverty and political stability, and take into consideration the large subsidies in some industrialized countries.

· The ex post assessment is very welcome. Consistent with the comments we and other Chairs made at the discussion on Mozambique, we would like to see, in future ex post assessments:

- less description, more critical analysis;

- more extensive probing of the views of the authorities, donors, and private sector; and

- more analysis on shocks.

As well as these general remarks, I made some specific comments on the ex post assessment, which I hope will be helpful in giving the staff a better sense on how we would like to see these documents evolve.

It is evident from reading the Article IV report and ex post assessment that Mali has made good progress since 1992, under three successive programs. The authorities have reiterated their interest in having a successor PRGF arrangement, and we agree with the staff that a Fund-supported arrangement with low access would be the most appropriate form of Fund engagement at this time. For the most part, the same arguments that we, and many other Chairs, made a few days ago in favor of a PRGF-supported program for Mozambique also apply to Mali, so I will not repeat them here. I do want to emphasize, however, that Mali remains particularly vulnerable at this time due to the crisis in Cote d'Ivoire.

The staff report has correctly identified the many challenges that Mali still needs to tackle, and has sketched out many of the elements of a new PRGF-supported program. We were particularly pleased to see that the authorities intend to undertake an Investment Climate Assessment. I would like to stress four points on developing the new program:

· First, we have to be extremely cautious about the kind of reforms that we will be demanding of the cotton sector, not only because the sector is important to Mali, but also because of the uncertainty created by the large cotton subsidies in some industrialized countries. These subsidies are large and volatile, so that today's diagnostic may not be appropriate for tomorrow. We would, therefore, hope that the PRGF documentation provides a comprehensive assessment of the cotton sector. The reforms need to be well-sequenced, practical, cognizant of its impact on poverty and political stability, and take into consideration the large subsidies of some industrialized countries. This advice should also be part of the Fund's larger strategy for cotton producers in the region.

· Second, I would like to see a clear strategy mapped out on how to make the country less vulnerable to shocks and better able to deal with them should they occur. This is an issue that although the Fund has been cognizant of over the last three programs, has not been able to make much progress on. Mali's continued vulnerability was evident from the DSA in the completion point documents, which showed how the debt-to-export ratio would ratchet up to over 300 percent if Mali was hit with a series of droughts.

· Third, we share the staff's concern for the continued increase in the wage bill, and agree that overall costs will need to be contained. That being said, higher pay may be required for some public service employees to recruit and retain appropriate staff. Moreover, the increase in the aggregate wage-bill should be guided by the extent of donor support.

· Fourth, consistent with what we and others (particularly the U.K.) have suggested for other PRGF-supported programs, we hope to see:

- the program documents include a low-case scenario (based on less favorable economic projections), accompanied by a mapping out of contingency measures, as well as a high case scenario, that makes a case for larger external support to help attain the MDGs; and

- a commitment by the IMF staff to undertake PSIA over the course of the program.

The Ex Post Assessment: Some General Comments

Like the ex post assessment (EPA) of Mozambique (the first to be discussed at the Board), we found the exercise very useful and agree with the overall conclusion that important progress has been made toward macroeconomic stability, laying the foundations for sustainable growth, and reducing poverty. In this sense, the paper accomplishes one of two key goals (as we see it) of ex post assessments: to identify what has been accomplished and what still needs to be done.

However, we found the paper less successful in the other key goal of determining what the Fund and authorities could have done better. As with Mozambique's EPA, overall the report was too much like an Article IV report with a longer timeframe, with too much description and not enough critical analysis about what we can learn from previous programs, and how we can do better going forward. In this regard, an in-depth assessment of how the authorities, private sector, and donors viewed the Fund's engagement is vital in undertaking this kind of analysis. It would also have been useful to closely examine what more could have been done to help Mali prepare for, and deal with, shocks.

Some Specific Comments

As well as these overall remarks on the EA, I also have some specific comments and questions. The staff could respond to some of these questions (if they have readily available answers). More importantly, I hope these comments will be helpful in giving the staff a better sense on how we would like to see these documents evolve.

The EPA concludes that, overall, progress was good, and identifies four key reasons that Fund-supported programs have succeeded. But, what were the main program failures, and the key reasons for these shortcomings (for example, why has progress on poverty reduction and economic diversification been slow)? How will the challenges be addressed (more successfully) in the future?

The staff notes that liberalization in the cotton sector has been difficult, and introducing competition may disrupt production and have serious political repercussions. Is there a relevant best-practices country to turn to where there has been successful liberalization? Has the sequencing been correct so far?

Paragraph 19 is the most interesting section in the report, but more details on each of the four main points made by the authorities would be more useful, as would a more fulsome response by the staff to each of the points:

· The authorities think that the adjustment pace had been too rapid and had not been given time to deal with the political aspects and social aspects of reforms. Which adjustments were too rapid? Does the staff agree? What could the Fund have done differently?

· The authorities felt that program conditionality weakened ownership. Yet, in paragraph 18, the authorities considered that conditionality was a key element to program success. Could the staff provide more information to reconcile these two views?

· The authorities thought that the program did not sufficiently take into account the vulnerability of the economy to exogenous shocks. Does the staff agree? If so, how will it be rectified going forward?

· The authorities considered the delay of a disbursement , when a single condition was not met, too severe. Although we would generally agree, what were the specifics? In retrospect, does the staff think it was the right thing to do?

· The additional details of the EPA provided in paragraph 20 of Appendix I are also interesting. Did the team undertaking the EPA speak to the staff that worked on previous Mali programs (e.g. mission chiefs) to find out why the number of prior actions and structural benchmarks increased over time?

· Paragraph 32 indicates that the authorities are looking for further technical assistance, but how successful has technical assistance been in the past? How could it become more successful?

Mr. Misra submitted the following statement:

Considering the impact of the crisis in Côte d'Ivoire and the decline in cotton production due to adverse weather conditions, Mali has performed fairly satisfactorily in 2002 and 2003. The authorities are to be commended for having acted swiftly to minimize damage from the transport bottlenecks created by the Ivorian crisis. We broadly share the staff's assessment of Mali's macroeconomic situation, and will confine our observations to some key issues.

Fiscal performance has been generally satisfactory, helped by significant improvement in revenue mobilization. Over the last three years, however, the trend of decline in government expenditure relative to GDP has been reversed, even though there was only a marginal increase of 0.5 percent of GDP in expenditure on health and education. The authorities need to stay the course on fiscal consolidation to ensure that the external debt remains sustainable and competitiveness is preserved. In this regard, we wish to recall that at the time of the last Article IV discussion in 2001, this Board had welcomed the initiative to reform the civil service with a view to controlling public sector wages and promoting fiscal consolidation. However, the wage bill is projected to increase by 15.8 percent in 2004, with the recruitments for priority sector accounting for only 38 percent of this growth. The increase in civil service wages have outstripped inflation by a wide margin. The government is reported to have completed a physical count of public servants to reduce the wage bill. We would like to know the outcome of this count and encourage the authorities to update the civil service payroll using this census. According to the Economist Intelligence Unit, 5.3 percent of the annual public salary bill could be saved if all the "ghost" employees were eliminated. The staff's comments are welcome.

It is reported that the government is planning to provide paid jobs to 37,400 persons and that special agencies are to be created for this purpose. While we support the objectives of the five year program to tackle youth unemployment, we are not sure if creating new public sector jobs by setting such numerical targets is the optimal way of going about this. Is this program related to jobs that are required for expansion of health and education systems? Staff may wish to elaborate. The widening civil service retirement fund is another area that the authorities will do well to address promptly. We would also urge the authorities to consider the staff's suggestion that tariff cuts be extended only to the lowest compensation tranches.

We agree with the authorities' strategy to achieve higher levels of growth by diversifying the economy through development of infrastructure, value addition to export of raw materials, and promoting the textile industry. A number of factors constraining private sector investment, particularly foreign investment, have been identified in the staff report. However, many of these can only be implemented gradually, and their impact felt over the long term. We believe that improvement of physical infrastructure and development of sectors of comparative advantage may achieve a comparatively rapid acceleration of growth. This will require considerable investment, which may not be forthcoming in the private sector at the current stage of development of Mali's economy and financial sector. We, therefore, would like to underscore the importance of requisite levels of public investment while pursuing policies that promote private sector development. In fact, considering their need to attract investment we are not entirely averse to authorities' proposal to grant incentives like tax exemptions and subsidies.

We agree with the staff that these create distortions, but a more realistic view may have to be taken in situations when limited choices are available to the authorities, and considering the number of countries that have resorted to similar measures. We endorse the authorities' plans to strengthen the highly successful microfinance institutions.

We welcome the authorities' continued commitment to structural reforms manifested in the progress in their plans to privatize SOEs in cotton, airports and railroad management, and telecom sectors, and restructuring and privatizing commercial banks. Reforms in the cotton sector are, doubtless, of the greatest importance, considering its pre-eminent role in Mali's economy. However, there was stated to have been a lack of interest from strategic buyers. The authorities also appear to want to proceed with caution, considering the social, political, and economic implications of restructuring such a large component of Mali's economy. We urge that the impact of proposed reforms be fully assessed and countervailing measures adequately provided for, while implementing the changes. More generally, we feel that the emphasis in the staff report on privatization as a key to diversification and to high and sustainable levels of growth may be somewhat overstated.

Consistent with the authorities' view that agriculture is the sector with the highest growth potential, a number of projects have been identified in the PRSP that could contribute to diversification of Mali's economy. We, therefore, fully share the authorities' concern that the continued prevalence of trade barriers and agricultural subsidies in industrial countries may prevent them from fully harnessing this potential. In fact, the progressive elimination of cotton subsidies as suggested by Mali and other countries in the region may have a far more positive impact on poverty reduction than a PRGF arrangement. Incidentally, Mali is reported to not only have a relatively open trade regime but does not even apply the common measures for protection agreed by WAEMU.

Since August 1992, Mali has had three successive, back-to-back ESAF/PRGF arrangements, the last of which expired in August 2003. The authorities have requested another arrangement. There is no doubt that Malian authorities have, over this period, pursued sound policies; macroeconomic stability has improved, and there has been progress in implementing structural reforms. We have no hesitation, therefore, in supporting their request. However, we do have some concerns about the design of the PRGF-supported programs in general and over the policy of repeat use of PRGF resources.

Box 6 in the staff report, which sums up the staff's assessment of Mali's performance under Fund-supported programs over this ten year period, reveals that poverty reduction is "still an elusive goal." Somewhere else in the report the poverty ratio in 2002 is given as 64 percent, but no comparative figures of other years are given. We would request that the staff provide a more detailed and precise account of the impact that ESAF/PRGF programs and the delivery of full HIPC relief have had on poverty reduction in Mali. For, if there has been no significant decline in the incidence of poverty despite such a protracted period of successfully implementing Fund-supported programs, there is perhaps a need for the weaknesses to be identified, and appropriate lessons to be drawn and incorporated into any future arrangement.

The second issue is that of the logic of repeat use of PRGF resources in quick succession. We agree with the staff that Mali is not likely to have high access to international capital markets in the foreseeable future. The issue, therefore, is that of inadequate resource flows—official and private—to LICs. However, we are not sure if a Fund-supported program is the answer or that it can catalyze such investment flows. Have PRGF-supported programs on a continuing basis resulted in greater capital flows than before? We would be interested in hearing from the staff about empirical evidence on this issue. Further, the staff report states that the authorities attach more importance to reaching an agreement with the Fund than to the level of access. The staff are of the view that the reform agenda in Mali is incomplete and that a low-access Fund arrangement will help the authorities prepare a comprehensive set of policies and measures. On the other hand, Mr. Ondo Mañe, in his informative statement, emphasizes the importance of the size of the arrangement as well. We believe that the issues of financing requirement and policy advice are separate and that the latter can be accomplished even outside the scope of a Fund-supported program, provided there is sufficient ownership. Such ownership seems to have been absent going by the authorities' views cited in the report referring, inter alia, to the rapid adjustment pace and "imposed" program conditionality. The staff may wish to clarify these issues.

We wish the Malian authorities success in addressing their challenging endeavors.

Mr. Ge and Ms. Wu submitted the following statement:

We thank the staff for a comprehensive set of papers and Mr. Ondo Mañe for his helpful statement. Following on from the sixth review under the PRGF arrangement in July when we praised the authorities for their progress, we are pleased that they have continued their efforts in every aspect of the economy. As a result, the overall performance has been satisfactory despite the difficult regional environment. Real GDP has registered a continuous and stable growth due to the high cotton and gold production, inflation has remained low, the external position has improved and although the 2003 deficit is expected to widen, the overall balance will still record a surplus.

These achievements are noteworthy but so are the challenges. The longer-than-expected impact of the crisis in Côte d'Ivoire on the economy as a whole—illustrated in Box 1—reinforces Mali's vulnerability to the regional political environment. In addition, Mali's heavy dependence on its agricultural products and exports makes it highly susceptible to weather conditions and terms of trade fluctuations. To cushion these potential shocks and to minimize the vulnerabilities, the authorities need to deepen their reforms, especially in diversifying the economy, privatizing the cotton sector, strengthening fiscal consolidation and improving the investment environment.

Diversifying the Economy

During the previous PRGF-supported programs, the authorities have been encouraged to diversify their economic base, as trade is so heavily concentrated on a few commodities. From Box 3, we commend them for seeking ways to add value to their traditional exports while promoting nontraditional ones. We hope these measures will not only help the authorities maintain sustainable growth and create greater employment opportunities, but also minimize their economic vulnerabilities. During the process, the authorities should be encouraged to improve its governance and legal and regulatory environments in order for the private sector to play a more active role.

Privatizing the Cotton Sector

The liberalization of the cotton sector continues to be a difficult task and we have sympathy for the authorities' concerns. It is never easy to reform an economy's major sector in view of its considerable size and share of the economy. However, we take note that the authorities have begun the bidding process for the CMDT, as well as discussions with the IFC on the privatization issue. Although the process should be sped-up, it should not be rushed and should be conducted in an orderly manner.

Strengthening Fiscal Consolidation

Infrastructure development, pro-poor programs and other economic reforms will definitely create greater-than-expected expenditure and therefore fiscal consolidation is crucial in ensuring the sustainability of the fiscal position. To achieve the 2003 fiscal objectives, the authorities need to enhance the revenue base and refrain from granting ad-hoc tax exemptions, while keeping the tax on petroleum products at their current levels to maintain high revenues and containing the civil servant wage bill to keep expenditure at the targeted level.

Improving the Investment Environment

Foreign investment is, of course, necessary for an economy's development and a good environment is crucial for attracting such investment. To this end, the authorities need to take effective measures to improve the environment. The obstacles to private investment first need to be identified and the Investment Climate Assessment, undertaken with the help of World Bank, is a move in the right direction. Steps to surpass these obstacles—training the workforce and tax incentives—can be worked out immediately after this.

Successor PRGF-Supported Program

We recognize that significant progress has been made under the previous Fund-supported programs as regards macroeconomic growth, fiscal performance, structural reforms, and trade liberalization, and the important role played by the Fund in this process. However, as addressed in Mr. Ondo Mañe's statement, the reform agenda is unfinished and we hope the Fund can continue to provide help. In this regard, we support the authorities' intention to pursue a new medium-term program to assist them in sustaining stable economic growth and deepening their structural reforms. Taking the authorities' comments from the previous program in account, we believe the Fund can further improve its advice and conditionality. Program design and implementation will always be a learning process for both the authorities and the Fund.

With these remarks, we look forward to a continued and more constructive dialogue between the Fund and the Malian authorities. We wish them all the best in their future reform endeavors.

Mr. Daïri submitted the following statement:

As reflected in the well-written staff report and ex post assessment paper, and in Mr. Ondo Mañe's informative statement, Mali has managed to build a strong track record of policy implementation over the past decade, despite an often unfavorable environment. The authorities have demonstrated strong commitment to sustained sound macroeconomic policies and structural reforms, including in tax administration and public expenditure management, privatization, trade liberalization, and financial system strengthening. As a result, economic growth has been strong, averaging more than 5 percent in the period 1994-2002 and should be stronger in 2003, inflation has been brought down to very low levels, and the current account deficit narrowed significantly. The authorities' continuous strong commitment to their programs has enabled the country to reach the completion point under the enhanced HIPC Initiative, allowing significant improvement in its debt sustainability indicators. However, despite a decline in poverty over the past ten years and improved per capita income, as noted in the assessment document, income disparities remain very large, and we welcome the staff's comment on the issue.

Notwithstanding the significant strides made thus far in achieving macroeconomic stability and implementing structural reforms and the resulting good performance record, the economy remains subject to a number of fragilities. In particular, it remains heavily reliant on a few, export-oriented commodities, with cotton and gold mining accounting for almost half of total growth and more than 80 percent of total exports. Achieving economic diversification over the medium term, while preserving macroeconomic stability, will be crucial to sustain high growth and contribute to reaching the Millennium Development Goals. The authorities' commendable commitment in this regard is reflected in their intention to prepare a medium-term program, in line with their PRSP, that would address the remaining reform agenda, including pursuing fiscal consolidation, completing the privatization process and promoting private sector participation, strengthening the financial system, and enhancing governance.

In the fiscal area, important progress has been made in revenue enhancement and expenditure rationalization. Much remains to be done, particularly in view of the considerable need for social spending, the still high debt burden, and the limited scope over the medium term for increased revenues. Attention should be directed to reducing tax exemptions, further improvement in public expenditure management, and curtailing non-priority outlays, including subsidies, while pursuing a cautious wage policy.

Commendable progress has been made in privatization, with the outsourcing of management of the railroad company, the final phase of the privatization of the cottonseeds oil company, the launching of a tender for the management of Mali's airports, and the intended further reduction of government's participation in commercial banks. We welcome the authorities' ongoing efforts, with external assistance, to advance the reform of the cotton sector. In this connection, while there may be merit in splitting the state-controlled cotton company (CMDT) into three or four private companies, it remains unclear whether limiting purchase rights for each of these future companies to a designated area would encourage competitiveness and efficiency. We welcome further elaboration from the staff on this issue. More generally, restructuring or privatizing the cotton sector is an issue of crucial importance where utmost caution should be exercised, and decisions made after a genuine consultative process.

Mali's experience indicates the extent to which a country's genuine reform efforts can be hindered by an unfavorable environment and policies of advanced economies. It is unrealistic to expect that a landlocked country like Mali, with very low per capita income, poor infrastructure and social indicators, and limited capacity, would be able to absorb exogenous shocks such as the effects of cotton subsidies or regional turbulence, without substantial external assistance. In this regard, the significant decline in foreign assistance to Mali referred to in paragraph 7 of the ex post assessment is a matter of great concern, and we appreciate the staff's elaboration on the reasons and support Mr. Ondo Mañe's call for increased ODA. We also reiterate our call for early elimination of agricultural subsidies and trade barriers to developing countries' exports. We reiterate our concern with the low level of government revenue from the gold sector and appreciate the staff update on their intention to discuss with the authorities how to raise this contribution, as promised during last February Board discussion on Mali.

In view of the country's unfinished agenda, its continuous reliance on foreign assistance, and the limited capacity, Fund's further financial and technical support remains crucial to build on the significant progress achieved thus far. In this regard, we support the authorities' interest in a successor PRGF-supported program. As in the case of Mozambique, a Fund-supported program would constitute an important framework for continued domestic discipline and for catalyzing the necessary assistance of the international community.

Following the recent case of Mozambique, the staff's ex post assessment of Mali's performance under Fund-supported programs is welcome. We look forward to early adoption of a uniform process. We reiterate our preference for ensuring freshness of perspective by assigning the ex post assessment to teams other than those involved in program negotiation and monitoring, although we welcome the multi-departmental approach used in this case. We see merit in separating the ex post assessment document from the Article IV staff report. In addition, as underscored by other Directors, the effectiveness of these assessments would further improve from providing more space for the authorities' views. We note the authorities' reported broad agreement with the thrust of the assessment and their satisfaction with the support provided by the Fund and the useful role played by conditionality and financing assurances. At the same time, the authorities believe that the pace of reform was too fast, that there was not enough flexibility to accommodate exogenous shocks, and that conditions were too demanding and often imposed rather than negotiated, which resulted in weakening program ownership. The staff's further elaboration is welcome.

Mr. Kremers and Mr. Croitoru submitted the following statement:

Key Points

This is one of the first ex post assessments and as such does a good job. Some aspects, such as lessons for the Fund, however, should be improved in subsequent assessments.

We agree with the ex post assessment's conclusion that Fund-supported programs have contributed to progress in Mali and can be expected to do so also in the years to come. We therefore support continued program involvement in Mali.

Does the staff share the opinion that Mali, given its fragile debt sustainability, should use grants rather than loans (including a PRGF arrangement)? And might, in that context, a precautionary PRGF arrangement be more appropriate than a PRGF-supported program with artificially low access?

Vulnerability of the Malian economy should be reduced by accelerating growth through diversification of the economy and an increase in private sector investment.

We have looked at this staff report with particular interest, both because it is Mali and because together with the Mozambique case, which we discussed last Wednesday, it is one of the first instances of an ex post assessment of longer-term Fund program engagement.

The Ex Post Assessment: Some General Comments

The idea behind such an assessment, emanating from the IEO report on prolonged use of Fund resources, is to take a step back and conduct a critical review of the plusses and minuses of the Fund-country relationship. Also, these assessments should disseminate 'best practices' and lessons learned, and maximize the effectiveness of the review process. This will provide an excellent opportunity To Whom It May Concern: reconsider the overall country and Fund strategy. To make this a meaningful exercise, however, the plusses and minuses should be sought not only on the part of the country, but also on the part of the Fund. To facilitate the step back, staff members with some distance from the recent program relationship can supplement the staff team making the assessment.

Looking at the Mali staff report from the perspective of ex post assessments, we come to the following findings. First, the report is based on a healthy perception of the core competence of the Fund. We found the paragraphs 39-40 convincing. Second, our overall impression is that Mali has made substantial macroeconomic policy progress over the past 10 years and that Fund-supported program engagement has contributed to that. Third, notwithstanding these generally positive remarks, the ex post assessment is wanting in three dimensions:

Comparing the composition of the staff teams, on p. 1 and on p. 41, one gets the impression that some differentiation has indeed been applied, but it remains unclear how. It would be better to specify exactly who did what and why.

Throughout the staff report it remains unclear whether the assessment has also generated some lessons for the Fund and, if so, what they might be. Box 6 talks only about program performance, not about program design, although the Fund has adapted its approach for low-income countries. The report seems to suggest that the programs of the Fund, including policy recommendations, were always appropriate and effective if executed properly. That may be true, but the report should at least address also the critical questions that have been asked about the performance of the Fund. An apparent lack of self-criticism is not satisfactory and requires improvement to make these assessments a useful tool.

There are some pointers to possible lessons for the Fund. On p. 12, the authorities note that the adjustment pace forced by the Fund has been too rapid and to the detriment of political support and social consequences (this is also argued by the government of Mozambique in its ex post assessment). Moreover, it seems that the number of performance criteria and prior actions have risen substantially, whereas the results in Mali seem better under programs with less performance criteria and prior actions (p. 49). These issues are not addressed by the staff.

Furthermore, on p. 23 the authorities are said to attach more importance to program content than to program financing, and to have the view that a formal agreement with the Fund is a vehicle to mobilizing foreign financial assistance. By contrast, in the appraisal on p. 25 (paragraph 45) the staff argues that the authorities have found financial support crucial. This raises the important strategic question of what the key role of the Fund in Mali will be: money or program content? The ambiguity is reflected in paragraph 46, where the staff agrees with the authorities that continued financial support remains crucial and recommend a low access PRGF arrangement. Might there be lessons for the Fund in the choice and availability of facilities?

Our third general point concerns the time schedule of the assessment. It is unclear why, when it is concluded that Mali's policy performance was good and a follow-up program was valuable, the Fund has waited half a year with negotiating such a follow-up program. This suggests that the timing of the ex post assessments can be improved; one should not wait until a program passing the 7-year threshold is finished, but if possible make preparations for the assessment before the conclusion of the current program, so that, if desired, a follow-up program can be agreed upon without a large time gap. Having a large gap between programs makes donors uncertain, hurts the credibility of the authorities and creates misunderstandings among the population.

The Future of the Relationship Between the Fund and Mali

Regarding the need for Fund financing, as discussed above, we have our doubts. The overall balance of payments of Mali is in surplus. Besides that, the EU and bilateral donors have stepped up their budget support programs (on a grant basis) and the World Bank is expected to do so (on a loan basis) within the framework of its recently adopted CAS. At the same time, the debt-sustainability situation of Mali is fragile and the proportion of grants in external finance should increase (paragraph 38). Therefore, a loan such as that under the PRGF would not be a preferred option. We are interested to learn the opinion of the staff on this issue, and would welcome information on the expected level of (donor) funding and the envisaged catalytic role of the Fund. Does the staff share the opinion that Mali should use grants rather than loans, including a PRGF arrangement? And might, in that context, a precautionary PRGF arrangement be more appropriate than a PRGF arrangement with low access?

Although the ongoing reform program still needs to be completed, priority should now also be given to economic growth, strengthening public finance management, and governance.

From this perspective, we support the staff's analysis concluding that the vulnerability of the economy should be reduced by accelerating growth through diversification of the economy and an increase in private sector investment. The present PRSP of Mali has adequately analyzed and defined the potential and appropriate strategy for pro-poor growth.

We also support the priority given by the Fund to improving public finance management. However, this is not merely a process of institutional reform but to a large extent a process of capacity building within the Ministry of Finance. Also at the level of line ministries and regional and municipal administration, limited administrative capacity poses a problem. Capacity, or lack of it, should be taken into account in the design of reforms.

Already in the last PRGF arrangement, less than half of the structural performance criteria were observed on time. With this in mind, we invite the staff to comment on the realism of some of the performance criteria linked to the complicated process of cotton sector reform, especially given the remarks made by the authorities in the context of the ex post assessment regarding the feasibility of the staff-proposed timeline of reforms.

While we are thus not entirely convinced by the ex post assessment, from our own observations and from the experience of the Netherlands as a donor 'in the field,' we agree with its conclusion that Fund-supported programs have contributed to progress in Mali and can be expected to do so also in the years to come. We therefore support continued program involvement in Mali.

Mr. Meissner and Mr. Meyerhoefer submitted the following statement:

We broadly concur with the staff's macroeconomic assessment and commend the Malian authorities for the successful economic stabilization over the past years under three successive ESAF/PRGF-supported programs:

We welcome the progress made in strengthening public expenditure management and in achieving fiscal consolidation as well as attaining and developing a high level of cooperation within the WAEMU.

We call on the authorities to conduct a prudent approach to new lending—even if concessionary—in order to maintain fiscal consolidation and debt sustainability. To this end, and to foster regional and international competitiveness, the staff is correct in suggesting a prudent wage and expenditure policy.

Furthermore, we agree with the staff that the authorities should refrain from intervening directly in the economy and from granting tax exemptions or offering subsidies because of their distorting and unsound fiscal effects and uncertain benefits. At the same time, we acknowledge the difficulties that Mali faces in the international markets and we support its demand for cutting agricultural subsidies in industrial countries.

We support a continuing IMF engagement in Mali through technical assistance. Here, the West AFRITAC, based in Bamako, provides a good basis. Furthermore, we wonder how the Fund could best support Mali to achieve its goals of the reform agenda that still need to be addressed. While we note that Mali is a prolonged user of Fund resources, we also acknowledge that it is a good performer under Fund-supported programs and that further reform efforts lay within the field of the Fund's core competencies. Under the condition that the *Guidance Note on Prolonged Use of Fund Resources* (revised in August 2003 under the title *Operational Guidance for Assessments of Countries with a Longer-Term Program Engagement*) are observed, we see some merit in discussing a new PRGF arrangement for Mali. In this context, as stated in our preliminary statement on Mozambique, we are looking forward to the upcoming policy discussion on the Fund's role in LICs.

Ms. Jacklin and Mr. Baukol submitted the following statement:

Key Points

We congratulate the authorities for their significant progress under Fund-supported programs in the last decade. The commitment to the policies in the programs has put Mali on the right track, and we encourage the authorities to continue their efforts to promote macroeconomic stability, implement structural reforms, improve fiscal performance, and fight poverty.

Challenges in the fiscal area in the short term involve improving the quality of expenditures, including in the social area, while broadening the tax base. In the medium term, fiscal consolidation is needed to keep debt indicators on a sustainable path.

Additional challenges relate primarily to structural issues, including development of the financial sector and liberalization of the cotton sector. Such issues will be the key to poverty alleviation in the medium term.

This Article IV consultation marks an important point in the Fund's relationship with Mali. As in the case of Mozambique last week, the ex-post assessment raises the question as to the best use of IMF tools for continued policy support and whether another program is necessarily the most effective path forward for the Fund and Mali.

Fiscal and Debt

The authorities deserve credit for their recent efforts to maintain fiscal discipline in an environment negatively impacted by the crisis in Côte d'Ivoire. And, we welcome the ongoing progress in the ability to track poverty-related spending, as shown in Box 9. On the revenue side, the authorities have made progress in boosting tax revenues by improving administrative capacities and improving arrears collections. We encourage the authorities to reduce periodic tax exemptions in order to have a stronger and more predictable revenue flow.

Nonetheless, we note with concern the fiscal financing gap of 2.5 percent of GDP for 2004, related in part to large increases in government spending, particularly on wages outside of the social sector. While the situation in Côte d'Ivoire might necessitate some increased spending on security, the mounting wage bill will complicate efforts to maintain a sustainable fiscal position. The fiscal projections for 2004-2006 are also worrisome, showing an increase in the budget deficit (after grants), to be financed by additional borrowing. We concur with the staff that the authorities need to consolidate fiscal policy in the medium term and secure more grant resources to prevent another debt build-up. It is not clear if the 2004-2006 plans are consistent with this view. We note that current projections already give a slightly higher debt burden for 2007-2021 than the projections at the completion point in March.

Mali's post-completion point status, and the fiscal financing gap, point to the need to closely monitor the debt burden and profile, including concessional debt. Demonstrating strong economic performance will help boost donor confidence and maximize the grant assistance needed to support increased poverty-related spending in 2004 without adding to the debt burden. As a footnote, we can confirm that the U.S. has provided completion point assistance on the total (small) amount of U.S. debt (Table 10).

Structural Reforms

Mali has made significant inroads on a number of structural issues in recent years. For example, the establishment of a private management contract with the railroad is key to ensuring diversification of transport routes and could ultimately reduce transportation costs to Mali. We urge the authorities to continue their progress with the privatization of CMDT, including a rapid end to regional monopsonies, and to begin the process of privatization of the telecommunications company. A number of other measures are also important for private sector development, including strengthening governance and the judicial system, reducing government distortions in the economy, and streamlining regulations. We urge the authorities to work closely with the MDBs in these areas.

In terms of financial sector development, plans to privatize and restructure the commercial banks are integral to the broadening and deepening of financial services in Mali. We find this project particularly important given the deterioration of NPL ratios this year. Further development of the microfinance sector will be important to provide financial services to rural and poor areas. We welcome Mali's efforts to implement CFT measures, such as blocking the assets of terrorists. We urge Mali to work toward enhancing the effectiveness of its AML/CFT regime and its reporting to the UN.

Ex Post Assessment

Mali has had an IMF-supported program with only a few interruptions for 20 years. It is useful to analyze progress under these programs and make a judgment on the proper role of the Fund going forward. We therefore welcome the stand-alone Article IV consultation discussions and preparation of an ex post assessment on past programs. Overall, the authorities have made solid progress on economic issues in the context of past programs. And, while the ex post assessment provides information about past IMF engagement, we concur with Messrs. Bennett and Reddell that it would have been more useful if it had included additional analysis, such as:

· a clear description of the goals of the past IMF-supported programs and the track record in meeting the goals, including the effectiveness of IMF technical assistance,

· a discussion of the potential for 'graduation' of the country from Fund-supported programs, including an evaluation of the Fund's financial role, and

· more analytical judgments on the lessons learned for Fund engagement. We note, for example, the significant increase in structural conditions in the recent PRGF arrangement, most of which were not met. What conclusions does the staff draw in terms of the appropriateness of these conditions? What is the role of the World Bank in these areas?

Future IMF Role

The staff presents a number of arguments in favor of a new low access PRGF-supported program, including that a program would help policy formulation and implementation, help deal with shocks, and provide signals to donors. But, the Fund's long-term financial engagement in Mali raises the question as to whether the Fund is considering the full range of tools that may be available to meet Mali's needs. For example, the IMF can provide significant policy assistance, through ongoing surveillance and technical assistance, to help the authorities design and implement macroeconomic policies. And, the IMF can use close surveillance and 'assessment letters' to provide signals to MDBs and donors, as needed. Given the low access planned for a new program, it is not clear that IMF financing is needed to deal with remaining BoP issues.

We note the authorities' request for continued Fund financial support, as described in Mr. Ondo Mañe's statement. As the Fund moves forward with discussions with the authorities on a possible new program, we encourage the staff to explore also the possibility of meeting the key objectives of a program relationship by other forms of engagement. More generally, as noted in the discussion in Mozambique, we look forward to reviewing alternative options, including a strong surveillance-type relationship, in the upcoming Board review of the Fund's role in low-income countries.

Mr. Usman submitted the following statement:

Key Points

· We commend the authorities for their steadfast implementation of prudent macroeconomic policies and structural reforms. It has helped them weather the storm of the Ivorian crisis, world market price shocks and uneven rainfall.

· High vulnerability to exogenous shocks, and the need for fiscal consolidation and deepening of structural reforms, justify further Fund involvement with financing.

· We support a successor arrangement with low access for Mali.

· The ex post analysis provides some lessons for program design in the areas of privatization, high real interest rates regimes, development of alternative policy scenarios, among others.

· Privatization is being rushed without adequate preparation on, for example, social safety nets and regulatory bodies, often leading to higher prices and unemployment, and without benefit to the local investors' participation; this explains the lack of public support.

· Efforts for diversification in the agricultural sector are being inhibited by agricultural subsidies in industrial countries.

· PRGF-supported programs should promote alternative policy scenarios, the assessment of the impact of exogenous shocks, and a methodology for contingency planning, as part of capacity building for macroeconomic management.

· High real interest rates regimes, a problem prevalent in many low-income countries, explain the lack of credit growth to the private sector.

We thank the staff for the useful papers and Mr. Ondo Mañe for his insightful statement. Mali's economy has been hit by three major exogenous shocks in 2002 and 2003: the crisis in neighboring Côte d'Ivoire continues to affect Mali, disrupting trade and transportation routes and increasing business costs; the country experienced large fluctuations in agricultural output, including that of the main export, cotton, due to uneven rainfall; and cotton and gold output and exports have been affected by price fluctuations on the world market.

The authorities performed well in adjusting to these adverse developments and macroeconomic stability was preserved; the rate of inflation and the fiscal deficit were reduced and the current account deficit was contained. The authorities also persevered with structural reforms, particularly in improving expenditure management, strengthening the banking system, and making the investment environment more conducive to private sector development. The authorities' satisfactory performance under the Fund-supported program has helped trigger assistance from development partners to help them cope with the contagion of the crisis in Côte d'Ivoire. We note from the letters distributed by the staff that the World Bank and the EU have requested the Fund's seal of approval of Mali's performance with a view to further extending concessional loans to cope with the crisis, while the international community has helped in financing the influx of refugees. We commend these efforts.

Going forward, Mali continues to face challenges in the short term. The situation in the neighboring country remains uncertain and the authorities should continue taking measures to contain the impact on their economy and preserve macroeconomic stability. Also, the appreciation of the euro against the U.S. dollar, the evolution of labor costs and the increased transport and insurance costs imposed by the Ivorian crisis have eroded Mali's competitiveness. The authorities need to expedite structural reforms in order to improve competitiveness. There is need to open new export markets, including in the region and we welcome that the authorities are committed to implementing the WAEMU common external tariff. Improving skills, containing labor costs, fostering financial intermediation, and improving access to microfinance, will also help promote non-traditional exports.

Regarding the role of the Fund, Mali has successfully implemented Fund-supported programs since 1992, with significant positive impact on reducing government intervention in the economy, promoting private sector development, improving public sector finances, improving the regulatory environment and strengthening the banking system. The country has also benefited from the HIPC Initiative, and investment in social sectors has increased. Notwithstanding these achievements, the country continues to experience large swings in output growth, reflecting the impact of exogenous shocks, mainly the vagaries of the weather, fluctuations in world market prices, and regional geo-political developments. The impact of these shocks on the balance of payments remain large and the current account deficit remains high. Moreover, the fiscal deficit remains large. We, therefore, support a new PRGF arrangement with low access for Mali, which would help to cushion the impact of exogenous shocks on the balance of payments, inflation, and the budget; pursue fiscal consolidation; and deepen structural reforms.

We observe that Mali shares most of the challenges facing other prolonged users of Fund resources and this should inform the design of future PRGF-supported programs and should also help to inform donors on how to effectively channel their assistance. A key common problem is lack of diversification. The Fund should look beyond macroeconomic aggregates, and in collaboration with the World Bank, the African Development Bank, and local institutions, explore opportunities for diversification. These include promotion of value addition, instead of exporting raw materials; development of SMEs and their enhanced access to micro-finance; and developing infrastructure. We would support, in Mali and other similar countries, identifying new drivers of economic and export growth, and assisting such sectors with subsidies and tax incentives, the fiscal position allowing. This is an area where we feel donors should also channel their assistance, into productive, employment creating and poverty reducing ventures.

High real interest rates is another common problem translating into lower credit growth to the private sector in Mali and other countries. In the circumstances, countries do not benefit from reducing inflation. Such monetary frameworks are not conducive to promoting private sector investment and growth, and the Fund should address this issue in program design, particularly where conditions are not ripe for adequate competition in the banking sector.

Privatization has not garnered enough public support in Mali and many other countries which are consolidating democracy, reflecting a number of problems that should be addressed. Privatization is often made a conditionality under programs, and rushed, selling assets at giveaway prices. Privatization is pursued prior to having adequate social safety nets to help retrenched workers retrain for other gainful employment. Privatization is always viewed as benefiting foreigners, as locals do not have sufficient financial resources to participate. Also, the absence of regulatory bodies is such that privatization becomes a mere transfer of monopoly powers from a public enterprise into private hands and, subsequently, to increase in prices and unemployment. We urge the Fund to re-examine these problems in the context of program design to help garner the necessary support for accelerating privatization in the cotton sector, airports, telecom sector, railroad management, and commercial banks. In general, privatization should be implemented gradually, starting with commercialization to eliminate losses, and subsidies from central government upfront. In this regard, we share Mr. Misra's observation that privatization, as key to diversification and high economic growth, seems overstated in the staff report.

Agricultural subsidies in industrial countries. The adverse impact of industrial countries' agricultural subsidies is well documented in literature in the context of Mali's cotton sector, but not fully reflected in the staff report. Overall, the agricultural sector provides vast opportunities for diversifying Mali's economy and in reducing poverty. However, such investment is not worthwhile in the absence of markets and if subsidies continue to distort world market prices. We urge that industrial countries remove subsidies to their agricultural products.

Finally, as the authorities contemplate an exit strategy we believe that past PRGF-supported programs have not adequately promoted alternative policy scenarios, nor have they provided scope for assessing the impact of exogenous shocks and methodology for developing contingency planning and measures. These are necessary as part of an effort to strengthen the authorities' capacity for macroeconomic management.

Mr. Brooke and Mr. Williams submitted the following statement:

Key Points

· Despite the impact of exogenous shocks, including regional conflict, weak institutional capacity and high levels of poverty, Mali has made good progress under successive Fund arrangements. We note that much of the remaining reform agenda falls within the Fund's core competencies and support the authorities' request to negotiate a new PRGF arrangement;

· A new Fund-supported program should support measures to increase revenue mobilization; strengthen institutional capacity; improve public financial management and accountability; reform the public sector, including mechanisms to ensure the wage bill and the civil service retirement fund are affordable; and, support actions to improve the investment and business climate;

· The PRGF arrangement should also include Poverty and Social Impact Analysis (PSIA) of supported reforms and include alternative scenarios on the pace of reform and levels of external assistance; and

· Options to reduce the delay between the production of the ex post assessment and successive PRGF arrangements should be considered.

We agree with the ex post assessment that the authorities have shown a strong commitment to prudent macroeconomic policies, including implementation of structural reforms, and poverty reduction under successive Fund-supported programs. The authorities are to be congratulated for this excellent performance, especially as Mali has experienced considerable exogenous shocks—including adverse climatic conditions and commodity price movements, the negative impact of regional conflict and a significant variance in external development assistance—and continues to suffer from very low capacity and high levels of chronic poverty.

We note the authorities' request for a new PRGF arrangement and, given the strong case presented in paragraphs 39 and 40 of the report, we support the staff recommendation that negotiations should start on a new program. We suggest that this new program:

· support measures to increase revenue mobilization; strengthen institutional capacity; improve governance and public financial management and accountability; reform the public sector, including advocating mechanisms to ensure the wage bill and the civil service retirement fund are affordable; and, support actions to improve the investment climate and the enabling environment for private enterprise;

· include alternative scenarios for development assistance—higher and lower cases—to build a case internally for more rapid reform and externally for larger aid flows by demonstrating the link between aid and attainment of the Millennium Development Goals (MDGs). The projections for external assistance and assumed policy scenarios should be discussed and agreed with the authorities and relevant stakeholders;

· commit to undertake Poverty and Social Impact Analysis (PSIA) for those reforms supported by the PRGF arrangements, so as to ensure the sequence and design of reforms is appropriate. (This would also address one of the authorities' key criticisms in the ex post assessment that the poverty and social impact of supported reforms was not adequately addressed in programs.)

We support many of the general comments by Messrs. Bennett and Reddell on the content of the ex post assessment, particularly on the need for a more critical analysis of Fund engagement; greater consultation with, and analysis of, the views of the authorities, development partners, civil society and the private sector; deeper analysis on the impact of exogenous shocks on the economy and poverty; and, cross-country analysis, particularly with other countries in the sub-region.

Finally, we note the significant lag in the consideration of this ex post assessment, the conclusion of the previous program, and the (possible) presentation of a successor arrangement, and we would like the management to consider options to reduce such delays in the future.

The staff representative from the African Department (Mr. Briançon), in response to questions from Directors, made the following statement:

There are three main issues that I would like to discuss in response to the questions: the ex post assessment, on which we received a number of very useful comments; comments regarding the staff report; and future Fund involvement in Mali.

Concerning the ex post assessment, we intend to take the comments received into account in forthcoming reports, which will hopefully be for a successor PRGF arrangement. But, for now, I would like to discuss the constraints under which we prepared this assessment. As you know, the guidelines were issued in July, and our mission for the Article IV consultation was at the end of August. We tried to prepare the assessment in a very short time in order to avoid further delaying the Article IV consultation. This explains why our focus was in trying to prepare a forward-looking report, rather than assessing specific measures. We conducted a broad assessment, mainly looking at the challenges ahead for Mali. We did not address the question of program design, and we did not provide as detailed an assessment as we could have if we had more time and more staff to do so.

Concerning some issues that were raised on conditionality, as many Directors noted, there was an increase in the number of conditions in the last PRGF arrangement. Some raised the question, what does that mean in terms of ownership of the program? The authorities also had some comments regarding some of those conditions. When you look at the number of conditions, you will see that about 40 percent relate to the cotton sector in the structural area. As you know, during that period, especially in 2000-02, Mali faced a very serious crisis in the cotton sector that threatened the viability of the banking system, and created large fiscal strain, since the government had to intervene to support the state monopsony, CMDT. Against this backdrop, when the staff at that time were discussing the program, it was felt that measures needed to be taken to try to stabilize the situation, which explains a number of the structural measures that were included.

Actually, there was an agreement concerning this reform and the others that were included as structural measures in the PRSP. Reform of the cotton sector, including its liberalization, is one of the important reforms that are included. I think that the authorities are fully committed to implement those kinds of reforms. Of course, once there was a crisis, some measures had to be taken rapidly, and that created some tension between what could be done and how the Fund could support this reform. As you will recall, in 2001, access to PRGF resources was increased by 5 percent of quota, because of that crisis. It seems that there was a good reason to incorporate this type of conditionality in the program.

The authorities made some comments regarding some of the conditionality being imposed, although they recognized the need for conditionality. The authorities do not have a major issue with the quantitative performance criteria and program indicators, and generally accept them. The issue is with structural conditionality, especially at a time of crisis when the authorities were trying to deal with emerging problems as rapidly as possible. It is clear that the discussions were sometimes a little more challenging than usual, and I think this fact is reflected in the comments from the authorities. The discussion we had with the authorities on the assessment was a rather broad one. We did not go into detail, measure by measure. The authorities' comments are reflective of their general impression of structural reform; it was difficult for them to move as fast as the staff was suggesting, and the staff was making suggestions trying to maintain macroeconomic stability.

There were also some comments with regard to program shortcomings that some Directors would have liked to have seen described in more detail. This would have required a much greater depth of analysis than for which we had time. Suffice it to say that, in terms of the weakness of institutions, it is probably an area where we should have taken a deeper look when the program was prepared. The administration in Mali is very weak; the staff lacks training, so implementation of a broad program is sometimes difficult. It is an issue that deserves to be considered.

There was a question on the changes in poverty and income disparity under the last three programs. First, it has been difficult, because of the lack of data, to measure the reduction in poverty at this stage. The authorities are currently working, with the donor community, on improving their social indicators and, in the coming year, we hope will have a better data set with which to assess poverty reduction. Second, there may have been some improvement, but the level of income is so low that, it does not show up in the data since a lot of the farmers remain below the poverty line. For instance, cotton producers, in a good year, receive an income of less than $1 per day. Even with an increase in income, cotton farmers would still be considered as being very poor and so we do not see this improvement reflected in the poverty data. Third, as we noted in the report, a large proportion of growth was coming from the gold sector over that period, an event not foreseen in the program. Gold has a limited impact on revenue in Mali, employing about 2,000-3,000 workers out of a workforce of about 5 to 6 million. Indirectly, because they contribute to government revenue, it had provided resources for the government to implement the poverty reduction program.

Another question concerned the reduction of vulnerability to external shocks. Some of the reforms, as the ones in the cotton sector, include measures to reduce external shocks. Better management of the cotton sector, and strengthening institutions will improve capacity to manage exogenous shocks. One aspect, which although not directly under the Fund's responsibility is nonetheless important, is improvement of infrastructure. It is somewhat surprising that Mali has essentially only one road via which exports and imports are routed. At the time of the crisis in Côte d'Ivoire, about 70 percent of Mali's trade was going through the port of Abidjan, which created serious problems for the country. It is probably why the privatization of the management of the railroad was somewhat accelerated—so that the railroad could be used as an alternate route for exports and imports.

The last aspect in terms of the ex post assessment is regarding technical assistance. There were two areas where the Fund provided technical assistance: fiscal and statistics. In the fiscal area, it was quite successful in increasing revenue and improving budget management, which includes a better procedure to monitoring poverty-reducing outlays. In terms of statistics, there was some progress in compiling macroeconomic data, which has allowed Mali to participate in the General Data Dissemination System. However, as we noted in the staff report, there are still major problems in terms of methodology and institutional weaknesses.

With regard to the staff report there was a question concerning the medium-term framework and projections. At this stage, the projections are very preliminary, as the government was still working on its medium-term framework. We will revise the projections at the time of the next mission. On the issue of the relatively large deficit and related concern of debt sustainability and whether the government should obtain grants rather than borrow from bilateral and multilateral donors, the authorities are very much aware that they are very close to the threshold, and that the situation needs to be carefully monitored. There was, as I believe we mentioned, a seminar on that issue. The authorities do their own debt sustainability analysis and it was clear for them that it is an issue that needs to be closely watched.

The situation is related, as some noted, to somewhat of a decline in external assistance relative to GDP over the medium term. It is unclear why that happened. However, at the time of the devaluation of the CFA franc in 1994-95, countries in that zone received quite a bit of assistance, the grant proportion of which has since been declining, particularly relative to Mali's GDP. This is an issue that we will again look at during forthcoming missions. I think it is also related to the existing weaknesses in managing projects. There are resources available, but the authorities have a difficult time implementing projects, so they get delayed and, as a result, some of the grants are not being used.

There were quite a few questions regarding the cotton sector, as well as a suggestion that we present a complete analysis of the sector. I believe that a couple of years ago a complete analysis had been undertaken, but we will conduct another for the next report. What I can say at this stage is that the authorities have devised a strategy and a timetable for the first stage of the liberalization of the cotton sector and divide CMDT into four private enterprises. This is obviously not full liberalization, but it is a first step that we hope will provide the time necessary for the authorities to create the institutions that need to accompany reform and strengthen producers associations that will be playing a much more important role in the sector. It will also provide greater transparency, with four companies instead of one. In case of shocks, hopefully this structure will provide a better cushion compared to what we saw in 2001-02 when there was one large enterprise that dominated the sector.

On the question of cotton subsidies from industrial countries, we are discussing this issue with the World Bank in the post-Cancùn context. At this stage, we are reviewing how we can integrate this issue into the strategy—what aspects of the reform may need to be adjusted—because there is a strong belief that, independent of the subsidies of industrial countries, reform of the sector is absolutely essential so that it might contribute to growth and poverty reduction in Mali.

There were some questions regarding fiscal policy, including mention of the civil service and the fact that about 7 percent of the wage bill was going to ghost employees. Last February the government conducted a census of all public employees, which was also a prior action for the last program. Public employees had to come and show their administrative file to demonstrate they were effectively employed by the government. About 5 percent of the public employees did not show up. We urged the authorities to stop paying salaries to that 5 percent of employees, an action which they took in November. Our understanding is that after the authorities stopped paying these salaries, a portion of this group did show up. So, it is difficult to say what the result of the census was, as we do not yet know. We do not have the information.

There was also a question regarding the creation of a youth job program. This is correct, the government is trying to launch a youth job program, and are now in the process of creating an agency. They have set a budget allocation of CFAF 1.2 billion for 2004, but not much was done up to now.

There was also a question concerning revenue contributions from the gold sector, and related technical assistance. A mission from FAD is scheduled for mid-January to look at this issue. That mission had been delayed by about six months.

Regarding future Fund relations with Mali, when we discussed the issue in Mali there was a very broad consensus among the government, business community, trade unions, and donors, on the need to have a Fund-supported program for different reasons. In general, the authorities want to be able to discuss a program with the Fund, as it gives more credibility to the program and could strengthen their hand if it is assessed as a strong program. They consider that a very important element. Others consider it important that the Fund continue its surveillance and help monitor government policy, especially for those who have less access to information on the country. Bilateral donors, for example, consider the Fund is in the best position to conduct macroeconomic analysis and, if the Fund were not so involved, there was a risk that disbursement of some of financing might be delayed.

The staff representative from the Policy Development and Review Department (Mr. Fetherston) added that the suggestions that Directors had made on the form and content of ex post assessments were well-appreciated. The comments were similar to those raised at the recent Board discussion on Mozambique. The staff would be reflecting carefully on the implications of Directors' suggestions and views for future ex post assessments.

Mr. Daïri thanked the staff for their clarifications, and added that the ex post assessment would have been the place for in-depth analysis of the key long-term issues, such as income disparity, the cotton sector, and declining external assistance, that Mali was facing. The issues might become diluted over time, in the absence of a firm timetable to investigate these issues, although there was an FAD mission to Mali next month. The staff was encouraged to undertake that analysis.

Mr. Williams agreed with the staff's evidence in support of a successor Fund-supported program, including Mali's continued vulnerability to exogenous shocks, especially relevant because it was geographically situated in West Africa, a region which had experienced several conflicts. In the event of a shock, a Fund-supported program and the familiarity it afforded to the country would allow the Fund to act quickly, efficiently, and effectively. Also, in West Africa specifically, and sub-Saharan Africa more generally, future Article IV consultations would benefit from a greater discussion on HIV/AIDS, especially in light of the detrimental impact the pandemic had on growth. The crises in the region had led to a migration of workers, and with it, increased channels through which HIV/AIDS might be spread. This issue would probably warrant greater attention in future documents.

The staff representative from the Policy Development and Review Department (Mr. Fetherston) took note of the suggestion about the treatment of HIV/AIDS, and indicated that although HIV/AIDS had featured prominently in reports of southern African countries, there may be scope to extend such coverage to the West Africa region as well.

Mr. Ondo Mañe considered that the absence of clear guidelines on how the Fund should be involved in low-income countries, was detrimental for countries that were on a positive path to reform and that had performed well under Fund-supported programs. The problem was highlighted during the discussion on Mozambique, with no clear conclusion. He urged the Board to rectify the situation, and noted that the issue had also been raised in the recent discussion on the Board's work program.

Mr. Daïri strongly supported Mr. Ondo Mañe's comments, and added that the Fund would have to be careful in setting an appropriate incentive structure, especially regarding good performers.

The Acting Chair (Mr. Carstens) noted the point made by Messrs. Ondo Mañe and Daïri.

Mr. Boitreaud made the following statement:

> I would like to commend the Malian authorities for their strong economic and fiscal policy performance, which has fostered macroeconomic stability and allowed for steady progress on the structural front, despite the vulnerability of the country's economy to recurrent droughts, large fluctuations in commodity prices, and the adverse impact of the crisis in Côte d'Ivoire. This good macroeconomic performance lays the ground for a market-led economy and private sector development that will generate, hopefully, growth and welfare to the population. As we already had this year, opportunities to comment at length on the performance of Mali at the occasion of the completion point and of the reviews of the recent PRGF arrangement, I

will limit my intervention to three broad comments: the impact of the Ivoirien crisis and regional integration, lessons from the ex post assessments in the performance of Fund-supported programs, and the future role of the Fund in Mali.

First, Box 1 in the report highlights the major long-run impacts of the Ivoirien crisis on Mali's economy, due to transport cost increases and delays, especially for the cotton sector—a point mentioned by the staff today. It describes, also, the shortfall of tax revenues and the loss of regional trade activities. The Malian authorities took prompt action to facilitate the rerouting of trade through alternative ports in West Africa and minimized the impact of the crisis on the private sector, and granted some tax exemptions which helped to mitigate the impact on the economy. Now, the authorities are accelerating the rehabilitation of major access roads and are intensifying trade facilitation activities in close cooperation with their neighbors. There is often a silver lining in the most clouded sky and maybe the crisis in Côte d'Ivoire plays the role of an electric shock, underscoring painfully the importance of more, and better, regional integration, coupled with improved regional infrastructures, especially the transport network, but also more diversified trade.

Second, we welcome the staff's ex post assessment of Mali's performance under Fund-supported programs—the second one, after the recent case of Mozambique. We thank the staff for having produced this document on short notice. Given the number of prolonged users of Fund resources in Africa, it is clear that the burden of producing ex post assessments weighs, and will weigh, heavily, on the staff members working in this region, who are already under intense pressure. So, let me take this opportunity to underline that their work and efforts are both appreciated and valued by this Chair.

The ex post assessment, as mentioned by the staff, is still an ongoing process, and we would like to offer, like other Directors, some suggestions for future assessments. Like Mr. Bennett, we believe that a clear strategy should be mapped out on how to make the country less vulnerable to shocks and better able to deal with them should they occur. This is an issue that does not concern only Mali, but many other low-income countries, especially in Africa. We encourage the staff to provide the Board with innovative proposals in our forthcoming discussion on the role of the Fund in low-income countries.

Like Mr. Daïri, we noted with interest that the authorities believe that the pace of reform was too fast, there was not enough flexibility to accommodate exogenous shocks, and conditionality was too demanding and often imposed rather than negotiated, which resulted in weakening ownership of the program. A look at Box 2 in Appendix I, shows a clear increase in the number of structural and quantitative performance criteria from the first ESAF-supported program to the last PRGF-supported program. This pattern is certainly justified at least in part, as explained by the staff, but I think more space could have been granted to this issue in the ex post assessment. More generally, the effectiveness of this assessment would be further improved by providing more space for the authorities' views.

Third, concerning future relations between the Republic of Mali and the Fund, we are convinced that, at this stage, the country still needs the framework of a Fund-supported program. As described in the case of Mozambique last week, Mali remains subject to external shocks, potentially affecting the commodity prices of its imports or main exports, but also, as mentioned earlier, the economy of this landlocked country of the Sahel region is still highly vulnerable to regional political instability and adverse weather conditions. Moreover, Mali remains a very poor country, with a per capita income below $250 dollars, and ranks 172 out of 175 in the 2003 UN Human Development Index. Last, but not least, we have to mention the lack of institutional and human capacities.

Regarding the modalities of the Fund's continued financial involvement in the country, we are rather open. Like in the case of Mozambique, a low access PRGF arrangement is the only available option under our current policy but, depending on the timeframe and outcome of our discussions on the role of the Fund in low-income countries, other alternatives could be envisaged, like a precautionary PRGF arrangement and a surveillance instrument dedicated to protecting poor countries from external shocks. In any case, we believe that the choice of the instrument should put great emphasis on the needs of the country as described by the authorities, who remain the best experts in this domain.

Regarding the content of a potential, new PRGF-supported program, we see merit in many of the suggestions made by Mr. Brooke and Mr. Williams in their preliminary statement among others, such as the inclusion of alternative scenarios for development assistance discussed and agreed with the authorities and other relevant stakeholders, and the commitment to undertake poverty and social impact analyses for those reforms supported by the program, so as to improve their design and sequencing.

With these comments, let me again commend the authorities, and thank the staff, and wish the authorities every success in their road toward sustainable growth and poverty alleviation.

Mr. Moreno made the following statement:

We start by thanking the staff for the very balanced and comprehensive set of papers, and Mr. Ondo Mañe for his helpful statement. We appreciated the appendix of the ex post assessment of performance under

IMF-supported programs. This is the second of such reports under the guidelines for countries with longer-term program engagement. As other Chairs have stressed, it is a good starting point. We broadly share the staff's assessment and will limit our comments to a few main aspects.

First, we believe that it is important to stress the authorities' good performance in adjusting to major exogenous shocks in the past two years, most notably from the crisis in Côte d'Ivoire and weather-related declines in cereal and cotton production. Mali continues on a good path toward macroeconomic stability, with sustained growth and declining inflation. Consistent economic policies have been reflected in Mali reaching the completion point under the enhanced HIPC Initiative in March 2003.

Second, despite this short-term success, many challenges remain ahead for a country among the poorest in the world and, as Mr. Boitreaud has stressed, ranked fourth to last in the UNDP Human Development Index. Policy efforts should aim at accelerating growth, reducing poverty, and increasing Mali's competitiveness to reduce vulnerability to external shocks. Among the main policy actions, we would stress the need to advance measures to diversify the economy, revenue mobilization, improve expenditure management, deepen financial intermediation, improve the investment climate, and pursue further integration within the WAEMU.

Third, these challenges will require a combination of a number of efforts: strong political commitment, coordinated donor support, and enhanced assistance from the international community. Among these efforts, we believe that strong and continued Fund involvement in the country will be central. Mr. Ondo Mañe's statement clearly expresses the importance that the authorities attach to a Fund-supported program as a guide for reform, catalyst of donor support, and attraction foreign direct investment. The staff again stressed the importance of this Fund-supported program at the beginning of this meeting.

We think that there is a consensus in the Board on the need to continue our engagement with Mali. We will have the opportunity to evaluate that engagement in a future meeting, when a new potential Fund-supported program is presented to the Board. While we should not prejudge this commitment, we believe that the staff makes a clear case for a successful PRGF arrangement, for the reasons explained in paragraphs 39 and 40. As of now, a successor PRGF arrangement is the main instrument at hand to continue our support to Mali, which is a good example of success in Fund involvement. The possibility of other forms of engagement that might come up in our discussion on low-income countries in January, as has been suggested by some Chairs, will be something that we might consider if and when they are available.

Finally, on a procedural note, we would welcome clarification from the staff on the presentation of the ex post assessment of performance under IMF supported-programs. In the case of Mozambique, it was presented as a separate paper, which led to a discussion on how the Board assessment of the documents should be included in the summing up. Here, we have an appendix which, in my view, justifies a more clear reference in the summing up as far as the Board assessment is concerned. I would like to ask which of these two forms we expect to be the norm in the future.

To conclude, we would also like to associate ourselves with the comments made by Mr. Reddell on the need for a standardized cross-country analysis, especially in surveillance reports, and with Messrs. Reddell and Bennett, and others, on the potential for improving ex post assessments with a more analytical approach in terms of the lessons learned from our involvement, and greater analysis of the views of the authorities and development partners. Here, we would also welcome comments from the staff on the input received from the World Bank and outside experts in the preparation of the assessment as established by the guidelines.

With these remarks, we wish the authorities all success in their endeavors.

Ms. Zubkova made the following statement:

This year appears to be particularly noteworthy for Mali's relationship with the Fund, as it was marked by the successful conclusion of two programs: first, reaching the completion point under the enhanced HIPC Initiative in March and second, completing the final review of the PRGF arrangement in August. In light of this, and taking into account the authorities' willingness to have a successor PRGF arrangement, today's discussion represents a good opportunity to give careful consideration to the performance of Mali under past Fund-supported programs. In this respect, the staff paper provides helpful analysis and basis for the discussion, and I would like to thank the staff for their efforts. I would also like to thank Mr. Ondo Mañe for the updated and useful information on the recent developments in Mali.

I agree with many of the general comments made by Messrs. Bennett, Reddell, Kremers, and Croitoru on the content of the ex post assessment, including that it would benefit from cross-country analysis, as well as a stronger focus on possible lessons for the Fund. Still, the results of the assessment presented in the staff paper are encouraging. I was pleased to note the numerous accomplishments reached by Mali in different areas under Fund-supported programs over the last 10 years, including acceleration of growth, improvement in the fiscal stance and debt sustainability, trade liberalization, and progress in the privatization program.

However, despite all this progress, key challenges remain for Mali in the areas of poverty reduction and economic diversification. It is disappointing to learn from the staff that the progress in these areas is likely to be slow and uncertain. At the same time, it testifies that despite the strides made during the last decade, there remains a substantial unfinished agenda of reforms. Therefore, it is encouraging that a broad political consensus exists on current policy orientation, which gives hope that the government will remain strongly committed to their started reforms.

In light of this, I agree with the staff that renewed support from the Fund would help the authorities to continue their reforms and mobilize foreign financial assistance. I agree that a new arrangement should be with low access, or perhaps even of a precautionary character.

I concur with staff on the main challenges Mali faces. However, I would like to make some points for emphasis with regard to the possible future arrangement.

No doubt, achieving high and sustainable growth is a priority for Mali's authorities. In this regard, the per capita income growth of 2 percent in Mali appears to be the average level achieved during the last decade among countries with a PRGF arrangement. However, one can still observe the weak link between growth and poverty reduction, keeping in mind that Mali remains one of the poorest countries in the world. It testifies that individuals are ill-placed to take advantage of new opportunities created by the adjustment programs. The concern that the poor do not share fully in growth is disappointing and is not a unique problem among countries with PRGF arrangements. In this regard, I join Mr. Misra in welcoming the more detailed account of the impact of the Fund's programs on the poverty reduction in Mali as well as the increased focus on the impact of this on the possible new program.

The reinforced structural focus under the new program would have seemed appropriate. More specifically, as the cotton sector problems have important macroeconomic repercussions, and although they are not in core areas of the Fund, they should remain in conditionality. However, I note that although the number of structural benchmarks increased throughout the successive programs, their performance in fact worsened, as it follows from the staff's assessment that the performance was better under the ESAF arrangement than the last PRGF arrangement. In this regard, it would be interesting to learn the staff's view of whether they suppose that 26 structural benchmarks under the last PRGF arrangement were too many for successive implementation and if it was not sacrificing quality for quantity?

There are a number of important challenges on the fiscal policy front, such as to enhance revenue mobilization, improve governance, and strengthen the institutional capacity. Taking into account the high primary fiscal deficit and projection for increasing debt, it is hard to reject the staff's suggestion for consolidation. On the other hand, the possibilities for a revenue increase in the near term are rather vague and most of the burden of adjustment will fall on the expenditure side, making the task of consolidation even harder and barely feasible, particularly if one takes into account the huge financial needs of the country with regard to the PRSP. In light of these facts, I wonder which level of fiscal consolidation appears feasible to the staff.

On the expenditure side there is a clear need for an improvement in prioritization. This need is underlined throughout the paper in several ways. First, the share of social spending items, though improved slightly this year, continues to be very low. Second, the growth of the wage bill is barely attributable to recruitments in priority sectors, like health and education. More on the expenditure side, a solution has to be found in the near future for the reduction of the widening deficit of the civil service retirement fund, which is financed through the budget. In fact, I got the impression that there are many more challenges on the expenditure side than on the revenue side in the near term. At the same time, I note the technical assistance mission from the Fund in the nearest months is expected to assess the tax policy, not expenditure policy, even though during the period in review 8 technical assistance missions on tax policy have already taken place.

Last but not least, diversification and attracting private foreign investment rightly continue to be at the central agenda of the government. In this regard, I very much welcome the authorities' intention to undertake, with the assistance of the World Bank, an Investment Climate Assessment.

Mr. Zakharchenkov made the following statement:

At the outset, let me commend the staff for the interesting papers and Mr. Ondo Mañe for his informative statement. Since we are in broad agreement with the staff's assessment of recent economic developments and generally concur with the policy matrix proposed for 2004, I will focus my remarks only on the most important issues.

First, as we commented during the discussion on the similar case of Mozambique, a low access PRGF arrangement is the most appropriate tool of future Fund engagement in Mali at this stage. In light of the generally strong track record of implementation of Fund-supported programs over the past 10 years, we are in favor of a successor PRGF arrangement.

Second, with regard to the ex post assessment of performance under previous Fund-supported programs, we think that it is overly descriptive and would benefit greatly from the inclusion of a more critical analysis, cross-country comparisons, and a clear description of the goals of the past IMF-supported programs, as well as the track record in meeting these objectives. In this connection, we share the views expressed by Mr. Bennett and Mr. Reddell in their preliminary statements on this subject.

Third, fiscal issues warrant the particular attention of the authorities. We noted the existence of a residual fiscal financing gap of 2.5 percent of GDP for 2004 that is yet to be secured. Should the authorities experience difficulties in securing the necessary donor financing, it may be necessary to rollover maturing government domestic bonds instead of reducing net domestic liabilities as proposed by the staff. The growing wage bill outside the social sector is a source of concern. The authorities should reassess their wage policy to make it consistent with the need to increase recruitments in the social sector. Finally, we agree with the observation that public borrowing to finance fiscal deficits in the period ahead should be limited in order to prevent another debt build-up, as suggested by Mr. Baukol.

Fourth, on the structural front, we welcome further steps to strengthen expenditure management, implement reform of the cotton sector, and continue the privatization process, including the banking sector. The development of MTEFs for health and education with the participation of the World Bank is a welcome step. However, in order to lay a solid foundation for sustainable private sector-led growth it will be important to avoid disruptive administrative measures like granting tax amnesties, which rose considerably in the first half of 2003, and offering subsidies, most notably in the cotton sector, as noted by the staff in paragraphs 21 and 28 of the report.

With these remarks we commend the Malian authorities for the considerable progress achieved thus far in the economic reform process and we wish them continued success in their future endeavors.

Mr. Abel made the following statement:

We welcome that, by following the staff's advice, Mali has again significantly improved its macroeconomic performance during the past year. Even though the outlook for 2003 has been threatened by political crises in the region, the authorities' commitment to reform remains strong. And indeed the worsening of external conditions makes adherence to the Fund's guidelines all the more important.

We are also glad to know that the Malian authorities are fully aware of these difficulties, and are firmly determined to implement the reform program and make progress with their poverty reduction strategy, as pointed out by Mr. Ondo Mañe. The authorities understand that in order to create the strong, sustainable growth needed to reduce Mali's widespread poverty, the economy must be diversified beyond the cotton sector, the export base must be expanded, and private sector development must be promoted.

It is regrettable that progress so far with this well-conceived agenda remains so slow.

We welcome the authorities' firm intention to proceed with privatization as Mr. Daïri, Ms. Jacklin, and Mr. Baukol also noted. This is a welcome change, but again burdened by past delays.

As Ms. Jacklin and Mr. Baukol noted Mali has had an IMF-supported program with only a few interruptions for 20 years. As several other Directors, we welcome the preparation of an ex post assessment of past programs as part of this Article IV staff paper. We agree with the overall assessment that the authorities made good progress in the context of past programs. We also concur with Ms. Jacklin and Messrs. Baukol, Bennett, and Reddell that the ex post assessment would have been more useful if it had included a clear description of the goals of the past IMF-supported programs and the track record in meeting their goals, including the effectiveness of IMF technical assistance.

We find the staff's arguments in favor of a new low access PRGF-supported program convincing. We concur with Ms. Jacklin and Mr. Baukol that we should also consider a wide range of other possibilities, including the Fund's involvement in helping policy formulation and implementation, in dealing with shocks, and providing signals to donors.

We note the authorities' request for continued Fund financial support, as described in Mr. Ondo Mañe's statement. As the Fund moves forward with discussions with the authorities on a possible new Fund-supported program, we encourage the staff to also explore the possibility raised by Ms. Jacklin and Mr. Baukol in relation to other forms of engagement.

However, we maintain the same arguments that we and some other Chairs made a few days ago in favor of a PRGF-supported program for Mozambique, namely, we do not think that replacing a Fund-supported program with ongoing surveillance activities and technical assistance, as proposed by our German and U.S. colleagues, provides the same level of political support for reform, nor does it constitute a clear enough signal to other donors.

We support any form of continued cooperation between Mali and the Fund.

We also agree that Mali will be a good example to consider in next January's review of Fund involvement in low-income countries.

We wish all success to the authorities in their efforts.

Mr. Al-Nassar made the following statement:

I thank the staff for the well-written and insightful report, and Mr. Ondo Mañe for his comprehensive and helpful statement. I welcome Mali's continued economic growth in conditions of sustained low inflation and rising external reserves. The authorities are indeed to be commended for this creditable outcome in the face of adverse effects resulting from the crisis in Côte d'Ivoire. I am also encouraged by the authorities' determination to maintain macroeconomic stability and speed up structural reforms. I broadly agree with the staff's appraisal and will add a few remarks for emphasis.

On the fiscal front, the limited consolidation over the next three years is understandable in view of the need to increase spending on the social and other priority programs. However, the envisaged increase in the wage bill and the rise in government subsidies and transfers in the 2004 budget is a concern. Here, I agree with the staff on the need to contain expenditures by tightening the wage policy. In this regard, I welcome the efforts to strengthen expenditure management, especially the measures taken to strengthen tracking of poverty-reducing outlays and the ongoing work on a comprehensive medium-term expenditure framework for health and education. I also agree that additional revenue-enhancing measures may be needed in order to attain the revenue target.

On structural reform, further strengthening and deepening of financial sector reform is a priority. It is clear that the lack of competition, high level of nonperforming loans, and high operating costs have led to wide spreads and to limited bank lending. In this regard, I welcome the ongoing restructuring and privatization of the commercial banks. I also welcome the greater focus on the growth potential of microfinance institutions, which is important for developing the rural sector. Moreover, the effort to strengthen the legal and regulatory framework of the financial sector with assistance provided by the World Bank is encouraging.

Turning to other structural reforms, I am encouraged by the continued efforts to strengthen the reform of the critical cotton sector. Clearly, completing the privatization program, enhancing the legal and regulatory environment, and improving human capital and physical infrastructure are also crucial for Mali's growth prospects over the medium term.

Finally, given the authorities' overall good track record under the previous program and since a considerable part of the remaining reform falls under the Fund's core areas of responsibility, as noted by the staff, I support continued Fund involvement in Mali through a successor PRGF arrangement.

With these remarks, I wish the authorities success.

Mr. Santos made the following statement:

We thank the staff for a job well done. The main message that we take from the report is that the Malian economy will face an important challenge, as its additional sources of growth, mostly in export-oriented sectors—which allowed higher growth to co-exist with the narrowing of external imbalances—are now set to fade and have reduced contribution to economic activity. Therefore, new sources of growth need to be identified, and preferably in sectors that allow the pattern of export-led growth to persist.

The report also identifies foreign direct investment as the main ingredient to achieve a more diversified, but still export-led, pattern of growth. To that end, it stresses the need to reduce costs and pursue reform policies that strengthen productivity growth. In view of the rigid policy environment and, in particular, with the monetary and exchange rate arrangement in place, that is, no doubt, the only way to improve external competitiveness.

While that is obvious policy advice, no quick results should be expected in terms of both a higher level and lower variance of economic growth, particularly as macroeconomic policies are rigid, an exchange rate buffer is not available, and structural reforms take time to deliver dividends in terms of higher productivity growth. Moreover, as far as cost-cutting measures are concerned, the generous wage increases already granted to civil servants. and intentions implicit in the budget, raise some concern—even more so if the private sector, which is supposed to be an engine of growth, is bound to follow the wage norm set by the public sector.

In this regard, while we understand that it might be difficult to calculate, the real effective exchange rate measured on the basis of unit labor cost rather than on the CPI would provide another good measure of external competitiveness. Since labor productivity has not matched wage growth, it is not difficult to guess that growth in unit labor costs has outpaced consumer price inflation and, hence, a real effective exchange rate based on unit labor costs could well lead to a different and less benign picture regarding external competitiveness.

Finally, I have one point on the cotton sector. The report notes that this sector has been affected by subsidies granted in industrial countries to cotton production, as they have kept world prices depressed. However, it is mute on the potential effect of the sharp appreciation of the CFA franc vis-à-vis the U.S. dollar, which is the currency of denomination of world cotton prices, since production prices that are more relevant for production decisions, are set in CFA franc and the appreciation, per se, contributes to keeping production prices depressed, or, to the extent that such prices are protected, to reduce profitability of the sector. We believe this should also be clearly understood.

Mr. Inderbinen made the following statement:

> From our part, we would like to commend the authorities for strengthening economic policy over the last decade in a period that was often fraught by a difficult external environment. We would also like to thank the staff for the documentation and, in particular, the ex post assessment, which we thought contained much insight. We would, however, like to associate ourselves on this point with Mr. Reddell, Mr. Bennett, and others. We also believe that such assessments will profit from more material on achievements against original program targets, on the shortcomings of policies, and especially on the Fund's advice and conditionality. We believe in this instance that among the areas that would have merited closer attention is the sequencing of structural reforms, not least because this was mentioned by the authorities as well, and the effectiveness of the substantial provision of technical assistance. We take the staff's point on these issues, in that the first assessment of technical assistance was positive, I believe, and also that the suggestions will be taken up in further Article IV rstaff eports and ex post assessments contained therein.
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> Finally, on the authorities' request for a further program, we believe, like others, that a low access PRGF arrangement would be the most appropriate at this point in time. However, like other Chairs, we are also looking forward to discussing alternative possibilities for Fund engagement in countries like Mali—low-income countries that are among the more advanced in terms of stabilization and reform. On this, we take Mr. Ondo Mañe's point on not penalizing good performers, and Mr. Williams's point on the vulnerability that these countries often are exposed to.

The staff representative from the African Department (Mr. Briancon) responded to questions concerning public expenditure, by indicating that the World Bank was working with the authorities to develop medium-term expenditure frameworks for health and education, which would be extended to the rest of the public sector. Therein, the implications for reaching key Millennium Development Goals were also being reviewed. On the issue of the effect of the appreciating U.S. dollar, it had been more than offset by the increase in cotton prices. In dollar terms, the price of cotton had reached 72 cents a pound, up from the January level of 36 cents, and just below the November peak of 80 cents. Preliminary indications were that CMDT would post a significant profit in 2003.

Mr. Santos stated that he understood that world market prices of cotton went up in dollar terms, but notwithstanding, that industrialized countries' subsidization of their domestic cotton sectors has had a dampening effect, and led to a depressed price for cotton on the world market, as has the appreciation of the euro in CFA terms. He hoped that world market prices stayed at the current levels, otherwise if the exchange rate movement did not unwind, it would be problematic.

The staff representative from the Policy Development and Review Department (Mr. Fetherston) responded to points on the format of ex post assessments, and recognized that Mali's ex post assessment was treated differently than that of Mozambique. The staff was currently refining proposals for standardized procedures.

Mr. Ondo Mañe made the following concluding statement:

> Let me thank the staff for their hard work in Mali, especially in the absence of clear guidance of the Fund's role in low-income countries, and in particular, in countries with, albeit successful Fund-supported programs, prolonged use of Fund resources, and for their comprehensive answers on questions raised by Directors. Also, I would like to thank my colleagues for their comments and policy advice on Mali. I can assure you that I will faithfully convey to my authorities, your suggestions and recommendations aimed at helping them strengthen their economic policies and measures.
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> As I indicated in my earlier statement, despite an unfavorable regional environment, Mali's economy and financial performance continued to improve, as evidenced by GDP growth and a decline in the inflation rate. With the high culture of consensus that exists between the government and civil society in Mali, my authorities are confident that they will achieve further progress, not only in the economy, but also in social and political areas.
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> As recognized by Directors, my Malian authorities have made good progress on the three successive programs since 1992. Directors also recognized that over the past three years, my Malian authorities have implemented a strong macroeconomic program, particularly in the cotton sector, despite an international decline in prices resulting from subsidies to cotton production in industrialized countries. The favorable domestic environment has been fostered by prudent policy measures implemented by my authorities.
>
> My Malian authorities have also made important progress in implementing the PRSP. They are determined to use the available financial resources to improve the living standards of the population. They agree that fiscal consolidation is of paramount importance, and will make every effort to contain expenditure and improve revenue collection and governance. As I already indicated, and as advised by Directors, the strategy will focus on diversifying the productive base, enhancing competitiveness, and preparing the economy for durable and sustainable growth led by a strong private sector.
>
> Although Mali has reached the completion point under the HIPC Initiative in March 2003, there are still a number of challenges that my Malian authorities are determined to steadfastly address, as they recognize that the reform agenda is still unfinished. For that reason, they see support from the Fund as an essential element of their economic development. In this context,

we consider Mali's access to Fund financial assistance as very important. Here, I would like to thank Directors who have recognized Mali's continued vulnerability, as evidenced in the debt sustainability analysis and the completion point document, which indicate that its debt-to-export ratio would increase rapidly, and the overall situation could worsen dramatically, if the country is hit with a series of exogenous shocks.

Before I conclude, let me assure Directors, once again, that I took note of their comments and statements. I took note of the recommendations made by Mr. Misra, Mr. Daïri, and others on the cotton sector, market access issues, private sector development, economic diversification, quality of ex post assessments, and the future role of the Fund in Mali. Also, I would like to thank Mr. Boitreaud and Mr. Reddell for their clear statements on the role of the Fund, the importance of exogenous shocks, and issues related to ownership of the country and the design of Fund-supported programs.

To conclude, let me thank the staff for their support and advice to my Malian authorities, and take this opportunity to reiterate their strong determination to pursue their reform effort. I am confident that, as in previous programs, my Malian authorities can count on technical advice and financial support, as well as a further increase in ODA from the international community, to pursue economic development.

The Acting Chair (Mr. Carstens) reminded Directors that the current meeting dealt with the second case of an ex post assessment. As had been done in the first case of Mozambique, the Article IV summing up would form the basis of a PIN, and the second part of the summing up would capture Directors' comments on the ex post assessment and issues related to the Fund's future involvement in Mali, and would not be published.

The Acting Chair (Mr. Carstens) made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal, and welcomed the opportunity to review Mali's performance under Fund-supported programs since 1992. They agreed that during this period important progress was made by the authorities with respect to macroeconomic management and implementation of structural reforms, which has helped strengthen Mali's economic performance and lay the basis for sustained growth and poverty reduction. However, Directors considered that Mali continues to face serious challenges, including its vulnerability to exogenous shocks and the impact of the crisis in Côte d'Ivoire.

Directors welcomed the work done by the staff to identify key policies to address these challenges, based on its review of Mali's long-term performance under Fund-supported programs. The priorities include consolidating the fiscal position, bolstering competitiveness and diversifying the economy, and enhancing the business climate—including through privatization and improved governance—in order to spur growth and reduce poverty. Looking ahead, Directors noted the favorable prospects for 2004, especially if the regional security situation stabilizes, with stronger domestic demand expected to be underpinned by higher output and prices of agricultural commodities, notably cotton. They urged the authorities to use the opportunity provided by the favorable outlook to press ahead with the implementation of the above-mentioned policies.

Directors commended the authorities for their actions to strengthen fiscal performance, noting that fiscal objectives for 2003 appear likely to be met, despite domestic and external budgetary pressures. They called on the authorities to stay the course of fiscal consolidation and adopt measures to ensure that the 2004 fiscal targets are attained. These measures should center on strengthening revenue performance by reducing tax exemptions, reining in the growth of public sector wages as well as of expenditure not directly related to poverty reduction, and reforming the civil service retirement scheme. Directors expressed concern about the initial medium-term projections, which suggest a possible widening of the fiscal deficit and an increase in debt. To protect against these vulnerabilities, Directors called for continued efforts to reduce the fiscal deficit, monitor the debt burden closely, and increase reliance on external grants.

Directors welcomed the marked decline in inflation in Mali, and the recent lowering of interest rates by the Central Bank for West African States (BCEAO). Directors noted that Mali's financial institutions generally comply with prudential norms. They expressed concern, however, about the high level of nonperforming loans. Directors urged the authorities to continue to strengthen the legal and regulatory framework for the financial system and to promote financial deepening. In this context, they welcomed the authorities' plans to privatize the commercial banks, and urged the further development of microfinance institutions in rural areas. While welcoming Mali's recent efforts in the area of combating the financing of terrorism, some Directors also called for further strengthening of the effectiveness of the AML/CFT regime.

Directors emphasized the need for ongoing implementation of the wide-ranging agenda of structural reforms. In order to meet the objectives of promoting economic diversification and improving the environment for private investment, the authorities will need to give high priority to developing infrastructure, streamlining the regulatory framework, improving governance and the judicial system, and enhancing labor productivity. In this connection, Directors looked forward to the planned Investment Climate Assessment to be undertaken with the assistance of the World Bank.

Directors underlined the importance of reforms in the cotton sector. They welcomed the decision to split the cotton monopsony (CMDT) to help increase competition in the sector over the medium term. Given the importance of the cotton sector, Directors encouraged the authorities to proceed with the implementation of these plans in a careful and orderly manner. A few Directors noted the adverse effects on Mali of subsidies to the cotton sector in some industrialized countries, and cuts in this support were called for.

While Mali's economic data are generally satisfactory for surveillance purposes, Directors encouraged the authorities to continue to improve the quality and timeliness of national accounts data in line with the recommendations of the recent STA multi-sector mission.

Looking ahead, Directors concurred that further financial support in the form of a low access PRGF arrangement offers the best prospect for assisting the authorities to implement the remaining reform agenda and tackle the enormous challenges still facing Mali. However, a few Directors noted that the projected balance of payments surplus over the medium term and increased donor support raised questions about the need for further Fund financial assistance, and urged the consideration of other forms of Fund involvement.

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

Points Related to Future Fund Involvement

Directors noted that Mali has completed satisfactorily three Fund-supported programs since 1992. These programs, together with the political transition to a democratically elected government and the devaluation of the CFA franc in 1994, have contributed to stabilizing the economy, achieving strong growth, keeping inflation low, and narrowing the external current account deficit. The authorities' success under these arrangements also allowed Mali to reach the completion point under the enhanced HIPC Initiative, which led to a marked reduction in the country's debt burden. However, despite some progress in improving social conditions, poverty remains high. Moreover, as a landlocked country in the Sahel region with a narrow economic base, Mali's economy is still very vulnerable to exogenous shocks, including droughts, fluctuations in terms of trade, as well as a difficult political environment in some of the neighboring countries.

Directors took note of the authorities' strong interest in a successor PRGF arrangement to support the implementation of the unfinished reform agenda and assist them in framing policies that maintain macroeconomic stability. Given the authorities' strong record of policy implementation, most Directors expressed support for considering a successor PRGF arrangement with low access. Such an arrangement would underpin a comprehensive set of policies aimed at accelerating growth and reducing poverty, provide a framework, under alternative scenarios, for policy adjustment in case of exogenous shocks, and facilitate the coordination of international financial support. Directors observed that much of the remaining reform agenda falls within the Fund's core competencies. However, a few Directors asked the staff to explore the alternative options to a Fund arrangement, including technical assistance, surveillance, and close collaboration with donors.

The staff will continue to explore ways to ensure continued close Fund involvement with Mali, including a possible successor arrangement. In carrying their work forward, the staff will take into account the lessons learned from the ex post assessment and Directors' views and suggestions during today's Board discussion.

Mr. Moreno pointed out that, in the summings up of the two ex post assessments cases so far, the Board's views on the ex post assessment had been confined to the section that was not for publication. In the case of Mali, the ex post assessment was actually part of the Article IV staff report, and not a separate document. In addition, Box 6 of the report was a summary of the ex post assessment. It would be useful and more transparent to include references to Board views on the ex post assessment in the Article IV summing up, which could then serve as the basis for the PIN.

Mr. Williams, supported by Messrs. Boitreaud, Inderbinen, Croitoru, and Vermaeten, agreed with Mr. Moreno's comment, and added that the Article IV consultation PIN should also note the Board's support for a low access successor PRGF arrangement.

Mr. Ondo Mañe expressed reluctance to link the Mozambique and Mali cases, and indicated that he did not want to see Mali's position weakened in the interest of building a precedent for summing up procedures. Directors' views should be reflected in the Article IV consultation summing up, including Directors' support for a new PRGF-supported program, maybe with low access.

The staff representative from the Policy Development and Review Department (Mr. Fetherston) stated that both for Mali and Mozambique, an internal summing up had been appended to the Article IV consultation summing up. It was agreed that, in the case of Mozambique, the Article IV consultation summing up would include a brief statement concerning Directors' views on future program engagement with that country. In the Article IV consultation summing up for Mali, there was more than a brief reference to issues of future program engagement.

Mr. Williams noted that there were two issues with respect to the ex post assessment. The issue dealing with a future Fund arrangement in Mali was sufficiently addressed in the Article IV consultation summing up. The other, on the Board's views on the quality and content of the ex post assessment, was not reflected in the current draft of the Article IV summing up. The Article IV consultation summing up should include some broad, general comments in this regard. More pointed, specific comments could be reserved for the internal summing up.

The Acting Chair (Mr. Carstens) agreed with Mr. Williams and considered that the draft Article IV consultation summing up adequately reflected the view that most Directors supported, in principle, a successor Fund arrangement for Mali, while a few Directors indicated their desire to explore alternative arrangements. In response to Mr. Ondo Mañe's comment, Mali's position was not being weakened to facilitate the creation of any precedent for summings up. The section of the summing up for internal distribution was related to the fact that this was the second case under the new guidelines on ex post assessments, and to create a body of Board views that would allow the ex post assessments to evolve.

Mr. Moreno supported Mr. Williams, and added that the Board's discussion on ex post assessments included, not only references to future Fund involvement, but on past Fund involvement, which should also be included in the Article IV consultation summing up. Perhaps the Board should consider procedures for reflecting Board views on ex post assessments in summings up.

Mr. Williams supported Mr. Moreno's addition, and noted that there were three issues, including that on the assessment of past performance, both that of the Fund and the authorities, which should be reflected in the Article IV consultation summing up. Improvements and enhancements to the ex post assessment should be reserved for the internal summing up.

The Secretary (Mr. Anjaria) remarked that the procedures for the treatment of ex post assessments in summings up were evolving as experience accumulated. The current procedure had been instituted on the basis that the ex post assessments had been closely aligned with the Article IV consultation process, whenever the authorities had expressed an interest in another PRGF arrangement. However, Board meetings that dealt with ex post assessments could not prejudge any subsequent meeting on the request for a PRGF arrangement. The summing up procedure instituted for Board meetings on Article IV consultations combined with ex post assessments was similar to that for combined Article IV and use of Fund resources discussions. This procedure was put in place because it was both familiar to the Board, and would afford the flexibility of having some elements of the discussion be the basis of a PIN, and other more sensitive elements be reserved for internal use. The latter was thought important because there may be cases in the future where the Board may agree with future Fund involvement, but express various concerns. As for Directors' suggestions for future ex post assessments, these views would be fully reflected in the minutes of the Board discussion, which were the official record of Board discussions.

Mr. Reddell agreed with the Secretary's comments, but supported Mr. Williams's point that the lessons from the ex post assessment on the Fund's engagement over the past ten years should be reflected in the PIN.

The Acting Chair (Mr. Carstens), after some further brief discussion, considered that the draft Article IV summing up already sufficiently reflected the experience with Mali's past performance under Fund-supported programs.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/03/113 (12/12/03) and EBM/03/114 (12/15/03).

5. INCOME POSITION FOR FY 2004—REVIEW

The Fund has reviewed the income position for FY 2004 in accordance with Rule I-6(4)(b). (EBS/03/163, 12/5/03).

Decision No. 13145-(03/114), adopted
December 12, 2003

6. MEMBERS OF EXECUTIVE BOARD—CODE OF CONDUCT—AMENDMENTS

The Executive Board approves the proposed amendments to the Code of Conduct for Members of the Executive Board. (EBD/03/112, 11/26/03).

Decision No. 13146-(03/114), adopted
December 12, 2003

APPROVAL: March 1, 2004

SHAILENDRA J. ANJARIA
Secretary