January 16, 2003
Approval: 1/24/03

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 02/96

10:00 a.m., September 13, 2002

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

E. Aninat, Acting Chair
S. Sugisaki, Acting Chair

Executive Directors	**Alternate Executive Directors**
S.M. Al-Turki	A.S. Alazzaz
	A.A. Al-Nassar, Temporary
	D. Ondo Mañe
	N. O'Murchú
	D. Lewis-Bynoe, Temporary
	F. Vermaeten, Temporary
	D.C. Guinigundo
	W.-D. Cho, Temporary
	B. Siegenthaler, Temporary
K. Bischofberger	R. von Kleist
P.C. Padoan	A. Lanza, Temporary
	P. Lathouly, Temporary
	R. Gauba, Temporary
	M. Marques, Temporary
	J. Sipko, Temporary
	D. Farelius, Temporary
	P.A. Dohlman, Temporary
	J.W. Ralyea III, Temporary
	S. Boitreaud
	S. Le Gal, Temporary
	S. Rouai, Temporary
	Y. Lissovolik, Temporary
	O.E. Garner, Temporary
T. Scholar	D. Merotto, Temporary
M. Portugal	
C.D.R. Rustomjee	
	M.B. Chatah
	S.A. Bakhache, Temporary
	Liu F., Temporary
	A.D. Marinescu, Temporary
	T. Komatsuzaki, Temporary
	R. Maino, Temporary
	D. Vogel, Temporary

S.J. Anjaria, Secretary
M. Watson, Acting Secretary
T. Davidson, Assistant
S. Maxwell, Assistant

Also Present

IADB: G. Castillo, Regional Operations Department 3. IBRD: R. Brigish, Africa Regional Office. N. Hicks, J. Stein, Latin America and Caribbean Regional Office. African Department: J. Fajgenbaum, Deputy Director; P. Beaugrand, F. Caramazza, R. Chembe, D. Dunn, G. Kalinga, P. Lopes, W. Mahler, M. Nowak, S. Sayek. External Relations Department: A. Gaviria, L. Mboto Fouda. Fiscal Affairs Department: G. Palomba, S. Tareq. Legal Department: M. Federici, S.C. Ho, T. Laryea, D. Siegel. Monetary and Exchange Affairs Department: A. Ouanes. Policy Development and Review Department: L. Cui, T. Dorsety, L. Ebrill, M. Hadjimichael, W. Mitchell, A. Thomas. Secretary's Department: M. Da Costa, P. Ramlogan. Treasurer's Department: J. Honda. Western Hemisphere Department: M.E. Bonangelino, Deputy Director; J. Dodsworth, Deputy Director; E. Faal, J. Guzman, J. Nelmes, T. Pellechio, R. Rennhack. Office of the Managing Director: A. Mazarei, A. Tweedie. Advisors to Executive Directors: S. Antic, K. Kpetigo, J. Milton, K. Sakr. Assistants to Executive Directors: E. González-Sánchez, T. May, G. Nadali-Ataabadi, M.L. Nikitin, A. Rambarran.

1. EXECUTIVE DIRECTOR

The Executive Directors welcomed Mr. Alazzaz as Alternate Executive Director for Saudi Arabia.

Length: 10 minutes

2. UGANDA—POVERTY REDUCTION AND GROWTH FACILITY—THREE-YEAR ARRANGEMENT; AND POVERTY REDUCTION STRATEGY PAPER PROGRESS REPORT 2002 AND JOINT STAFF ASSESSMENT

Document: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility (EBS/02/163, 8/29/02; and Sup. 1, 9/12/02); Poverty Reduction Strategy Paper Progress Report 2002 (EBD/02/128); Poverty Reduction Strategy Paper Annual Progress Report—Joint Staff Assessment (EBD/02/129); and Updated Debt Sustainability Analysis and Assessment of Public External Debt Management Capacity (EBS/02/162, 8/27/02)

Staff: Kalinga, AFR; Hadjimichael, PDR

Length: 2 hours, 50 minutes

The staff representative from the African Department (Mr. Kalinga) submitted the following statement:

> Additional information has become available since the issuance of the staff report on the request for a three-year arrangement under the PRGF by Uganda (EBS/02/163). The information does not change the thrust of the staff appraisal.
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> Recent macroeconomic developments
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> The 12-month rates for headline and underlying (excluding food crops) inflation increased in August to negative 0.5 percent and 0.7 percent, respectively, from negative 2.5 percent and 0.1 percent in June.
>
> Revised figures indicate that merchandise export earnings for 2001/02 (July–June) were lower than previously estimated, rising by 0.5 percent from the previous year, compared with the earlier estimate of 3.3 percent. The weaker performance mainly reflected lower-than-expected receipts from noncoffee exports.
>
> Financial sector
>
> In line with the recommendations of the recently completed full-scale bank audits, the Bank of Uganda closed the TransAfrica Bank on September

2, 2002 and set a deadline of October 15, 2002 for the recapitalization of the Cairo Bank. A new management team was installed at Cairo Bank.

Under delivery of HIPC Initiative debt relief

In addition to court decisions in favor of several commercial creditors and Iraq totaling US$36-40 million, attorneys representing Libya announced their intention to sue the government (for over US$100 million) for outstanding debt obligations. Fund staff received verbal assurances from the Burundi authorities that they would suspend their court action against the government of Uganda (about US$15 million), but no written confirmation of the actions taken by the government of Burundi has been received.

Conflict in northern Uganda

The Ugandan People's Defense Forces (UPDF) stepped up its campaign in northern Uganda against the 15-year rebellion by the Lord's Resistance Army (LRA), recently deploying 15,000–20,000 troops in the area. Insecurity has been the main cause for lack of progress in reducing poverty in the region, and violence has heightened with near daily reports of LRA raids on refugee camps and civilian targets, as well as confrontations with the UPDF.

Peace agreement signed with the Democratic Republic of Congo (DRC)

On September 6, 2002, the presidents of Uganda and the DRC signed a peace agreement formally ending the war between their countries. Under the agreement the remaining (estimated) 2,000 Ugandan troops presently in the DRC will be withdrawn by December 31, 2002.

Mr. Rustomjee submitted the following statement:

My Ugandan authorities are grateful to Fund management and the staff for the financial assistance and technical advice extended to the country through the years, which has been important to the transformation of the Ugandan economy that has been taking place for nearly one and a half decades. Such support together with the assistance extended by Uganda's development partners has played a substantive role in facilitating the progress made by the authorities in achieving macroeconomic stability and advancing the vast institutional reform agenda. Also, Uganda's extensive good track record of policy implementation and structural reforms has enabled the country to be among the first to benefit from substantive debt relief under the enhanced HIPC Initiative. For my authorities, these were critical elements in laying the ground for the more vigorous pursuit of a comprehensive strategy to fight poverty. The attainment of high real GDP growth rates and low annual inflation rates were determining factors that have lead to the reduction in the incidence of poverty from 56 percent to 35 percent over the past decade. My authorities look forward to the approval of their request for another three-year arrangement under the PRGF, which they perceive to be instrumental in their quest to continue to fight poverty by sustaining high levels of economic growth in the context of price stability.

Notwithstanding a rather unfavorable external environment, economic performance in Uganda remained impressive as reflected by the relatively high growth rates and stable macroeconomic conditions maintained over the years. However, the recent assessment of the Ugandan economy makes it evident that, these achievements notwithstanding, the support from the international community will continue to play a critical role, as domestic savings are still inadequate to address the unfinished agenda of reforms and the complex issues pertaining to the Poverty Eradication Action Plan (PEAP). The authorities have made continuous efforts to strengthen confidence, both at home and abroad, by maintaining an enabling environment where private sector participation would increasingly become the guiding force for promoting economic growth. However, a stronger response by the private sector is needed for Uganda to achieve its growth potential.

Recent Economic Developments

During 2001/02, and despite further deterioration in the terms of trade and global economic slowdown, the economy continued to perform relatively well. Although slightly below anticipated, real GDP growth remained robust at 5.7 percent, with particularly strong contributions from the agricultural, telecommunications and construction sectors. The maintenance of a prudent financial policy has strengthened the downward trend of inflation, with the underlying inflation declining to 3.4 percent by the end of the fiscal year. A sharp drop of 20 percent in food crop prices lead to a significant decline in the headline inflation to minus 1.8 percent. As a result of the lower food and cash crop prices, nominal GDP growth was limited to 6.5 percent, well below the 11.4 percent initially envisaged. Despite pressures arising from unanticipated spending, the overall fiscal deficit, excluding grants, was broadly adhered to. Performance of the external sector continued to be adversely affected by the decline in commodity prices, particularly of coffee on which Uganda's exports continue to rely heavily. As a result of the continuous fall in coffee prices that reached a 40-year low, receipts from coffee exports declined by 23 percent, limiting the increase in total exports receipts to only 3.3 percent from the previous year. The substantive drop in coffee prices was also a major contributing factor to the significant deterioration of some debt sustainability indicators, despite the substantive debt relief provided to Uganda under the HIPC Initiative.

Medium-Term Objectives and Policy Framework

My authorities are fully aware that the attainment of the poverty reduction goals greatly depends on the potential to sustain high levels of economic growth over the medium-term. Uganda has achieved a high degree of macroeconomic stability and advanced substantially on broad structural and institutional reforms and the authorities are committed to maintaining these gains. At the same time their strategy now is to focus on policies to boost private sector activity and domestic savings to be the determinant factors for economic growth. To this end, the authorities intend to direct their efforts with priority, towards improving basic social and economic infrastructure, strengthening financial intermediation, improving the enforcement of laws and regulations, and enhancing the efficiency in the delivery of public services. These policies are now an important component of the revised PEAP/PRSP. Based on this strategy the economy is expected to grow at an annual average rate of 6.6 percent over the medium-term, annual underlying inflation will be contained to 3.5 percent, and gross international reserves will be maintained at about 6 months of imports. Achieving greater fiscal sustainability was also made a key goal of this strategy.

The Program for 2002/03

The authorities are fully aware that sustained fiscal restraint is central in maintaining macroeconomic stability. Therefore, the focus will be on continued fiscal consolidation hinging on the increased effectiveness of government spending. The aim is to ensure that expenditures are directed with priority to areas and programs that promote strong economic growth and that meet the poverty reduction goals. In this context, precedence will be given in allocating resources to the Program for the Modernization of Agriculture (PMA) a key initiative for enhancing rural productivity, to the strategic exports promotion initiative, and to the PEAP. My authorities are particularly concerned with the size and sharp growth of public administration expenditures. As a result of a study commissioned to address this problem, they are in the process of putting together a package of measures aimed at streamlining the scope of these operations to core areas. Given the complexity of the problem they propose to address it in stages. The first phase, which will be implemented before end-2002, envisages the standardization and reduction of some benefits across the public sector. The second phase, involving the reduction of personnel, the elimination of some activities and rationalization of both the local and central government activities is envisaged to be implemented in FY 2003/04. The third and final phase entails actions that will require changes in the Constitution, including the size of the Parliament. In the meantime, the authorities intend to take the necessary steps to prevent the emergence of budgetary overruns during the current fiscal year. The use of supplementary allocations is also expected to be greatly reduced, as such allocations are now subjected to prior approval by the Parliament. The integration of the externally funded projects into the sectoral ceilings of the Medium-Term Economic Framework (MTEF) is envisaged to start in the next fiscal year. These measures represent significant steps to strengthen the budget management system.

The authorities are also determined to boost revenue performance, by improving tax administration, especially by strengthening tax enforcement and compliance, as well as by introducing new tax measures. Further improvements in fiscal performance are expected to occur as further progress is made with the implementation of the civil service pay reform and the reform of the pension system. As a result of all these measures the overall fiscal deficit is expected to reduce to 10.4 percent of GDP in 2002/03 and narrow even further in the following years.

As a reasonable amount of resources will be channeled to the districts, the authorities are taking the necessary steps to ensure that the decentralization process is done in an orderly and successful manner. To this effect, mechanisms are being instituted to improve the monitoring and accountability of the local governments by enforcing the submission of monthly reports of their fiscal operations. Technical assistance is also being provided to the local governments to help them to build up their revenue generating capability.

Prudent monetary policies followed by the Bank of Uganda (BoU) have been critical for keeping inflation under control and below 5 percent. The authorities' commitment to maintain a flexible exchange rate regime has served the country well and the BoU intervention will seek to maintain orderly conditions in the foreign exchange market. The central bank will continue efforts to strengthen monetary management and improve its efficiency. In this regard, BoU is targeting to mop-up the excess liquidity held by the commercial banks and the sterilization of the liquidity injected into the economy by donor-financed government spending. Progress made in reforming the financial sector will be pursued with the focus on strengthening the central bank's supervisory capabilities. The new Financial Institutions Statute (FIS) aimed at reinforcing the BoU's regulatory authority is awaiting approval from the Parliament.

On the external side, the implementation of the strategic exports program (SEP) was fundamental in reducing Uganda's high exposure to the risk to single commodity price fluctuations. The strategy aims at promoting the exports of several commodities in which the country has comparative advantage. This program will have the great advantage of expanding and diversifying Uganda's export base. With the envisaged strong recovery in the export sector, which needs to be facilitated by increased market access by developed countries, the external account deficit is projected to decline to about 11.5 percent of GDP in five years, down from the projected 16 percent in 2002/03.

The expected recovery in export performance as a result of the diversification strategy will be a fundamental element in reversing the recent sharp deterioration experienced by Uganda in its debt sustainability position. As indicated by the updated debt sustainability analysis, although most debt sustainability indicators are expected to improve over the medium-term, the NPV of debt-to-exports ratio will remain well above the HIPC Initiative threshold for several years to come.

Like other countries in similar conditions, Uganda continues to face enormous difficulties in securing an agreement with some non-Paris Club creditors to obtain debt relief in terms comparable to those accorded under the HIPC Initiative. Some creditors have indeed, resorted to suing the government in courts and judgments have even been passed by the local courts awarding creditors payments. Given the size of these claims, it has had a significant and unanticipated negative impact on both the debt and budget positions, with the potential of derailing the implementation of the country's reform program. The authorities are therefore hoping to receive assistance from the BWIs to enable them to reach an agreement with these creditors. They would also appreciate receiving legal technical assistance for the purpose of amending the law regarding the statute of limitations on financial claims on the government.

It is my Ugandan authorities' intention to press ahead with the needed reforms and foster the conditions for a strong and sustainable private sector-led growth that would enable to achieve the poverty reduction objectives laid out in Uganda's PRSP. In this effort, they hope to able to count on the continuous support from the international community.

Mr. Reddy submitted the following statement:

We thank the staff for a set of cogently written papers and Mr. Rustomjee for his insightful statement.

Uganda has been an example of steadfast implementation of sound macroeconomic policies and structural reforms resulting in strong economic growth, low inflation and reduction in poverty. It is unfortunate, therefore, that a sharp deterioration in its terms of trade has clouded the prospects of consolidating these gains. Its external debt sustainability indicators have also worsened despite being one of the first HIPC Initiative countries to have successfully reached the completion point. It is unfortunate that Uganda has had trouble securing the full debt relief and has even been sued by commercial, and even one bilateral creditor. In the circumstances, we fully support the proposed new PRGF-program, even though it comes only a year after the conclusion of the previous three-year arrangement. The program would serve as a signal of the Fund's readiness to support a country faced with an adverse situation primarily due to exogenous factors, and its confidence in the continued commitment and ability of the Ugandan authorities to follow good economic policy.

We support the broad objectives and strategy of the program aiming to increase real GDP growth based on major infrastructure building investments and structural reforms to improve investor confidence. Adequate financing of poverty reducing programs is to be ensured while keeping inflation reined in by increasing government revenues through improved tax policy and administration measures and pruning inessential expenditure. We hope that the upcoming revised PRSP will give due attention to distributional aspects of growth also, since inequality is reported to have increased despite substantial reduction in poverty between 1992 and 2000. We welcome, in this regard, the commitment to pursue direct pro-poor government programs and the series of specific actions planned for restoring the favorable trends in infant mortality, immunization etc. We commend the authorities' initiative to diversify their export base and increase export earnings in order to reduce their overwhelming dependence on a single commodity and the consequent vulnerability.

While we broadly agree with staff regarding their assessment of risks to the program, we wonder if factors like governance, local government operations, and termination of ad hoc investment incentives are not overstated. In fact, we would urge caution in setting overly ambitious targets and time frames and overloading the administrative capacity. We would also urge the need for a gradual approach to prescribing reporting and monitoring requirements for local government operations so that the authorities' important experiment in decentralization doesn't become a victim of over-bureaucratization. The staff has commented on the weaknesses in the public services delivery. Decentralization could address many of those weaknesses. It is notable that the economy performed relatively well in 2001/02 despite unfavorable external conditions and the authorities achieved wide ranging successes, strengthening the budget management systems and improving the soundness of the banking system. We believe that the track record of the Ugandan authorities inspires confidence and warrants continued international support, at least in the medium-term.

We share the authorities' sense of disappointment over less than expected response of foreign direct investment in particular and private sector investment generally, to Uganda's long track record of sound macroeconomic policies and liberalization. This raises questions about the need for greater realism in the projections of the impact of recommended structural reforms on private sector development in the low-income countries and the extent to which private capital flows can be a substitute for the ODA. The authorities' concern that the simplification of investment code, eliminating tax holidays, might have placed Uganda at a comparative disadvantage relative to its neighbors and the reaction of putting in place ad hoc incentives are expected responses. This should serve to guard against over-emphasizing the beneficial impact of and the pace of liberalization measures and building unrealistic expectations.

Finally, we wish the Ugandan authorities continued success in their policy endeavors.

Mr. Ondo Mañe submitted the following statement:

Uganda's economic performance in 2001/02 has been broadly satisfactory, despite the adverse external environment. Indeed, although below original projections, real economic growth remained high at 5.7 percent, with strong contributions from the agricultural, telecommunications and construction sectors. The increase in food production together with the maintenance of prudent financial policy, as Mr. Rustomjee reminds us in his helpful statement, were instrumental in reducing headline inflation rate to negative levels. Progress was achieved in the fiscal area where the target for the overall fiscal deficit, excluding grants, was met. However, the expected improvement in the external sector did not materialize as Uganda, like many other HIPC Initiative countries, continued to suffer from the decline in commodity prices. This decline also caused a deterioration of some debt sustainability indicators. Nevertheless, we are very much encouraged by the continued progress being made in the reduction of poverty in Uganda. Indeed, the commitment of the authorities to this objective has enabled the incidence of poverty to fall from 56 percent to 35 percent over the past decade, as noted in Mr. Rustomjee' s statement.

The broad progress being made by Uganda in its adjustment efforts is very encouraging. We agree with staff that the country has achieved a high degree of macroeconomic stability, and that important headway has been made in the implementation of structural reforms. It is important now that the authorities accelerate their efforts to increase domestic savings and investment, and to improve further the environment for the development of a strong private sector, which can play an important role in boosting economic activity. In this context, we very much welcome the request for a new PRGF. We are in broad agreements with the objectives and policy measures envisaged, and we can support the proposed decision.

Despite the significant improvements achieved in the past years, Uganda's economic and financial conditions remain fragile, and the authorities will need to continue their efforts to maintain stable macroeconomic conditions, which are essential to sustain strong economic growth. Therefore, we agree with the authorities' determination to continue the process of fiscal consolidation, and, in particular to continue the efforts to raise the revenue-to-GDP ratio. It was, therefore, encouraging to note the overall improvement in revenue-to-GDP in 2001/02, despite the removal of import duties on raw materials. However, we note that outlays increased significantly in 2001/02 due, among others, to higher salaries for parliamentarians and larger allocations for state house, elections and defense. Given the severe budgetary constraints in the past, the increases were probably needed. However, we would urge the Ugandan authorities to exert restraint on expenditures. We, thus, commend the authorities for their intention to put together a package of measures aimed at streamlining public administration expenditure. Their intention to address it in stages is probably the best approach, given the lack of institutional setting and capacity, and at the same time it improves the chance of success. However, it will be very important that the authorities develop a clear timetable for the implementation of the measures, and that they adhere to it strictly. One important challenge is the improvement of monitoring and accountability of local governments' fiscal operations. Actions underway with the assistance of the World Bank to improve timely and accurate reporting are appropriate. The local governments are playing an important role in the donor-supported poverty reduction strategy and therefore their fiscal management should be strong enough to ensure that goals of PEAP will be achieved.

On the revenue side, we welcome the intention of the authorities to increase the revenue-to-debt ratio through new tax and administrative measures. However we would like to emphasize the need to avoid repeated changes in the tax structure as it renders the budgetary process unpredictable and more difficult. Moreover, it could send a signal of instability of fiscal policy and therefore could have adverse impact in FDI. At the same time we commend the authorities for the harmonization of fiscal taxes with those of the neighboring countries, which should help avoid unhealthy competition. As regards the administrative measures, we welcome the measures being taken to improve efficiency and the measures taken so far to fight corruption and to implement business plan in the URA are encouraging.

In the monetary sector, we agree that the broad-money framework is appropriate to conduct monetary policy and should be maintained. However, given previous deviations, it would be judicious for the monetary authorities to develop other monetary policy frameworks in case the current one proves inappropriate. Likewise, we think that the flexible exchange rate regime has been well managed, and that Uganda's has maintained external competitiveness. In addition, we welcome the decision to mop up excess reserves in the commercial banks and to sterilize donor-related inflows, and we are looking forward for the adoption of the new FIS, aimed at strengthening Bank of Uganda's banking sector supervision.

As regards structural reform, we welcome steps taken to improve governance in public sector and business environment, especially the adoption of the new Leadership law and that of the new Inspectorate General Statute as well as the introduction of a commercial court. The actions in the electricity sector are encouraging, but we would urge that these actions be well sequenced and that the appropriate institutional settings be established. In the financial sector, the authorities have made good progress to improve performance of the banking sector. Strengthening the legal environment for financial intermediation, together with a modernization of payments system and the provision of wider financial services to rural areas, should significantly restore confidence in the banking sector and contribute to enhance economic activity.

In the external sector, the strategic exports program (SEP) elaborated a few years ago by the government to diversify exports is a commendable initiative and is critical to lessen vulnerability due to the volatility of commodity prices. It could help to improve the debt ratio. The staff report, at paragraph 31, highlights the impatience of the Ugandan authorities with the response of FDI to Uganda's long track record of sound macroeconomic policies and economic liberalization. The new arrangement aims at promoting economic growth on a sound basis over the medium term, but we would like to know if the staff thinks that the measures envisaged under this arrangement will address the obstacles to increased FDI? We share Mr. Rustomjee's view that increased market access will be crucial to achieve success of the SEP.

Turning to the debt issues, increasing court suits against Uganda by non-Paris Club creditors after the completion point are worrisome, as it could adversely affect the debt reduction strategy under the HIPC Initiative. We encourage those creditors to postpone their judicial actions and to seek ways to reach agreement on their claims, and we support the authorities' request for assistance from the BWIs to enable them to reach an agreement with these creditors. Overall, we encourage the authorities to pursue good debt management and to consider some of the options highlighted by the Updated DSA to address the debt situation.

As regards poverty reduction, we welcome the significant progress made to increase ownership through a broader participatory process. The implementation of the PEAP/PRSP in 2001 is broadly satisfactory. Most of the recommendations of the previous JSA have been followed and the Report expresses candidly the achievements and the remaining challenges over the next few years. The forthcoming revision of the PEAP/PRSP in mid-2003 should be an opportunity to address shortcomings surfaced in 2001. We agree with the staff that the strategy so far continues to provide a credible framework for Bank and Fund assistance.

In conclusion, we support the request for a new three-year arrangement under the PRGF and wish the authorities success in their endeavors.

Mr. Steiner and Mr. de los Santos submitted the following statement:

We would like to express our support for Uganda's request for a new three-year arrangement under the PRGF. This new program is indispensable for the authorities to consolidate the gains accomplished with the implementation of previous Fund-supported programs, and to continue their fight against the still-high levels of poverty facing the country. The Ugandan experience in program execution is commendable, with strong ownership and notable economic and social progress being their flagships. The strong economic performance of recent years, characterized by robust real GDP growth, low inflation, increased foreign reserves, and the maintenance of macroeconomic stability, has translated into a significant reduction in poverty indicators. We commend the authorities for these achievements.

We would also like to praise the authorities for important advances in the implementation of the Poverty Eradication Action Plan (PEAP), which is their PRSP equivalent. We note the consistent increase in outlays for programs aimed at enhancing living conditions of the poor, with expenditures under the Poverty Action Fund (PAF) increasing from 1.9 percent of GDP in FY 1997/98 to 5.7 percent of GDP in FY 2001/02. It is encouraging that most of these expenses have been concentrated on improving primary health and primary education conditions, water and sanitation infrastructure, agriculture and rural roads.

While we recognize those heartening results, we are also aware that there are several challenges ahead that need to be properly addressed by the authorities in order to reduce potential risks that could hinder progress on the ongoing economic and social agenda.

Fiscal consolidation is paramount to ensure the maintenance of macroeconomic stability, the continued success of the poverty eradication strategy, and the reduction of risks on the external sector. The high level of the overall fiscal deficit, excluding grants, which at end-FY 2001/02 remained at 12.6 percent of GDP, is a source of concern. The authorities need to make important progress on budget implementation and local government finances to reduce the deficit. In this connection, we share the staff's unease regarding the distorting effects of the government's continuous resort to supplementary budget appropriations and their impact on crucial expenditures.
Mr. Rustomjee's remarks regarding an expected significant reduction of such allocations, now that they are subjected to Parliament's approval, are welcome. The changes introduced with the 2001 Budget Act and the extension of the expenditure commitment control system (CCS) are welcome steps towards improving the budget management system.

Strengthening the fiscal position will also demand increases in revenue. While we note a continued improvement in total revenues since FY

1999/2000, collected revenues still fell short of target by 3.6 percent in FY 2001/2002. Tax collection and administration need to be enhanced. To this end, we see as promising the authorities' decision to enact during FY 2002/2003 the set of measures encompassed in Box 5, which are expected to raise revenues by 0.2 percent of GDP. Tax revenues relative to GDP are still low at 11.8 percent, and it appears that there is still room for raising this level without economic drawbacks.

The adoption of a prudent monetary policy has served the economy well, and has kept inflation low. It would be appropriate to keep the actual stance. Despite the sharp decline in T-Bill rates, which has taken place since August 2001, banking rates remained relatively unchanged, with lending rates at around 17 percent and intermediation spreads still above 10 percent. We would appreciate staff's comments on the underlying reasons for this apparent rigidity on the behavior of banking rates, the possible measures to address the issue, and its potential impact on private sector development prospects in Uganda.

On the structural reform front, we congratulate the authorities for their notable progress in strengthening the banking sector, through stronger supervision and enforcement of regulations and prudential norms. Nonetheless, further measures are still needed to address the remaining areas of concern pointed out by staff in paragraph 22, which—if properly undertaken—would enhance the efficiency and health of the banking sector, as well as broaden financial intermediation. We also share the staff's view that further enhancement of governance remains essential for greater private sector participation and in order to assure timely and adequate flows of donor assistance. The introduction of a commercial court to expedite the resolution of business conflicts and Parliament's approval of a new Leadership Code are important steps in this direction.

Finally, the recent deterioration of debt sustainability indicators is somewhat disturbing. While export growth in 2001 was encouraging, the country is still highly dependent, on the one side, on coffee exports —a commodity with highly depressed international prices and without a favorable outlook for the short to medium term; and on the other side, on donor assistance, which could be hampered by the difficulties in securing for the country HIPC Initiative debt relief from some non-Paris Club creditors. We hope that the authorities' plan to diversify and boost exports through the Strategic Exports Program (SEP), coupled with stepped-up efforts to reach an understanding with creditors on a timely fashion, will bring Uganda the required resources to implement its ambitious economic and social agenda, while improving prospects for reducing external fragility.

Extending his remarks, Mr. Rustomjee reiterated his gratitude to the staff for its hard work in helping the authorities bring their PRGF request to the Board. There were two elements that had been included in the staff's preliminary statement on which the authorities had some concerns and which contained aspects of a broader dimension: first, the difficult debt sustainability situation, which was clearly illustrated in the debt sustainability paper; and second, the appeal to non-Paris Club creditors to stay litigation on claims that they consider owed to them. This had become a significant problem—not just for Uganda—and had generic implications for the integrity of the HIPC Initiative framework.

Mr. Sipko made the following statement:

> At the outset I would like to express our thanks to the staff for a useful set of papers and to Mr. Rustomjee for a very comprehensive and detailed preliminary statement.
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> Although Uganda has done well in terms of increased growth, low inflation, keeping foreign exchange reserves at an appropriate level, and reducing the incidence of poverty, the authorities still face many challenges, especially in the areas of fiscal consolidation, debt sustainability and relations with non-Paris Club creditors, public sector restructuring, and improving governance at all levels of public services. As we broadly agree with the staff appraisal, I would like to concentrate on the aforesaid comments.
>
> First, under the medium-term economic framework, the Ugandan authorities expect relatively high economic growth with low inflation and improved external sustainability over the next five years. The current account deficit is expected to widen this year, and it will be financed by donors. The current account deficit is expected to be around 12.3 percent of GDP in 2006 and 2007. Could the staff tell us how this deficit will be financed?
>
> Turning to fiscal policy, the ratio of government revenue to GDP must be improved. This ratio does not compare favorably with the other sub-Saharan countries. We join the staff in urging the authorities to improve tax administration. Their efforts should include computerization, professional skills, training, and suppressing corruption and smuggling.
>
> It is crucial to streamline and prioritize expenditures. In this connection, we were heartened by Mr. Rustomjee's confirmation that the main goal is making sure that expenditures are directed toward strengthening growth, social priorities, and the reduction of poverty. We also applaud the authorities' intention to improve public administration. The arrangement of the World Bank training on the budget method for government officials is especially welcome.

Continued reform in the financial sector is needed with special attention given to strengthening the central bank supervisory capabilities. The new financial institution status is a step in the right direction, aimed at insulating the bank's intervention from political influence and strengthening supervision.

Our primary concern is the deterioration in debt sustainability indicators. In this context, we urge the authorities to continue with fiscal consolidation and concentrate on increasing export performance. In addition, we learned from the staff paper that the problem with non-Paris Club creditors has not been resolved, and we would welcome the staff's comments about the latest developments. We would also wish to learn more about the potential for additional court cases and the authorities' approaches in this area.

Finally, because the program is based on a very good track record, especially in terms of macroeconomic stabilization, continuing structural and institutional reform, and the pace of poverty reduction results, we support the authorities' request for a three-year arrangement under the PRGF.

Mr. Dohlman made the following statement:

Uganda has solidified macroeconomic stability and has identified important reforms going forward. While less progress has been made in areas such as corruption, Uganda has, on balance, built a good track record.

In general terms, we have doubts about countries without obvious balance of payments problems accessing the PRGF, as it ties up scarce PRGF resources. While we support the substance of the proposed reform program for Uganda, the key reforms could probably be done with IMF and World Bank technical assistance supported by World Bank loans. On the other hand, the low access in this program sends a welcome signal that Uganda may soon graduate, and the PRGF creates positive incentives to implement key reforms. We therefore join Mr. Reddy, Mr. Steiner, and others in supporting the proposed PRGF arrangement. Going forward, however, we urge the staff to give serious consideration on how best to assist post-HIPC Initiative countries.

Debt Sustainability

We acknowledge the staff's conclusion that Uganda remains on a sustainable path, despite the upwardly revised NPV debt/export ratios. Debt service ratios do seem manageable. Lower-than-expected growth in export earnings is an important factor in the deterioration of the debt/export ratios as compared to previous projections. However, new borrowing has played a bigger role. As the staff notes in the Debt Sustainability Analysis (DSA), the new borrowing projections contained in the Decision Point (DP) macroeconomic framework were mistakenly not included in the DP NPV debt/export projections. Thus, the projections contained in the DP document were significantly understated, and the deterioration in this debt ratio, while of concern, is much less dramatic than it first appears.

Future assistance in the form of grants—including higher IDA grants—along with further diversification of Uganda's export base would further strengthen Uganda's outlook. We are disturbed to read about continued delays, and in some cases legal action, by non-Paris Club and commercial creditors in providing comparable treatment. The authorities' welcome decision to publish the reports will help put further pressure on those creditors to participate. We also urge preparation of updated DSAs on a regular basis as suggested in paragraph 53 of the DSA, although more frequently than every 3-4 years.

Governance

Turning to governance issues, the staff report cites the failure to improve governance as a potential risk to the success of the program (page 6), and we agree. Though there have been improvements in budget management, and measures are being implemented to reduce corruption in the Uganda Revenue Authority, the enforcement of rules and regulations pertaining to governance and accountability has been weak (page 9, paragraph 5). Mr. Reddy suggested in his preliminary statement that governance issues might be overstated. On the contrary, we believe corruption remains a significant drag on the economy, as reflected by a near-bottom ranking in Transparency International's 2002 Corruption Perceptions Index, and has been an important factor in lower-than-expected FDI. We urge more concrete steps by the authorities to enhance the enforcement of existing rules on governance and to pursue additional measures.

Growth

We also have some concerns about growth. Low investment, savings, and productivity (page 11, paragraph 11) growth suggest a weak foundation for sustaining high levels of growth. Standardizing investment incentives, rather than continuing to provide them in an ad hoc manner, should be pursued by the authorities as a necessary component of a growth strategy. On a related point, we agree that completion of the Bujagali project will have a positive impact on growth, but we are concerned about possible delays due to an ongoing WB corruption investigation. Could the staff comment on the implications of such delays?

We welcome efforts to diversify exports under the strategic exports program. But rather than picking specific product areas for support, we believe it would be better to focus on infrastructure improvements to create a better environment for a broad range of products, including apparel, which is now AGOA eligible.

Fiscal

On fiscal issues, the authorities should be congratulated for their recent efforts to increase revenues, including efforts to fight corruption in the Uganda Revenue Authority. These efforts need to be continued and augmented if Uganda is to ensure fiscal sustainability, and we welcome the program's emphasis on this area. Another significant challenge will be improving budget management at local levels, which the staff report nicely explains. Improving accountability and transparency of local expenditures is key to ensuring the effective use of limited resources and meeting goals for improving social indicators.

On the expenditure side, we note that military spending exceeded program targets this past year. In light of the developments in northern Uganda, we urge the staff to watch military spending closely and to report their findings during PRGF reviews. Similarly, public administration spending was above targets and has detracted from investment in priority social areas. We urge the authorities to adhere to their strategy to reduce such spending (page 26, paragraph 34).

PSIA

We welcome Uganda's PSIA, but believe there is room for improvement in several areas. While we welcome increases in electricity tariffs, some discussion of how to offset the impact on the poor would be useful. Second, further evaluation (beyond what is in Box 3) of the potential anti-poverty impact of the Bujagali project would be welcome. Third, there should be some discussion of means to accelerate the slow progress in improving access to clean water and sanitation. We would also be interested in the potential for improved security to increase tourism.

CFT/AML

On terrorist financing, we urge the government to implement a blocking order on terrorist assets, as called for in the November 2001 IMFC Communiqué. On money laundering, we encourage the authorities to continue their efforts to develop a comprehensive and effective system of anti-money laundering controls. Uganda's active participation and continued support of the Eastern & Southern Africa Anti-Money Laundering Group is welcome. These efforts are critical to move group members toward full compliance with international standards.

Mr. Vermaeten made the following statement:

Like others, let me start by thanking the staff for the well-written and comprehensive set of papers and Mr. Rustomjee for his helpful statement.

Uganda should be congratulated for the quality of its PRSP progress report and for the refreshing candor with which it was written. The documents present an honest and realistic assessment of the weaknesses and strengths of the performance on PRSP objectives, as well as the challenges facing the country. Moreover, the government should also be commended for its efforts at ensuring that key stakeholders were consulted and involved in the drafting of the document.

We support the government's focus on poverty reduction activities while it pursues policies that are conducive to economic growth, export diversification and promotion, and enhanced revenue performance, which are all key elements of the PRGF. The Canadian International Development Agency (CIDA) has prepared lengthy and detailed comments on the PRSP progress report, and I will pass those along to staff and Mr. Rustomjee.

We fully support the PRGF-supported program. Uganda has been a strong performer for a number of years, and we are confident that the authorities will diligently implement this well-designed program. That being said, we strongly urge the authorities to follow through on the advice given by the staff, especially to stop providing the ad hoc investment incentives, aggressively rationalize public administration operations, and strengthen tax revenues.

I would like to concentrate the rest of my remarks on five areas, which Mr. Dohlman has somewhat touched upon as well, but I will approach them from a slightly different perspective. The five areas I would like to talk about are the size of the program, risks associated with the Bujagali hydro project, dealing with a lack of creditor participation, the DSA, and governance.

First, on the size of the access level under the program, Uganda's PRGF, like the PRGF for Rwanda, is very small. Given the size of the program, I assume the primary reason the program was put in place was for the Fund to provide its advice and seal of approval for the benefit of bilateral creditors. As more and more countries get through the HIPC Initiative, I am sure we will see more of these situations. I agree with Mr. Dohlman that we should reexamine the issue of whether the Fund could provide its seal of approval in a different manner, such as a precautionary PRGF arrangement, a PRGF-supported program without funding, or a Staff-Monitored Program.

Second, on the Bujagali hydro project, the staff has identified the delay of the project as a risk to growth. The growth targets are quite optimistic, but may be achievable, given Uganda's strong record on program ownership and policy implementation. Obviously, the Bujagali project is an important source of growth, and like Mr. Dohlman, I would be interested to get an update on the project. If it does not go ahead, to what extent will growth be affected, and if investors pull out and Uganda still goes ahead with the project, what are the implications for the macroeconomic framework? I would also be interested in knowing if the project is guaranteeing electricity prices to third parties that could result in the Ugandan government having to subsidize electricity prices down the road should the cost of production increase at the Bujagali facilities.

The third area I would like to comment on, and an area Mr. Rustomjee highlighted this morning, is the lack of participation by some non-Paris Club creditors in providing HIPC Initiative relief and, worse, vulture funds getting court orders for full payment of debt with interest and penalties. My understanding of the recent discussions on the SDRM is that there was a prevailing view that the SDRM framework would not have to cover domestic debt because countries could, in a fairly straightforward way, modify their own laws in order to restructure domestic debt that is subject to their laws. How much scope is there for Uganda to change its laws in order to deal with some of the creditors that are going to the Ugandan courts to recover their claims? In fact, has Uganda considered changing its domestic laws? I would think, and again I would appreciate the staff's views on this, that there would not be a great deal of stigma attached to restructuring debt because effectively the HIPC Initiative is a process where the international community accepts that a country's debt is no longer sustainable and has to be restructured.

Related to this question is that of providing technical assistance to deal with vulture funds. If the money can be found so that the World Bank's Legal Department provided technical assistance to Uganda, what could we hope to accomplish? Would technical assistance just stall creditors or is it possible that the technical assistance would mean that the debt could somehow be restructured close to the common reduction ratios envisioned under the HIPC Initiative framework?

Fourth, I have a couple of comments and questions on the DSA, which we found informative and helpful. Of course, we are concerned about the deteriorating debt ratios. This next part Mr. Dohlman has touched on. I just want to explain it a little more and ask some questions. From my understanding, the original DSA undertaken at the decision point inadvertently did not include a significant share of the new future debt, so as a result, Uganda did receive the right amount of HIPC Initiative relief, but the debt-to-export ratios over time were significantly underestimated. This is important. For those who have the DSA report, you might want to turn to page 13, Figure 3 or you will never understand my comment. It is the bottom left graph that I am looking at, and it shows the two lines, the top being the current projection of debt to exports over time, and the bottom is the projection at the decision point based on the incorrect or incomplete data. If you look at this graph, it seems like there has been a massive deterioration of the debt-to-export ratio. As Mr. Dohlman has pointed out, I think a more valid comparison would be to take the current projection and compare it with the corrected projection at the decision point. The corrected projection is the debt-to-export ratio at the decision point that includes all future debt that was incorporated in the macroeconomic framework at that time, so from my conversation with the staff, that line would be quite a bit different than the lower line. Roughly speaking, it would hover around 150 percent line until the year 2010 approximately, and then start to decline. Of course, if you were then to compare the current projection with the corrected line, you would still see a deterioration in the debt-to-export ratio, but it would not be nearly as dramatic. Could the staff put another line in the graph or put in a new graph that compares the current projection with the corrected decision line? It is quite important given that we are going to publish this document. As it stands now, the graph dramatically overestimates the deterioration of the debt-to-export ratio. That is the last thing the HIPC Initiative needs.

Fifth, and finally, on governance and corruption, it was encouraging to read that the authorities are taking the issue of governance very seriously. The authorities, with the help of the Bank and Fund, are undertaking efforts to enhance governance and reduce corruption in a variety of ways, and affecting almost every aspect of government. The case of Uganda illustrates the many facets associated with governance and reducing corruption. It also suggests to our chair that perhaps it is time for the Fund and Bank to start thinking about whether we should attempt to design a ROSC module on governance so we can more systematically and comprehensively design a strategy to strengthen governance and measure progress. I am not asking for immediate feedback from the staff today given that the discussion on ROSCs is scheduled for Board consideration in the next couple of months, but a ROSC on governance is worth considering. Of course, it is easy to dismiss the idea and say the program is already adequately dealing with improving governance, and moreover, we have ROSC modules that touch on specific areas of governance. However, the case for Uganda shows that we need to do better. Despite being a star performer and having a long track record of good leadership, Uganda still checks in at a miserable 93 out of 102 in the new Transparency International Index, and that is about the same spot they were last year, and we still read pretty regularly about corruption in the newspapers. Uganda remains unhappy about the level of FDI. Perhaps a ROSC module on governance could be helpful to speed up and make the reforms more effective.

Mr. Boitreaud made the following statement:

We thank the staff for a comprehensive and instructive set of papers and Mr. Rustomjee for his excellent statement. Uganda's macroeconomic performance over the past year is commendable: the country maintains a high level of growth in the face of adverse external conditions and the inflation remains well contained. These positive results certainly pay tribute to a sound track record of policy implementation and liberalization and the authorities are reaping some fruits from their long commitment to reforms. The governmental strategy to diversify exports under the well-designed Strategic Exports Program has also played its part in the robust performance of the Ugandan economy.

Let me indicate at the outset that we support the request for a new PRGF arrangement. But, to have any reasonable chance of success, the forthcoming PRGF-supported program should be implemented fully and expeditiously by the authorities. Such a commitment is all the more necessary when one considers that the program is built on rather optimistic although not unrealistic hypotheses and that it is subject to a long list of downside risks. Indeed, there is neither room for complacency nor for delay since the whole picture for Uganda is bleaker than what could be derived from its macroeconomic achievements. On the content of the program, we share the thrust of the staff's appraisal and its priorities, namely raising revenue collection and improving tax compliance and enforcement. I will therefore limit my intervention to three issues: revenue collection, governance, and poverty reduction.

First, the level of revenue collection is particularly worrisome as it remains below 12 percent of GDP, and according to the staff's projection will increase very slowly over the next years. Like the staff, we welcome the authorities' recognition that weak revenue collection could seriously hinder the sustained implementation of the PRGF-supported program and the achievement of financial stability. We urge the authorities to implement the comprehensive fiscal reform package listed in Box 4 of the report and improve fiscal management, particularly at the local level.

This leads me to my second point: bad governance and corruption. Corruption remains dire at every level of the Ugandans administration and economy. It considerably weakens the efforts directed at improving the business environment and the investment climate. In this regard, the disappointing response of foreign direct investment to Uganda's reforms underlines the very damaging effects of corruption on the economic development of the whole country. This chair will attach great importance to progress made in stamping out corruption in the public administration, notably but not only in the Uganda Revenue Authority.

Third, despite impressive results over the last decade, the poverty reduction process still faces numerous challenges, primarily its financing. Like the staff, we welcome the authorities' decision to continue to place poverty reduction at the center of its development strategy, but the proof of the pudding is in the eating and we will be convinced only by an effective implementation. Spending cuts and budget reallocations are too often detrimental to education, health, and social resources. Table 7 of the staff's report on budgetary expenditures is sadly instructive: in 2001/2002 the outturn for social and economic expenditures is 35 percent less than budgeted. During the same fiscal year, the outturn for security spending is 8 percent higher, and the outturn for public administration is 42 percent higher than budgeted. The increase in spending for members of parliament, state house, or missions abroad may be warranted, but it sends a mixed signal, to say the least, to the population and to the donor community. The increase in security expenditures is even more difficult to justify: the threshold of 2 percent of GDP will probably be broken in 2001/2002 and the staff forecasts total defense expenditures at around 2 percent of GDP in 2003/2004 and 2004/2005. Strong efforts are needed from the authorities to reverse this worrying trend and ensure adequate funding for poverty reduction. It is of the utmost importance not to lose the momentum in efforts to further reduce poverty levels, notably in the eastern and northern regions, and devote sufficient means to the fight against the HIV pandemic.

Finally, turning to the debt sustainability analysis, let me thank the staff for an excellent and comprehensive paper. Like Mr. Dohlman, we acknowledge the staff's conclusion that Uganda remains on a sustainable path, despite the upwardly revised NPV debt/export ratio. We broadly support the various options presented in the paper to address the debt situation, notably further diversification of Uganda's export base. As underlined by other directors, the staff's analysis stresses the importance of the commitment of non-Paris Club official creditors and commercial creditors to the enhanced HIPC Initiative.

This being said, let me wish every success to the authorities in their challenging endeavors.

Mr. Guinigundo made the following statement:

We join other Directors in commending Uganda for having established a strong record of sound macroeconomic management, implementing key structural policies, and formulating a good poverty reduction strategy. As Mr. Rustomjee emphasized in his statement, Uganda was the first country to benefit from both the original and enhanced debt relief under the HIPC Initiative, reaching its completion point in April 1998. In terms of net present values, Uganda has received debt relief of $347 million and $656 million under the original and enhanced HIPC Initiative frameworks, respectively. We are pleased at the result, which was the reduction in the NPV of Uganda's external debt-to-exports from 196 percent to 150 percent.

But there are challenges to Uganda's capability to sustain macroeconomic stability, improve governance in institutions, and reduce poverty. I am not going to raise any issue on military expenditures. The staff came out with a statement yesterday saying the peace agreement was signed with the Democratic Republic of Congo, and we hope this will have some promising results in terms of the security situation in Uganda.

Let me focus on three issues. First, there is a need for Uganda to diversify its export base. While Uganda was indeed the first to benefit from HIPC Initiative debt relief, its external debt sustainability indicators, as the staff report shows, have turned for the worse upon its completion point.

Non-coffee exports should be expanded because history shows a decline in coffee prices is enough to wreak havoc on Uganda's balance of payments and growth prospects. This gains more urgency because the staff shows that Uganda had remained competitive in coffee. In a sense this reflects the limitation of having to rely on primary exports. It also underscores the need for removing trade barriers in key markets.

The other point I wish to stress on is the precariousness of Uganda's financing situation. This country depends heavily upon donor assistance to finance public operations. Not only is the fiscal deficit large, something in the order of more than 11 percent of GDP this year, its own spending on poverty reduction is endangered if both revenues and expenditures are not altered to establish fiscal consolidation. If political tension is not fully resolved and foreign investments and grants do not come through, all the policy components put together without sufficient funding could just fall apart.

Finally, we should also raise the problem of under-delivery of HIPC Initiative relief, which, as the staff shows, involves non-Paris Club and commercial creditors. No less than full support to Uganda is necessary at this point to ensure that Uganda's debt position is upgraded to sustainable. By all means, Uganda should be asked to put its macroeconomic house in better shape, diversify its export base, seek technical assistance in public external debt management; but then the full HIPC Initiative debt relief should be delivered.

In connection with this last point, we agree with Mr. Reddy that we should be more cautious in overly emphasizing the beneficial impact of liberalization measures in Uganda, which could build unrealistic expectations without due regard to the unique circumstances of that country, and in that respect, any member country undergoing a Fund-supported program.

Because Uganda has (i) established a good track record in pursuing sound macroeconomic and structural policies; (ii) its authorities remain committed to the cause of reforming the economy, and uplifting the standards of living of the Ugandans; (iii) medium-term prospects are still essentially fragile; and (iv) key reforms are still to be installed and more assistance for capacity building are still required, we support the proposed decision to approve Uganda's request for a three-year arrangement under the PRGF in an amount equivalent to SDR 13.5 million. Uganda's PRSP paper also appears to provide a sound basis for this assistance.

Mr. Padoan made the following statement:

We thank the staff for a good and illustrative set of papers and Mr. Rustomjee for his helpful statement.

Uganda is facing a critical phase in the effort to benefit from debt relief, strengthen growth, and reduce poverty. The critical phase is due both to adverse external conditions and to policy actions that have not been fully consistent with debt sustainability. This has occurred in spite of a good track record of implementation and sequencing of sound macroeconomic policies.

That the phase is critical is also highlighted by the long list of risks to the program discussed in the report. It is also a source of concern that the post completion point DSA shows a deteriorated outlook.

The report indicates the factors on which the request for a new PRGF-supported arrangement is predicated, and we broadly concur with the staff's views. While each of these factors is relevant on its own merit, it is their joint effect that must be considered to justify the request. The basic message is straightforward, however. The Ugandan authorities must increase their efforts in institution building, policy implementation, and the fight against corruption. In addition, Uganda must direct limited resources toward the achievement of social goals in education, health, and infrastructure while cutting down military and excess personnel expenditures. This will help the country progress in growth and poverty reduction thanks to a more appropriate allocation of resources, but also because of the implications for better and more transparent governance in the public sector.

That a step forward in governance and policy implementation is needed is also signaled by the up-to-now disappointing results in terms of investment, both domestic and foreign. The staff mentions the negative effect of incentives offered by neighboring countries as well as the intention of authorities to harmonize their investment codes. Is this concern justified? Is there any evidence that disparities in incentives and FDI treatment in the region is a major cause of limited FDI inflows in the country? Staff comments would be welcome.

It should be clear that investment will rise in terms of GDP by strengthening and deepening the financial system, improving tax policy and administration both at the national and local levels.

In addition to investment, growth will be supported by export performance. Uganda remains competitive in its core non-coffee exports but it is crucial that the strategic export program be implemented so as to diversify the export base and improve comparative advantage. Exchange rate policy over the medium term will have to be supportive of changes in comparative advantage avoiding unwarranted appreciations as has been the case in the recent past.

Uganda is heavily dependent on donor assistance to finance government operations and will remain so for some time to come. Unfortunately, debt sustainability has deteriorated since completion point assessment due to a fall in export revenues, but also to an incomplete treatment of new financing. Needless to say, such events cannot be repeated in the future.

To address debt problems several options are considered. We share the view that a number of measures should be taken to this effect, but we see export diversification, improved debt management, and aid effectiveness as key elements, in addition to delivering full HIPC Initiative relief. To this effect appropriate pressure on creditors must be exercised.

Risks to the program are high and clearly spelled out. Many, but not all, will have to be confronted by appropriate efforts by authorities. Their good track record is reassuring in this respect. We support the proposed decision and, wishing authorities success, we look forward to a close monitoring of the program.

Mr. Bischofberger made the following statement:

Like previous speakers, I thank the staff for an excellent set of papers and for preparing an update of the debt sustainability analysis. I also thank Mr. Rustomjee for his informative statement. The authorities deserve credit for the economic performance in recent years. As other speakers have noted, economic growth has been robust, macroeconomic conditions remained stable, budget management is being improved, and poverty incidence is on a downward trend. Nevertheless, there are many challenges ahead that need to be properly addressed. We, therefore, see some merit in the idea of continued strong Fund presence in Uganda, with a view to assist the country in implementing its challenging structural reform and macroeconomic policy agenda. Against this background, we support Uganda's request for a new PRGF arrangement.

However, it is disconcerting that even a good performer like Uganda is still dependent to such a high degree on donor inflows. Clearly, this highlights the need to further strengthen efforts of export diversification, of revenue mobilization, as well as of improving budget management and the efficiency of public service delivery. In this latter area, the remaining shortcomings mentioned by Staff, including governance problems, poor monitoring, and crowding out of high-priority expenditure through supplementary appropriations, are serious and need to be addressed resolutely. As previous speakers pointed out, improved governance and progress in the fight against corruption will also be important to promote higher FDI inflows.

Furthermore, in view of the deterioration of the debt situation and the rather favorable balance of payments position, the question arises, whether Uganda really should incur new debts vis-à-vis the Fund. We, therefore, welcome the proposed low access of only 7.5 percent of quota. In this connection, I support Mr. Dohlman's proposal to look more deeply into the question how to best assist post-HIPC Initiative countries.

Having said that, I agree with the thrust of the staff appraisal, and shall only make a few brief comments on fiscal and monetary policies and on debt sustainability:

First, on fiscal policy, the significant non-priority overspending for public administration and defense has been a matter of concern for some time. This is a trend that must be reversed. We hope that the recent peace agreement with the Democratic Republic of Congo will lead to more political stability, thereby supporting economic development and fiscal discipline in Uganda and in the region. Further on fiscal policy, we welcome the substantial deficit reduction envisaged for this fiscal year. However, we wonder if the programmed revenue increase from tax administration measures can be realized, given the staff's assessment that the planned anticorruption effort in this area—which we very much welcome—is likely to have only very limited short-term effects. As regards the planned expenditure reduction, we note that this is partly to be achieved by lower repayment of arrears. This is not very satisfactory, as arrears clearance had already been an important goal under the previous arrangement.

Second, on monetary policy, we welcome the success achieved in keeping inflation under control. Monetary management will remain challenging, given the expansionary effects of large donor inflows and the associated sterilization needs. We, therefore, support the authorities' efforts to deepen the market for long-term bonds. We also agree that the adoption of a formal inflation-targeting regime within the program period would be premature.

Finally, like some other Directors, I am somewhat concerned by the recent deterioration of Uganda's debt sustainability indicators, although I note that this is only partly to be blamed on lower export earnings. But as I already indicated, stronger export diversification and further improvements in debt management and the poverty reduction strategy will be all the more important.

We are also concerned by the under-delivery of HIPC Initiative relief by some non-Paris Club and commercial creditors. Technical assistance could be considered here, if this can be done in a meaningful way. Lastly, I welcome the intention to prepare more regular DSA updates.

With these remarks, I wish the authorities every success.

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

One of the first issues to be raised concerned how the current account deficit over the medium term would be financed. In the documents, it is clearly stated that one of the factors underlying the relatively higher than earlier projected current account deficit is the impact of the Bujagali project on the balance of payments. The project has high import content. Accordingly, the deficit of about 16 percent of GDP would be funded largely by donor assistance, which is projected at about 10 percent of GDP, and the balance, which is about 6 percent, is mainly accounted for by private inflows, of which 3.5 percent is due to the Bujagali project.

A second issue was raised concerning the economic implications of delays in the Bujagali project. At the moment, with the installation of a new power plant at the Kiira hydro project, Uganda is basically self-sufficient in its energy requirements, and the Bank's projections support that notion. Assuming that the Bujagali construction is started this year, it would take about five years to complete, and thereafter in the first four to five years of its existence, a large proportion of its outputs would be exported to neighboring countries until such time as demand picks up again to fully offset the outputs. Consequently, its immediate impact on growth in the medium term would be fairly limited, as it is not needed immediately. However, the projections for the current 2002/03 fiscal year hinge upon the Bujagali project having some stimulative impact of between 0.5 to 0.7 percent of GDP. Assuming that the project is delayed by 6-12 months, which is the basis upon which we are working, then GDP growth would be commensurately lower, at around 6 percent against the 6.5 percent. Revenues would be around 0.1 to 0.2 percent of GDP lower, and imports would also be lower by about $90 million.

The question of the current government intervention in north Uganda was raised. As the staff statement indicates, the northern part of Uganda has been the region with the lowest income in the country. It has not benefited significantly from the growth that Uganda has enjoyed in the past decade. Both the income distribution issues and the success of the poverty reduction planned, depend to a considerable extent, on the ability of the government to reestablish secure economic conditions in the north. At present, none of the donors are able to establish meaningful programs and projects to address it because of security conditions. It is therefore likely that the present incursions, given the number of troops, will put some fiscal pressure on defense, which is probably inevitable. However, if they were to yield the intended results, then the beneficial effects, both on GDP growth and on poverty reduction would be sizable.

The other area of Uganda that has not benefited substantially is the Karamojong in the northeast. This is also a security-related issue, and hence it is difficult to divorce security considerations from poverty reduction considerations in the context of Uganda today. Linking that to the question of diminution of security and tourism, the areas of important tourist potential in Uganda are in the southwest, on the Rwenzori Mountains, which border the Democratic Republic of Congo (DRC) and Rwanda. Therefore, the actions that Uganda is able to do on its own cannot address the question of the potential for tourism. They must come in the context of how the problems of DRC and Rwanda and the Great Lakes regions are addressed. To the extent that these remain problem areas, then the potential for tourism in Uganda will continue to be constrained.

A question was raised on the level of access under the PRGF for the current arrangement and the question of whether some alternative arrangement would have suited the purposes. Uganda was the first to benefit from the HIPC Initiative arrangements and to have a PRGF-supported program. When the last program expired in March, we undertook extensive discussions with the donor community and the government on what the potential successor arrangement could be and how it might influence donor aid to Uganda. From the discussions with the principal donors, it became clear that the product that most of them understood in terms of content and Fund involvement was a PRGF arrangement, and they were worried that hardly before a year had elapsed following the approval by the Board of the HIPC facility for Uganda, that we might be coming up with a new arrangement or a new set of facilities to support our relations with Uganda. They felt that a clearer way forward, for at least the next three years, would be a continuation with an arrangement that they understood in terms of its conditionality. The government was also clear in its desire that there should be no disruptions in the perception of Uganda's commitment to reform and to meet the most rigid standards set by the international community. On that basis, it became clear that we would recommend to the Board what we felt would maximize Uganda's benefits from the donor and investment communities.

A question was raised as to whether Uganda was likely to subsidize exports of electricity to neighboring countries. The answer at the moment is no, although indeed most of the supply in years one to four from the Bujagali project would be for export purposes. The pricing arrangements that have been discussed were going to be subject to annual revisions depending upon cost, and no subsidies were going to be entailed.

On the question concerning the non-Paris Club creditors and legal issues, from our extensive discussions with the authorities, we view these creditors as three separate groups. The first group pertains to commercial creditors, where both the Ugandan legal institutions and private and commercial creditors may have seen a loophole in both Uganda's legal system and the international community rules, and are trying to maximize from idstortions in the framework. At this stage, the government's view has been that if both legal experts from the Fund and the Bank were to review Uganda's legal framework, they might help to identify if there are certain aspects of the procedures that the prosecution in Uganda could use. For example, we are told that if the Minister of Finance responds to particular queries on the validity of a certain figure from an equity by a commercial creditor, his response, in itself, acknowledges that the base number that the creditors are using are valid. The government is not sure how to handle those technicalities without appearing unresponsive to international standards.

The second group of creditors are HIPC Initiative-eligible countries, such as Burundi, that feel they are poorer than Uganda. They are unable to appreciate how and in what context they should be providing debt relief to Uganda, which has a GDP that is double their own size along with ample foreign exchange reserves. In discussions with this group of countries, we have tried to indicate that some of these issues could be resolved in terms of a multilateral context. Some of these debtor countries have been able to appreciate the situation, although the question remains difficult, especially for countries such as Burundi that have been outside of the international framework for sometime.

The last group of countries we have been told tend to take a more political approach to the HIPC Initiative instrument and their own involvement within the instrument. In such cases, the staff's advice to the government has been limited.

A question was raised on the deterioration in the debt sustainability analysis. This is a difficult issue, partly because the base of the computations, both in the initial HIPC Initiative and the enhanced HIPC Initiative, was considered at a time when the prices of coffee were very high—over two dollars per kilo at one point, and falling to 40 cents per kilo at present. It appears that for as long as the base of the computation is a three-year average, then there will be such a result. Thus, part of the problem is purely technical. When we look at the coffee market over a 40-year period, from 1960, the average price of coffee was 71 cents per kilo. This particular cycle, of which the peak was around 1996/97, and now appears to be at the low, has not made a difference to that average price. If you take this period out, you end up with approximately that price for the earlier phase. Hence, presumably if an average price of US$0.71 per kilo in the determination of Uganda's sustainable level of external det, the amount of debt relief would have been higher. It appears that there are technical problems that also underpin the fundamental conclusions, which are referred to in Table 3 and the table on page 13.

The staff will look at the table on page 13 to consider if we can, indeed, bring in the other factor that Mr. Vermaeten suggested, but it may take sometime to work this out jointly with the World Bank.

A question was also raised on the feasibility of the revenue projections for the coming year. As I indicated earlier, there is a question now that the delay in the Bujagali project might affect those projections by about 0.1 to 0.2 percent of GDP. However, noting the past difficulty of projecting revenues in Uganda, the staff did not build the projections on the basis of historical buoyancy into these figures—we took a more conservative base. In addition, the results for the first two months of this fiscal year indicate that collections are about 6-7 percent higher than projected, but it is too short a period to begin to change projections. The mission scheduled to visit Uganda in October will review these numbers again, both on the revenue and expenditure side, in light of more recent developments.

The question was raised on the disparities in the investment incentive structures of Uganda when compared to those in neighboring countries. I will focus only on the two that belong to the East African Community, which are Tanzania and Kenya. Both of these countries are coastal countries with low transport costs, which clearly tend to reduce transport costs. Moreover, they have more attractive incentive packages in that they provide investors with export free zones that have lower tariffs and income tax rates. Uganda abolished all export incentives in the early 1990s, and therefore to the extent that it does not have that facility which both Kenya and Tanzania have, they stand at a disadvantage in the eyes of investors that might have seen Uganda as a potential home. The authorities have requested for Fund and World Bank assistance to review the feasibility of a harmonization of the investment incentive within the East African Community. This work is now being reviewed by the two institutions.

Mr. Padoan asked if the staff had any evidence on whether the conditions in neighboring countries had indeed affected FDI inflows to Uganda.

Mr. Dohlman asked for elaboration on the possibility that the HIPC-to-HIPC debt relief might be resolved in a multilateral context. On the question of technical assistance, the U.S. chair was in agreement with other Directors that such assistance might be useful in facilitating repayment. On military spending, there was an indication that there could be upward budgetary pressure due to military actions; would the staff seek any kind of an offset and how would that be factored into a revised program? Also, on the DSA, it would be useful if the revision suggested by Mr. Vermaeten were incorporated in the published version of the staff report.

Mr. Vermaeten wondered if, in the event investment partners were to pull out of the Bujagali project, Uganda would proceed alone with the project, and if so, what would the implications be to the macroeconomic framework? Regarding domestic debt, when the Board discussed the SDRM, the staff had stated that domestic debt would not have to be covered by the SDRM because it could be restructured domestically. Was there any of that type of debt in Uganda, which the SDRM would not need to cover? On the inclusion of another graph in the DSA, the staff should take as much time as needed to gather the necessary information in order to present the most accurate report. It was not essential for the Fund to publish the document immediately.

Mr. Rustomjee considered that, as the authorities were willing to publish material, it was in their interest to have the documents released as early as possible. While there was no objection to modifying the graphs, the staff was encouraged to make the changes relatively quickly so that the authorities could benefit from the good public image that would result from publication.

The debt sustainability document raised the issue that underlined an important point, Mr. Rustomjee continued. The graphs, numbers, and definitions could be changed, but the reality was that Uganda was a country that had been going through adjustment for well over a decade and a half, and had benefited quite rightly as the first beneficiary of a very good policy on debt relief in a multilateral framework. However, there was the fundamental reality that a change in the price of a single commodity had put in jeopardy the sustainability of Uganda's debt regardless of how one modified the definitions and graphs. After a long period of adjustment, one single exogenous shock suddenly placed everything in a different light. In any case, the commodity price fluctuation and the structure of the Ugandan economy, which was too reliant on a single commodity, was all embedded in the report itself, and that report should be released in a timely manner.

The staff representative from the African Department (Mr. Kalinga) remarked that the reference to HIPC Initiative debt relief in a multilateral context referred to those countries such as Burundi, where it might be feasible to build some of intra-HIPC debt obligations within the amounts that were discussed for potential donor assistance to the countries involved.

The Acting Chair (Mr. Sugisaki) added that, in the context of the assistance to Burundi, for instance, the donor community should take account of that HIPC Initiative assistance given by Burundi to other countries, and providing more assistance to Burundi in order to offset that debt relief given by Burundi.

The staff representative from the African Department (Mr. Kalinga) remarked that, with regard to the impact of differential incentives on FDI, the Ugandan Investment Authority had indicated to the staff a number of investments that they had lost on account of their inability to provide export processing zones, which existed in neighboring countries. On the question of the potential budgetary impact of the increased insecurity in the north, at this stage it was a difficult question. The north had special characteristics that made it difficult to assess. The staff's understanding was that the donor community was cognizant of the need to address the issue even if it were to result in a temporary increase in defense appropriations geared solely for the northern operations. With regard to questions on the Bujagali project, the Bank staff was in a better position to respond to Directors.

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

> I would like to address four broad questions that have been raised by a number of Directors. First, to complement the response by Mr. Kalinga on the question of PRGF access in the case of Uganda and the possible post-HIPC Initiative assistance by the Fund to HIPC Initiative countries and the link between PRGF access or precautionary PRGF, I would like to add that the issue of precautionary PRGF arrangements versus low access in Fund facilities is something that is not entirely clear in the existing Board practices.
>
> In an earlier Board discussion, dating back to 1999, the Board discouraged the use of PRGF arrangements in a precautionary mode because it was felt that it would encourage the countries to actually draw on them and to their reserves because they are concessional. However, even precautionary PRGF arrangements tie down overall PRGF resources and thus preclude the Fund's ability to lend these resources to other more needy countries. I should clarify in this context that the PRGF facility is the only Fund facility where members do not need to represent that they have a balance of payments need, either to request the arrangement itself or to request a disbursement under the arrangement because the facility is simply meant to address underlying balance of payments disequilibria. Of course, even for the regular facilities under GRA resources, representation by a member country that they need to add to their reserves would actually qualify as sufficient for balance of payments need. The Fund retains the right to challenge ex post these representations by member countries, but it has not done so thus far. From the point of view of what we can do in the case of Uganda or other HIPC countries that may come up very soon, is that a precautionary arrangement would be just as limiting in terms of the Fund's ability to lend PRGF resources as an explicit access under the PRGF facility. In the case of Uganda, it was felt that the low access would give the same message to the country and to the donor community in terms of signaling the Fund's endorsement of the program as a precautionary arrangement would have, and it might also economise the amount of resources used because it is kept at a low level.
>
> At the same time, there is a procedural issue that we have not sorted out yet, and all of these issues will be addressed in the context of the Fund's policy toward low-income countries, a Board paper that is provisionally scheduled for discussion in December. In the context of the PRSP process, the Fund—together with the Bank and other donors—would participate in providing advice to the country during the PRSP preparation process. The

PRSP and subsequent PRSP progress reports on the PRSP are being discussed by the two Boards in the context of arrangements by the Fund and the Bank so that the Boards may give their endorsements. If we did not have a PRGF-supported program for a country, then we would not have a vehicle with which the Board would need to consider the PRSP, for operational reasons. That question would need to be addressed. So for the time being, we feel that the way that Uganda has been treated is consistent with the spirit of all of these considerations while we are awaiting Board guidance on these issues.

On creditor participation, Mr. Kalinga mentioned a number of considerations. I could add that thanks to the continued efforts of the managements of the Bank and the Fund to the non-Paris Club bilateral creditors, India had indicated in mid-June to management that it would be willing to participate in the HIPC Initiative for all the HIPC Initiative countries. India is one of the countries mentioned in the Uganda Board paper as a country that has not indicated a willingness to do so, but I would like to update that this has changed since the paper wass written, and it was brought to our attention by the Executive Director for India. We are grateful for that.

The third range of questions is in the area of litigation by non-Paris Club creditors, bilateral or commercial creditors, and how legal technical assistance can help. In the specific case of Uganda, the staff report mentions a request by the authorities to the Legal Department of the Fund to look into the statutes of limitations on financial claims against the government. From the point of view of several major shareholders that expressed interest in providing such technical assistance, what was meant is to address some of the concerns expressed in the recent HIPC Initiative progress report paper whereby the fact that where there is litigation—either in the court systems in the country or abroad—so many senior staff are involved in the process of preparing either a defense or briefings for the courts. This ties up the country's limited administrative resources and in itself is extremely disruptive. Thus, getting assistance from abroad to help a HIPC country alleviate these difficulties would be helpful. Sometimes, not necessarily in Uganda, the very risk of tying up the top echelons of the Ministry of Finance for so long for a litigation case may prompt the country to agree out of court to solve the problem to avoid the administrative complications and probably even minimize the costs. At the same time, having technical assistance in legal and financial restructuring issues may help HIPC Initiative countries agree informally with their creditors on restructuring plans. Of course, this is all at the level of theory at this stage, but we will be looking into it with our colleagues in the Bank as to how we can help mobilize the assistance from other major shareholder countries, as the Fund and the Bank have very limited resources in that regard.

Related to that, I am not sure the SDRM framework would apply to HIPC Initiative countries facing litigation because the SDRM framework could potentially envisage the initiation of a debt restructuring exercise with protection from hold out creditors. But in the HIPC Initiative context, this exercise of restructuring has been embarked upon and is at an advanced stage of implementation side. Hence, changes at the margin invoking the SDRM framework (which is not yet a Fund-approved policy) may not be the most appropriate approach, but ultimately it boils down to legal reforms.

In Uganda's case, one particular constraint that the authorities have faced, that had more or less created additional rigidities and difficulties, is that the domestic legislation holds the permanent secretary of the Ministry of Finance personally responsible for the implementation of court decisions in debt litigation cases. So, even if at the political level the government may decide not to honor a court decision, the civil servant concerned is held personally liable to the courts.

The final set of questions is on the issue of governance and the suggestion as to whether a ROSC module on governance might be something to consider further. Certainly in the broadest sense, the ROSCs in the standards and codes will be discussed by the Board sometime in October, which might be a more appropriate framework for addressing this question. However, I could mention specifically that already of the 10 or 12 ROSC modules that we have, issues of governance are covered in virtually every one of them. For example, we have a special module for corporate governance, which is handled by the World Bank with assistance from the OECD. The Fund handles the ROSCs for fiscal transparency and the transparency of monetary and financial policies, which play a key role for governance. Governance in itself is a multi-faceted concept. It affects every aspect of economic, political, and social life. It has legal aspects, policing factors, and it cannot be easily put in one technical model that would apply to all the institutional arrangements that exist in different countries. The only available alternatives are some quantitative and subjective assessments done by Transparency International. As mentioned earlier, Uganda has a rating of 93 out of 102. Of course, that set of ratings do not cover all HIPC Initiative countries, but among the HIPC Initiative countries that are covered, Uganda is the one with the lowest rating. Ghana, for example, has the highest rating among HIPCs with a rating of 50, to give you a range, whereas Tanzania is around 71.

The staff representative from the World Bank (Mr. Brigish), in response to questions posed by Directors, made the following statement:

I wish it were possible for us to say that the issues inhibiting the Bujagali project are clear and defined and the ways of addressing them in a timetable, therefore, were known and that options were available. However, I am afraid we are not yet at that point. There are four corruption investigations ongoing at this point, and while they are quite well coordinated, and while the

> investigators understand the need for expedition, the fact is that any one of these could throw up additional issues that are unknown at this stage, which could further complicate the picture.
>
> In terms of the sponsor's (AES) position, they have said that they do not wish to go ahead with this operation unless and until any and all hint of their involvement in these corruption matters has been eliminated. They are taking a position that the investigations must, in fact, precede anything.
>
> In terms of what would happen, therefore, if the government decided to go ahead with this operation, one cannot say because, even notwithstanding AES's own uncertainties, there would be uncertainties related to the engineering and procurement consortium, which is comprised of five companies, one of which has stated its intention to withdraw from the project. So, that uncertainty would exist, as would the role, if any, that commercial banks would play in the financing and the role of export credit agencies, if any, in an alternative framework. These are the some of complications that surround the issue and it is not feasible at this point to start looking at options in any concrete way. AES has a senior mission going to Kampala next week, and we do believe that some of these issues will be discussed at that time, and perhaps some additional information might become available following the mission.

Mr. Vermaeten observed that, on the matter of publication, although it was preferable to publish staff reports quickly, it was important that the information and graphs contained in the reports were an accurate reflection of what actually happened in Uganda. It was much better to have an approximation of a line on the graph with a footnote indicating that it was an approximation, rather than having no line at all. Also, in the Board's discussion on the SDRM, there was a consensus that there was no need to have the SDRM cover domestic debt; so, the question was, what kind of domestic debt could a government itself restructure? Perhaps it was a smaller subset than the Board had originally envisioned.

Mr. Rouai made the following statement:

> I thank staff for the high-quality set of papers, and Mr. Rustomjee for his comprehensive statement.
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> There is no doubt that Uganda is one of the top performers in Sub-Saharan Africa. I had the privilege to meet recently with the authorities in Kampala, witness their competence, and realize their dedication and their commitment to improving the economic situation and prospects in Uganda. I also perceived a sense of frustration regarding the adverse environment despite their best efforts in reducing the country's vulnerabilities. I consider their decision to embark on a new PRGF arrangement as another demonstration of their genuine ambition to improve the economic and social conditions in Uganda. I support the proposed decision, including the low level

of access. While I note that Uganda will remain heavily dependant on donor assistance, I sincerely hope that the country will be in a position to become the first HIPC country to graduate from the use of Fund's resources.

I support the broad objectives of the program focused on an increase in real GDP growth to be sustained by investment in infrastructure and pursuit of structural reforms to further improve the environment for private local and foreign investment. One of the major challenges facing the authorities is the need to reduce dependence on coffee. In this connection, I welcome the emphasis put by the authorities on the Strategic Exports Program (SEP) as the vehicle for involving the private sector in making the most of the potential of Uganda and in achieving exports diversification. I note, however, that major elements of this strategy, like exports promotion and product enhancement, are not worked out yet. In addition, as a land-locked country, Uganda needs to make extra efforts to develop transport and maintain infrastructure, including rural roads. Insuring security and good government are also very important and I appreciate the coverage devoted to these issues in the PRSP progress report. On the related matter and while I appreciate the comments made by the staff, I am disappointed the lack of a comprehensive tourism policy, unlike in neighboring Kenya and Tanzania that could contribute to diversifying exports earnings and enhancing debt sustainability.

Finally, I wish to associate myself with the concerns expressed by other Directors regarding the recent deterioration in Uganda debt sustainability indicators. Uganda was the first country to embark on both the original and enhanced HIPC and played a major role in fostering the credibility of the framework. While the success of Uganda in achieving debt sustainability and reducing poverty rest with the people and the authorities, the international community have also a lot at stake and should spare no efforts in helping the country to secure full HIPC relief, including from non-Paris Club creditors, and to continue to play the leading role.

With these comments, I wish the authorities all success.

Mr. Alazzaz made the following statement:

It is encouraging that the authorities of Uganda remain committed to maintain macroeconomic stability, promote strong growth, and reduce poverty. The key to success, however, is steadfast and sustained implementation of the agreed policies. Given the strength of the proposed program, the past track record, and Mr. Rustomjee's statement on the authorities' determination, I support the proposed arrangement under the PRGF.

The program includes key steps to help achieve the higher growth and poverty reduction contemplated in the authorities' Poverty Eradication Action

Plan. On the fiscal front, I welcome the authorities' determination for continued budgetary consolidation. The focus on increasing revenue and improving effectiveness of government spending is appropriate. I welcome particularly the commitment to limit public administration expenditures. The strategy should ensure efficient use of budgetary resources with increased allocation to the priority sectors.

I welcome the authorities' commitment to a prudent monetary policy. Low and stable inflation is essential for not only enhancing investor confidence, but also strengthening external competitiveness. In this connection, I fully endorse the steps taken to improve the Bank of Uganda's capacity to conduct monetary policy and strengthen its regulatory authority. In addition, I am encouraged by the ongoing efforts to modernize the payments system, expand financial services to rural areas, and improve the legal environment for financial intermediation. The decision to privatize the Uganda Development Bank and bring the National Social Security Fund under the Bank of Uganda's supervision is a step in the right direction. These efforts should enhance the health and efficiency of the financial sector, strengthen the private sector's confidence, and increase the credibility of financial policies.

The projected improvement in the underlying balance of payments is encouraging. I also welcome the staff's assessment that debt sustainability is expected to improve over the medium term. This promising outlook, however, will depend on continued implementation of prudent macroeconomic policies, improved debt management, and success of the export promotion strategy.

With regard to the PRSP annual progress report, I agree that the strategy continues to provide a credible framework for Fund concessional assistance.

With these remarks, I wish the authorities further success.

Mr. Siegenthaler made the following statement:

Uganda has a good track record of implementing sound economic policies and sensible reforms. These efforts have led to significantly lower poverty rates, a good growth performance and stable macroeconomic conditions. Of course, many challenges remain, the most important being the one of reducing and eventually overcoming the still very substantial need for donor assistance. We believe that overall the proposed program is adequately addressing these challenges and thus support it.

Let me just make three points.

First, as others have stressed, one of the major problems in Uganda is poor governance and corruption. The low ranking in the Transparency

International Index has also been mentioned, even though, to be fair, it has actually improved a bit recently. But what strikes me is that the overall progress of Uganda's economy has apparently not been transformed into a significantly improved governance performance. Most of the countries perceived as corrupt as Uganda are countries with ongoing conflicts, misguided policies and/or a generally unstable environment. All this is not – or not anymore – the case for Uganda. It is therefore disappointing that so little progress has been made in this area, as is also noted in the candid PRSP progress report.

The staff report and the program put a lot of weight on improving governance in order to limit the waste of public resources, particularly in the Revenue Authority. This is very appropriate, I fully support it and hope that it will do a lot to improve the weak revenue performance. However, reducing corruption is important not only to avoid revenue loss but also to encourage investment, both foreign and domestic. The authorities are reportedly disappointed about the still relatively weak FDI flows. But these weak flows should not be all that surprising. After all, corruption is a major disincentive for investment. I would have wished that the staff paper stressed this link a bit more in order to further encourage the authorities to do more about the problem. Like the Joint Staff Assessment, I also regret that the PRSP progress report does not set out a consistent and prioritized set of actions and would hope that this shortcoming will be corrected in the next report. In any case, I strongly support Mr. Dohlman and others in calling for additional measures to improve governance. Such measures would also be more sustainable in the longer run than any ad hoc tax or other incentive schemes.

Our second area of major concern is on budget management. For a country as advanced as Uganda, the extent of the respective problems are quite astonishing. It is particularly disturbing that these problems have led to priority social expenditures being crowded out by politically motivated spending. I therefore welcome the program measures that are envisaged in this area. In my view, the success of this new PRGF-supported program will hinge critically on whether or not these measures will be fully implemented. I hope that the authorities' actions will prove wrong a comment which I read in a respectable independent publication, noting that not much improvement can be expected in the area of budget management since "weak administrative capacity and a lack of political commitment will continue to act as stumbling blocks."

My final point is on debt sustainability. Overall, I fully agree with the staff that Uganda remains on a sustainable path and I also agree with others that the deterioration of the debt-to-export ratio is not as dramatic as it appears. But it is clear that the PRGF-supported program will need to be fully implemented in order for Uganda to stay on the path that the staff is projecting. The envisaged fiscal consolidation, for which I would like to commend the authorities, and the emphasis on generating higher fiscal revenues, will play a key role in this respect. Regarding the HIPC Initiative, it is disturbing that some non-Paris Club creditors are delaying their contributions. It is even more disturbing that some of them are relatively rich countries, which are thereby setting a bad and very unwelcome example for the poorer ones that are struggling to make their contribution. In this respect, I do welcome the remarks made by staff concerning the participation of India.

Mr. Maino made the following statement:

Like previous speakers, we commend the Ugandan authorities for implementing sound macroeconomic policies and for advancing key structural reforms that allowed the country to be the first HIPC Initiative country to have successfully reached the completion point. We understand the authorities' regret concerning the less than expected response of foreign direct investment and private sector investment. Like Mr. Reddy and Mr. Guinigundo, we consider unfortunate that Uganda has experienced difficulties in securing the full debt relief and that the country has even been sued by commercial, as well as by one bilateral creditor.

Notwithstanding the sharp deterioration in its terms of trade and the worsening of external debt sustainability indicators, well described by Mr. Rustomjee in his informative statement, we remain confident on Uganda's ability to consolidate these gains by maintaining macroeconomic stability and by advancing the institutional reform agenda. Given the present circumstances, in particular the sharp external shock, we support the proposed new PRGF-supported program as a clear signal of the Fund's willingness to support a country confronting an adverse external situation, and committed to following sound economic policies.

As we are in general agreement with the staff appraisal and with other Directors' views expressed so far, especially on the issues related to the fiscal performance and the progress achieved in poverty reduction—in light of the upcoming revised PEAP/PRSP—we would confine our comments to two points: namely, the Medium-Term Objectives and Policy Framework and the financial sector.

On the Medium-Term Objectives and Policy Framework: As staff underscored, the execution of this plan constitutes the right instrument to achieve higher rates of economic growth in Uganda. In this regard, we concur with the staff on the remaining risks to the program arising from the ad-hoc approach to investment incentives and the soft approach to streamlining public administration operation. At the same time, we encourage the authorities to diversify the export base and to increase export earnings through the newly created strategic exports program keeping in mind the overwhelming dependence on a single commodity subject to extreme price fluctuations. The strategy should also serve to reduce the consequent vulnerability of Uganda's external sector and promote growth based on real comparative advantages. Improving external competitiveness and further underpinning the enactment of an expanded trade is critical for Uganda's long-term policy strategy to achieve sustainable growth. Regional economic cooperation points today to the importance of more effective coordination and better harmonization in macro policies and in particular customs and tax administration with trade partners in the region and with other non-area partners. In this regard, facilitation of market access and support for more level playing field for developing countries' exports is critical.

Financial sector: We welcome the improved health of the banking system made evident by the higher ratio of capital to risk-weighted assets and by decreasing non-performing advances. We note the authorities′ efforts to advance a consistent incentive structure in the financial system by completing pending sales and mergers in the banking sector. In this regard, we also welcome the focus on strengthening the central bank's supervisory capabilities and enforcement of prudential banking regulations. The BOU has an important role to play in intensifying bank surveillance and in consolidating capacity building in this area, including efficiently developing the long-term instruments and institutions for financial intermediation.

Given Uganda's long track record of sound macroeconomic policies, liberalization of the economy and the efforts made to sustain the poverty alleviation strategy, the financial support from the donor community, including continued access to concessional assistance from the Bretton Woods institutions is deemed essential. At this stage of the reform process, Uganda needs the support of the international community to maintain the pace of adjustment and reform. With these comments, we wish the Ugandan authorities every success in their ambitious policy undertaking to reduce poverty and to sustain strong growth

Mr. Farelius made the following statement:

Uganda has indeed a commendable track record of pursuing sound economic policies and implementing structural reforms. Not least, the transformation from a very coffee-dependent, inflation-prone, and war torn economy some fifteen years ago to today's more diversified, market oriented economy in a low-inflation environment is commendable and offers valuable lessons for other countries. The reduction of the incidence of poverty from 56 percent to 35 percent during this period is a natural result of the authorities' resolve on prudent economic policies.

However, as noted by others, there are of course still several challenges that need to be properly addressed by the authorities in the future for the economic progress to be further expanded. I am like other speakers concerned by the recent non-Paris Club litigation. I share the thrust of the staff appraisal and can support the proposed decision. I would like to focus my remarks on four specific issues.

My first remark concerns the importance of diversifying the export base. Although considerable progress has been made in making the economy less dependent on a single export commodity, more efforts are needed to expand the export base. Here, as noted by the staff, it is important that the strategic exports program continues to focus on elaborating a strategy for expanding markets for Ugandan products. Further regional integration will also be important to expand export markets.

Secondly, as also raised in Mr. Ondo Mane's statement, in order to realize the medium-term objective of economic growth over 6 percent it is important that the authorities accelerate their efforts to increase domestic savings and investment. Here, in order to promote savings, it is vital that efforts are directed towards building confidence in the financial sector. I welcome the steps taken to reform the financial sector i.e. the sale of the Uganda Commercial Bank. I am also encouraged by the proposed steps to deepen financial intermediation and building greater confidence in the banking system, not least the new Financial Institutions Statute, which I hope will be enacted swiftly.

Third, as regards monetary policy, I note that the authorities contemplate moving to a formal inflation-targeting regime. I would encourage further discussions on this issue, not least because I think it would improve transparency and lead to a better public understanding of the objective of monetary policy.

Finally, as noted in the staff report, the management of monetary and exchange rate policies have been complicated by the large sterilization requirements arising from donor inflows. Apart from better coordination between donors and the authorities in order to increase the predictability of aid inflows, it is important to generate further instruments for liquidity management. In this regard, I welcome the proposal to lengthen the maturity structure of the domestic bond market. Furthermore, the increase of aid flows puts heavy pressures on the administrative capacity of the authorities and I find it important that the new Budget Act, together with the expenditure commitment control system, CCS, results in a more efficient management of the budget process and enhances the monitoring of expenditures. I also note, as stated in Mr. Rustomjee's informative statement, the authorities determination to boost revenue performance by improving tax revenue. The proposed program of streamlining public administration expenditures as well as further efforts to combat corruption will, in the long term, be vital for Uganda to eventually become less aid dependent.

Mr. Liu made the following statement:

We thank the staff for their well-written papers and Mr. Rustomjee for his helpful statement. Uganda's performance under the previous PRGF-supported arrangement was commendable, with robust real GDP growth, low inflation, increased foreign reserves, maintained macroeconomic stability and a significant reduction in the incidence of poverty. However, a sharp deterioration in its terms of trade and a deterioration of some debt sustainability indicators highlight the importance of the continued support from the international community. Therefore, we fully support the proposed PRGF-program, which will enable Uganda to consolidate the gains achieved from previous Fund-supported programs, and to continue its fight against the still-high levels of poverty facing the country. Since we are in broad agreement with the staff appraisal, we will limit our remarks to a few areas for emphasis.

We are of the same view that fiscal consolidation is key to ensuring the maintenance of macroeconomic stability, the continued success of the poverty eradication strategy, and reduced risks for the external sector. Therefore, we commend the authorities for their intention to put together a package of measures aimed at streamlining public administration expenditure. On the revenue side, we are pleased to note the authorities' determination to boost revenue performance by improving tax administration, especially from strengthening tax enforcement and compliance, as well as by introducing new tax measures.

The adoption of a prudent monetary policy has served the country well and should be continued. The commitment to maintain a flexible exchange rate regime is welcome. We are pleased to note that the authorities will continue their efforts to strengthen monetary management and improve efficiency. We commend them for their considerable progress in strengthening the banking sector, through the strengthened supervision and enforcement of regulations and we look forward to the adoption of the new FIS, aimed at further strengthening the Bank of Uganda's banking sector supervision.

On poverty reduction, like other speakers, we welcome the significant progress made to increase ownership through a broader participatory process. The implementation of the PRSP in 2001 was broadly satisfactory. We agree with the staff that the strategy so far continues to provide a credible framework for Bank and Fund assistance.

On the external side, we join other speakers in commending the authorities' initiative to diversify their export base and increase export earnings in order to reduce their overwhelming dependence on a single commodity and the consequent vulnerability and can share the view that increased market access will be crucial to enable Uganda to succeed in the strategic exports program.

In conclusion, we support the request for a new three-year arrangement under the PRGF and wish the authorities every success in their future endeavors.

Mr. Merotto made the following statement:

As Uganda is a very important development partner for the United Kingdom, I had hoped to speak earlier, but unfortunately my office's diligence in following yesterday's fire alarm was not matched by their diligence in requesting an early speaking slot, so I hope Directors will bear with me in delivering what is a briefly trimmed version of my statement.

First, let me join others in thanking the staff for a very clear set of reports and Mr. Rustomjee for his helpful statement. I endorse the staff's assessment and support the proposed decision, so I will be relatively brief and make a few points for emphasis. Messrs. Vermaeten, Boitreaud, Padoan, and others have captured the key points well, and I support their assessments of the priorities for the authorities moving forward, but first I would like to say that I found the staff papers on the PRGF clear and helpful. I particularly appreciated the thorough assessment of strengths and weaknesses of past program performance and the clearly written justification for a successor program, which I endorse.

Like others, I also strongly welcome the attention paid in the document to poverty and social impact assessment, and I encourage the staff to deepen its use of government-led ex ante poverty and social impact assessment in the implementation of this program. More broadly, the paper also addresses the other key features of PRGF-supported programs, especially pro-poor budgeting and fiscal flexibility, to which I will return.

I strongly support Uganda's request for a new three-year PRGF arrangement. I fully endorse the scope and intensity of the quantitative and structural conditionality of the program—on which the authorities have high ownership, and which are consistent with the calls that this Board has made for streamlining conditionality.

As Mr. Rustomjee notes in his statement, Uganda's macroeconomic performance has been exemplary and has resulted in a prolonged period of stability with growth. Nonetheless, whilst donors continue to look for a Fund seal of approval in the form of a Fund-supported program backed by resources before they commit to providing aid, there is still a clear and valuable role for the Fund with a PRGF-supported program in Uganda, as Mr. Kalinga clearly explained in his response.

In fact, Uganda illustrates quite well the ongoing medium-term need for the Fund in Africa. In the face of numerous risks and external shocks, even a country like Uganda, with a strong track record of maintaining sound policies and achieving macroeconomic stability, clearly faces an uphill battle to maintain economic stability whilst implementing a poverty reduction strategy backed by unpredictable, if substantial, donor transfers. As Mr. Bischofberger said, we know that the long-term solutions are diversification, export-led growth, private sector development, domestic resource mobilization, and a reduced reliance on aid, but these take time in a heavily indebted poor country, and they require continued maintenance of macroeconomic stability, which the Fund can help countries attain. In the face of such uncertainty and substantial risks that the staff notes, it may be a mistake for the Fund to declare Uganda as having graduated from PRGF resources. We have experience of early graduation from some countries in Africa in the early 1990s—and maybe this will come out in the IEO report on prolonged use—where donor assistance became even less predictable. We will take up this issue in the discussion of the IEO report on prolonged use of Fund resources and also, as the staff said, in the discussion on low-income countries.

Moving now to the details of the program, whilst endorsing the fiscal projections, I would underscore the need to avoid an excessively conservative fiscal stance. I welcome the discussion in the paper on the need for more predictable donor flows and urge the staff to report on long-term donor commitments as a means of making this problem more transparent. Further investigation of the impact of high aid flows and sterilization policy on the economy would be helpful. Also on fiscal issues, all external resources, including resources from global funds, need to support rather than distort macroeconomic management and government budgetary systems, and should therefore be on budget.

On the program projections, I would simply join other Directors and the staff in noting, that growth projections may be on the optimistic side in the short term. Faster progress on the Bujagali hydroelectric project, better-designed strategic exports, and initiative will be needed to make these projections become realized.

On the structural side, it is good that there is such strong agreement between the staff and the authorities on the main priorities, and we support the emphasis on raising revenue and improving governance. As I said before, Box 6 meets the calls for streamlining conditionality. I particularly welcome the proposed reforms to public administration, but would emphasize the importance of proceeding at a pace the authorities can manage. I join Mr. Boitreaud in supporting the staff's concerns that spending should be more in line with the budget and with PRSP priorities, and that the growth of political spending should be curtailed.

Lastly, I also welcome the new debt sustainability analysis, and join others in noting that non-delivery of HIPC Initiative relief is a significant concern for this Board and I join others in calling for full compliance by creditors. The problem demonstrates the need for technical assistance to HIPC Initiative countries, such as the legal advice, which Mr. Rustomjee proposes to forestall court cases. So, I join other Directors in supporting Mr. Rustomjee's request for the staff to make a proposal for World Bank/IMF managed technical assistance funded by donors.

Mr. Komatsuzaki made the following statement:

Uganda has maintained good performance after exiting the HIPC Initiative and the expiration of the PRGF-supported program. Macroeconomic performance was stable and broadly in line with expectations. Nevertheless, there remain important weaknesses. I generally agree with the staff appraisal and the PRGF review, but will comment on a few areas in which those risks exist.

Uganda continues to maintain a high fiscal deficit, a large part of which is covered by grants from donors. Revenue to GDP ratio remains at a relatively low level and has not increased much despite generally strong economic growth. I welcome the measures the authorities are planning in the area of tax reform and tax administration. The anti-corruption efforts on the part of the revenue authorities are especially important. On the expenditure side, the key is to contain overall expenditure while protecting the social expenditure through a reallocation of resources. The authorities' effort to reduce public administrative expenditure is a step in the right direction. In the area of expenditure management, while we agree with decentralization itself, we are concerned that decentralization might have been pushed forward too quickly. We hope that the authorities do not try to extend the Commitment Control System (CCS) too hastily when they review its desirability and feasibility.

We agree that the base money framework is pertinent, and the adoption of formal inflation targeting requires better data and a better understanding of the monetary transmission mechanism. Regarding the monetary transmission mechanism, we wonder if staff has some ideas why the lending and deposit rates declined only moderately despite the rather sharp decline in Treasury bill rates. If the commercial banks have excess liquidity and they are sound, it seems that they could extend more lending and the lending rates could decline easily. I also had the impression from reading the report that this modest decline was not entirely predicted. I wonder if the staff has some explanation for this decline. We welcome the authorities' efforts to dispose of the problem banks and to extend financial services to the rural areas. At the same time, we would like to point out that an appropriate supervisory framework has to accompany the extension of the financial services.

I welcome the update of the debt sustainability analysis and support its conclusion. Debt to export ratio certainly is an important benchmark that works as a starting point to gauge debt sustainability for the HIPC Initiative countries. The notion of debt sustainability is more complex than a single figure, however. We need to assess the situation in a more comprehensive way. In this sense, it is encouraging that cash flow debt-service sustainability has remained well within indicative HIPC Initiative guidelines over the past 20 years.

Having said that, there are risks and uncertainty to this assessment. The staff paper suggests several issues to be addressed to respond to the current debt situation. We would like to comment on some of those points.

First, the export outlook deteriorated due partly to the decline in commodity prices. That outlook has been revised downward. Since it is hard to forecast commodity prices, actual export performance could be better or worse than this projection. But the problem is volatility, and this underscores the importance of export diversification. A strategic export program appropriately focuses its attention to export diversification. Hopefully this will lead to productivity gains and increased international competitiveness.

On a related matter, an increase in FDI would contribute to external sustainability and future economic growth. It is unfortunate that the FDI has not increased as envisaged, and we wonder if the staff has some clue on the reasons for this. Do potential investors give any reasons for their hesitance?

Another problem is that debt relief under the current scheme is not complete due to nonparticipation of some of the creditors. As we have repeated in many cases, nonparticipation would threaten the principle of fair burden sharing. In the case of Uganda, under-delivery is substantial in its amount as well, being equivalent to 48 percent of exports. New developments described in the statement by the staff representative are very disappointing.

On new borrowing, not only does it have to be restricted to highly concessional loans, but the amount of borrowing is important as well. Excessive borrowing will impact the fiscal situation in the long run. Paragraph 29 of the staff paper suggests that underestimation of new concessional borrowing after the completion point was one of the main reasons that NPV of debt to export ratio deteriorated. This, in turn, shows that the amount of borrowing matters.

In order to establish the environment where the external borrowing will not be excessive, a gradual fiscal consolidation is needed.

With regard to new borrowing, it is also important to strengthen the debt management capacity of the authorities and monitoring by the Fund and the Bank. We would like to stress that new borrowing from non-participants to the HIPC Initiative cannot take place.

With these remarks, I wish the authorities every success.

Mr. Bakhache made the following statement:

We are in broad agreement with the staff assessment and policy recommendations and can support the proposed decision. Our remarks below will be rather selective.

There is little doubt that the Ugandan authorities' prudent financial policies along with the successful implementation of a number of structural reforms have yielded substantial positive results. The economy's resilience has improved as growth remains relatively strong and macro indicators are broadly in line with the previous PRGF-supported program in spite of adverse external conditions. Generous financial assistance from the international community, including debt relief, has also been a major contributing factor in the progress in poverty alleviation policies. With these developments, Uganda has become an example of the substantial benefits that the combination of good policies and donor support can impart on a country.

Notwithstanding the observed progress, it is clear that major fragilities remain. The country is very dependent on donor assistance and there is little room for slippages in the implementation of the reform program. As such, strong efforts are needed to preserve and build upon the significant gains made in addressing poverty in recent years. Aside from implementing specific poverty reduction measures, the focus of policy should be on preserving financial stability, promoting private sector investment, and improving public expenditure management. Implementation of policies in these areas will contribute meaningfully to sustained growth and hence a reduction in poverty.

The low access provided under the PRGF-supported program shows that there is no issue of availability of concessional financial resources for Uganda. The program is clearly in place to anchor policy implementation and is playing an almost purely catalytic role.

One of the main policy priorities for the Ugandan authorities lies in the fiscal area. The availability of large amounts of foreign resources seems to have created significant domestic pressures for higher public spending in non-wage recurrent spending, including public administration. While it may well be the case that this area requires significant improvement, we note that supplementary budgets to finance this type of spending have been approved in the past few years, as shown in Box 1 of the report. Notwithstanding the important improvement in the budget management system, we feel that more efforts are needed to ensure that resources are spent in an efficient and well-targeted manner. Toward the same end, local government budget management should also be improved.

In spite of some improvements, revenue performance needs to be strengthened further. While substantial increases in the revenue-to-GDP ratio can only be expected over the medium to long run, and despite the availability of funds from other sources at this time, in our view this issue deserves immediate attention. The proposed improvement in the functioning of the Uganda Revenue Authority is a good step in this regard. At the same time, we fully agree with the staff that the authorities should complement tax administration measures with new tax measures since efficiency gains alone are unlikely to lead to large increases in revenue collection.

While instrumental for growth and poverty reduction, the large inflows of official assistance have also become a complicating factor in the conduct of monetary and exchange policies. A better understanding of the macroeconomic and policy implications of aid flows is important, and we encourage the staff to work with the authorities on this matter. While there are no signs yet of any erosion of competitiveness, the authorities should keep a close look at exchange rate developments and stand ready to adjust their policies to avoid a large appreciation in the currency. Sterilization of donor flows appears to be needed to mop up liquidity and we welcome the new operating procedures in this regard. We note that the authorities plan to introduce a long-term bond of three to five years mainly for sterilization purposes. While we agree that introducing such instruments bodes well for financial deepening, it would seem that using government long-term bonds for sterilization purposes would impose an unduly large fiscal cost on the government. Unless such a bond was part of the government debt management, we wonder whether it would not be preferable to put in place central bank instruments for that purpose in order to avoid imposing the cost of a monetary operation on the budget. The staff's comments would be appreciated.

Uganda's medium and long-term economic growth prospects depend to a larger extent on private investment, including foreign direct investment, than on donor assistance. Strong commitment to the reform agenda, including better transparency and accountability of public finances, as well as a better functioning banking sector and judiciary, will undoubtedly strengthen investors' confidence. While the authorities' impatience with the lack of response of foreign direct investment to the adjustment and reform efforts so far is understandable, it is important that any attempt to increase FDI through investment incentives should take into account policies in this area in other countries of the region. We agree with the staff's assessment of debt sustainability in Uganda.

It is not surprising that there has been deterioration in the sustainability indicators of debt sustainability, particularly in light of the drop in coffee export earnings. We are pleased however that the medium-term projections show an improvement in debt indicators. Progress in the policy areas identified by the staff, including diversifying the export base, would help in this regard.

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

On the question of the domestic debt, this is not a considerable problem in Uganda at this stage. Domestic debt amounts to about 5 percent of GDP. The authorities are trying to restructure this debt to make it more longer term, and it is being addressed with the help of MAE.

On tourism policy, Uganda has had a comprehensive tourism policy, but it had to be shelved because of the insecurity in some regions, and the authorities are hoping to activate it as soon as the security situation improves.

Turning to governance and transparency, in some areas Uganda has fairly good structures. The budget system is good, the accounts are produced on time, audited on time, and Parliament discusses the budget within six months of the close of the fiscal year. Uganda has a fairly good legal structure with an independent government that is constitutionally mandated, but enforcement has been problematic, and this is partly due to fiscal resources. Another aspect is that in the past five years, the decentralization has added significantly in the number of self-accounting fiscal entities by almost ten times, and this has made it difficult for the auditing capacity to increase commensurately, and these problems will take time to address.

Administrative restructuring is, indeed, predicated upon strong political will. These issues have been discussed at great length with both Parliament and the president, and there is a convergence of views on the steps to be taken and the direction in which this must be done. In fact, the committee that is supervising the implementation of these issues is headed by the president himself.

The question of why banking deposits and lending rates did not decline as much as expected can be explained by two principal reasons. First, the fall in the rates for treasury bills significantly affected the profitability of the commercial banking system, and for some with a very small access or with exposure to lending possibilities, they found it difficult to adjust their lending rates. Already, they were starting from a position with a large margin between lending and deposit rates. However, the paramount reason is the risk and the segmentation in the market, which makes it difficult for the various borrowers and lenders to move between the different markets. For the larger borrowers with an international reputation, they did experience significant benefits from the lowering of the rates, but for the majority of borrowers, particularly Ugandans, with very difficult collateral problems, both in terms of valuation and legal processes involved, the benefits were small. These structural impediments, which affect risk, take time to resolve, and they remain at the core of the problems surrounding the banking system in Uganda.

On the factors underlying low FDI, Uganda has undertaken several surveys, and at the top of the list has been shortage of power, poor communication and infrastructure, and corruption. In past reports we have addressed the issue at great length, so we do not mention it to the same degree in the present staff report. The question of power is being addressed, as I mentioned earlier. Communication has been addressed, as it is decentralized and it is becoming efficient. Infrastructure forms a key element of the poverty reduction strategy. Corruption remains a key issue in Uganda, and needs to be addressed in a more determined manner. Indeed, the views of Directors have an importance on this issue, and they do recognize this in Kampala.

On long-term bonds and the fiscal impact, the laws of Uganda provide that all interest on treasury bills and bonds be paid by the government, even where the central bank bears the cost. In the case of the central bank instruments, it is indirectly a fiscal issue in that it only reduces the profits that are transferred to the government, and therefore the issue remains one of the optimal design of the instruments and how best to meet and lock in the various components of sterilization. Noting that sterilization operations are essentially structural issues and not just management issues, the government has been following the recommendations of MAE that in this area the use of bond instruments appears to be the better course and that a lengthening of the maturity structure of the instrument may make sense in reducing the volatility of the markets, which has been a major issue in past years.

Mr. Boitreaud noted that, as the Board had not yet discussed the issue of the SDRM together with the HIPC Initiative, the staff's comments should be considered to be of a personal nature rather than the official view of the institution. Given that the SDRM had been designed to solve collective action issues, which would prevent creditors representing a minor part of a debt of a country from interfering in the restructuring process, and in light of the fact that Uganda and many other HIPC Initiative countries faced minor creditors interfering in the restructuring process under the HIPC Initiative, perhaps HIPC Initiative countries would at least benefit from the legal framework of the SDRM. They would gain the legal ability to prevent such litigation.

The disturbing impact of the wide fluctuation of commodity prices on the situation of Uganda was another example in favor of encouraging the Fund to think about how to help low-income countries absorb such volatility, Mr. Boitreaud continued. It was important to pursue these efforts and to find some means, perhaps even some facilities, to help countries absorb such volatility.

Mr. Rustomjee made the following concluding statement:

Let me first thank my colleagues for their comprehensive interest in the case of Uganda, for their helpful comments, and for supporting the new program, which is very much a feather in the cap of the authorities. I am sure that they are going to be delighted at what I took as unanimous support for the program.

I am also thankful to colleagues for recognizing the efforts that have been made by the authorities. In that sense, it is always a pleasure to represent Uganda at the Board. I will reflect all of the comments that were made back to the authorities.

I wanted to thank Mr. Sugisaki for his visit to Uganda in January this year. He gave valuable advice to the authorities at that time, and has taken a deep interest in Uganda's case. I want to thank the staff, not only for making my life easy by answering every question comprehensively, but also for the nature of the partnership that they have established with the authorities, which is thoroughly professional and certainly is one of the models of how a relationship between the Fund and a low-income country should be.

On the fiscal side there was recognition by colleagues of the improvements that have been made in budget management. There were clearly concerns about the crowding out of social expenditure by expenditure on security and public administration. I will also reflect to the authorities what I understood from some colleagues as their pleasure at the signing of the peace agreement between Uganda and DRC. As Mr. Kalinga mentioned, that will be very helpful going forward on the issue of security expenditures.

There were comments by several colleagues on the issue of revenue/GDP ratio being too low and that revenue performance should be strengthened. Several reflected on the implementation of the issues in Box 4 of the report. The need to improve budget management at local levels is valuable, especially given the extent of decentralization that has been undertaken in Uganda.

The point by Mr. Merotto on the need for all flows to come on budget is a generic issue that our chair has been advocating for some time. It is extremely important that inflows to Uganda come on budget, as an example of a country that has established all the kinds of institutional mechanisms necessary to try to manage inflows such as medium-term expenditure frameworks, significant work on public expenditure management, and the tracking of HIPC Initiative spending. It is important that the donor community and all those that are providing inflows of a concessional nature, particularly, start integrating this with the budgets of the member.

There was a comment on avoiding an excessively conservative fiscal stance going forward, and that will be a valuable piece of advice for the authorities—not necessarily now, but in two or three years, as the program continues.

There were many comments on the issue of ad hoc incentives and the need for the Ugandan Revenue Authority to continue with their efforts, while also making stronger efforts to combat corruption.

On monetary policy and the financial sector related issues, I have taken note of the point of welcoming the conduct of monetary policy to date, which was made by several colleagues, and also the points on deepening the financial sector and deepening the markets for long-term bonds. The suggestion that it may be premature for an inflation-targeting framework to be adopted within the framework of the proposed, and also Mr. Farelius's use of the word of further discussion on the development of the framework, will be very valuable for the authorities exactly for the reasons he raised in terms of better understanding of the purpose of monetary policy and better diffusion of this understanding throughout the public. It will be essential for the credibility of inflation-targeting framework going forward.

I have noted Directors' views on the Bank of Uganda's need to strengthen supervisory capacity and intensify bank surveillance, as well as the suggestion that now the new financial institution statute should be legislated and enacted.

On debt sustainability analysis, there were two elements to the comments of colleagues. Directors were clear on the issue of export performance and the need to diversify the export base, as well as recognizing the efforts that have been made so far. There was also a suggestion for further regional integration as one method of trying to expand the export base. On tourism policy, Mr. Rouai identified the challenge of Uganda as a landlocked country. This is relevant in the East African situation because the other two partners have are coastal, so the costs of transport are significantly reduced in their case. This does present a particular challenge for a member country trying to expand its export base.

On the debt sustainability analysis itself, I have noted the concerns, which we all share, on the deteriorating debt ratios the issue of accounting for new borrowing. That is a valid aspect of the discussion, and I will take that back to the authorities for their reflection.

The concern about non-Paris Club creditors coming to the table with their equitable burden sharing, and also the concern for potential new litigation was an issue raised at the very beginning of the discussion. This is an ongoing concern for the authorities and they will be very watchful in this area.

The need to update the debt sustainability analysis on a regular basis is a valuable suggestion not only for Uganda, but also on a wider scope. I have also noted the suggestion of Mr. Bischofberger that, if legal technical assistance can be meaningfully done, this could be useful in helping the debtor country, particularly in the early stages when litigation is being threatened.

The point that Mr. Hadjimichael had raised on senior policymakers spending significant amounts of their time literally rushing to defend a case, to rush into court, or to try to persuade a potential litigant from not pursuing their claim, it is extremely draining. In a country like Uganda, it is valuable use of critical policymakers' time. Thus, better legal assistance would be very helpful.

I have taken note of the comments on governance and corruption, and will reflect those back faithfully to the authorities, particularly the valuable comments on the significance of this phenomenon for the low foreign direct investment thus far, the need to pursue additional measures, the concern on the Bujagali project, and the need for close monitoring of that on an ongoing basis. On the issue of ROSC on governance, Mr. Hadjimichael's comments were very valuable in reflecting that governance issues are being taken care of in many other issues where ROSCs are being affected. The point that governance ought to have improved in the context of higher levels of growth, the point made by Mr. Siegenthaler, was a valuable reflection on the status as it is at the present.

On the macroeconomic side, I welcome the comments on the strong track record of the authorities and the faith that colleagues have in that track record being pursued into the future, and of course the reflection of results as regards inflation reserves and growth particularly, especially given that there is a tough external environment. I did note the point that medium-term prospects are viewed as nevertheless being fragile and that there are many risks to the current program. The need for increased savings, the disappointing FDI, and the heavy reliance on donor support, which are all features of this program as we go ahead.

On terrorist financing and anti-money laundering, I have noted the point on enforcing the blocking order. I also welcomed the comment on Eastern and Southern African Anti-Money Laundering Group, which is a quite an active group. They are trying to do the best they can to pool and share information and then try and pursue on a broad basis steps that are being taken.

There were comments also on the PRSP as providing a strong basis of support for the PRGF and generally for use of Fund concessional resources. The authorities have devoted a great deal of effort to the PRSP and also to the progress report. It is again a critical use of senior policymakers' time at the point where it all starts becoming integrated with the budget framework of the member country. They will be very appreciative that their efforts are being recognized. There were also comments as regards the PRSP itself. Certainly many challenges remain; there are some sectors where further attention would be needed as they progress, and also the issue of greater attention to the regional dimensions of poverty, which has been raised in previous discussions.

There were important comments on program size and recognition by colleagues that this is not a large-scale program in terms of potential access; it is at the low end of the scale.

On the issue of prolonged use of Fund resources and on program design, I am pleased that colleagues recognized that this is a program that will be owned by the authorities. The program design may includes optimistic growth projections, and the Bujagali will be a key element in the outcome of the program, with significant implications for the growth outturn.

I understood the message of colleagues that the authorities should implement this program fully and that they share the priorities that have been embedded in the program. I also welcome the comments of a number of Directors that for this program to succeed, the predictability of donor assistance will be important. This is a point that is raised in the staff paper as a reflection, and it is a valuable comment in the context of the outturn of the program for the future.

On exchange rate policy, a few colleagues welcomed the commitment of the authorities to maintain the flexible exchange rate. There were also a couple of comments on avoiding unwarranted exchange rate appreciation, as has happened in the past. Also, I have noted the discussion we have just had a little while earlier on the large sterilization needs arising from the large donor inflows and the need for liquidity management instruments to address this.

In conclusion, I will take all of these comments back to my authorities. I would simply reflect that Uganda does provide a sort of ground for reflection on a more generic basis for many of the challenges that our institution faces in dealing with low-income countries. There is the issue, for example, of the fact that it has conducted sound economic management and sound performance over a long period of time, and yet remains a repeat user of concessional Fund resources. I feel that going forward, not on an individual case, but as a collective of countries, it would be useful to try to forge some kind of a generic institutional response to this. I have in my constituency, Uganda, Tanzania, and Mozambique—all as very successful cases of continued use of concessional Fund resources. It is not an easy conundrum, but it is something that probably will grow as the PRGF takes root as PRSPs succeed, and in two or three years we will probably have a nice collective of countries that are seeking an institutional graduation of some kind, including a new form of instrument perhaps.

There is also the generic fact or challenge that notwithstanding long-term sound performance, these kinds of countries remain hugely reliant on donor resources, and this is a challenge. I am not quite sure how we address it, but it seems to be almost an irony, but not quite because from what we understand, they will remain reliant on donor resources for such a long time.

The other generic challenge of how these countries—which have used Fund resources for such a long time and have been doing so successfully and with the acknowledgment of all those who are approving these programs—are still somehow not getting access to capital markets quickly enough. That is a long-term challenge for these countries, but something on which we could try to work. There is the challenge that was raised earlier in the discussion on the fact that, this is the first HIPC Initiative completion point case, but then the HIPC Initiative framework and the experience of this very successful country have not completely tallied. There is this challenge of exogenous shocks and how this can be absorbed within the HIPC Initiative framework, which is already so robust and flexible and has proved itself so often. Nevertheless, along comes this challenge of just a single exogenous shock that suddenly puts everything into question again.

There is the challenge of HIPC-to-HIPC debt, which Uganda also reveals. Iinnovative solutions can be put forward here. This is a subset of the HIPC Initiative challenge to address the kinds of problems that HIPC-to-HIPC countries confront. Burundi and Uganda should not be spending so much policymakers' time exercising angst to try to resolve a relatively simple problem of $12 million. It is something that could be addressed if we were to look at it in a ring-fenced sort of way.

There is also the issue of income distribution, which is another generic challenge that we will also face with some of the other countries that are succeeding. Notwithstanding the successive programs and with extensive World Bank involvement in some of these countries, income distribution may not be being addressed as well as it could in the context of growing economies. All of this is to say that I think the Independent Evaluation Office may have a great deal of excellent opportunities for case studies arising out of the Uganda case.

The Acting Chair made the following summing up:

Executive Directors welcomed the strong economic performance achieved under Uganda's first PRGF-supported arrangement, and commended the authorities for continuing since then with sound macroeconomic policies, which have helped to sustain strong economic growth with low inflation. They welcomed the significant progress made in reducing the incidence of poverty; agreed that Uganda's comprehensive Poverty Eradication Action Plan (PEAP) continues to serve as a meaningful framework for Fund concessional assistance; and considered the scheduled updating of the PEAP in 2003 to be appropriate and timely. Directors encouraged the authorities to continue to broaden the participatory process in the preparation of the PEAP, and to further develop mechanisms that link the macroeconomic framework and budget process to specific actions identified in the PEAP. They welcomed the authorities' candid presentation in their progress report on the implementation of the PEAP.

Directors endorsed the authorities' new three-year economic program, which they considered indispensable to consolidate the gains accomplished and to continue the battle against still-high levels of poverty. They stressed that efforts to increase domestic saving and investment, improve further the environment for the development of a strong private sector, and maintain macroeconomic stability, will be essential for sustaining strong economic growth and further reducing poverty. These efforts would need to be underpinned by strong progress in institution building, the establishment of satisfactory governance structures, and the fight against corruption.

Directors expressed concern about the recent deterioration of Uganda's external debt sustainability indicators, which resulted mainly from the decline in export receipts associated with a sharp drop in coffee prices. They welcomed the authorities' efforts to improve Uganda's debt indicators, without jeopardizing poverty reduction, through gradual fiscal consolidation and an expansion and diversification of the export base in the context of regional integration. Directors were concerned about the under-delivery of HIPC Initiative assistance, and disappointed that several commercial and official creditors had resorted to litigation to recover debts owed by Uganda. They urged all creditors, particularly official ones, to reach agreement quickly with the authorities on the full delivery of assistance in line with the HIPC Initiative. They saw scope for technical assistance in this regard.

Directors considered fiscal consolidation to be of paramount importance for continued macroeconomic stability and the success of the poverty eradication strategy. They noted that improving revenue collection and strengthening budget management will be essential to ensure that key economic and social programs are adequately funded. They urged the authorities to implement as soon as possible their plans for curbing nonessential expenditures on public administration; to reduce military spending in light of the signing of the peace agreement with the Democratic Republic of the Congo; and to strictly limit discretionary expenditures in supplementary budgets.

Directors welcomed the bold actions taken to stamp out corruption at the Uganda Revenue Authority. They urged the authorities to press forward strongly on this matter, and some Directors suggested that additional tax policy measures would be required to achieve the medium-term revenue targets. In this connection, Directors urged the authorities to discontinue granting ad hoc incentives to investors, and welcomed efforts to move to a generalized nondiscriminatory system of incentives, in harmonization with other members of the East African Community.

Directors commended the authorities' emphasis on the effectiveness of spending on poverty reduction, at both the central and the local government level, and they underscored the importance of achieving progress with regard to both poverty and income distribution. In view of the increased role of local governments in the delivery of public services, Directors supported measures to enhance the reporting, monitoring, and accountability of local government operations.

Directors considered that the current framework for conducting monetary policy has served Uganda well, although a few Directors suggested keeping the framework under review going forward. They commended the new operating procedures in the treasury bill and foreign exchange markets, which have allowed market participants to more readily distinguish sterilization operations from short-term liquidity management transactions and from foreign exchange interventions to smooth temporary, disorderly exchange rate movements. These procedures have enhanced the stability of the money and foreign exchange markets, despite the complications to monetary and exchange rate policies posed by the need to sterilize large liquidity injections arising mainly from donor-supported government spending. Directors endorsed the stance of monetary policy, and stressed the importance of continued sound monetary and exchange rate management—especially in view of the possibility that donor assistance could rise substantially under new initiatives in the years ahead. They also urged the authorities to take further steps to combat money laundering and the financing of terrorism.

Directors applauded the steps being taken to strengthen and deepen the financial sector. Privatization of the Uganda Commercial Bank, the closing of the TransAfrica Bank, and active banking supervision have contributed to improvements in financial sector indicators. Directors welcomed the authorities' commitment to privatize the Uganda Development Bank, to shift supervisory responsibilities for the National Social Security Fund to the Bank of Uganda, and to seek parliamentary approval of the new Financial Institutions Statute.

Directors were disappointed in the limited inflow of foreign direct investment, despite Uganda's long track record of sound macroeconomic management. They urged the authorities to improve governance and fight corruption with greater vigor. Directors believed that a well-established reputation for good governance would have a strong positive impact on foreign direct investment and flows of donor assistance. In this regard, they welcomed the introduction of a commercial court and Parliament's approval of a new Leadership Code.

Directors approved the requested three-year PRGF arrangement, in an amount equivalent to SDR 13.5 million.

The Executive Board took the following decision:

1. The government of Uganda has requested a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 13.5 million.

2. The Fund has reviewed the Poverty Reduction Strategy Paper Progress Report submitted by the government of Uganda set forth in EBD/02/128 (8/27/02), and concludes that the poverty reduction strategy of Uganda continues to provide a sound basis for Fund concessional financial assistance.

3. The Fund approves the arrangement set forth in EBS/02/163, Sup. 1, 9/12/02, and decides that Uganda may request the first disbursement under the arrangement. (EBS/02/163, Sup. 1, 9/12/02)

Decision No. 12850-(02/96), adopted
September 13, 2002

3. GUYANA—2002 ARTICLE IV CONSULTATION; POVERTY REDUCTION AND GROWTH FACILITY—THREE-YEAR ARRANGEMENT; ENHANCED INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—ADDITIONAL INTERIM ASSISTANCE; AND POVERTY REDUCTION STRATEGY PAPER AND JOINT STAFF ASSESSMENT

Document: Staff Report for the 2002 Article IV Consultation and Requests for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and for Additional Interim Assistance Under the Enhanced Initiative for Heavily Indebted Poor Countries (EBS/02/167, 8/30/02); Poverty Reduction Strategy Paper (EBD/02/133, 8/30/02); Poverty Reduction Strategy Paper—Joint Staff Assessment (EBD/02/134, 8/30/02); and Statistical Annex (SM/02/149, 5/17/02)

Staff: Guzman, AFR; Ebrill, PDR

Length: 1 hour, 30 minutes

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

This statement provides additional information that has become available since the circulation of the staff report.

On September 4, 2002, the World Bank informed the staff that the final element of the prior action relating to procurement reform has been completed to their satisfaction. Specifically, a Ministerial Circular was issued that directs government procuring entities and relevant personnel to implement the interim procurement framework agreed recently with the World Bank.

With this action, all prior actions for the authorities' request for a new three-year PRGF arrangement have been implemented in full.

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

Introduction

Almost 15 years ago, Guyana launched an impressive economic adjustment effort against a backdrop of prolonged negative growth, an unsustainable debt situation, and extreme poverty. Strong program ownership, skillful management, and the support of the international community led to a gradual resumption of stability, buoyant growth, and a substantial reduction in poverty during most of the 1990s, despite a series of negative shocks. Reflecting its good track record of policy performance, Guyana started receiving debt relief under the original HIPC Initiative in May 1999 and, in

November 2000, became eligible for additional debt relief when it reached the decision point under the enhanced HIPC Initiative.

Guyana's macroeconomic performance since 2001 has been broadly satisfactory, especially in the context of adverse terms of trade shocks and tenuous political circumstances. The global slowdown and its sluggish pace of recovery as well as declining world prices for key export commodities such as sugar and bauxite weakened Guyana's growth and export performance. During the period surrounding the March 2001 general elections, serious political and social disturbances resulted in loss of lives, arson and destruction of property, disruption of trade, and loss of government revenue.

Despite these very difficult setbacks, our Guyanese authorities took decisive actions to bring their PRGF–supported program back on track, undertaking fiscal measures and advancing critical reforms in the sugar and financial sectors. They are, therefore, highly concerned that the interruption of their program—which cannot be totally attributed to policy slippages—has given rise to the need for a new track record of performance, delaying interim HIPC assistance and other forms of concessional financing. They are making good progress in implementing most of the completion point triggers under the enhanced HIPC Initiative, signaling their determination to move forward, even under adverse circumstances. They request the Board to demonstrate flexibility in applying the established framework.

Our authorities thank the staff and management for the report, which together with the full PRSP, provide a comprehensive overview of their strategy to attain fiscal and external viability, generate growth, and reduce poverty. They look forward to the Executive Board's approval of the new three-year PRGF arrangement and additional interim HIPC assistance for Guyana.

Recent Economic Developments

In 2001, real output rose by around 1.5 percent, after remaining sluggish in 1998–2000. Inflation fell to 1.5 percent at end–2001 but began to rise to around 6 percent through the end of June 2002, partly reflecting higher fuel prices consequent on the elimination of electricity tariff subsidies. The Bank of Guyana maintained a cautious easing of monetary policy to facilitate economic activity while keeping inflation at single digit levels.

Despite the pressures emanating from the negative terms of trade shock and ongoing political difficulties, our Guyanese authorities contained the overall public sector deficit to 7 percent of GDP in 2001, in line with the program. They raised electricity tariffs to eliminate across-the-board subsidies to consumers, increased the gasoline tax, and restrained spending. Following wage increases of over 25 percent granted in 1999 and 2000, public servants demanded further large increases of 35 percent in 2001 and 30 percent in 2002. Our authorities eventually ended negotiations and unilaterally imposed a 5.5 percent across-the-board increase, well within the agreed limit of 6 percent for 2001. They continued to maintain HIPC–related social expenditures at about 15 percent of GDP, higher than the target set for the completion point.

The external current account deficit widened in 2001, reflecting a weakening of exports. Export earnings stagnated for rice, declined by some 20 percent for bauxite and 8.5 percent for sugar, but increased 3.25 percent for gold. Imports were flat and lower than program projections. On the capital account, net foreign direct investment and concessional loans were lower than programmed. HIPC Initiative debt relief, therefore, covered the overall balance of payments deficit.

As part of the prior actions agreed to with the staff, our Guyanese authorities presented a budget for 2002 consistent with the agreed macroeconomic program, and reached understandings with the World Bank on wage and employment policies to support modernization of the state-owned sugar company (GUYSUCO). They have also adopted interim measures to enact a pending prior action with respect to procurement legislation.

The Macroeconomic Framework for 2002–2006

The medium–term macroeconomic framework spanning the period 2002-06 agreed with the staff as the basis for the new PRGF arrangement envisages a gradual recovery to growth rates to pre-1997 levels, with increased production of sugar and rice leading the recovery and an expansion in gold and timber output providing additional stimulus. Inflation is targeted to fall gradually over the medium term, reflecting a monetary stance geared to support the growth objectives. The external current account deficit is programmed to narrow to 17 percent of GDP by 2006. Capital inflows would be higher than in previous years, given the growing levels of foreign direct investment associated with new timber and mining projects and new growth areas such as information, communication, and technology.

Fiscal policy remains predicated on the need to strengthen public savings and keep the declining public sector deficit financed by external concessional resources, without recourse to domestic borrowing. Our authorities intend to limit the public sector wage bill to the expected rate of inflation and productivity increases, and to reduce employment in the central government and GUYSUCO through attrition and in the state-owned bauxite companies (LINMINE and BERMINE) through restructuring They are working with the IDB on reforming the civil service with a focus on improved efficiency and service delivery. Total public sector expenditure in relation to GDP would increase as a result of higher allocations to basic health and education services under the HIPC Initiative and public investment associated with restructuring of the sugar and bauxite sectors. Our authorities intend to continue strengthening budget execution and control, especially through better targeting of social safety nets to vulnerable groups. On the revenue side, they will reform the tax system and its administration, taking into consideration the recommendations made by a recent FAD technical assistance mission.

While the overall fiscal deficit (after grants) is projected to widen through 2004 as a result of one-time expenditures associated with the privatization or closure of LINMINE and the restructuring of GUYSUCO, it will subsequently fall to under 6 percent of GDP by 2006. Public debt is also expected to fall significantly from 150 percent of GDP in 2001 to 99 percent of GDP in 2006.

Monetary policy will be guided by the need to meet the inflation and balance of payments targets of the program. In this context, the Bank of Guyana will further intensify open market operations and continue its efforts to develop a secondary market for treasury bills. The program allows for a pickup in credit to the private sector commensurate with the anticipated economic recovery. Our authorities intend to adopt additional measures to improve the institutional framework of the financial sector, including the privatization or resolution of the Guyana National Commercial Bank (GNCB).

The modernization of GUYSUCO is integral to the structural reform effort. GUYSUCO is the largest sugar producer in the Caribbean and the biggest contributor to the Guyanese economy. The sugar sector in Guyana accounts for 35 percent of agricultural output, and contributes 16 percent of GDP and about 25 percent of export earnings. It provides half of public employment directly, and is indirectly linked to over 50,000 other jobs in the rest of the economy. GUYSUCO's employment cost structure, however, is twice the international average, and it faces the gradual loss of preferential arrangements in export sugar markets. For these reasons, our authorities are preparing a social impact analysis of the GUYSUCO restructuring, with World Bank assistance. The proposed investment of US$110 million, would, inter alia, expand production at a modernized and efficient Skeldon sugar factory, shift field production to high yield areas, and lower unit costs closer to international levels. The project will be financed with concessional resources.

Guyana's Fight Against Poverty

Guyana's full PRSP was completed last November and its macroeconomic framework updated this April to take account of changes in the international and domestic environments. The PRSP represents the participation of some 10,000 persons in a country of 750,000 and consisted of nearly 300 consultation sessions with participants from across Guyanese society. The main goals of the PRSP are to raise per capita output and employment growth rates to pre-1997 levels, improve access to social services, and expand and strengthen social safety nets.

With a per capita income estimated at US$770, Guyana remains one of the poorest countries in the Western Hemisphere. The profile of the poor has not changed much during the 1990s despite a sharp reduction of people living in poverty from 43 percent of the population in 1992–93 to about 35 percent in 1999. Most of the poor live in rural areas with extreme poverty concentrated among the indigenous Amerindians, in part because of difficult terrain although in recent years there has been improvement in basic services including water, schools, and health huts. The government is committed to reducing the percentage of poor to around 31.5 percent of the population by 2005.

Our authorities' strategy for poverty reduction centers on investments in human capital in education and primary healthcare. In the education sector, they intend, among other initiatives, to increase the number of trained teachers, build new schools to reduce overcrowding, strengthen the program of textbooks to provide every child with free schoolbooks, and to provide universal access to secondary education. The national health strategy seeks to improve maternal and child health, reduce the incidence of communicable diseases, and improve access to secondary and tertiary care services in regional, district and the Georgetown Public hospitals. The government considers housing, water, and sanitation critical for poverty reduction and intends to use part of the resources from the enhanced HIPC relief to finance small community–based projects in these areas.

Conclusion

Our Guyanese authorities wish to assure the Executive Board that recent adverse domestic and external shocks have not diminished their resolve to persevere with adjustment and reform efforts. This is clearly evidenced by their track record of performance. They are committed to fully implementing the measures in the proposed program, and look forward to continued support from the international community, including the Fund, to foster sustainable growth and reduce poverty in Guyana.

Mr. Reddy and Mr. Jayatissa submitted the following statement:

We thank the staff for the well–written report and Mr. Portugal and Mr. Rambarran for the helpful preliminary statement. Guyana has been facing major economic hardships due partly to external factors and also due to the complex political situation. These have resulted in policy slippages in both macroeconomic and structural areas. While we are concerned about these developments, we welcome the authorities efforts to gather the momentum of economic reforms. The flexibility that the staff has shown in reaching an understanding on a new three–year arrangement under the PRGF is appropriate. Taking into account the progress made since end 2001 and the authorities renewed commitment to implement good economic policies we support the authorities requests for a new program and additional relief under the enhanced HIPC Initiative.

We note that the consensus building process on reforms has been difficult and as the staff has rightly pointed out the "political cooperation and consensus building will improve only gradually". In this context there appears to be a major risk to the program due to possible delays in implementing reforms, in addition to the possible adverse changes in the external environment. As the staff has pointed out, since mid –2001 the authorities have demonstrated their commitment to the program by implementing some of the reforms.

The progress made in structural reforms, particularly in highly sensitive and difficult areas such as electricity subsidies, wage policy, and privatization is encouraging. In the areas of privatization, it is mainly the initial stages that have been completed, as in the case of some other programs. We trust that the authorities will strive to make continued progress in both macroeconomic and structural reforms to provide a sound basis for higher sustained economic growth and poverty reduction and hope that the proposed program will be properly implemented.

We too support the authorities planned actions, mainly wage restraint in civil and public enterprise, reduction of public sector employment excluding the education and health services, and focusing public investment to modernize the sugar sector and towards growth-oriented projects. We also support the recommendation to expedite the implementation of tax reforms aimed at broadening the tax base, elimination of ad hoc exemptions and improving the efficiency and equity of the tax system. We note the plans to link wages to inflation and productivity. In this regard, we appreciate the staff comments on the reliability of the available price indices, and productivity measurements. What is the state of the preparedness of the authorities to introduce a wage setting formula on this basis? And what are the risks of getting entangled in a high inflation high wage spiral, putting the macroeconomic program at great risk?

We also endorse the authorities recent exchange rate and monetary policy directions and endorse the staff's recommendation to avoid further monetary easing. We hope that the authorities will proceed with financial sector reforms as appropriate, given the weakness of the financial sector. We also welcome the other planned measures to improve public sector governance and efficiency. It is appropriate that they are encouraged to improve budgetary and expenditure management, and also improve their statistical system covering key macroeconomic statistics and social statistics.

Mr. Rustomjee submitted the following statement:

We would like to thank the staff for the document to facilitate the 2002 Article IV discussion for Guyana, as well as the authorities' request for a new three-year Fund supported Poverty Reduction and Growth Facility (PRGF) and additional interim HIPC relief from the Fund. We also thank Mr. Portugal and Mr. Rambarran for their helpful preliminary statement in support of Guyana's request.

Guyana experienced difficulty in implementing policies under the previous program as a result of both internal and external factors. Subsequently, several slippages occurred and the mid–term review could not be completed, hence the commitments under the arrangement expired at end–2001. Notwithstanding these setbacks, we are pleased to note from Mr. Portugal's and Mr. Rambarran's statement that the authorities' took decisive actions to bring their PRGF-supported program back on track. This commitment provided the authorities with the scope to negotiate a new three-year Fund supported program. We support the request for a new program, as well as additional interim HIPC relief from the Fund. The design of the program, including the growth objectives, envisaged structural reforms, poverty alleviation expenditures, and the conditionalities, is in our view appropriate.

Concerning social stability, we commend the efforts by the political leadership to address the prevailing tension in the country. Social and political stability will in our view contribute to the successful implementation of the new program.

Monetary, Exchange Rate and Financial Policy

The relaxed monetary policy stance adopted during 2001 was appropriate in the light of the weaker than expected growth performance envisaged under the program, and also because credit extension to the private sector remained stagnant. We consider a continuation of the monetary policy stance appropriate at present to contribute to increased growth, while we would urge the authorities to remain vigilant against inflationary pressures. We also note that the exchange rate has depreciated somewhat over the last few years. We welcome the authorities' commitment to continue to pursue a floating exchange rate policy and only to intervene to achieve the net official international reserves target.

As regards financial sector stability, we are pleased to note that the technical assistance mission to assess the overall strength of the supervisory practices in the financial sector concluded that banks are generally well capitalized and have sufficient liquidity. The finding that the recent strengthening of the regulatory framework mitigated risks in the banking sector, is also welcome. The mission noted however some concerns regarding overall performance of the financial sector, and recommended areas that need improvement. We would urge the authorities to carefully assess and implement those recommendations that would contribute to the overall strength of the financial sector.

Fiscal Policy

Several factors contributed to slippages in the implementation of fiscal policy as programmed during the early part of 2001, including delays in eliminating electricity subsidies, a deterioration in revenues collections, and higher than programmed expenditures. We are pleased with efforts made by the authorities to correct this situation during the second half of 2001, particularly to increase revenues, and to keep expenditures in line with the program objectives. The progress made in restructuring state assets and the ongoing civil service reform will also contribute to long–term fiscal sustainability. We would urge the authorities to implement reforms to the tax administration system as envisaged, in order to eliminate inefficiency, broaden the tax base and improve governance in the fiscal environment. We find the proposed tax reforms contained in Box 5 appropriate. We are also pleased note that a Fiscal ROSC was conducted in Guyana in July this year, which we are sure will provide useful recommendations to authorities to strengthen fiscal operations in the country.

Social Impact Analysis and Enhanced HIPC Initiative Completion Point Status

Box 3 in the staff paper provides very useful information regarding the Social Impact Analysis of reform in Guyana. This analysis focuses appropriately on the impact of reforms on certain groups, including the poor. We concur with staff that social safety nets should be developed to address adverse short–term social conditions that could result in the implementation of policies under the proposed new program.

Guyana has made substantial progress toward reaching the completion point. We welcome the assessment by the joint staffs that the full PRSP provides a credible framework for poverty reduction, and for Bank and Fund concessional financing. We would urge the authorities to continue to implement the needed procedures to correct the shortcoming identified with the tracking of poverty–reducing expenditures with the aid of Fund and Bank technical assistance.

Finally, we wish the authorities every success with the implementation of the program and their future endeavors.

Mr. Mirakhor submitted the following statement:

Key points

Strengthening the fiscal effort and improving public sector savings are crucial to place the public debt on a downward path and free up resources to provide much–needed support to key investments and social spending.

While easing monetary policy may be necessary to provide a stimulus to economic activity, vigilance is required to ensure that inflation remains in check.

Guyana has the potential to replicate the growth rates realized in the nineties. To make this possible, however, requires social stability, macroeconomic consolidation, economic diversification, private sector development, and human and institutional capacity building.

The PRSP represents a credible poverty reduction strategy and merits Bank and Fund concessional assistance.

Despite risks to the program, we share staff optimism about the authorities' ability to overcome them through steadfast implementation of adjustment and reforms.

In view of the renewed momentum in policy implementation, we support a new PRGF arrangement for Guyana.

We thank the staff for a well–written paper on developments in the Guyanese economy and the challenges that lie ahead, and Mr. Portugal and Mr. Rambarran for their comprehensive statement. While impressive gains were made in macroeconomic stabilization, growth, and poverty reduction during 1993–97, exogenous factors compounded by domestic policy weaknesses in recent years have served to depress growth and per capita income. The authorities are, however, striving to arrest the slide in the economy through strengthened adjustment and reform policies for which they are to be commended. In view of Guyana's renewed momentum in policy implementation, we support a new PRGF arrangement.

Commendable corrective actions have been taken during the second–half of 2001 to contain the fiscal deficit. Strengthening the fiscal effort and improving public sector savings are crucial to place the public debt on a downward path. This would allow the freeing up of resources to provide much–needed support to the private sector as well as to help finance key investments and social spending. Initiatives to raise revenue by reforming the tax system based on FAD recommendations (elaborated in Box 5) are welcome. We attach high importance to strengthening tax administration, reducing the scope for discretionary exemptions, and broadening the tax base. The planned cuts in current expenditure are also noteworthy. Restricting public sector wage increases and eliminating utility subsidies will create space for spending on the social sectors and accommodating the costs of restructuring state enterprises. We welcome initiatives to reform the budget and expenditure management systems and treasury operations and the overall public sector modernization program. Also important are plans to enhance transparency and efficiency in the public resource management, and participation in the Fiscal ROSC is an important step in this direction. Prompt action is required to implement the new public procurement legislation and strengthen pre–investment analysis of public investment projects. Regarding the planned bridge over the Berbice River, it is hoped that the economic benefit, based on full feasibility studies will be the overriding consideration and that any transactions contravening the PRGF arrangement would be avoided.

Monetary policy stance has been appropriately supportive of low inflation and the floating exchange rate. However, to counter fiscal policy slippages, monetary policy had to bear the brunt of macroeconomic adjustment, resulting in tight credit conditions. While an easing of policy under present conditions may be necessary to provide support to economic activity, vigilance is required to ensure that inflation remains in check. Although bank capitalization and liquidity seem adequate, non–performing loans are high, and the banking system remains fragile. We welcome measures to strengthen the financial sector, including restructuring of the insolvent GNCB and streamlining legislation on collateral and bank ownership concentration. Efforts to strengthen the supervisory capacity and procedures of the Bank of Guyana are also well directed. The authorities are encouraged to implement the recommendations of the safeguards assessment of the BoG.

Commendable efforts are underway to implement delayed structural reforms. Particularly noteworthy is the planned restructuring of GUYSUCO and LINMINE, which, together, have considerably strained the budget and the financial system. Although the restructuring entails short–term social and fiscal costs, it will bring long–term benefits from enhanced efficiency. It is important, however, that appropriate safeguards are instituted to cushion the potential adverse impact of the reforms in the absence of adequate formal social safety nets. We, therefore, welcome the initiatives proposed in Box 3 to undertake social impact analysis and develop social safety programs as well as provide the resources to that end.

The expectations of a recovery in economic activity over the medium term is somewhat clouded by the unfavorable outlook for sugar and bauxite in the world market. Moreover, base–line growth rates, while higher than realized in recent years, will not suffice to make serious dents in poverty.

Guyana has, indeed, a potential to replicate the growth rates realized in the nineties. To render this possible, however, would require social stability, macroeconomic consolidation, economic diversification, private sector development, and human and institutional capacity building. External debt indicators seem to follow a downward trend over the medium, thanks to assistance under the HIPC Initiative. Nonetheless, prudence is required to keep the trend going. To this end, prudent debt management would be required to supplement the fiscal consolidation effort. Despite risks to the program, we share staff optimism about the authorities' ability to overcome them through steadfast implementation of adjustment and reforms.

We share staff's assessment on the strengths of the PRSP, including the extensive consultative process and the sound underlying macroeconomic framework. At the same time, the challenges to this strategy are worth keeping in view. In particular, steadfast implementation of adjustment and reforms are key to securing broad support internally and externally. That being said, we agree that the PRSP, on the whole, represents a credible poverty reduction strategy and merits Bank and Fund concessional assistance. Progress has been made in tracking poverty–reducing expenditure, and the authorities are urged to undertake further improvements in this area as recommended by the staff. Considering other data weaknesses, we welcome the authorities' intention to improve compilation and dissemination practices.

Mr. Cho made the following statement:

At the outset, we welcome that reforms in Guyana are now getting back on track, so that we will be able to support a new program for Guyana. The fact that all prior actions have now been met was one of the lesser reasons that we support the new program. Rather, our support is based on our broader observations such as:

- The new program has been designed in a more consistent manner with the PRSP.
- The underlying macroeconomic projections have been revised to be more realistic than those in the original framework.
- We believe the new program includes a reasonably comprehensive package of structural reform in order to overcome obstacles for the economy's sustainable growth.
- The authorities are beginning to establish its track record and are eager to demonstrate their ownership, as evidenced in their preparation for the PRSP as well as the new program.

Having said that, we also note that there are still substantial downside risks to the program, as the staff rightly recognizes. It is our sincere hope that the new program will facilitate an enhanced HIPC for Guyana in order to reach its floating completion point soon. We will focus on these risks to the program for emphasis.

The biggest challenge to the program lies in a seemingly timid national consensus about it, as indicated in poor participation of both opposition parties and the business community in the PRSP process. In particular, we are concerned that the reason for non–participation by the Private Sector Commission was due to its perception that the PRSP is about poverty reduction, not economic growth.

If this were to be a prevailing public perception, it would indeed imply a serious stumbling block for the success of the program. The PRSP is meant to layout a coherent strategy to ensure sustainable growth in a country's fight against the poverty problem. Therefore, economic growth is supposed to run in parallel with poverty reduction, rather than the two goals conflicting one another. The ill-perception about the PRSP might have been caused either by deficiencies in the design of the PRSP, and thus the new PRGF-supported program, or by the authorities' insufficient efforts for broader engagement in the PRSP process. As we would like to believe that the former cause was not the main culprit, we urge the authorities to make concerted efforts to more forcefully persuade all interested parties.

Labor unions' resistance is another factor that may endanger the program. Surely, wage moderation is an essential element for the country's sustainable growth, given that a sizable deficit of the non-financial public sector (NFPS) prevents private sector activities from growing. The fact that the planned separation of temporary and unqualified staff from the civil service was not able to be executed, is also worrisome. In our view, this poses a serious risk to the program, especially because the program consists of a series of privatizations or resolution of ailing public enterprises.

Admittedly, asking labor unions to come to terms with the reality is not easy for any government. Nevertheless, encouraging them to join a policy dialogue with the government is worth attempting by treating them as a wing of the country's social partnership and by giving them a greater role in its policy formulation. For example, the social safety net that the country needs badly could be an ideal item to discuss in this policy dialogue. Developing a medium-term wage policy framework, as advised jointly by the Fund and Bank staff, may not be an unrealistic goal if trust is to established in this dialogue.

Moving on to the contents of the program, we agree with the staff that tax reform is the key to the program. The current "too high tax on too few people" structure is certainly detrimental, not only to the country's Treasury, but also to its unity. It is particularly disconcerting that remissions have been an increasingly major source of tax exemptions. We strongly encourage the authorities to implement the tax reform as indicated in Box 5 of the staff report, under a strong belief that a fairer and more transparent tax system will contribute to national consensus for sustainable growth and poverty reduction.

While welcoming that NFPS capital spending has been better prioritized, we share the staff's caution that its investment program remains somewhat ambitious and relies on capital intensive projects. We agree with the authorities that the Build Operate Transfer (BOT) type of private sector participation can be a good alternative to public sector investment. But this often requires a certain form of the government guarantee and matching investments from the national budget. Accordingly, these projects should be brought under the same degree of public scrutiny as any other public investment, such as a reliable feasibility study and an environmental assessment.

On financial restructuring, we note that the authorities are determined either to privatize the insolvent GNCB. But having witnessed that the liquidation of the much smaller GTICL ran into problems due to shareholders' legal action, one may raise a concern about possible disruption to the authorities' plan for GNCB. We note that GNCB being government owned may be different from GTICL's. Nevertheless, we would like to hear from the staff on whether the court's ruling on the GTICL would have any implications for GNCB.

Finally, the lack of the institutional capacity in Guyana continues to be a pressing concern. The discrepancy between the NFPS deficit and its borrowing requirement appears to be a notable example of this problem. This may turn out to be a technical error. However, if left unnoticed and uncorrected, it could be a widening loophole which may invite corruption and thus derail the country's pursuit of a national consensus toward sustainable growth. We ask the staff both at the Fund and Bank to help the authorities enhance their institutional capacity.

Ms. Lewis-Bynoe made the following statement:

We commend the authorities of Guyana for their renewed commitment to promoting macroeconomic stability and attaining long–run sustainable growth and poverty reduction. We acknowledge the considerable effort made by the authorities in completing their first PRSP and concur with the staff and other speakers on the importance of the PRSP and the PRGF program in helping to create macroeconomic stability, encouraging sustainable debt management, and restoring investor confidence. In our opinion, the documents before us today present plausible arguments in favor of IMF concessional lending and debt relief under the enhanced HIPC Initiative for Guyana. The PRGF is also appropriately tranched, giving the authorities the opportunity to demonstrate their commitment and strengthen their track record.

We believe that the authorities of Guyana have taken an important step by re–committing themselves to the process of economic reform given their difficult economic circumstances, aptly described by the staff in their report. While we do accept that exogenous factors (adverse terms of trade and a global recession) contributed to the present situation, we also consider that domestic developments, notably, a difficult political environment and a deteriorating fiscal position that resulted in unsustainable high debt, further complicated matters.

In this regard, we agree with the staff, who must be commended for their thorough assessment of the situation, particularly their acknowledgement of the importance of the authorities' ability and commitment to implementing prescribed policies to the success of this undertaking. Prudent fiscal management and fiscal discipline are critical and so we would urge the authorities to be mindful of the potential for macroeconomic instability arising from excessive public sector spending. Of course, it goes without saying that, financial stability is important to the process of growth and development and so financial sector reforms must be given priority.

Public sector reforms must play a vital role in this process, both as a means of addressing the fiscal imbalance in the short term and as an avenue for poverty reduction. Indeed, expenditure restructuring and revenue enhancing measures should have the dual effect of increasing public sector savings and increasing the resources available for social priorities (improving the provision of social services and establishing social safety nets), poverty reduction and investment. Given the drain on public finance that the sugar and bauxite industries represent, restructuring these sectors can also offer significant benefits.

Generally, we accept the combination of fiscal, monetary and structural policies prescribed by the staff and agreed to by the authorities as appropriate under the circumstances, but would like to further stress the following:

- Institutional strengthening (rationalizing the civil service and improving governance) as a means of enhancing the capacity for implementing reforms.
- The removal of impediments to investment (legislative or otherwise) thus creating a climate that is conducive to investment.
- A program of privatization aimed at allowing for a more efficient use of resources.
- An export diversification plan to reduce vulnerability to external shocks should be included in the economic strategy.

Furthermore, given the size of the reforms required and the growing urgency of the situation, the authorities need to mobilize stakeholders and so we want to urge them to seek a speedy resolution to the political situation. They must strive to attain a political climate that is both conducive to change and supportive of the measures being undertaken. We welcome the renewal of the dialogue with the opposition, as a step in the right direction. Perhaps, the authorities should consider employing a public awareness campaign as well. To reach the benchmarks established for the PRGF program and the HIPC completion point requires the coordinated effort of all stakeholders.

Finally, on the issue of the PRSP, the analysis of the macroeconomic obstacles facing the country is comprehensive and insightful. The authorities' renewed interest in donor coordination is noteworthy and we would urge them to continue these efforts. However, while the document outlines priorities in the context of the broad macroeconomic objectives of the country, these are not matched against available resources in a realistic way. Therefore, the list of priorities needs to be set out in order of importance.

Ms. Lanza made the following statement:

At the outset let us thank the staff for their well–written and insightful set of papers and Mr. Portugal and Mr. Rambarran for their candid and very comprehensive preliminary statement.

Guyana's economic performance over the last few years has been shaded both from adverse terms of trade shocks and from a complex political situation which have hindered economic growth and poverty reduction efforts. However the authorities made tremendous efforts to maintain macroeconomic stability at the very difficult time of the electoral period and showed increased ownership thereafter in upholding the reform momentum. The overall outlook for Guyana remains nonetheless very fragile and will likely continue to face significant challenges in the near future. To this extent it is crucial that the authorities strengthen their ownership of the program and strive to achieve political cooperation and consensus building that support policies to deliver macroeconomic stability and pave the way to undertake far–reaching structural reforms through the use of the limited domestic resources but by mostly attracting foreign resources. The ability of Guyana to channel foreign investment in the country is a prerequisite for ensuring success of the public companies restructuring and privatization process. To this end many actions should be promptly put in place by the authorities. Actions range from fiscal consolidation and tax reform, to financial sector reforms, to institutional capacity building and governance, to improvement in the debt burden.

As we broadly agree with the trust of the staff appraisal we will concentrate on four remarks for emphasis.

First, Guyana's economic structure highly depends on natural resources while being a very open economy. This clearly places the country in a very vulnerable position in terms of adverse terms of trade shocks. In addition the industrial basis of the country is still very concentrated around some core activities like bauxite and sugar which are still largely state–owned. In enhancing the privatization process and attracting foreign investments the government should place great emphasis on diversifying the industrial activities and activate new services in the comparative advantage sectors. This will not only further protect the country against adverse external shocks but also provide a more ample tax basis and increased revenues for the government. We would greatly appreciate it if the staff could elaborate further on this point.

Second, and following on the last remark, we urge Guyanese authorities to strengthen their fiscal position. To this end we share the staff's view that the tax reform envisaged in the authorities program is essential for improving governance and enhancing the environment for private investment and growth. While we understand that this is a highly sensitive matter for the authorities, we concur with the staff that eliminating the scope for discretionary exemptions and corruption and improving the overall efficiency and equity of the tax system is the only way to secure the program from risks of failure. Needless to say that wage moderation in the public sector in line with the expected rate of inflation and productivity increases will be a crucial part of fiscal sustainability. We expect the authorities to strongly comply with this agreed criterion. However, given that the political environment is a serious cause of concern and could easily jeopardize the program we would greatly appreciate to hear from the staff if they have elaborated a contingency plan to rescue the program and the economy both in the event of adverse external shocks and internal political disruptions.

Third, and again in connection to the first point, we would like to emphasize the critical importance for private investment and growth to rely on a sound financial sector. We therefore urge the authorities to speed up with the process of either privatizing or resolving GNCB within 2002 and implement measures to recover its nonperforming loans.

Finally, we urge the authorities to take benefit from the available support of the World Bank and the IDB to evaluate the social impact of the planned reforms as to design appropriate safety nets and speedily progress in poverty alleviation.

With this remarks we wish the authorities every success in implementing their challenging agenda.

Mr. Scholar made the following statement:

As the staff report notes, through a program of market reforms in the 1990s, Guyana made good progress in terms of productivity gains, stronger growth, and progress in tackling poverty and inequality. But following a number of recent shocks to the economy, both internal and external, growth has faltered and progress with it. The PRGF, and the PRSP on which it is based, and the additional relief that we are considering today under the enhanced HIPC Initiative, offers Guyana a very good opportunity to restore the momentum of reform and the resumption of growth, so we are happy to support today's decisions.

It will be vital that the Guyanese authorities take this opportunity, which will require determined policy action for some time to come. As Mr. Mirakhor has stated, Guyana has the potential to replicate the growth rates realized in the 1990s, but to make this possible will require social stability, macroeconomic consolidation, economic diversification, private sector development, and human and institutional capacity building.

First and foremost, as others have noted, is the need for political stability. We recognize that Guyana is in a difficult situation. There are a number of processes under way to reduce polarization and to promote greater inclusiveness, in particular the recent initiative of the Commonwealth Secretariat, which aims to restore dialogue between the two main parties. We support this process, and encourage the authorities to continue in their work. Second, on structural reform, we underline the need to eliminate subsidies in key exports sectors and move toward greater privatization. Third, tax reform is not only an essential part of fiscal consolidation but also sends a rather powerful signal of the authorities' determination to press ahead with reforms. Fourth, wage restraint in the public sector again feeds directly through not only to fiscal policy, but also signals determination on the part of the authorities. In this regard, there is a delicate balance to be struck, given the political situation, and wage restraint is something that will need to be taken forward carefully. I would be interested to hear the staff's response to the question posed by Mr. Reddy and Mr. Jayatissa on the plans to index wages.

All of the above as well as other reforms that are set out in the papers should, over the medium term, increase productivity and strengthen confidence, especially private sector confidence in the economy. It should also establish a stronger and broader base for growth and, in doing so, free up resources for tackling poverty and inequality. But it is important to recognize that this is very much a medium-term agenda, which will pose big challenges in the short term. In that context, we were particularly pleased to see the poverty and social impact assessment in Box 3. This is always important, but especially so in a program of this sort, which does have considerable short-term costs, especially on the most vulnerable and the poor. A general point that we have made in policy discussions of PSIA is the need to ensure that it is entirely systematic and comprehensive, and coordinated across different players involved, including the government itself, the IFIs, and donors.

We also stress the need to ensure transparency in discussions of PSIA so that all sectors of society have an open discussion of the options that are available to them in dealing with the various policy choices and the options for going forward. I wonder if the staff could comment on how this is to be achieved in Guyana while ensuring transparency and comprehensiveness.

The authorities' efforts to strengthen their systems of public expenditure management are particularly welcome, included the fiscal ROSC just concluded. We look forward to the recommendations being implemented, recognizing that this will probably need technical assistance from the IFIs and bilateral donors. Again, that is something that will need to be carefully coordinated.

This is a large and long-term agenda, and it will require a period of sustained and intensive collaboration between all of Guyana's partners, Guyana itself, and the international community. One thing in particular it will require is stronger and more effective donor harmonization amongst the bilateral donors, and harmonization between the authorities and the IFIs. The difficult events of the last year have placed a strain on those relationships. I hope that with today's discussion behind us, these difficulties can be left behind and the collaborative partnership continued.

Mr. Marques made the following statement:

After a weak start in 2001, Guyana's policy implementation improved in the second half of the year. But in spite of several politically difficult corrective measures, the central government deficit widened when weak revenues were outpaced by expenditures. The authorities reacted by cutting capital spending, but total expenditures increased anyway due to increased public sector wages and a substantial rise in transfers to public enterprises with which weak revenues could not keep up.

In 2002 and later years the only way to contain the fiscal deficit will be to increase current revenues, and obtain additional donor assistance. The authorities expect that income tax revenues, which exceeded their budget target in 2001, will increase again, and that the revenues from consumption taxes, which were below their target in 2001, will also increase. But in light of Guyana's only moderate GDP growth and continued sluggish consumer demand, these expectations appear somewhat unrealistic.

The authorities should therefore strengthen their fiscal efforts and continue improving their management of the budget and expenditures. The tax reform initiatives presented in Box 5 of the staff paper, including the elimination of discretionary tax exemptions, should be implemented immediately. The authorities' plan to negotiate public sector wage restraint and restructure the sugar and bauxite industries are promising, but any success will depend critically on better relations between the two major political parties, and a reduction of political uncertainty.

The underperformance of the financial sector is still a cause for concern. The profitability of domestic financial institutions is hostage to the large bad loan portfolio, weak demand for credit from the private sector, and the scarcity of lending opportunities. The high liquidity and capitalization levels of the banks are somewhat reassuring, but the regulatory framework must be further strengthened to counter the risks created by the high level of nonperforming loans. The authorities' intention to take full advantage of technical assistance, especially from CARTAC, must be complemented by strong concrete actions.

Guyana also confronts a more fundamental problem. The economy as a whole is racked by ethnic divisions which will extend themselves to the winners and losers produced by the reform process. A durable improvement of Guyana's economic prospects, and a real reduction of poverty, will depend on overcoming this challenge. I thank the staff for encouraging the authorities to address this issue in the PRSP, which has pointed their efforts in the right direction. But much remains to be done.

For poverty reduction to succeed it is particularly important for the framework aimed at macroeconomic stability to include improved governance, progress with structural reforms, and stronger public administration. The staff correctly points out the urgency of analyzing the social implications of certain planned reforms to make sure that persons who are harmed by the reform process are targeted for assistance.

Given the modesty of the staff's projected decline in the ratio of NPV public debt-to-GDP, from 106 percent at the end of 2003 to 99.5 percent at the end of 2006, based on the assumption that Guyana will reach its floating completion point early in 2003, I am struck by how difficult it is to achieve long-term external debt sustainability. This once more illustrates an inherent flaw of the HIPC Initiative: Guyana will be left with a debt roughly three times the size of Bolivia's, although Bolivia is the wealthier country. To correct this flaw we made, some time ago, some proposals aiming at raising additional ODA.

On the key reforms and objectives to be achieved before the HIPC completion point, I was pleased to learn from the staff that the final element of the prior-action procurement reform has been completed. Unfortunately this only applies to the interim procurement framework. To further improve the efficiency and transparency of public procurement, I look forward to early enactment of the revised legislation.

I do not understand the rationale for allowing the authorities to offer satisfactory progress with tax reforms as a substitute for making satisfactory progress in improving the framework for private sector investment reform. There should be progress in both areas. As usual, the staff's comments would be welcome.

It will take some time to increase political cooperation and build consensus, but the authorities' proposed program should be able to meet this challenge, provided that the policies are strongly implemented. The authorities' renewed commitment, and the promising progress achieved so far, encourage me to support a new PRGF arrangement and additional interim HIPC assistance for Guyana.

Mr. Al-Nassar made the following statement:

Last year Guyana faced a difficult economic situation. With the real growth falling short of expectations, the fiscal position worsening and structural reforms stalling. While the deterioration of the terms of trade and the global slowdown contributed to those outcomes, policy slippages played a role. Here, I am encouraged by the authorities effort to put the economy back on track. The prior actions that have been taken are welcome but further efforts are needed to put in place the conditions favorable to sustained high growth and poverty reduction. I, therefore, support the authorities' request for a new PRGF arrangement, which will help them in addressing these issues.

Achieving the fiscal target for 2002 is critical. Here, broadening the tax base, eliminating discretionary tax exemptions, and increasing revenue collection are priority. In this regard, the authorities' plan to reform the tax system and its administration consistent with the FAD's technical assistance recommendations is a step in the right direction. On the expenditure side, it is encouraging that the total expenditure is projected to remain stable. Here, I welcome the commitment to restrain wage increases and to focus the capital spending on the state–owned sugar company's (GUYSUCO) modernization as well as poverty–reducing projects. With regard to the Berbice River bridge project, I concur with the staff on the need for a comprehensive study of the project's feasibility and its economic impact.

The priority of monetary and financial sector policies to contain inflation is appropriate. Therefore, I agree with the staff that further monetary easing should be put on hold in view of the recent upward inflationary pressures. Indeed, if the pressures persist, the authorities should stand ready to tighten the monetary stance. Accelerating the ongoing financial reforms should facilitate the conduct of monetary policy. In this regard, revising the Bank of Guyana Act along with the efforts to privatize the Guyana National Commercial Bank (GNBC) are important steps. The authorities also are encouraged to further strengthen financial regulations and supervision.

I broadly concur with the joint staff assessment that the PRSP provides a sound basis for Bank and Fund concessional assistance. I am also reassured by the significant progress made in implementing the enhanced HIPC initiative completion point triggers. Further efforts, however, are still needed to help asses the impact of adjustment and reform policies on the poor and to develop social safety programs to reduce any negative impact.

With these remarks, I wish the authorities success.

Mr. Vogel made the following statement:

I would like to thank staff for a well written report, and Mr. Portugal and Mr. Rambarran for their helpful preliminary statement. First of all, we welcome Guyana's improved macroeconomic performance since 2001 in a context of adverse shocks and a difficult political environment. However, much needs to be done to achieve a higher and sustainable growth rate, allowing Guyana an exit from being one of the poorest countries in the Western Hemisphere.

On the fiscal side, the main issue to be addressed by the authorities refers to the tax system and administration. In this regard, the elimination of discretionary tax exemptions will be critical. Even though the authorities may consider that some kind of discretion in granting new exemptions could promote private investment, it is clear that in the medium term this will be more costly than beneficial because of the culture of tax evasion and governance problems that it engenders. Therefore, we are encouraged by the possibility that the authorities could adopt the recommendations for tax reform proposed by a recent FAD technical assistance mission. As Box 5 points out, this reform could allow for a broadening of the tax base, reducing economic distortions, improving equity and strengthening tax and customs administration.

With respect to current expenditures, we welcome the authorities' intention to continue prioritizing public sector wage moderation. Meanwhile, we concur with staff on the desirability for some wage differentiation in key areas of the public administration in order to attract and retain highly skilled personnel. In addition, we are encouraged by the plan of the authorities to reform the civil service with assistance of the IDB focusing on improved efficiency and service delivery that may be very useful to eliminate certain irregularities in civil service payrolls.

In the financial system, the adoption of additional measures, including the privatization-resolution of the Guyana National Commercial Bank and the improvement of the financial supervisory capacity, should help to strengthen the sector and to rebuild confidence thus improving credit conditions, which are one of the main risks to the program. Moreover, the efforts to increase credit to the private sector should be complemented by a continued accommodative monetary policy stance, even though we concur with Mr. Rustomjee that the authorities need to remain vigilant against inflationary pressures.

Turning to other structural reforms, while we welcome the efforts aimed at improving governance, we are encouraged by the authorities' intention to address the situation of the state owned bauxite companies, to stop the continued drain of resources from the public finances. At the same time, the use of privatization receipts for poverty reduction programs, i.e. human capital development, is commendable.

With these comments, we support the proposed decision and wish the authorities every success in their challenging reform endeavors.

Mr. Ralyea made the following statement:

The last time the Board considered Guyana, this chair abstained on an enhanced decision point for Guyana and a second annual arrangement under the PRGF. Our abstentions were motivated by Guyana's poor track record and the weak nature of its economic program. Unfortunately, the authorities' performance under the second arrangement validated our abstention. We also have deep reservations about this program, but some elements of its design give us some comfort.

We welcome the back loading of program disbursements, the prior actions, and significant number of structural performance criteria in key areas. Now it is up to Guyana's authorities to show results. We expect a long period of sustained performance before a recommendation is brought to this Board or the Boards of the IDB and WB that Guyana has satisfied the requirements for the enhanced–HIPC completion point. To the extent possible, that performance should reflect efforts to reduce current expenditures in terms of GDP to the level envisaged under the last arrangement.

Let me now turn to a few critical fiscal and governance issues. We believe there are severe governance problems with tax administration. We agree with the staff that tax reform should be comprehensive and include steps that improve the governance of tax administration, and reforms that broaden the tax base while reducing excessively high tax rates. However, we were disappointed to learn that the authorities are reluctant to make changes in some of these areas. We strongly encourage the authorities to work closely with the Fund and the World Bank to design a reform package that meets these goals.

The size of the wage bill continues to limit the availability of resources for social expenditures or debt reduction. For that reason, we would discourage any modification of the completion point triggers as the authorities seem to desire. In a similar vein, the standards for procurement reform built into the program should not be lowered.

We agree with the staff that there is room for improvement in both the PRSP document and the PRSP process. Stronger outreach efforts would appear to be critical given the opposition party's and the Private Sector Commission's lack of formal participation in the PRSP consultations. Equally important is the need to address institutional weaknesses and put in place systems that improve accountability and governance. For example, we note that an adequate framework for monitoring and evaluating implementation of the PRSP does not exist. In a country with a history of governance problems, putting a strong monitoring system in place in advance of such reforms is critical.

We also support the staff's call for the authorities to further prioritize the programs and projects included in the PRSP to ensure that public resources are used effectively and efficiently. In that light, the authorities' plan to build a bridge over the Berbice river appears ill advised. More broadly, the authorities should implement all the measures proposed by the staff to make the PRSP document and process a success.

We welcome Guyana's application for membership in the CFATF and encourage Guyana to participate actively in the CFATF once it becomes a full member. Regarding the combating of the financing of terrorism, Guyana's legal framework is broadly in line with international norms, but enforcement and sanctions should be strengthened.

Finally, we expect a full safeguards assessment to be completed in time for the first review of this arrangement. Given that the external audit assessment found that the external audit mechanism may not be adequate, we would appreciate the staff informing us of what the authorities have done to implement the recommendations from that assessment.

Mr. Le Gal made the following statement:

Like previous speakers, I would like to thank the staff for a well written document, and Mr. Portugal and Mr. Rambarran for their insightful preliminary statement. I share the staff's analysis and, therefore, I will limit myself to three comments for emphasis.

First, the economic recovery and the reduction of inflation are welcome and this confirms that the authorities have started to take corrective measures following the early 2001 slippages. Nevertheless, growth was lower than initially expected and the fiscal deficit remains high. We support the staff's recommendation for a rigorous policy mix. Regarding fiscal policy, we agree that measures aiming at increasing the tax base, improving compliance, and eliminating discretionary exemptions are necessary. We welcome the decision of the authorities to have a fiscal ROSC in 2002, and to launch tax reform. We invite them to implement all the changes suggested by the staff. On the expenditure side, we also support the call for wage moderation, but we encourage the authorities to preserve spending in education and in the social sectors. Regarding monetary policy, we concur with staff to give prominence to the inflation objective and to put further easing on hold.

Second, turning to structural reform, we agree with the staff that the restructuring of public enterprises is a critical element for increasing the economy's growth potential. I thank the staff for the details in Box 6 about the sugar industry and the description of the modernization plan. We encourage the authorities to implement this strategy in a timely manner.

Third, we agree with the request for additional interim assistance, but would like to underscore that, under the agreed methodology, the current projections will not call for any topping up at the completion point. To conclude, I would like to associate myself with the comments made by Mr. Scholar and other speakers on the need for strengthening the national dialogue, as this is a necessary condition for the success of the program and the poverty reduction strategy. With these remarks, I wish the authorities to succeed in their endeavors.

Mr. von Kleist made the following statement:

Once again, the staff has provided us with an excellent analysis. Despite the difficult external environment and the complex political situation, the authorities of Guyana have made substantial efforts to maintain macroeconomic stability and have raised the reform momentum recently, and we commend them for this success.

I would also like to stress at this point that Guyana has a good record in environmental protection. The willingness to preserve one's natural resources and to pursue an ecologically sensible policy is one important aspect of sustainable economic development that often is not emphasized enough.

Against this background and since we generally share the staff's assessment, we support a new three–year PRGF arrangement and additional interim HIPC relief.

We expect--and I want to be very clear about this--the authorities of Guyana to keep this program on track, to avoid slippages similar to those that have derailed previous attempts. Fiscal policy must ensure sustainable public finances. Therefore, no time should be lost in fully spelling out and implementing the tax reform. The current time table is not very ambitious, which could endanger the program's fiscal target. Given the recent rise in inflation, the authorities should refrain from loosening monetary policy further. The flexible exchange rate has served the country well.

Wage increases must continue to be stability-oriented. We welcome the authorities' firm stance concerning wage increases in the public sector. Some faster shedding of surplus personnel would also have been welcome. In addition to stronger wage differentiation, as suggested by the staff, measures to further qualify and re–train surplus workers could have a strong positive impact. Structural reforms, as outlined by the staff, have to be carried out vigorously.

Concerning Guyana's participation in the HIPC Initiative, we missed some detailed information regarding adequate participation by the so-called other creditors, one of the central conditions for granting interim assistance. Some additional staff comments would be welcome.

Concerning the PRSP, we join the staff's assessment that it was prepared through a broadly satisfactory participatory process. Lastly, we also join the staff's call to the authorities to improve the statistical data base.

Our support should be understood as giving Guyana a fresh chance. The authorities of Guyana have to make sure that this second program remains on track, even if unexpected developments should occur.

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

On programming issues, and more general issues of risks, a question was asked what contingency plans exist or what policies could be put in place to deal with risks, in particular as regards terms of trade shocks and political breakdowns or political instability. The program is based on a flexible exchange rate. If there is a serious deterioration in the terms of trade, the options are quite limited for Guyana. Thus, price flexibility is important, and the authorities have indicated that they are committed to a flexible exchange rate policy to help deal with such an event. In Guyana, a depreciation of the rate has a positive fiscal impact. This would also tend to promote stabilization.

A key issue that arises when looking at the problem of exchange rate movements is the issue of whether wage policy can be maintained in the context of a depreciating exchange rate. This brings up Mr. Reddy's question of whether there is a risk of a wage-price spiral or whether the authorities are prepared to implement a wage-setting formula based on inflation and productivity increases. Labor relations in Guyana have been difficult in recent years. The authorities are strongly committed to a policy of adjusting wages in line with inflation and productivity. In 2001, they managed to contain wage pressures despite heavy union pressures to raise wages substantially. In 2002, wage pressures have remained contained. Thus, the staff are hopeful that the authorities this year will be able to once again hold the line on wages at levels that are consistent with the program. What is referred to are wages in the overall public sector, both in the government and in the sugar sector.

So on the issue of terms of trade shocks and how to adjust, there is some scope for exchange rate flexibility but, given my answer on the wage issue, it is limited. The way to move forward is to proceed with and accelerate key structural reforms where there is scope for improvement. This is for two reasons. One is the issue of competitiveness and export diversification. There is a need to accelerate cost reductions and, thus, structural reforms embedded in the program have to move forward. Another aspect which is important for being able to grow or recover growth is the issue of domestic savings or fiscal savings. Savings have declined in recent years. Structural reforms would have to advance, particularly in the sugar sector, to bolster savings in order to protect necessary investments in economic infrastructure. Thus, given a terms of trade shock, the policy framework would broadly be the same; it is just that some of the measures that are being contemplated would have to be accelerated. Having said that, accelerating structural reforms is difficult in a situation in which GDP is not rising and there is a contraction of the economy.

In terms of contingency plans in the case of a political and social breakdown, I do not know how the program would proceed. A necessary condition for implementing economic policies in an orderly manner is to have political stability and to have some sort of consensus on the way forward. In light of this consideration, the staff are concerned and have urged the authorities to move forward with a dialogue between the leadership of the parties.

The staff find that the PRSP process is an important instrument for building consensus in the society and to building trust. In the program itself, the staff have included some reforms which also tend to reduce sources of political friction. Reforms of the tax system, public procurement, the public sector investment program, budget management, and project selection all would contribute to reducing the discretion of officials. The goal is to make allocation of resources more rule-based and efficiency-based rather than discretionary. The staff have found in conversations with the leaders of the opposition and with the private sector many complaints about how things are handled in these respects. Nonetheless, even though all governance improvements would tend to support political stability, without growth political stability will be difficult to obtain.

There was another question regarding wage policy and concerning the reliability of inflation and productivity indicators for setting rules. Indeed, the staff and the authorities have a problem in that regard because of weak capacity in statistics. Efforts are being made to improve the data. In the meantime, the authorities and the staff are working with proxies for productivity growth and employment.

There was a question whether the court ruling on the non-bank that was intervened in 2001 has implications for the privatization of the large loss-making, state-owned bank, the GNCB. It does not have implications because the GNCB is a public institution. The court challenges arose from the owners of the non-bank institution. The procedures that were used by the central bank for intervening and for liquidating the bank were challenged by the owners of Globe Trust, the non-bank. This does not apply in the case of the GNCB. Having said that, there is a need to look again at the Financial Institutions Act, as well as legislation and regulation of the financial system, and to strengthen the central bank to help make sure that the problems that have occurred with the non-bank do not recur (with perhaps a larger institution) in the future.

There was a question regarding ways to promote export diversification. The approach that the authorities have taken in their PRSP is rational in the sense that, in order to diversify the economy, there is a need to improve competitiveness. This would happen by reducing costs of production and reducing uncertainty in the economy. One uncertainty in the system is the political issue discussed earlier. There are also the issues of tax reform, where taxation of certain products is very high. Especially in an agricultural economy, transportation costs are extremely high because fuel taxes are high. The cost of automobiles and trucks is also high due to taxation. So, there is a need to reform the tax system, broaden its base, and reduce tax rates. There is also an issue of financial sector reforms. What I refer to is that the costs of borrowing are high in Guyana, not only because of the problem of nonperforming loans, but also because of inefficiencies in the judiciary. It takes a long time to try to realize assets which back loans by going through the courts. Thus, there is a need to look at issues that affect credit risk. The IDB is looking into this issue and is in discussions with the authorities to put in place credit risk institutions. Further, other reforms in the financial sector that reduce costs would also be helpful in reducing interest rates.

On infrastructure issues, public sector investment in Guyana is high, but growth is not, at least in recent years. This raises issues about the efficiency of public investment. The staff are trying to deal with this issue in two ways. One is through improving public procurement processes by making sure that the projects that are implemented are done through competitive means and appropriate procedures. A second element concerns the selection of projects for the public sector investment program, and the need to make sure this is done in a manner that takes into account both economic and social considerations.

We are trying to proceed with reforms that hopefully will tend to reduce the costs of doing business by improving infrastructure among other initiatives. In an agriculture based country, it is important that the land titling process and property rights be clear, and this is not the case in Guyana. There are also issues, for instance, concerning the opening of the telecom market. This is another important reform given that the sector has high costs not only associated with the prices of telephone calls, but also associated with the interruption of business and the inability to communicates. There is the issue of improving the legal and regulatory framework for mining. This has to be modernized. There is the issue of expanding the electricity network. The government is working on a whole series of initiatives together with its development partners to improve the business climate by reducing costs. Competitiveness is the key element to the development of the productive sectors of the economy, and the authorities are moving forward in many of these areas. The staff hope that they will proceed quickly on some of the key reforms that are in the program.

There was a question on social impact analysis and whether it was comprehensive and transparent. Here, the World Bank, the Inter-American Development Bank, and other key development partners of Guyana are taking the lead. Given the weak institutions and the weak capacity in the country, and the limited resources of these institutions, it is important to be selective in terms of the work that is done in this area. That is why in the program the staff have put so much emphasis on doing social impact analysis of the main reforms that the staff know will have a substantial impact on diverse social groups. Second, our emphasis has been to proceed on a more broad basis with improving the delivery of essential public services, such as education and health. The World Bank and the IDB are doing important work in this area, as well as other development partners, and important progress has been made over the last decade and will continue to be made, but it is important to be selective.

There was a question regarding the framework for private investment and whether tax reform really should substitute for reform of the investment legislation, or whether both should be done at the same time. The World Bank commissioned a study on private investment incentives and they found that political stability is the key issue, along with judiciary efficiency. In terms of the legislation, the tax issue is key, in the sense that the important aspect of the investment legislation is precisely removing uncertainty regarding taxation. In this context, and because of the reasons that are explained in the staff report, the way to move forward in this area is to press and to support the authorities to do a comprehensive tax reform to improve investment incentives, and to remove this impediment to growth.

There was a question regarding whether there is adequate participation of creditors for the HIPC completion point. My understanding is that about 90 percent of creditors have indicated their support for Guyana reaching the HIPC completion point and providing debt relief under the HIPC Initiative. I believe that is to be the case, but I do not have a ready answer. If there is any discrepancy, I will communicate that bilaterally.

Finally, there was a question regarding progress of the safeguard assessment. Some progress is being made to improve the timeliness of the issuance of the auditor's management letter. We understand that modifications to legislation are necessary to proceed in others areas of the safeguard assessment. We will be working with the authorities and advising them on how to proceed in this area by the time of the first review.

Mr. Portugal made the following concluding statement:

I would like, first, to thank the staff again for the report and for the answers that have been provided today. I would also like to thank my colleagues here for their statements and their oral interventions and for the support to the program, their comments and suggestions, which I will pass to the authorities.

As I mentioned in my preliminary statement which was recognized in some of the statements and the interventions today, since the late 1980s into the late 1990s Guyana has made quite considerable progress in its reform program. There was a substantial increase in growth in that period, considerable reduction in inflation and also substantial increase in the per capita income, which increased from US$430 in 1993 to US$715 in 1997. Since 1998, as a result of a decline in terms of trade, appreciation of the exchange rate and also a very fragile and polarized political environment, implementation of policy and progress became slower. But, even then, they continued to make progress. They reached, for instance, both the decision and the completion points in the previous HIPC.

Last year was another year where the situation was difficult. First, growth, which was projected in the program at 4.2 percent, in fact came out to be only 1.4 percent. There were very substantial political disturbances following the March elections, and these ended up generating slippages in fiscal policies, both because government revenues were smaller than expected and the revenues of state-owned enterprises were smaller than expected, but also because the political situation led to some delays in implementing some measures, like the elimination of subsidies in electricity.

Since the second half of last year, a number of measures have been taken. There was an adjustment in electricity tariffs. There was a cut in expenditures, an increase in excise taxes for gasoline, and the public sector deficit was more or less contained. Guyana missed the target by 0.7 of GDP; the target was a deficit of 7 percent and they ended up having 7.7 percent.

There were also a number of structural measures that had been taken. In fact, all the structural measures that were established for the earlier program were complied with, although with delays, except one, which was the dismissal of 1,000 civil servants in addition to the 1,300 that they had dismissed. In this case, both the World Bank and the IDB agreed that, given the political situation and the benefits that would be derived from this measure, it was best that it was not pursued at that moment.

As the staff mentioned, they managed to maintain a very restrictive wage policy. They made progress on the question of the privatization of the GNCB. They started negotiations to privatize the loss-making bauxite company, and also begun a number of reforms and started discussions with the World Bank on reforms in the sugar sector. So, although the situation is difficult, as it has been mentioned here, it is mainly due to the huge divisiveness that exists in the country in terms of ethnic conflict. Many of these sectors have a high concentration of employment of either one or the other of the main ethnic groups, so many of the measures of restructuring are portrayed in terms of ethnic division. In spite of these problems, they have made some progress, and I am grateful to the Board in supporting this program today. I will convey to the authorities the message that has been given here and to try to continue to work with them to implement this program and come to a completion point hopefully in the beginning of next year.

The Acting Chair made the following summing up:

Executive Directors broadly agreed with the thrust of the staff appraisal. They observed that the Guyanese economy experienced difficulties and setbacks in recent years associated with adverse external shocks and political and social tensions that had, at times, prevented the consensus building needed for implementing critically important structural reforms. Directors expressed concern that, as a result of these developments, as well as policy slippages, per capita income had declined since 1998, and that the authorities' PRGF–supported program had gone off track in early–2001. They accordingly welcomed the authorities' determination to address these difficulties in the period ahead with the support of the international community. They considered that over the medium and long term, Guyana has the potential to replicate the growth rates realized in the 1990s. However, this will be possible only with social cohesion and macroeconomic stability, economic diversification, private sector development, and human and institutional capacity building.

Directors noted that since mid–2001 the authorities have taken steps to improve policy implementation, and that this has allowed broadly stable macroeconomic conditions to be maintained. In particular, the authorities have been successful in preserving low inflation and a comfortable level of international reserves, as well as in reining in the fiscal deficit, including by limiting government wage increases. Directors also noted the authorities' efforts to move ahead with key structural reforms, including advancing the privatization of the state–owned bauxite company, as well as the restructuring of the state–owned sugar company (GUYSUCO) and the public commercial bank (GNCB).

Against this background, Directors welcomed the adoption by the authorities of the medium term macroeconomic framework for 2002–06. They also considered that the authorities' program for 2002 will help to underpin both the growth and poverty–reduction objectives of the PRSP. In this context, Directors stressed the importance of complementing the macroeconomic stability that has been achieved with determined efforts to implement structural reforms and strengthen governance.

Directors emphasized the need to maintain a fiscal stance aimed at increasing public savings to help finance necessary investments, and bringing public sector debt ratios firmly on a downward path over the medium term. Wage moderation will be crucial for the program's success. Directors urged the authorities to contain the growth of the public sector wage bill by continuing to limit across–the–board wage increases and reducing employment through attrition. Against the background of the weakness in tax administration and the sharp increase in discretionary tax exemptions that in recent years have weakened revenue collection and undermined the climate for private investment, Directors welcomed the authorities' plans to reform the tax system and its administration. The tax reform should eliminate the scope for discretionary exemptions, broaden the tax base, and reduce high marginal tax rates. Some Directors urged the authorities to develop contingency plans to address potential slippages in fiscal targets.

Directors considered that the floating exchange rate regime continues to serve Guyana well. They supported the authorities' commitment to maintain inflation in the low single digits, while allowing market forces to determine the value of the exchange rate. In this context, given the pick–up of inflation in early–2002, Directors cautioned against further monetary easing until there is firm evidence that the program's inflation targets will be achieved.

Directors noted the actions being taken to strengthen the financial sector, including the recent strengthening of the regulatory framework. They urged the authorities to intensify their reform efforts in this area by developing and implementing a plan to recover the nonperforming loans of the state–owned commercial bank, and moving forward as promptly as possible with its privatization or closure. Directors also emphasized the need to strengthen financial supervision capacity and procedures, introduce effective supervision of building societies and other nonbanks, and reform arrangements to speed up creditors' ability to realize loan collateral. Directors saw scope for a strengthening of the implementation of anti–money laundering and anti–terrorist financing efforts.

Directors agreed that reform of the public enterprises is essential for improving public savings and making available more resources for poverty alleviation. A successful restructuring and transformation of GUYSUCO into a competitive firm is a key element of this reform, given its substantial share in output, foreign exchange earnings and employment. Directors urged the authorities to implement the modernization plan for GUYSUCO with assistance from the World Bank, which aims at shifting the focus of managerial actions, employment and worker remuneration policies, and investment decisions towards enhancing company profitability. Directors also urged firm progress in privatizing or restructuring the state–owned bauxite companies, which drain scarce resources from productive and poverty–reducing activities, and which absorbed large fiscal transfers in 2001.

Directors viewed the authorities' public sector reform plans as critical for enhancing public sector efficiency, improving governance, and promoting a predictable and equitable environment for private sector activity. These will involve implementing a comprehensive public sector modernization program, key elements of which will be to enact revised procurement legislation and regulations consistent with World Bank advice, reform budgetary and expenditure management systems, and strengthen the preinvestment analysis of public sector capital projects. Directors commended the authorities for undertaking a recent Fiscal ROSC and urged them to address its findings in order to improve fiscal management and enhance fiscal transparency.

Directors expressed concern that Guyana's macroeconomic statistics suffer from a number of weaknesses, particularly in the areas of the national accounts, public finances, and monetary statistics. They urged the authorities to devote further effort and resources to improve the quality, timeliness, coverage and dissemination of statistics, taking advantage of technical assistance.

It is expected that the next Article IV consultation with Guyana will be held on the 24–month cycle, subject to the provisions of the decision on consultation cycles approved by the Board on July 15, 2002.

Main Points Relating to the PRGF (for Internal Use)

There was broad support for the authorities' request for a new PRGF–supported arrangement. Directors were encouraged by the reform momentum shown since mid–2001, but underlined the need for strong and consistent policy implementation, as well as prompt corrective action should slippages occur.

Firm policy implementation and strong program ownership—particularly with respect to the difficult but critical structural reforms and wage policy—will be essential for mitigating the risks of the program, which include the still high public debt ratios; their susceptibility to adverse exogenous shocks; possible slippages in policy implementation; and the continued political and social tensions which could make consensus building on key issues difficult.

Progress has been achieved in implementing most of the completion point triggers under the enhanced HIPC Initiative, and it is essential that steps be taken to implement those that remain outstanding. Particularly important steps include strengthening government procurement practices, civil service reform, and establishing a track record of satisfactory policy implementation under the PRGF.

The recently completed PRSP provides a credible poverty–reduction strategy and sound basis for moving forward. Nevertheless, there is still room for further work in refining aspects of the strategy, particularly as regards the prioritization of structural actions and public investment projects, as well as ensuring consistency of a realistic macroeconomic framework with poverty–related targets. It will be important also to improve implementation capacity, and press ahead with the social and structural reforms that would enable the achievement of more ambitious poverty–related targets. Also, the authorities should improve the monitoring and evaluation of policies in the PRSP, and develop a mechanism for conducting such activities within an enhanced consultative and participatory framework.

The Executive Board took the following decisions:

Poverty Reduction and Growth Facility—Three-Year Arrangement

1. The government of Guyana has requested a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 54.55 million.

2. The Fund approves the arrangement set forth in EBS/02.167 (8/30/02), and decides that Guyana may request the first disbursement under the arrangement, on the condition that the information provided by Guyana on the implementation of the measures referred to in Table 1 attached to the Letter of Intent dated August 20, 2002 as prior actions is accurate. (EBS/02/167, 8/30/02)

Decision No. 12851-(02/96), adopted
September 13, 2002

Enhanced Initiative for Heavily Indebted Poor Countries—Additional Interim Assistance

The Fund as Trustee (the "Trustee") of the Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations (the "Trust") decides:

(a) that satisfactory assurances regarding the exceptional assistance to be provided under the enhanced HIPC Initiative by Guyana's other creditors continue to be in place;

(b) that the Trustee shall disburse to Guyana as additional interim assistance the equivalent of SDR 4.133 million, which shall be made available by the Trustee to Guyana in the form of a grant that shall be paid no later than three business days after the effectiveness of this decision to the account for the benefit of Guyana established and administered by the Trustee in accordance with Section III, paragraph 5 of the Trust Instrument; the proceeds of the grant shall be used by the Trustee to meet Guyana's debt service payments on its existing debt to the Fund as they fall due, in accordance with the following schedule: 38.0 percent of each principal repayment obligation falling due until end-December 2002, and 29.3 percent of each principal repayment obligation falling due between January 1, 2003 and the date 12 months from the date of approval of additional interim assistance; and

(c) that, for the purposes of Section III, paragraph 3(d) of the Trust Instrument, the conditions for the disbursement under (b) above are that Guyana has met all the measures set forth as prior actions in Table 1 attached to the letter dated August 20, 2002. (EBS/02/167, 8/30/02)

Decision No. 12852-(02/96), adopted
September 13, 2002

Poverty Reduction Strategy Paper

The Fund determines that the Poverty Reduction Strategy Paper (PRSP) submitted by Guyana set forth in EBD/02/133 (8/30/02) provides a sound basis for Fund concessional financial assistance. (EBS/02/167, 8/30/02)

Decision No. 12853-(02/96), adopted
September 13, 2002

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/02/95 (9/11/02) and EBM/02/96 (9/13/02).

4. BIENNIAL REVIEW OF IMPLEMENTATION OF FUND SURVEILLANCE AND OF 1977 SURVEILLANCE DECISION—FOLLOW-UP

The decision on "Surveillance—Changes in Article IV Consultation Cycles" set forth in SM/02/184, Supplement 1 and approved on July 15, 2002 shall be amended as follows:

1. In Paragraph 2, first sentence, replace the phrase "subject to the following exceptions: " with the phrase "except that the consultation cycle will be shortened under the following circumstances:"

2. In paragraph 3, add at the end of the existing sentence the phrase ", but in no event later than 24 months after the completion of the previous Article IV consultation." (SM/02/184, Sup. 3, 9/5/02)

Decision No. 12854-(02/96), adopted
September 13, 2002

5. LEAVE POLICIES—MODIFICATIONS

Male staff members shall be entitled to 5 work days of paternity leave upon the birth of a child, and an additional 35 work days if the father is the primary care giver.

Maternity leave, adoption leave, and paternity leave shall be calculated on the basis of work days, and the use of such leave shall be available on a full-time, part-time, uninterrupted, or intermittent basis.

The minimum service requirement for eligibility for maternity and adoption leave is eliminated.

The full entitlement of maternity, adoption, and paternity leave must be taken within six months of the date of the birth of the child or the placement of the child in the custody of the staff member.

Staff members shall be entitled to a maximum of 24 months of leave without pay for personal reasons during a Fund career.

The time limit for emergency travel shall be within one year of the death of the spouse, child, or parent.

A special family emergency leave up to a maximum of 60 work days per Fund career shall be created. This leave can only be approved after accrued annual leave and family care leave entitlement are exhausted.

Paid or unpaid administrative leave shall be extended to include special and unusual circumstances such as in situations involving evacuated resident representatives, or situations in which the continuing presence of a staff member at work may not be in the interest of the

Fund. Administrative leave for special and unusual circumstances shall not exceed six months per situation.

The changes set forth herein shall be effective as of the date of the decision. (EBAP/02/105, 9/4/02)

Adopted September 11, 2002

6. ADVISORS TO EXECUTIVE DIRECTORS—REMUNERATION

The Executive Board approves, with two objections from Messrs. Collins and Quarles, the recommendation to increase the remuneration of Advisors to Executive Directors as set forth in EBAM/02/113 (9/5/02). (EBAM/02/113, 9/5/02)

Adopted September 11, 2002

7. 2002 ANNUAL MEETING—EXECUTIVE BOARD—REPRESENTATION EXPENSES

The Executive Board approves the recommendation of the Committee on Executive Board Administrative Matters concerning representation expenses at the time of the 2002 Annual Meeting as set forth in EBAM/02/114 (9/5/02). (EBAM/02/114, 9/5/02)

Adopted September 11, 2002

APPROVAL: January 24, 2003

SHAILENDRA J. ANJARIA
Secretary