October 19, 2001
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 00/121

10:00 a.m., December 11, 2000

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

H. Köhler, Chairman
S. Sugisaki, Acting Chairman

Executive Directors	Alternate Executive Directors
	A.S. Alosaimi
	A.S. Al Azzaz, Temporary
A. Barro Chambrier	D. Ondo Mañe
	P. Charleton
	P.H. Whitehall, Temporary
	I.- K. Cho, Temporary
	T. Skurzewski, Temporary
	S. Sharipova, Temporary
B. Esdar	
R. Faini	C.A.E. Sdralevich, Temporary
	M.P. Bhatta, Temporary
	R.A. Jayatissa
W. Kiekens	J. Prader
	A. Jacoby, Temporary
	Å. Törnqvist
	I. Steinbuka, Temporary
	L. Redifer, Temporary
	P.A. Brukoff, Temporary
	G. Bauche
	S. Le Gal, Temporary
A. Mirakhor	M.R. Shojaeddini, Temporary
A.V. Mozhin	L. Palei, Temporary
	F. Varela
S. Pickford	S.P. Collins
	A. Maciá, Temporary
C.D.R. Rustomjee	I. Usman
	O. Himani, Temporary
Wei Benhua	Liu F., Temporary
	Y.G. Yakusha
	N. Budina, Temporary
	K. Harada, Temporary
	Y. Saito, Temporary
	R. Maino, Temporary
	L. Ocampos, Temporary

S.J. Anjaria, Secretary
A. Linde, Acting Secretary
M. Schulte, Assistant
G. Nkhata, Assistant
O. Vongthieres, Assistant

Also Present

IBRD: J. McIntire and J. van Houte, Africa Regional Office; R. Sura, HIPC Unit; K. Hallberg and F. King, Europe and Central Asia Regional Office. African Department: G.E. Gondwe, Director; E. Hernández-Catá, Associate Director; J.A. Clement, M.T. Hadjimichael, R.D. Kibuka, M.W. Plant, M.T. Tjirongo. European I Department: J.R. Artus, Deputy Director. European II Department: J. Odling-Smee, Director; G. Bélanger, Deputy Director; J.G. Márquez-Ruarte, Deputy Director; J. Berengaut, A.C.W. Lehmann, M. Luecke, P.H. Mathieu, D.E.W. Owen, G.C. Pastor, R.N.F. Semblat, M. Shadman-Valavi, E. van der Mensbrugghe, J.K. Wakemann-Linn. External Relations Department: L. Mboto Fouda, K.L. White. Fiscal Affairs Department: H.R. Davoodi, I.P. Szekely. Legal Department: H. Elizalde, R.B. Leckow. Monetary and Exchange Affairs Department: S. Geadah, A. Ouanes. Policy Development and Review Department: M. Ahmed, A.R. Boote, M.J. Fetherston, J. Hicklin, U.J.M. Jacoby, L.E. Psalida. Secretary's Department: S. Bhatia, K.S. Friedman, H. Hubloue, T. Turner-Huggins. Office of the Managing Director: C. Salmon, Personal Assistant; S. Tiwari. Advisors to Executive Directors: E. Azoulay, M. Beauregard, J.A. Chelsky, N. Guetat, E.J.P. Houtman, M. Kabedi-Mbuyi, S. Rouai, S. Thiam, R. Villavicencio. Assistants to Executive Directors: S.A. Bakhache, V. Bhaskar, T. Belay, N. Burnashev, T. Elkjaer, H. Hagan, M.S. Hililan, B. Kelmanson, S.N. Kioa, E. Kornitch, K. Kpetigo, D.H. Kranen, J. Kwakye, P. Lathouly, W.C. Mañalac, J.A.K. Munthali, D. Nardelli, R. von Kleist, E.S. Weisman, Xu J.

1. THE GAMBIA—POVERTY REDUCTION AND GROWTH FACILITY—THIRD ANNUAL ARRANGEMENT AND EXTENSION OF COMMITMENT PERIOD; INTERIM POVERTY REDUCTION STRATEGY PAPER AND JOINT STAFF ASSESSMENT; AND ENHANCED INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—DECISION POINT

The Executive Directors considered a staff paper on the second review under the second annual arrangement for The Gambia and its requests for the third annual arrangement under the Poverty Reduction and Growth Facility (PRGF) and for an extension of the commitment period (EBS/00/241, 11/28/00; Cor. 1, 12/7/00), together with the decision point document for the enhanced Initiative for Heavily Indebted Poor Countries (EBS/00/242, 11/28/00; Cor. 1, 12/7/00; Sup. 1, 11/28/00). They also had before them an interim poverty reduction strategy paper for The Gambia (EBD/00/99, 11/28/00) and an assessment of the interim poverty reduction strategy paper, prepared jointly by staffs of the Fund and International Development Association (EBD/00/100, 11/28/00).

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

> Since the issuance of the staff report (EBS/00/241) on November 11, some new developments have occurred which are summarized below in addition to a statement on The Gambia's need for additional donor financial assistance. These developments do not alter the thrust of the staff appraisal.
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> The budget speech was read to parliament on December 6 and outlined a budget for 2001 that, on a preliminary basis, is in line with the program described in the staff report. The speech focuses on poverty reduction with particular emphasis on the importance of good governance. It also mentions the agreement to settle the Alimenta (a private groundnut marketing company) property dispute and the concern about domestic debt and its related servicing, which is estimated to account for about 20 percent of recurrent expenditure and about 18 percent of domestic revenue in 2000.
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> The end-November expected payment of the first installment to Alimenta, in settlement of the government's seizure of the company's assets, has been delayed because of technical delays in reaching understandings with the European Union (EU) that would trigger the release of financial assistance. However, the budget speech provided details of the agreement to settle with Alimenta and the key elements of the government reform policy in the groundnut marketing that addresses concerns by the European Union in the sector. Specifically, the speech mentioned that marketing arrangements in 2000/01 are on a transitional basis. The government will assume ownership of the former Alimenta assets including the processing plants (following the settlement) and will ensure access to these facilities by all operators working within the Agri-Business Service Plan Association (ASPA) membership, made up of farmers and buyers. Moreover, in line with the divestiture

program, these assets will be divested starting in 2001. This policy statement together with the other understandings with the European Union are likely to facilitate the first payment to Alimenta before the end of 2000.

The budget speech also announced the inauguration of a new Supreme Court building and the introduction of the office of the Ombudsman; developments that will significantly expand access to legal services in The Gambia.

In December, the African Development Fund has announced the approval of a U.S. $1.04 million grant to finance the Tourism Development Masterplan Study in The Gambia. The Masterplan will guide the government to formulate and adopt appropriate policies and procedures, institute the necessary reforms, and legislation for the sustained development of the sector. The goal of the tourism sector is to contribute towards poverty reduction through increased earnings, employment, and productivity in a sustainable manner with due consideration to safeguarding the natural and social environment.

The payment to Alimenta, which is key to improved governance and in catalyzing groundnut-marketing reforms, will however, use external resources that would have gone to reduce the sizable domestic debt. Donors may wish to use the opportunity of the scheduled PRSP-related donor conference expected to take place by mid-2001 not only to fill the financing gap of SDR 5.9 million noted in the staff report but also to support the Gambian authorities in their efforts to implement a comprehensive domestic debt restructuring and reduction strategy. This would, inter alia, provide for additional expenditure to further reduce poverty.

Mr. Rustomjee submitted the following statement:

I wish to express the gratitude of my Gambian authorities to the Executive Board, Fund management and staff, as well as to the donor community, for the support received over the years. They are hopeful that such support and close cooperation will be continued so as to address the challenges that lie ahead. My authorities also take this opportunity to commend the staffs of the Fund and IDA for the cooperation and advice rendered during discussions with the Government and for their hard work in producing the documents for the Boards.

There is increasing awareness in The Gambia that bold and comprehensive policy reforms are indispensable to attaining macroeconomic stability and promoting economic efficiency and growth, given the pressing need to alleviate poverty. My authorities are thus firmly committed to the pursuit of such reforms. They are resolved to not allow backtracking from the current policy stance that is helping the country to make important advances toward attaining macroeconomic stability and improving long-term growth prospects. They look forward to the Board's approval of their request for a third annual PRGF arrangement. They are also hopeful that the Board will favorably consider the interim PRSP so that the decision point can be reached now to allow them to start making important strides toward poverty alleviation.

During the eight years to mid-1993, The Gambia made considerable progress in restoring growth and in reducing internal and external imbalances that had assumed major proportions. Real GDP growth averaged 3.3 percent, a rate that compared favorably with performance of other countries in the region during the period. Inflation declined significantly from around 70 percent to 6 percent. The overall budget deficit, excluding grants, substantially narrowed from 21.6 percent of GDP in 1986/87 to 2.2 percent by mid-1993. During the same period, the external position markedly improved with the current account deficit narrowing from 22 percent of GDP to 16 percent, while external reserves rose from less than a week of import cover to over 5 months. Moreover, notable advances were made in structural reforms aimed at enhancing the efficiency of the economy and stimulating private sector activity. The Gambia was also one of the first economies in the sub region to introduce a liberal trading and exchange regime. The overall adjustment effort was so successful that The Gambia was one of the first countries to graduate from the use of the resources of the enhanced structural adjustment facility ESAF) as early as 1991.

The authorities' quest for continued strong adjustment was stymied from mid-1993 to early 1997 by a host of adverse exogenous developments that caused a sharp fall in re-export trade (an important source of foreign exchange and budgetary revenue), the suspension of donor support, and a decline in tourism earnings. In the event, the momentum of reform was unable to be maintained in several areas, notably in the domain of fiscal policy. Despite the difficulties, however, the authorities continued to make significant progress in many areas, particularly in containing inflation, in conserving past gains from structural reforms including privatization, and in broadly preserving exchange rate stability.

Since mid-1998, in the context of a three-year PRGF arrangement, the stabilization and reform process gained new impetus. Output grew by an average of 5 percent during 1998-99, compared with an average of less than one percent over the preceding three years. The rate is expected to be sustained in 2000 allowing modest gains in real per capita income. Inflation remained below 3 percent during the same period and is expected to remain at about that level in 2000, despite the impact of upward adjustments in petroleum prices. Fiscal policy was considerably tightened as evidenced by the reduction of the overall deficit, excluding grants, from 7.8 percent of GDP in 1997 to 4.8 percent in 1999. Fiscal performance was threatened in late 1999 and early 2000 on account of shortfalls in customs revenue and more-than-expected interest outlays. However, thanks to the quick response of the authorities in implementing corrective measures to regain the ground lost, the deficit is expected to further narrow to 3.5 percent of GDP in 2000. Performance in the external sector was also encouraging with some narrowing in the current account deficit and a build-up in gross official reserves.

Performance as regards structural reforms has been remarkable, with the notable reduction and rationalization of external tariffs, implementation of important financial sector reforms aimed at enhancing financial sector competition and banking system soundness. The authorities have also made progress in privatizing or restructuring public enterprises. Moreover, investment related legislation is being amended to promote private sector growth.

The Government has also been committed to improving governance and transparency. Notable among the measures to address weaknesses in governance is the recent settlement of the dispute over the government's seizure in January 1999 of the assets of a groundnut processing and marketing company, the Gambia Groundnut Corporation (GGC). The Government has agreed to pay GGC full compensation. The resolution of the dispute, which had constituted one of the most important issues of concern to donors and the investment community, should facilitate the restoration of investor confidence and help accelerate reforms in groundnut processing and marketing in The Gambia. Indeed, it can be expected to have a significant salutary impact on the country's effort to combat poverty given the high importance of groundnut cultivation to the poor. Another important development in the area of governance has been the abolition in July 2000 of the preshipment import inspection scheme which was introduced in October 1999 and which, against the authorities intentions, has been the main cause of fiscal slippages. The scheme was put in place in good faith expecting positive results, but was soon abandoned because of the negative outcomes.

It is to be noted that, despite the setbacks in 1993-97, The Gambia's economic performance has been very encouraging. Indeed, the results are remarkable for a small country with limited natural resources, weak institutional capacity, and an economy that is vulnerable to external shocks. The authorities' strong will to succeed is certainly a major factor behind all that has been achieved.

Notwithstanding the substantial progress in macroeconomic stabilization and structural reforms, the unfinished agenda is substantial and formidable. The road ahead is indeed difficult because of the special characteristics of The Gambia as a country with a very narrow resource base which, in addition, has one of the highest population densities in the world. The Gambia is also one of the most food insecure countries in sub-Saharan

Africa. In the face of rapid population growth over the last two decades, the growth rates of output have not been adequate to reduce the incidence of poverty which is widespread, with more than 50 percent of the population living in extreme poverty. The large burden of external debt has also been thwarting the authorities' efforts at making a significant dent in poverty. Meanwhile, the external sector position remains fragile because of the country's dependence on a narrow range of commodities which are frequently affected by the vagaries of weather and volatility of world market prices.

The authorities have a strong commitment to meet these challenges with full determination. The economic strategy in the medium term, which is consistent with the approach adopted in the interim poverty reduction strategy paper (I-PRSP), that is now before the Board, aims at consolidating the gains made so far and addressing structural and policy constraints to economic growth and poverty alleviation. Accordingly, policies will focus on attaining high growth with low inflation to ensure gains in income per head. Fiscal consolidation will continue to receive high attention, as will the effort of promoting private sector development and attracting foreign investment. In line with the National Good Governance Policy, which was introduced in 1999, the Government will make meaningful strides towards enhancing transparency and accountability. The authorities will also endeavor to strengthen institutional capacity at all levels, including at the local level, so that positive results against poverty can be reaped.

Within the medium term framework, the authorities have formulated a program for 2000/01 for which they seek the support of the Fund under a third annual PRGF arrangement. The program takes the authorities' efforts a significant step forward toward attaining lasting poverty reduction, a key aspect of this being the continuation of their endeavor toward ensuring macroeconomic stability and deepening of structural reforms, including those aimed at stimulating private sector activities.

The budget for 2001, which was approved by the cabinet in October and is now being debated in parliament provides the tool for implementing the program under the third annual PRGF arrangement. An important aspect of the budget is that it provides increased allocation for education and health within the recurrent expenditure, while allowing an increase in capital expenditure in order to improve the capacity for providing social services. For other key social measures, there is a contingency budget that could be funded from the likely interim debt relief under the enhanced HIPC Initiative. The Government is in the process of establishing during 2001 a comprehensive accounting mechanism to monitor public resources that will be channeled to poverty alleviation, including funds from the enhanced HIPC Initiative debt relief.

The year 2001 presents a good opportunity for the authorities to refine and articulate their poverty reduction strategy in the context of the preparation of the PRSP which is expected to be completed by year's end. The interim PRSP, now before the Board, which is an outcome of a broad and solid consultative process with civil society and other development partners, provides a sound basis for the preparation of the PRSP. During its preparation, the Government intends to broaden the participatory process. Already it has demonstrated high-level commitment to the process with the opening of a national workshop, marking the start of the formulation of the PRSP, by the President of The Gambia on October 26, 2000. The PRSP once completed should provide a strong basis for attacking poverty and, in doing so, can be expected to represent a significant advance from poverty reduction efforts so far.

The preparation and updating of the comprehensive poverty reduction strategy is likely to put considerable pressure on The Gambia's already substantially limited institutional capacity and, in particular, its implementation will require reforms to improve the environment for private sector activity and promote the delivery and monitoring of public services. The authorities, therefore, intend to strengthen collaboration with donors and the Fund to ensure timely access to technical assistance.

Despite many difficulties, The Gambian authorities have proven over the course of more than a decade that they are firmly committed to strong economic reform and that they can also make significant progress in the process. It is therefore important that the adjustment record during the eight years to 1993, in addition to that of the past 2½ years, should be taken into account in the Board's consideration of the timings of the decision and completion points. Accordingly, my authorities request the Executive Board to consider a decision point that can be reached now so that they can start addressing the pressing need of combating poverty that is crippling a large segment of The Gambia's population. They are also hopeful that the completion point can be reached not long after the decision point.

Mr. Djojosubroto submitted the following statement:

It is encouraging to note that despite the mixed performances under the first and second annual PRGF arrangements, the Gambian authorities have responded appropriately well in meeting the quantitative performance criteria and most of the benchmarks. Budgetary performance has strengthened and the authorities are pressing ahead with a prudent financial policy. Economic growth has remained strong, inflation rate is kept low and the foreign exchange reserve is at a satisfactory level. The sets of staff reports are comprehensive and we are in broad agreement with the thrust of the staff appraisal and the proposed decisions. Mr. Rustomjee's statement was also very information. However, the following comments are offered for emphasis.

The improvement in revenue collection, considering the reduction and rationalization of external tariffs, is a commendable outcome. However, high interest payments and increasing cost of maintenance and their likely implications of the future of social expenditure are sources of concerns. It is therefore important to strengthen fiscal consolidation through improvement in revenue administration. The receipts from privatization could be used to repay the domestic debts and to avoid the heavy dependence on external grants. On the expenditure side, expenditure control and reporting must be strengthened and we are pleased to note that the 2001 Budget would extend reporting and control to all expenditures including the below-the-line accounts. Reducing the budget share of recurrent expenditure to accommodate increased capital investment is a step in the right direction, but the authorities must ensure that priority is placed on social expenditure and maintenance spending. The increases in the 2001 budget allocations for health and education are a welcomed commitment and the computerization of treasury accounts would no doubt expedite reconciliation and auditing and thus further improve accountability and transparency.

On the efforts to reduce poverty, there is a need for close coordination among the planning, budgeting and implementation agencies. It is important that the poverty reduction measures are fully costed in the budget in order to avoid an unexpected blow up in expenditure. The budget controlling mechanisms that monitors the implementations of the poverty reduction actions should be simple and operationally effective in order to achieve the desired outcome. We wish to emphasize that the strategies to reduce poverty cannot succeed without enhancing the productive capacity of the poor. In this context, agriculture, which employs more than two thirds of the population and generates about a similar proportion of household income, need institutional and infrastructural supports. The problem of food insecurity can be solved only through increased productivity and diversification to high yielding crops of the agricultural sector. To facilitate agricultural expansion, it is important to step up the availability of credit to meet the increasing demand. Similarly, tourism, which is another important sector, needs special attention. Investment and revitalizing a marketing authority would be facilitative in order to avoid the reliance on ad-hoc marketing, and the costly duplication of marketing efforts from small entrepreneurs.

The program for 2000/01 deserves Fund support via a third annual PRGF arrangement. We agree that this would provide a framework for continued efforts to consolidate macroeconomic stability, deepen structural reforms, and enhance investor confidence. Moreover, the I-PRSP reflects the firm commitment from the authorities to reduce increased poverty, which has been built on past policy and program efforts. It presents an informative analysis of poverty and it has a sound basis for the development of a fully participatory PRSP and for reaching a decision point under the enhanced HIPC Initiative and for Fund concessional financial assistance.

Given the established track record of Gambia in implementing broad macroeconomic policies and commitment to structural reforms, this Chair fully supports that Gambia has met the conditions for reaching its decision point under the enhanced HIPC Initiatives. The measures indicated in Box 7 are appropriate as triggers for the completion point under the enhanced HIPC Initiative and we support that the Fund and IDA should provide interim assistance to the Gambia between the decision and the completion points.

With these remarks, we wish The Gambian authorities success in their stride against indebtedness and poverty.

Mr. Mirakhor submitted the following statement:

Thanks are due to the staff for a well-written report and to Mr. Rustomjee for his excellent statement. We concur with the thrust of the staff appraisal. The Gambia has demonstrated a strong commitment to adjustment for which the authorities must be commended. In response to shortcomings in policies through early 2000, especially fiscal slippages, the authorities acted speedily to implement corrective macroeconomic measures. They also accelerated structural reforms and improved governance. As a result of prudent policies pursued in the second and third quarters of 2000, economic performance improved markedly with robust growth and low inflation.

The medium-term economic outlook for The Gambia looks very encouraging. However, while it is important to sustain the efforts and consolidate the gains—and the authorities must be encouraged to continue to strengthen the budget, pursue prudent monetary policy, and deepen and broaden structural reforms—economic stability and growth in The Gambia cannot be sustained in the midst of widespread poverty and poor social conditions. Poverty remains high and rife; public access to social services remains low; mortality rates are high; and life expectancy is short. Furthermore, HIV threatens to erode most of the economic gains made. There is therefore an urgent need to improve social conditions in The Gambia to buttress and sustain the positive macroeconomic performance. In this context, the authorities have put in a great deal of work to prepare an interim PRSP and must be commended for their effort, and should be encouraged and assisted to consolidate their interim paper into a final PRSP.

We agree with the staff assessment that The Gambia currently has an unsustainable debt burden which constrains its capacity to allocate adequate resources to social needs. Against the background of improved policies and economic performance under the PRGF and the preparation by the authorities of a satisfactory interim-PRSP, we fully support an immediate decision point under the enhanced HIPC. We support the staff proposal regarding the amount and delivery of assistance, including the provision of interim relief. We are also satisfied with the triggers for a floating completion point and we welcome the emphasis on transparency in the use of interim HIPC assistance. Finally, we fully support Mr. Rustomjee's call for timely delivery of technical assistance by the Fund and donors for poverty reduction policies and programs for The Gambia.

Mr. Barro Chambrier made the following statement:

Let me start by thanking the staff for the quality of the documentation. I also thank Mr. Rustomjee for his enlightening preliminary statement. My views are similar to those of Mr. Djojosubroto and Mr. Mirakhor.

I commend the Gambian authorities for the skillful manner in which they addressed the mixed performance witnessed during the first two annual arrangements under the PRGF. I am pleased to see that they could respond to the slippages by implementing a number of welcome corrective fiscal measures aimed at enhancing revenue collection while containing expenditure. As a result, all quantitative performance criteria as well as most of the benchmarks for end-September were met. However, challenges still lie ahead, and the economy remains highly vulnerable to adverse external shocks. Therefore, there is a need to pursue, in a sustained manner, fiscal consolidation efforts. In this context, I welcome the measures aimed at reallocating expenditures toward social objectives, while containing the overall deficit at sustainable levels.

The budget for 2001, which contemplates modest growth in revenue, should be seen as a positive effort, given the reform in external tariffs that would entail losses of needed resources. Similarly, we see the authorities' efforts to concentrate on expenditure containment measures as a step in the right direction. In particular, the extension of the reporting and control procedures for all expenditures, in order to permit a reduction in the ratio of the overall recurrent expenditure to GDP, is a sound decision.

Equally, the shifting in priority toward maintenance expenditure and delivery of social services are steps that could positively contribute to poverty alleviation. Furthermore, the planned increase in capital expenditure will not only boost growth prospects but will also help improve the capacity for providing social services. Let me say that, overall, I am pleased with the 2000 budget's acknowledgement of the importance of good governance. I welcome, in particular, the agreement to settle the Alimenta issue. It will also be critical to pursue a prudent monetary policy. It would be important to provide the needed technical assistance to Gambia, and coordination among donors is going to be critical.

The time line of the PRSP process seems to me ambitious, but realistic. It would be important to ensure a higher profile to the fight against HIV/AIDS and the action program. World Bank support on this front is also most welcome. On market reform, the authorities should be commended for implementing a number of structural measures that would create a level playing field and improve the environment for private sector activity.

With regard to other structural reforms, we encourage the authorities to press ahead with their efforts to remove impediments to efficient private sector activities, including drafting and passing important legislation needed to foster competitiveness in the economy. We believe that these reforms, undertaken in a transparent manner, will help increase the provision of market instruments in the economy.

As regards financial sector reform, we see merit in focusing on action entailing the strengthening of financial institutions. With regard to social policies, we concur with the authorities to allocate the bulk of the resources from HIPC assistance to the three priority sectors that would have the strongest impact: poverty, education, and health and rural development. We also believe that the mechanisms to ensure an efficient use of HIPC assistance contribute to the strengthening of governance and transparency, and that the freed resources will be effectively devoted to poverty alleviation. Let me say that, like Mr. Mirakhor, I also believe that the triggers contemplated for the floating completion points are particularly appropriate, with their emphasis on governance, social sector, and structural reforms.

To conclude, let me say that The Gambia's longstanding, large and participatory efforts signal its commitment to poverty reduction and establishing a sound basis for the formulation of a full PRSP by the end of 2001. In recognition of the track record in program implementation, the unsustainable debt burden, and the country's firm commitment to economic reforms and fighting poverty, we support the request to complete the second review, the approval of the third annual arrangement under the PRGF, and the request for setting the decision point.

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

Mr. Bauche made the following statement:

Concerning the PRGF, we approve the authorities' request for a third annual arrangement despite several slippages that occurred during the course of the program. Key to that approval is the resolve of the authorities not to backtrack from their current policy stance, as reaffirmed by Mr. Rustomjee in his eloquent preliminary statement, and as witnessed by the recent measures introduced by the authorities, especially in the governance field. I add that we find The Gambia's involvement in regional monetary efforts under the Accra Declaration all the more commendable now that the establishment of a monetary zone in West Africa will require demanding efforts in terms of economic and fiscal convergence.

Concerning the interim PRSP, we share the staff's assessment that the participatory aspects of the anti-poverty strategy are welcome and that they demonstrate the positive, proactive stance of the authorities. The decentralization of the process is well taken and will probably call for better prioritization of actions to be undertaken under the PRSP and for the strengthening of the institutional capacity of the country. Here, I fully agree with Mr. Barro Chambrier on the need for further technical assistance, along with better coordination among donors.

Like the staff, we think that the full-fledged PRSP would greatly benefit from more explicit commitments pertaining to public expenditure control. On HIV/AIDS, the situation is unfortunately, already critical. I fully agree with the staff that the defined target should be expanded and developed further so as to define a more ambitious strategy in that area.

Concerning the decision point, and considering the broadly satisfactory recent performance of The Gambia and the authorities' commitment to the structural reforms, we agree that Gambia has met the conditions for reaching its decision point. Of course, 2 1/2 years of performance under the PRGF have not allowed for a perfect zero default, but the direction is clear and the adjustment quite solid. Of course, 2 1/2 years of a track record is not quite the same as 3 years, but sometimes it is not how long you have been going but where you are going and how you get there that counts. Let me say that we also find the identified triggers for the completion point appropriate, and we support the proposed interim assistance.

With these comments, I wish the authorities the best.

Mr. Whitehall made the following statement:

The authorities should be commended for their efforts to strengthen supervision of financial institutions, the drafting of new legislation which will encourage private sector growth, and the substantial liberalization of external tariffs. In addition we note that they have rescinded the flawed preshipment inspection scheme and have virtually concluded arrangements to compensate Alimenta for the seizure of the company's assets. The authorities face an uphill task in alleviating the poverty situation and we wish to encourage them to maintain their commitment to reform and poverty reduction.

We fully support the five pillars of the very comprehensive strategy for poverty reduction (SPA-2) which builds on the shortcomings of SPA-1, particularly the emphasis on enhancing the productive capacity of the poor, increasing their access to social services and infrastructure, and developing their capacities at the local level.

We note that in the second review of the second annual arrangement under the PRGF that quantitative performance criteria were generally satisfied through end-September and most structural reforms were completed. We therefore fully support the extension of the third annual arrangement.

In our view, The Gambia has met the conditions for reaching its decision point. We welcome the use of explicit triggers (as delineated in Box 7) of required reforms prior to the floating completion point, particularly those conditions relating to macro-economic stability, governance and the monitoring of the use of savings arising from debt relief. These proposed conditions are reasonable and consistent with the overall goal of poverty reduction.

However, the proposed structural reform conditions i.e. the establishment of a multi-sector regulatory agency and privatization of two groundnut-processing plants, are not obvious conditions of debt relief. They should be part of Gambia's PRGF arrangement and not its HIPC program, unless a link to poverty can be shown. Perhaps the staff can give us some clarification on this issue.

With these remarks we endorse the debt relief package which we expect will facilitate The Gambia's poverty reduction and reform efforts. We also support the recommendation that IDA and the IMF provide interim assistance between the decision and completion points.

Finally, we want to conclude by wishing the authorities every success in their endeavors.

Mr. Jacoby made the following statement:

The Gambia's policy track record under the PRGF arrangement is by no means solid. It has been tarnished by fiscal slippages, governance problems, and an overaccommodative monetary policy. It is clear that to reach their decision point Gambia's authorities will have to show unqualified commitment to policy reform. In this connection, the corrective fiscal measures and the settlement of the Gambia Groundnut Corporation incident are encouraging. Also, the authorities have managed to substantially reduce the overall fiscal deficit while curbing inflation. But the fiscal targets for 2001 have been revised upwards and despite all efforts to strengthen expenditure controls, no detailed timetable for implementing a Medium Term Expenditure Framework has yet been announced. At this point I am prepared to agree that The Gambia has reached the decision point, but I have to stress that the authorities are far from achieving macroeconomic stability, let alone the conditions for sustained growth.

To reach those goals and trigger the floating completion point, the authorities must, inter alia, strengthen the fiscal policy apparatus and begin monitoring of poverty reduction policies and progress on governance issues.

Though on the latter point Box 7 of the decision point document is fairly explicit, I would like to propose an additional trigger point: namely, the final settlement of the Gambia Groundnut Corporation dispute as shown by payment of the final balance due by July 2001. Since specific triggers should ideally reflect the Joint Staff Assessment of the I-PRSP, I also suggest incorporating some which would reflect the staff's concerns about the linkage between poverty reduction and the macroeconomic framework. In particular, point 1 on Poverty Reduction should make it an explicit requirement for the full PRSP document to lay out a detailed plan for reforming the budgetary process, including a precise timetable. Closely related is the need for the government to develop a medium-term expenditure framework (MTEF). I therefore suggest that point 2 of Box 7, dealing with macroeconomic stability, should commits the authorities to accept the recommendations of the forthcoming study of an MTEF for The Gambia (as mentioned in paragraph 20 of EBS/00/241). Lastly, I am seriously concerned about the existence of regional disparities in the provision of health care, and I wonder if it would not make sense to require earmarking part of the health care budget for the poorest regions.

On the PRGF, I agree with the completion of the second review and can also support the authorities' request for a third annual arrangement. I would only request that the preparations for defining and implementing an MTEF should be made a structural performance criterion.

Mr. Pickford made the following statement:

I associate myself with the remarks made by Mr. Barro Chambrier and Mr. Bauche. On the decision point, I agree that The Gambia qualifies. As Mr. Bauche said, the PRGF track record has been patchy, but we now have 2 1/2 years of satisfactory performance. More specifically, on the PRGF-supported program, I think good progress has been made. Some targets on the fiscal side have not been met earlier this year, but this reinforces the need to concentrate more on budget deficits taking account of grants. I support plans to improve budget transparency, and specifically the link of the medium-term expenditure framework to the PRSP process. On the PRSP itself, I generally endorse the positive joint staff assessment of the interim PRSP.

Our perception of the level of participation in that process to date is more qualified than in the DSA itself, but this merely reinforces the need to have sustained commitment from the government to full participation as they take forward the process of completing the full PRSP. The timetable for the completion of the PRSP is challenging. It may end up having to be revised, because we do regard it as very important.

To ensure that full allowance is made for a fully participatory process in terms of what is in the full PRSP, further work will be needed on defining the sources of pro-poor growth, especially given the vulnerability of the Gambian economy to shocks, given its reliance on groundnuts and tourism. Also, it will be important to develop data on poverty and link them to the measures required to alleviate and eradicate poverty. One other element that will be important in developing the PRSP is to draw out firm plans for local government reform and decentralization, since that will likely be central to the effective delivery of the outcomes identified in the PRSP.

Turning finally to the completion point, transparency of public expenditure processes is clearly key in our mind for the completion point triggers. The Auditor-General has been doing useful work, and it is important that reports are followed up by the government. I have two questions for the staff on the completion point triggers. One is on the first trigger in Box 7, which talks of preparation of a full PRSP with satisfactory implementation for one year. Then it talks about endorsement by the Boards of the IDA and the IMF of the country's annual progress report. This is more specific than the language that we have used in the past. For instance, in the case of Zambia, we talked about satisfactory progress in implementing and monitoring the PRSP for at least one year based on an annual report. I wonder whether we actually mean that we are going to have specific endorsement of the government's annual PRSP report, as opposed to, and separate from, the normal completion point document presented at the time of the completion point. I wonder whether this is actually committing ourselves to something slightly more stringent and onerous than we have intended in the past.

On the triggers, there is a bullet under Section 4, social sector reforms, which talks about budgetary savings from interim relief being used in accordance with annual budgets approved by the task force and the HILEC committee. I do not think it really belongs under social sector reforms, and I wonder whether it actually adds anything to the section on governance, which talks rightly about strengthening public expenditure management, annual reports on overall budget execution, and semiannual reports on the use of interim HIPC relief. It seems to me that any report on the use of interim relief is going to have at its core an assessment of whether it is actually in accordance with the budgets that had been set. I am not sure if these words add anything to our triggers here.

This is not to minimize at all the importance of having strengthened public expenditure management systems. The seminar of last week stressed the importance for many of these countries of technical assistance to help improve those processes. I question whether it is appropriate to have this form of words in the triggers.

Finally, I note that Fund interim relief is intended to be relatively small. Nine percent of the repayments due the Fund in 2001 should be given relief according to Table 10. That proportion rises after the completion point to the teens and up to 30 percent at one point. The net effect is a small reduction in debt service payments due in 2001. I would like some clarification from the staff on why that percentage is so small.

Mr. Sdralevich made the following statement:

We support the proposed decisions. In broadly sharing the staff's assessment, we also endorse the Interim PRSP, and we support the decision point for The Gambia. We have some qualifications, mainly regarding the points made by Mr. Jacoby on the poverty-related triggers and the track record. In the framework of the acceleration of the accelerated procedures for HIPC countries, we will submit our full statement to the record and make only one short comment on the question of non-Paris Club creditors.

In light of the December 1 memo of Mr. Wei to the Managing Director, copied to all Executive Directors, it seems that at least one non-Paris creditor is not ready to provide the needed financial assurances. We are worried by this development: if firm assurances are not forthcoming, a potentially very serious issue can arise, that is, the other creditors will have to choose between interrupting assistance or taking charge of the additional nonproportional part of assistance. Furthermore, difficulties with the same non-Paris club creditor, and on the same grounds, could arise for other countries. Despite our concern, we are confident that this problem is going to be solved with the cooperation of all the parties involved.

With regard to the robustness of the DSA, its underlying assumptions seem reasonable. However, the reported results of the sensitivity exercises point to a high dependence to external conditions of the reduction of external debt to sustainable levels. In a very relevant example, the NPV of debt does not fall under 150 percent of exports before 2011 if a reduction of half percentage point in the rate of growth of tourism is assumed, an event which is highly possible due to a range of causes. This possibility underscores the more general risk that the HIPC initiative could turn out to be insufficient for the reduction of debt under slightly more adverse exogenous conditions than anticipated in the assumptions.

On the program, we take note of the corrections of the recent policy slippages undertaken by the authorities and of their commendable effects in structural reform. Nevertheless, we concur with the staff's judgment of a mixed record in the PRGF, underlined by budget deficit and domestic credit that are probably going to exceed the target objectives for 2000. We therefore encourage the authorities to tighten policies also in view of the macroeconomic stability needed for the HIPC Initiative.

On the Interim PRSP we mainly agree with the staffs. It is good work, but it obviously needs more time to evolve in a full PRSP, and we welcome the timetable for the latter to be ready by end-2001. Among the aspects to be improved we stress the consistency in costing and the need for the establishment of expenditure monitoring mechanisms. Also, we would like more attention to be given to the problem of HIV/AIDS. Lastly, the inconsistencies between the basic health objectives and the current and projected spending for large projects such as hospitals are perplexing. Such inconsistencies must be solved in order to have a working coherent social expenditure plan.

On the decision and completion points, we agree with the proposed timetable envisaging the latter at the end-2002, after one year of implementation of the full PRSP. Our main remarks relate to the completion point triggers.

First, we would like to underline that there are no triggers directly linked to indicators of poverty, with the exception of the improvement of the poverty data base and monitoring capacity, which should be a necessary precondition for any successful effort to reduce poverty rather than a trigger. Second, some of the triggers relating to social sector reform, while focusing of areas of great importance for the reduction of poverty, are perhaps a little too close to government interventions and too removed from the final outcomes.

Mr. Harada made the following statement:

We thank the staff for having prepared an excellent paper, and Mr. Rustomjee for an informative preliminary statement. We take a position similar to that of Messrs. Djojosubroto, Barro Chambrier, Bauche, and other speakers.

This chair appreciates the authorities' current collective actions in having presented the I-PRSP, in the hope that further efforts will be made to enhance revenue and improve expenditure management. We think that the program under the new PRGF is appropriate, and we support the request for a new PRGF arrangement. Also, we support The Gambia reaching its decision point today and the conditions for reaching the completion point indicated in Box 7 as well as the provision of interim assistance.

I wish the authorities every success in the future.

Ms. Redifer made the following statement:

Overall, this looks like one of the stronger cases we will be seeing over the next two weeks. The integration of the macroeconomic framework and the poverty reduction strategy seems well thought out and sensible. We have no difficulty supporting today's decisions. The following remarks will focus on our few remaining questions/comments.

Is it consistent with the rules to simply skip the second review of the second year of the PRGF and move straight to the third year?

The documents note that settlement of the Gambia Groundnut Corporation dispute will "catalyze reform" in the marketing and processing of groundnuts. Completion point triggers call for privatization of the two processing plants and a multi-sector regulatory agency, but otherwise there are no benchmarks in the Fund-supported program to measure progress on privatization, per paragraph 26 of the staff report, over the next year. Will this be addressed on the Bank side?

The same question holds for the judicial reforms described in the MEFP in para 28. These are covered by the IPRSP, but will Fund/Bank program conditionality support this in some manner?

Unlike the U.K. chair, we view The Gambia's triggers on the use of interim HIPC Initiative relief and over public expenditure management as a model for other HIPCs coming forward. The first trigger requires semi-annual budget reports on the use of the relief, to be reviewed by two monitoring groups, and the second trigger requires the relief to be used as stipulated in the budgets approved by the groups. We do think the substance of both triggers is needed. These efforts will help to provide accountability in the short term, while not sacrificing broader efforts at public expenditure management.

We also believe the approach of using a virtual Poverty Reduction Fund that includes HIPC Initiative resources but covers the broader envelope of social spending is also exemplary.

The IPRSP is strong. In developing a full PRSP and setting upcoming priorities, the authorities should be mindful of using annual public expenditure reviews to help assess the effectiveness of different types of social spending.

Continuing focus on growth strategies will be needed to ensure GDP growth keeps up with population growth. The projections indicate it may not. In this context, would like to echo Mr. Barro Chambrier's remarks on efforts to foster private sector development

We would like to echo the comments of several Directors in looking forward to a more fully developed HIV/AIDS strategy in the full PRSP, and I want to underscore Mr. Pickford's comments on the need for strong participation of civil society.

I also wish to echo Mr. Pickford's comments on the need to improve decentralized capacity and to improve expenditure management down through the level of local service delivery.

Finally, I want to address the issue raised by Mr. Pickford on the trigger requiring endorsement of the annual progress report of implementation of the PRSP. Endorsement of the annual progress report on full PRSP implementation would not necessarily imply a more onerous treatment than other countries have received. We can support some type of standardized wording of this trigger that takes out the requirement for "endorsement," as long as the annual report on the implementation of the PRSP is still a basis for considering the completion point.

Mr. Skurzewski made the following statement:

We readily agreed on The Gambia's eligibility for the enhanced HIPC Initiative during the discussion last month, and we only signaled some reluctance on the timing of the decision point. However, today we are glad to note that the decision point can be discussed simultaneously with the new PRGF arrangement, since this will serve to reduce the uncertainty that these rather rushed proceedings entail. We thus consent to the Gambia reaching its decision point, and to the suggested time profile for the provision of interim assistance. We also agree on the new annual arrangement and the extension of the commitment period, as proposed.

The overall macroeconomic picture seems to have improved. The authorities have been able to redress the fiscal situation, which had deteriorated earlier this year, and as a result of this performance criteria for end September were met. It should nevertheless be mentioned that the public deficit for 2000 will remain higher than originally programmed. We follow the staff in urging the authorities for expeditious implementation of the planned budgetary reforms, which in the medium term should allow to reduce the high level of the domestic debt. It is also apparent from the recently granted allowances that pressure for public expenditures remains a serious challenge. We also welcome the projected reduction of the current account deficit, but we are nevertheless worried that in the third year of the PRGF arrangement the deficit (excluding grants) would be still higher than in 1997, i.e., prior to the current PRGF arrangement.

Turning to the HIPC Initiative document, we welcome the expected participation of all major multilateral creditors, who have a large share in the

Gambia's external liabilities. We also welcome the AfDB's plans to provide interim assistance. As a relatively large fraction of The Gambia's debt is owed to non-Paris Club bilateral creditors, we are wondering, also in the context of Mr. Sdralevich's question, whether the staff has some update on the results of discussions with any of these countries and possible rescheduling on their part.

We agree on the completion point conditions, and we view the possible timing outlined by the staff as realistic, even if it is ambitious. We note that the actions required in the health sector have been limited compared with the proposals presented in the preliminary documentation, and we believe that this sector, and especially HIV/AIDS related measures, should get more focus in the new Strategy for Alleviation of Poverty. In all, we think the completion point triggers represent a reasonable set of policy requirements to secure that the HIPC resources are put to good use. As we stated last time, however, we would have welcomed the inclusion of some output—or impact—oriented indicators. On the other hand, we are content to have governance-related issues among the completion point conditions. Sound budgetary management, which should be facilitated by the envisaged public reports on budget execution and on the allocation of HIPC resources will, of course, as authorities recognize in their I-PRSP, be crucial to provide a successful impact of debt relief on poverty alleviation. We concur with exclusion of the resolution of outstanding issues regarding audition of public accounts from these triggers. However, the authorities should address this issue all the same.

Finally, we concur with the staff's assessment of The Gambia's I-PRSP. The document fulfills the requirements for the decision point and should, together with the earlier work already done in the context of the SPA, provide a solid foundation, on which to proceed with the formulation of a full PRSP.

Mr. Al Azzaz made the following statement:

Economic developments in The Gambia are positive, with sustained per capita GDP growth, low inflation, and some reduction in the fiscal deficit from 1998 through the first half of 2000. Notwithstanding these achievements, The Gambia needs to press ahead with adjustment and structural reform to reduce the economy's vulnerability, sustain high growth rates, and reduce poverty. Further implementation of the agreed policies will be a big step forward.

In the fiscal area, improving tax administration and strengthening expenditure control are priorities. Setting up a framework for poverty reduction expenditure and improving the prioritization and targeting of social services should indeed be expeditiously implemented. On the structural side, I am encouraged by the progress made so far; the reduction in external tariffs and the removal of the PSI schemes are steps in the right direction. I also commend the authorities for their efforts in privatization, and the progress made in the resolution of the GGC property issue.

It is essential to strengthen the supervisory and regulatory roles of the central bank, further reform the financial sector, and establish a legal framework that fosters private sector activity through privatization and increased competitiveness. Given The Gambia's satisfactory performance under the PRGF- and IDA-supported programs since 1998, the strength of the program for 2000 and 2001, and the commitment to reform, I support the authorities' request for a third annual PRGF arrangement. I also support the extension of the commitment period.

I broadly concur with the joint staff appraisal of the interim PRSP, and support the authorities' effort to reduce poverty, especially the focus on agriculture and small-scale trade. In this connection, I share the staff's view regarding the need to expedite reforms in the key groundnuts sector. I also agree that this interim PRSP provides a sound basis for the development of a fully participatory PRSP, and I hope that it will be completed as planned. On the HIPC document, I can support the proposed decision and provide an affirmative answer to the three questions raised on page 28 of the document.

Finally, I would like to join other speakers in thanking the staff for a well written and informative set of papers. With these remarks, I wish the authorities every success.

Ms. Budina made the following statement:

I associate myself with the statements of Messrs. Djojosubroto, Mirakhor, and Barro Chambrier. Since our intended comments were already largely covered by previous speakers, I would just like to make one brief remark regarding the I-PRSP.

We fully endorse the I-PRSP, and we think that the authorities demonstrated their commitment and ownership of their poverty reduction strategy, which is a continuation of an already existing strategy for poverty alleviation, and forms the basis for a full PRSP. An important lesson from the SPA I was that, although expenditures on health and education increased in the past, they did not always affect the poor. In this respect, given scarce resources, we would like to urge the authorities to prioritize social expenditure in order to achieve maximum positive effects on the poor. We consider the emphasis on improved female enrollment in basic education satisfactory.

Regarding the health sector, we would like to know why the government has focused expansion on health care delivery instead of a more appropriate primary health care program. Furthermore, on the consistency between macroeconomic policy and the poverty reduction strategy, we saw in the analysis presented in the I-PRSP that, to cut poverty in half within the next 15 years, the economy would have to grow approximately 7 percent per annum. The question is whether that performance is attainable and what needs to be done to ensure such rapid economic growth. Here, we agree with the staff that the authorities need to pursue stable financial policies, to improve governance, to adhere to strict control and transparency, and to liberalize further foreign trade.

The new poverty reduction strategy stressed the importance of agricultural sector development for poverty alleviation. Although the poor are concentrated in the agricultural sector, a process of urban migration and the development of the services sector would be of crucial importance for poverty alleviation. Given the fall in commodity prices and vulnerability of the economy to external shocks, it is important to consider, in depth, effective economic diversification in the final PRSP document.

We are pleased to note that the African Development Fund will provide a $1.4 million grant for a tourism development project, so we urge the authorities to give the tourism sector a more prominent place in the PRSP. Further, economic diversification would be essential for the achievement of external sustainability, because it would decrease the economy's vulnerability to external shocks and the possibility to divert funds away from poverty reduction expenditures, which was outlined as one of the major risks to the strategy.

Finally, we also associate ourselves with other speakers' comments about the importance of technical assistance to improve data quality in The Gambia.

Mr. von Kleist made the following statement:

Even though The Gambia has a stop-and-go policy record, I credit the authorities for taking measures to correct slippages, and can therefore support the authorities' request for a third annual arrangement under the PRGF. I only wish to emphasize a few points.

Improvements in the area of governance will surely improve investor confidence in the country and, are especially welcome. Concerning the balance of payments situation, however, it is regrettable that no lasting strengthening has been achieved during the past two years. It will therefore be all the more vital to adhere strictly to program parameters.

The necessary fiscal adjustment, which is rightly spelled out in the staff paper, does not seem to be adequately anchored in structural adjustments.

I especially missed concrete measures to widen the tax base. The concept of a broadly-based, value-added tax, which we had welcomed when first announced, is still vague. Staff comments on that would be welcome. Like other speakers, I missed strengthened efforts to diversify the agricultural sector further, and to reduce The Gambia's reliance on groundnuts, which would reduce the vulnerability of the economy to shocks in that market.

Turning to the HIPC Initiative, I welcome the combined successful efforts of the staff and the authorities to bring The Gambia toward its decision point today, and I support the proposed decision. It will be necessary, however, to monitor and control expenditures and strictly to make sure that the newly regained debt sustainability is not threatened again soon.

Mr. Maino made the following statement:

We welcome the discussion of the Interim PRSP, the Enhanced HIPC-Decision Point Document and the Second Review under the Second Annual Arrangement and Request for Third Annual PRGF for The Gambia. The Strategy for Poverty Alleviation, which is the basis for the Interim PRSP, clearly shows the government's firm commitment to the reduction of poverty.

As Mr. Rustomjee stressed in his comprehensive statement, the I-PRSP is the outcome of a broad and solid consultative process. The program is built upon participation of civil society and has a pivotal role for guiding the relationship among key stakeholders, donors, and NGO's that will certainly evolve into a full PRSP by end-2001. However, there is still a need to have a clear and fluid correspondence between policies implemented and their poverty impacts. In that respect, it will be useful to specify priority areas and intermediate targets to address the overall effectiveness of each program.

The government correctly underlines the need to propel economic growth as the most important strategy in the fight against poverty. The macroeconomic framework established by the government and based on the PRGF is consistent with the cost program being undertaken for public expenditure management. This will also strengthen accountability and transparency. But at this stage it becomes a priority to analyze in detail the costs associated with the social policies launched to combat poverty and advance a clear link to the budgetary process. In this vein, the accounting framework known as Poverty Reduction Fund constitutes a critical step towards solidifying the overall government reputation, even though a sustainable monitoring system is still needed for the long run.

We concur with the government in assigning important weight to agricultural and small-scale trade as essential elements to enhance productivity and foster economic growth. The government needs to push for faster reform progress in the area of private sector development and greater liberalizing efforts in the groundnut sector. Even though the implementation of the three-year PRGF since mid-1998 was mixed, the government's strong dedication to reform signals a renewed effort.

Notwithstanding satisfactory structural reforms and encouraging results in the macroeconomic area, the risks arising from the external sector—already threaten by a high level of domestic government debt—and from the implemented monetary policy are tantamount. The country's heavy dependence on a narrow range of commodities complicates any reversal in the terms of trade. External sustainability and the long-run success of the reform program rely on further reduction of external tariffs, trade diversification and access to advanced countries' markets. Although the efforts made on the expenditure side and the complementary fiscal reforms, monetary policy is still lax. Money supply should be kept in line with nominal GDP growth in order to provide a framework of low inflation while managing prudent interventions in the exchange rate system. The Gambian authorities should aim at synchronizing their intention to strengthen financial institutions supervision with the introduction of foreign currency deposits.

The Gambia demonstrated substantial progress to reach its decision point under the Enhanced HIPC Initiative. The debt sustainability analysis already reviewed by this Board early this year was a clear sign that The Gambia qualifies for assistance under the Enhanced HIPC initiative and that the country meets the requirements for reaching a decision point.

On amount of delivery of assistance, we support the staff's proposal and the provision of interim relief by IDA and the Fund until the completion points are met.

On the floating completion point, the triggers detailed in Box 7 for the completion point are appropriate given the social dimension of poverty summarized in the HIPC Initiative document. Once again, we encourage the government to monitor the implementation of the budget—which today is being analyzed by the Parliament to delineate costs estimates for each poverty reduction measure to be introduced in the future.

Mr. Elkjaer made the following statement:

I support the decision point for The Gambia today. On the triggers for the floating completion point, like Mr. Jacoby, I am concerned about expenditure control. I am happy to see that we have this semiannual report on the use of interim HIPC Initiative assistance. We saw it for the first time in Madagascar, and we have not seen that in any other HIPC Initiative case. I think this should be a standard part of the completion point triggers.

Like Mr. Pickford, I was also surprised to see that the Board should endorse the country's annual progress report. We have some problems in terms of ownership in that regard, and I believe that we should have a wording saying that the floating completion point will be reached based on this report instead of on the basis of an endorsement.

The staff statement talks about the problem of domestic debts and arrears. Could the staff specify the amount of resources that will be freed up for poverty reduction, if we take this domestic arrears problem into account?

Mr. Jayatissa made the following statement:

This chair also welcomes the authorities' commitment to promote growth, reduce poverty, and improve governance. We share the concerns expressed by some Directors, particularly the need to improve fiscal performance and monitor government expenditure. We support the authorities' endeavors to reduce poverty. The authorities have established a track record sufficient to reach the decision point. We support the third annual arrangement, and believe and that the authorities should receive sufficient assistance during the interim period.

Mr. Hililan made the following statement:

I associate myself with the views of Messrs. Barro Chambrier and Bauche, especially regarding the need for fiscal consolidation and governance. Also, given the importance of the agricultural sector, I see the need to diversify away from the high dependence on groundnuts, as Mr. von Kleist just said.

On the PRSP, I can also associate myself with the view expressed by Mr. Pickford on the issues of timing and participation. I agree with others that The Gambia has reached its decision point today. Triggers for the completion point reflect a limited but important set of policy actions designed to improve growth and reduce poverty. I also wish to support Mr. Rustomjee's call for technical assistance from the Fund and from donors. Like Mr. Barro Chambier, I think that there may be a need for donor coordination in this regard.

Mr. de los Santos made the following statement:

The Gambia's economic performance, under the PRGF-supported program, can be deemed outstanding. A combination of strong economic growth with low inflation are the main cornerstones of the successful implementation of the structural reforms adopted by the authorities. Although some budgetary slippages prevented keeping the budget deficit at or below the expected mark, the overall assessment of program implementation is a strong positive one, and the Second Review of the PRGF should be considered complete.

The implementation of the I-PRSP has been an outstanding participatory process with an impressive coordination and understanding among civil society and government agencies regarding the main actions for implementing programs to reduce poverty. There are still some areas that need further improvement or coverage, i.e. collection and preparation of statistics on the level and stratification of poverty along the country, or strengthening civil society's participation in the government process. However, the government has shown a strong commitment to continue its crusade to lower poverty levels. We welcome the government's initiative last October to start the SPA II, as the preliminary steps for the formulation of the PRSP. The I-PRSP has been a successful experience for The Gambia and we concur with the staff that it provides enough ground for the development of a fully participatory PRSP and for supporting the appraisal that The Gambia has reached the decision point under the enhanced HIPC Initiative.

The Gambia's debt burden has reached an unsustainable level. The enhanced HIPC initiative will help the country cope with the strong pressures originated by high debt-service payments. It is in this framework that we support that the Fund approve The Gambia's request for interim assistance equivalent to U.S. $100,000 for the time it will take to attain the completion point.

We support The Gambia's request for approval of the Third Annual PRGF Arrangement an the requested extension.

The staff representative from the African Department (Mr. Kibuka), responding to questions on the issue of privatization noted that, under the PRGF-supported program, there had been an attempt to divide the responsibilities between the Bank and the Fund, with the Bank taking more responsibility with regard to privatization and judicial reforms. The staff representative from the Bank would also address those issues.

With regard to the structural conditions included in Box 7—namely the establishment of a functional multisector regulatory agency, and the planned privatization of the two processing plants, the staff representative explained that those measures had been included among the completion point triggers, as they were of considerable importance to the ongoing reforms in the private sector. The regulatory agency was supposed to complement the privatization process, which was handled by the World Bank. In that context, a number of utilities would be privatized. The processing plants were supposed to revert to government ownership as a result of the settlement with Alimenta. It was important that they would again be privatized to competing firms so as to stimulate an appropriate level of competition in the private groundnut sector.

On the regional disparities in the provision of health care, the staff representative noted that the completion point trigger, currently included in the paper, aimed at providing for more resources in primary health care. The trigger in social sector reforms and the trigger under governance were both relevant and different from each other, given that the latter one focused on the ex post monitoring of expenditures, whereas the social sector reforms trigger focused on ex ante budgetary allocations.

On the debt profile, the staff representative recalled that a revised table had been issued, which showed that, for 2001, the proportion of repayment of the total due to the IMF was 9.6 percent. Fund debt relief was then determined with a view to offset the outstanding payments. Most of it was concentrated on the period when substantial principal payments were due to the IMF. On this basis, very minimal relief would be available during 2002 and 2003 when no principal payments were scheduled.

On the issue of the non-Paris Club creditors, the staff representative reported that there had been information that China would not be ready to provide assistance to The Gambia. However, the critical issue was that multilateral and Paris Club creditors, which accounted for about 80 percent of The Gambia's debt, had all agreed to participate in the HIPC Initiative assistance. There was currently no information on other non-Paris creditors, but the staff would pursue that issue further.

On the question of whether the authorities' desired growth target of 7 percent in the PRSP was attainable, the staff representative noted that the authorities had not provided any significant background to support that target in the discussions on the PRSP. Indeed, the staffs of the Bank and the Fund had raised the issue in the joint staff assessment, stressing that more concrete work needed to be done. In the short run, the staff expected a real GDP growth rate of about 5.5 percent, which was the PRGF-supported program target. However, if some of the structural impediments to growth could be addressed, the growth rate could rise further in the medium term.

On concrete measures in the context of the tax reform, and in particular on the VAT, the staff representative considered that the authorities needed to strengthen the capacity of the Tax Department substantially. The department needed to be computerized, and the coordination with other departments needed to be improved. Only after that should the introduction of a VAT be considered, given that it was a fairly complicated tax.

With regard to the diversification in agriculture, the staff representative agreed that this was important. However, in the short-to-medium term, and given the recent structural decline in the groundnut sector, the rehabilitation of that sector was of paramount importance. The diversification to other activities could only be addressed if the overall production level in the agricultural sector was improved to support an improvement in poverty reduction balances.

Responding to a question from Mr. Elkjaer on The Gambia's domestic debt and the need for restructuring and whether that could jeopardize the resources freed up by the HIPC Initiative relief, the staff representative noted that in 2000 and 2001, resources which had been intended to reduce domestic debt, as provided by the European Union in particular, were being diverted to pay Alimenta. That meant that domestic debt could not be reduced to the desired degree. In that regard, it would be useful if additional assistance were available for debt reduction and eventually debt restructuring. The savings in interest payments by the government would then be available to augment the HIPC Initiative resources going toward reducing poverty.

The staff representative from the Policy Development and Review Department (Mr. Hicklin), responding to a question from Mr. Pickford on the language used for the completion point triggers, noted that the first trigger stated that the full PRSP would be prepared and satisfactorily implemented for one year as evidenced by the endorsement of the Boards of the IDA and the IMF of the country's annual progress report. According to the Legal Department, that did not represent a substantive difference from the language seen in other reports, and the endorsement of these assessments of annual progress reports was consistent with the initial decision. That did not affect the program conditionality. Hence, the staff did not regard that matter as a substantive issue. In future documents, the language would be standardized.

On Ms. Redifer's comment regarding the noncompletion of the second review under the second year arrangement, the staff representative that it had not been possible to be completed because the arrangement for the year had already expired. However, the PRGF instrument did provide the possibility of a rephasing of resources within the third year arrangement. The Legal Department could provide further clarification on that matter, should it be needed.

Mr. Pickford considered that there was a substantive difference between the wording "endorsement by the Boards of the country's annual progress report" and what was understood to be the normal process—holding a Board discussion on all completion point triggers at the completion point on the basis of a staff completion point document. On that occasion, there would necessarily be discussion about the nature of the implementation of the PRSP over the full period between the decision point and the completion point. While there would be ongoing discussions in the context of PRGF program monitoring, it was not appropriate to standardize that particular form of words, as it implied that the Board might be expected to hold a specific discussion and consideration and endorsement of each year's annual progress report. It appeared that, if a country were able to reach the completion point within two years, the monitoring of PRSP implementation as entailed in the current language would be more heavy handed. The language that had been used in the Zambian case, which talked about an assessment of progress based on an annual report rather than on an endorsement of the annual report, was more appropriate.

With regard to the budgetary savings trigger, Mr. Pickford reiterated that his chair strongly supported measures underpinning improvements in governance and in public expenditure management. The whole purpose of the enhanced HIPC Initiative was to generate resources that could be used for poverty reduction. Nevertheless, there had also been agreement that the completion point triggers should concentrate on a few key measures of particular importance for poverty reduction. A general statement about budgetary savings being used in accordance with annual budgets was neither specific nor did it add much to what one would regard as a good public expenditure management system. It could therefore not be considered as an appropriate trigger.

Mr. Rustomjee broadly agreed with Mr. Pickford on both issues and said that he did not have a strong view on the first point, but that standardized language would be preferable. The Gambia had produced a good I-PRSP. While the use of the word “endorsement” was consistent with the understanding of the Board’s responsibility, it appeared to diverge from the language contained in the completion point triggers and could send a signal to the authorities that the Board was not satisfied with the process and the ownership of the PRSP. Therefore, the language used in earlier cases, such as Zambia, would be preferable.

On the budgetary savings trigger, Mr. Rustomjee said that that probably all of those considerations were embedded either in PRGF conditionality or in other areas of the completion point triggers, and that there might be some duplication. The Gambian authorities had established that they were serious about tracking resources that are given to them for poverty reduction and had included them into the budget.

Mr. Bauche shared the views expressed by Messrs. Rustomjee and Pickford. Unless there were doubts with regard to the implementation of the full PRSP, the language used should be standardized. On the second point, the current wording was acceptable.

Commenting on a point raised by Mr. Sdralevich on the participation of non-Paris Club creditors, Mr. Bauche expressed concern about the nonparticipation of non-Paris Club members. In the case at hand, the issue was both the financial services involved and the principle of burden sharing. For the sake of the HIPC Initiative, that concern should be taken seriously.

Mr. von Kleist shared the concerns expressed by Mr. Bauche and other Directors about the nonparticipation of non-Paris debtors in the Initiative. Participation of all creditors was a fundamental issue for the HIPC Initiative.

Ms. Redifer reiterated that the ex ante identification of specific budgetary uses for the resources freed up under the HIPC Initiative and the verification afterwards were important for the credibility of the Initiative from the country’s perspective, from the Fund’s perspective, and from the perspective of the creditors. The current wording of the completion point triggers was sound and would be a good standard for other countries.

The staff representative from the Policy Development and Review Department (Mr. Hicklin) agreed that the use of standardized language would be useful. However, both wordings, the one currently used and the one in the draft document, had the same substantive meaning. The staff would nonetheless assess the practice that had been applied in other cases to ensure that no problems would arise going forward.

Another staff representative from the Policy Development and Review Department (Mr. Boote) said that the current wording was intended to refer to the production by the authorities of an annual progress report which, under the general procedures for PRSPs, needed to be discussed and agreed to by both the Bank and Fund Boards as the basis for continued concessional lending by both institutions. That original substance had not been changed in any way by the addition to the wording. If that addition was deleted, the substantive intent would not be altered. If Directors wished, the staff could change the wording. While that would have to be agreed upon by the authorities, that did not appear to be a problem, in light of Mr. Rustomjee's comments. However, it also would have to be agreed to by the Bank Board. It appeared that the Bank Board had some concern concerning the use of the word endorsement and would therefore probably welcome that change. However, the substance would remain unchanged with or without mentioning endorsement explicitly.

Mr. Pickford commented on the point raised by Ms. Redifer about specific actions for reducing poverty and assurances concerning requirements on the use of the money. Those two demands were, to some extent, inconsistent, because being specific necessarily meant that there should not be such general statements.

Ms. Redifer reiterated that, in her view, the language for the trigger was appropriate as it stood and considered that her view was not necessarily inconsistent with Mr. Pickford's position. The country would decide the level of specificity in the use of resources as well as with regard to the means of verification.

The staff representative from the World Bank, addressing issues relating to judicial reform, reported that the Bank had recently closed a technical assistance project in an area that could be classified as a capacity building operation and that would be appraised in the first quarter of 2001. With respect to privatization, the Bank did not have an overall privatization operation as was the case in some other countries in the subregion. However, the Bank was working on the privatization of the national water and electricity company, NOWEC, and the so-called Gambia Gateway Project, which was a significant port improvement.

With respect to HIV/AIDS, the operation for The Gambia had been negotiated in the previous week, and would be submitted to the Board in mid January, the staff representative said. That should strengthen the national capacity for the fight against HIV/AIDS.

With respect to agricultural diversification, the staff representative noted that the concentration of activity in two export sectors left the country vulnerable to shocks. Given the inherent comparative advantage of agriculture, it was difficult in the short run to diversify, as groundnuts production was so important in terms of export earnings. Nonetheless, the Bank and FAO had recently completed an agricultural strategy for Gambia that included work on diversification, especially through the development of irrigated crops.

With respect to the health sector triggers, it had been noted that the triggers did not seem to insist enough on devoting savings toward strengthening health care in disadvantaged areas the staff representative said. However, the trigger would ensure that resources would be transferred in particular to the poorest area.

With respect to the effect of the expansion of tertiary health care, the staff representative noted that the Bank was engaged in a serious debate with the government at the highest level to better identify resource needs. Government ambitions in that area did not cause them to neglect primary and secondary health care.

Mr. Rustomjee made the following concluding remarks:

> I thank Directors for their detailed and helpful comments on The Gambia, the staff for preparing excellent detailed papers and for their comprehensive answers, the World Bank representative for the valuable comments, and colleagues for consenting to the third annual PRGF-supported program and for agreeing to the decision point for The Gambia on the basis that the I-PRSP fulfills decision point requirements.
>
> This discussion has been comprehensive in coverage, unlike some discussions recently where there were a few key focal points. I will be taking back to the authorities comments that the I-PRSP has been a generally good and sound basis for a full PRSP. More participation and stronger focus on growth strategies to increase GDP growth beyond population growth is needed, as is a strengthened focus on health, particularly on HIV/AIDS as a strategy; and also attention to agricultural and small-scale trade. Also, many Directors made the point that the annual public expenditure reviews should be used, but also that there should be stronger integration of the budgetary process with the MTEF. Many said that they would like to see a firm time line established for this.
>
> I would like to mention, in this regard, that the successful performance with MTEFs in the continent, at least in our portfolio, has taken a long time to develop, because they are comprehensive budgeting tools. I hope that the expectation is not for a very rapid development of this. It will take some time, and need lots of money as well. But we will certainly send a strong message to the authorities that this is an expectation as they go forward, and that they should press with these hard governance issues to provide greater strength in the final PRSP.
>
> The final PRSP should indicate more clearly the sources of pro-poor growth. It should also emphasize that data on poverty issues need to be better developed. Again, here, the authorities plead for resources to help them assemble the data on poverty. It is complex and, as I have mentioned in previous discussions, the issue of compilation of poverty data, unfortunately, is complicated by the disappearance of those who conduct the survey. It is one of those activities where capacity is cited and destroyed in a short cycle. It then has to be rebuilt when another household survey or poverty strategy survey needs to be developed. It is cost-intensive and does not build capacity unless extensive resources are committed.

On the issue of the completion of the PRSP, I understood from Directors that the timing may need to be revisited, although many saw that the time line is both ambitious and realistic. The poverty reduction fund was identified as a valuable tool, and one which needed to be built on. I thought there was a clear expression of the need for the authorities to use interim relief effectively and that there should be full accountability for that use. I think they will have no difficulty on that issue.

Aside from the I-PRSP, there was discussion of needs in many specific areas of structural reform, particularly widening the tax base by speeding up the VAT. Diversification away from agriculture, and particularly away from groundnut production, was seen as vital. Enhancing tourism potential was seen as needed, but Directors also expressed the need to diversify away from reliance on that industry. I thought there was also an expression by the Board that the Alimenta issue is now tantamount to being resolved. For those who participated in The Gambia discussions in the past, there was the big governance problem, and also a big potential drain in fiscal terms. Now the issue is being resolved. Directors recognized that this would also boost investor confidence.

Many chairs supported the call for increased technical assistance. The authorities want this emphasized. They are showing commitment and the will to get on with the job in most areas. Slippages were identified, and I will take back the concerns about fiscal policy. They are asking for enhanced technical assistance, and they will use it well. I thus ask that it be considered in the future plans of donors.

There was some leniency on the 2 ½- or 3-year issue. I will tell the authorities that some good will was extended in granting the extra half year on the track record issue. There was a series of individual issues on legal reforms, central bank reforms, and the government needing to follow-up on work already achieved with the Auditor-General's office.

There were concerns on the issue of non-Paris Club creditors. I will take back this issue of progress on privatization, particularly after the governance issue on the GGC has been resolved. To some extent, the question of regional disparities in health care was answered. Regional integration is key for the future of The Gambia. They have started these efforts and I believe they will move expeditiously. The comments by Mr. Bauche on that will certainly be valuable for them. If they pursue regional integration, they need to also have strong work done on fiscal and monetary grounds to be effective.

I request that technical assistance be placed high on the agenda. This is a country that is making solid steps and which has produced a good I-PRSP. Nevertheless, much more work is needed and they must have the resources.

The Chairman made the following summing up:

Executive Directors noted that, although overall performance under the first and second annual PRGF arrangements was mixed, all quantitative performance criteria and most of the structural benchmarks through end-September have been observed. Directors commended the authorities for taking measures to correct slippages under the program, including broad-based budgetary reforms to improve transparency and governance. They welcomed the continued recovery in output growth, the maintenance of low inflation, and the reduction in the overall fiscal deficit since 1998.

Directors noted the progress made in implementing structural reforms, in particular the reduction and rationalization of external tariffs, the deepening of financial sector reforms, the privatization and restructuring of public enterprises, and the strengthening of the database. They welcomed the agreement reached on the dispute regarding the government's seizure of the Gambia Groundnut Corporation's property.

Directors welcomed the authorities' program for 2000/01, which will be supported by the third annual PRGF arrangement. They noted that the program provides a coherent framework aimed at consolidating macroeconomic stability, deepening structural reforms, and enhancing investor confidence. They emphasized that the timely implementation of the program is key to achieving more sustainable and broad-based economic growth as well as a durable reduction in poverty.

Directors observed that the authorities will need to pursue prudent fiscal policy to consolidate the reduction in the overall deficit. The high level of domestic debt remains a concern. It is essential that revenue enhancing measures be fully implemented, to make room for priority social spending. Directors stressed the need for improvement in tax administration and a widening of the tax base, and underscored the importance of strengthening the expenditure reporting and control process. They urged the authorities to step up efforts to develop a Medium-Term Expenditure Framework and an accounting framework to track poverty reduction expenditures. Also, measures designed to improve the prioritization and targeting of social services need to be expeditiously implemented.

Directors welcomed the authorities' plans to tighten monetary policy in the period ahead and stressed the need to improve quickly the operation of the interbank foreign exchange market and the soundness of the financial system.

Directors considered that the consolidation, broadening, and acceleration of structural reforms remain key to improved private sector activity and a speedier reduction in poverty. Directors emphasized that strategies to reduce poverty can only be effective if they enhance the productive capacity of the poor. In this regard, they urged that timely and coordinated reforms be implemented in leading production sectors—agriculture, trade, and tourism—to contribute to the attainment of the objectives of the Interim PRSP. Directors supported the authorities' request for timely technical assistance from the Fund and donors for The Gambia's poverty reduction policies and programs. They stressed the importance of full participation by all non-Paris Club creditors in debt relief for The Gambia.

Directors also noted the progress made in improving economic and financial data and welcomed The Gambia's commitment to participate in the GDDS. Directors urged the authorities to continue to improve the timeliness and reporting of data.

Directors noted the considerable progress that has been made with respect to the poverty reduction strategy and welcomed the authorities' schedule for completing the PRSP by end-2001. They agreed that the I-PRSP provides a sound basis for the development of a full PRSP, for Fund concessional assistance, and for reaching the decision point under the enhanced HIPC Initiative. Directors commended The Gambia's poverty reduction strategy, including the detailed framework for poverty alleviation as described in the I-PRSP, which was based on a broad participatory process. Directors considered that linking the medium-term macroeconomic framework to the poverty reduction strategy will increase program ownership and enhance coordination of economic and social policies.

Directors agreed that the Gambia has reached the decision point under the enhanced HIPC Initiative. They agreed that The Gambia would reach the floating completion point when the conditions contained in Box 7 of the HIPC Decision Point Document EBS/00/242 have been met. These included completion of a full PRSP developed through a broad-based participatory process and satisfactory implementation for at least one year; maintaining a stable macroeconomic environment as evidenced by a satisfactory performance under the PRGF-supported program; strengthening transparency of the public expenditure process; and the satisfactory implementation of key measures, in particular in governance, health, education, and selected structural reforms. They emphasized that the challenge for the authorities is now to effectively implement these measures to benefit the poor.

The Executive Board took the following decisions:

Poverty Reduction and Growth Facility—Third Annual Arrangement and Extension of Commitment Period

1. The Gambia has requested (i) that the amount of the third loan under the second annual arrangement of the three-year arrangement under the

Poverty Reduction and Growth Facility (PRGF) (EBS/98/102, Sup. 1) be rephased and that a total amount in the equivalent of SDR 10.305 million be made available during the third annual arrangement, (ii) that the commitment period of the three-year arrangement be extended from June 28, 2001 to December 31, 2001, and (iii) that the third annual arrangement be approved.

2. The Fund determines that the interim Poverty Reduction Strategy Paper (PRSP) for The Gambia set forth in EBD/00/99 (11/28/00) provides a sound basis for the development of a fully participatory PRSP, for reaching the decision point under the enhanced HIPC Initiative, and for Fund concessional financial assistance.

3. The Fund extends the commitment period under the PRGF arrangement for The Gambia approved on June 29, 1998 (EBS/98/102, Sup. 1, 6/30/98) to December 31, 2001.

4. The Fund approves the third annual arrangement under the PRGF for The Gambia set forth in EBS/00/241 (11/28/00); and Correction 1 (12/7/00) and decides that disbursements may be made under the arrangement, on the condition that the information provided by The Gambia on the implementation of the measure specified as item 1 in Table 11 attached to the letter dated November 27, 2000 from the Secretary of State for Finance and Economic Affairs and the Governor of the Central Bank of The Gambia is accurate.

5. The Fund approves in principle the third annual PRGF arrangement. The approval shall become effective on the date when the Fund decides that the World Bank has concluded that the interim PRSP provides a sound basis for the development of a fully participatory PRSP, for reaching the decision point under the enhanced HIPC Initiative and for World Bank concessional financial assistance. (EBS/00/241, 11/28/00)

Decision No. 12352-(00/121), adopted
December 11, 2000

Enhanced Initiative for Heavily Indebted Poor Countries—Decision Point

1. Based on the external debt sustainability analysis for The Gambia (EBS/00/242, 11/28/00; Cor. 1, 12/7/00; and Sup. 1, 11/28/00), 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"), established by Decision No. 11436-(97/10), February 4, 1997, decides in principle that:

(i) in accordance with Section III, paragraphs 1 and 2 of the Trust Instrument (the "Instrument"), The Gambia is eligible and qualifies for assistance under the enhanced HIPC Initiative pursuant to the terms of the Instrument;

(ii) the completion point for The Gambia will be reached on the date when the Trustee determines that:

(a) The Gambia has satisfactorily implemented the policy reforms described in Box 7 of The Gambia's Decision Point Document under the enhanced HIPC Initiative (EBS/00/242, Cor. 2);

(b) The Gambia has a stable macroeconomic position and has kept on track with its Fund-supported program; and

(c) The Gambia has prepared a Poverty Reduction Strategy Paper and has satisfactorily implemented its poverty reduction strategy for at least one year;

(iii) the external debt sustainability target for The Gambia is 150 percent for the present value of debt-to-export ratio;

(iv) in accordance with Section III, paragraphs 3(a) and 3(b) of the Instrument, the equivalent of SDR 1.8 million of assistance shall be made available by the Trustee to The Gambia in the form of a grant to permit a reduction in the net present value of the debt owed by The Gambia to the Fund;

(v) in connection with the interim assistance contemplated under Section III, paragraph 3(d) of the Instrument,

(a) satisfactory assurances have been received regarding the exceptional assistance to be provided under the enhanced HIPC Initiative by The Gambia's other creditors, and

(b) the Trustee shall disburse to The Gambia as interim assistance the equivalent of SDR 0.08 million within three business days to an account for the benefit of The Gambia established and administered by the Trustee in accordance with Section III, paragraph 5 of the Instrument; and the proceeds of the grant shall be used by the Trustee to meet The Gambia's debt service payments on its existing debt to the Fund as they fall due, in accordance with the following schedule: 9.6 percent of each repayment obligation falling due through 2001; and

(vi) in accordance with Section III, paragraph 3(e) of the Instrument, the Trustee shall disburse the remainder of the assistance committed to The Gambia under paragraph (iv) of this decision at the completion point, together with interest on amounts committed but not disbursed during the interim period, calculated at the average rate of return per annum on investment of resources held by or for the benefit of the Trust.

2. Paragraph 1 above shall become effective on the date on which the Fund decides that the World Bank has concluded that:

(i) the Interim Poverty Reduction Strategy Paper provides a sound basis for the development of a fully participatory PRSP, for reaching the decision point under the enhanced HIPC Initiative and for Bank concessional financial assistance; and

(ii) The Gambia has reached the decision point under the enhanced HIPC Initiative. (EBS/00/242, Sup. 1, 11/28/00).

Decision No. 12353-(00/121), adopted
December 11, 2000

2. REPUBLIC OF KAZAKHSTAN—2000 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 2000 Article IV consultation with the Republic of Kazakhstan (SM/00/257, 11/17/00; Sup. 1, 12/7/00), together with a paper on selected issues in the Republic of Kazakhstan and a statistical appendix (SM/00/260, 11/20/00). They also had before them a background paper on the financial system stability assessment (FO/DIS/00/142, 11/27/00; and Cor. 1, 12/7/00).

Mr. Kiekens and Mr. Burnashev submitted the following statement:

Overview

The year 2000 was very good for Kazakhstan's economy, and the outlook for 2001 and beyond is promising.

Real output growth exceeded 10 percent in the first half of this year. This pace may well be sustained for the year as a whole. Obviously this strong recovery owes much to high world prices for petroleum and minerals. It is equally encouraging to observe that with industrial output up 16 percent in the first half of the year, and buoyant construction and transportation activities, the economy is strongly responding to higher demand. This shows that the ongoing structural reforms that Kazakhstan has implemented under successive programs supported by the Fund and multilateral development banks (MDBs) have greatly enhanced the economy's growth potential.

The strong growth and responsible policies have significantly improved Kazakhstan's macroeconomic indicators. The current account has swung from a deficit of 5.6 percent of GDP in 1998 to an expected surplus of over 4 percent this year. Similarly, the fiscal position of the general government is expected to move from a deficit of 7.7 percent of GDP in 1998, and 5.3 percent of GDP last year, to a surplus this year.

The skillful monetary management by the National Bank of Kazakhstan has brought the objective of single digit inflation within striking distance. Simultaneously the monetary authorities have avoided any pronounced real appreciation of the tenge, that could have undermined the competitiveness of the non-oil and non-mineral segments of the tradable sector.

While Kazakhstan has made significant progress with privatization and structural reforms that are already paying off, it is fair to recognize that the momentum of these reforms slowed during the year. Nonetheless, the Kazakh authorities are determined to resume their stance of previous years, in close cooperation with the Fund and the MDBs, and to revive the EFF arrangement. This will safeguard and invigorate broad-based economic development, employment creation, and will improve opportunities and living conditions for everyone in Kazakhstan.

Fiscal Policy

Higher prices for Kazakhstan's main exports and better fiscal administration are generating higher fiscal revenues, exceeding 5 percent of GDP this year. At the same time, expenditure management has remained extremely responsible. Thanks to lower interest costs, actual outlays may remain below the budgeted level. All in all, the fiscal position is expected to show a surplus, more than 6 percent of GDP better than allowed in the budget.

This very encouraging fiscal performance must not lead to complacency. The government is well aware that further improvements are needed to combat tax evasion, including in the oil sector. Widening the tax base will make the budget less volatile and reduce its dependence on oil revenues. The Kazakh authorities are also committed to working further with the staff to establish a better system for monitoring and forecasting budget revenues, particularly from the oil sector. This will further improve both the budget process and macroeconomic management.

The budget for 2001 is now being discussed in parliament. It represents a continuation of the cautious fiscal stance: revenue projections are conservative, and spending plans are disciplined. Mainly due to increased military spending in response to heightened security concerns in the region, the central government budget allows for a deficit of 3.6 percent of GDP. Obviously the final outcome will be affected by the difference between the assumed and actual figures for oil prices and oil production.

The government is considering how best to manage the oil windfall gains. The staff's study on "Stabilization and Savings Funds for Non-Renewable Resources--Experience and Fiscal Policy Implications" (SM/00/270) is a useful contribution to our authorities' thinking and their discussions on this subject with the Fund's experts.

Monetary and Exchange Rate Policies

Preserving price stability remains the primary objective of monetary policy. Notwithstanding a substantial net inflow of foreign capital, the central bank succeeded in reducing inflation from 18 percent at the end of last year to around 10 percent by the end of this year. To achieve this objective, the central bank has mostly sterilized this liquidity increase stemming from its purchase of about $428 million during the first 11 months by issuing about 35 billion tenge (worth about $240 million) of its own debt instruments in the open market. And despite some fluctuations, the monetary base has returned to its level at the beginning of the year.

One can observe the nominal exchange rate of the tenge has been broadly stable for most of the year. In real terms, the currency has appreciated by some 4 percent, which the central bank considers consistent with preserving the competitiveness of Kazakhstan's exports of non-natural resources.

The National Bank of Kazakhstan confirms that it has no objective of stabilizing the exchange rate. The exchange rate's past behavior should not be seen by the markets as a guarantee that similar behavior will continue in the future. The monetary authorities agree with the staff's advice to avoid excessive exchange rate appreciation, while making allowance for some appreciation to head off a resurgence of inflation in case foreign exchange inflows are too strong.

Financial Sector Stability

The FSSA report and its supplement document well the progress Kazakhstan has made with financial sector reform. The law on consolidated banking supervision has received its first reading by the parliament. Insurance legislation is also steadily advancing through parliament. When the law on consolidated supervision is enacted and implemented, Kazakhstan will generally be in compliance with 19 of the Basle committee's core standards for banking supervision.

Structural Reforms

Table 2 of the Supplement shows the visible progress made by the Kazakh authorities during the year. Admittedly, these reforms are proceeding more slowly than called for by the program: the government encountered well organized resistance, from various interest groups, which interfered with the passage of legislation through Parliament. But the government is still committed to achieve, inter alia, land reform, to enact legislation on transfer pricing, increase the transparency of operations in the mineral sector, including the activities of foreign companies.

Reform fatigue and complacency due to favorable economic developments are to be avoided. It would be very helpful if the Kazakhstan can get its EFF-supported program back on track. This would also facilitate the structural reforms to be supported by adjustment loans from the World Bank. These include public sector reform, social protection, environmental protection, energy sector reform, and other reforms to be specified in a new World Bank Country Assistance Strategy for Kazakhstan.

The staff representative from the European II Department (Mr. van der Mensbrugghe) informed the Board that the 2001 budget had been approved by parliament on December 7, 2000. It was consistent with the understandings contained in the staff report. Both revenue and expenditure had been increased by 6 billion tenge (about 0.2 percent of GDP).

Ms. Brukoff made the following statement:

External developments have been very positive for Kazakhstan since the last Article IV consultation, and the authorities' policy response to these changing circumstances has helped maintain macro stability. However, we have concerns about the transparency of policy-making and the absence of a clearly articulated medium-term strategy for diversified development to offset the country's increasing dependence on the volatile oil sector.

Budgetary Transparency and Governance

We were pleased to learn from the staff supplement that the authorities have stepped up provision of data on linkages between the oil sector and the budget. We hope that this analysis can be developed further, and that budgetary transparency, which has been poor to date, is now increasing with respect to this most important sector.

Clear accountability for how much the state is earning from its depletable resources and how those earnings are being used will be critical if the authorities hope to eliminate concerns about corruption and other possible leakages (through money laundering, for instance) in connection with this windfall.

To the authorities' credit, higher revenues have so far not translated into higher expenditures either at the central or local government level. But more progress on fiscal consolidation is needed, as non-productive expenditures and high non-discretionary expenditures will remain a risk for the foreseeable future.

And while expenditure levels have remained under control so far, expenditure prioritization is also a source of concern. Given this year's huge inflows and good prospects for the future, the coincidence of planned increases in military expenditures and declining expenditures on education, health and social protection is troubling, particularly since staff flagged the poverty situation as an area of concern.

While the authorities' impulse toward conservative revenue estimation and expenditure restraint is encouraging, the recently circulated paper on stabilization and savings funds for non-renewable resources makes clear that these policies must be presented in a transparent, analytically sound, medium-term fiscal framework in order to serve their stated purpose.

We urge the authorities to work closely with the Fund in creating the oil stabilization fund, to outline clear rules for its accumulation and disbursement, and to make clear what kinds of spending will be undertaken during times of economic downturn.

Tax administration is another area where greater efforts are clearly needed to ensure that Kazakhstan develops a tax base that is resilient in the face of oil sector volatility. Poor tax enforcement for the non-oil sector is no substitute for eliminating burdensome and duplicative regulations that stifle the emergence of a vibrant small and medium enterprise sector and maintain opportunities for rent-seeking.

Monetary and Exchange Rate Policies

While the tenge may not be fixed, it is clearly being heavily managed. The simultaneous pursuit of a steady nominal exchange rate and a reserve money target is likely to become an increasingly difficult juggling act given likely continued large external inflows. Therefore we welcome reassurance that the nominal exchange rate will be let go a bit if necessary to avoid stoking inflation.

This tension highlights the fact that monetary policy in Kazakhstan (which has been well run so far) cannot continue to bear the full burden of maintaining competitiveness in this economy generally and in the non-oil economy in particular.

Support must be forthcoming from tighter fiscal policy geared toward containing inflation, and structural reform needs to advance in areas such as privatization, property rights and trade liberalization to increase economic diversification as a hedge against oil sector volatility.

Financial System Stability Assessment (FSSA)

We were pleased that the authorities took part in this exercise. Overall, we share staff concerns over the fragility of the banking system, its minimal role in financial intermediation, and persistent weaknesses in the supervisory and regulatory framework.

Recent efforts to strengthen the banking sector through consolidation and the revocation of licenses of weak banks are important first steps. But the continued ability of the courts to reverse liquidation decisions by the National Bank of Kazakhstan (NBK) needs to be addressed since this undermines the central bank's supervisory role.

We concur with the requirements laid out by staff for putting the EFF back on track, which move toward enhancing the viability and transparency of the authorities' policies. Since the authorities are treating this arrangement as a precautionary one, its main value to them is its signaling effect to the markets. As such, this institution should be sure that the right signal is being sent.

Finally, it is disappointing that the authorities will not be publishing the results of this consultation, which would signal a greater level of commitment to transparency than has been apparent to date. We hope they will consider doing so in the future.

Mr. Yakusha made the following statement:

Higher than anticipated oil prices and the authorities' responsible economic management have resulted in substantial outturn in Kazakhstan's economy in the year 2000. It is hard to believe that just one year ago the country experienced balance of payments difficulties and macroeconomic imbalances, prompting the authorities to engage in a three-year EFF-supported program. Now with much approved external environment, Kazakhstan's economic situation has totally changed, and the improvements are visible through the whole spectrum of economic indicators. Obviously, we are pleased to see these favorable developments and commend the authorities for widely using the higher revenues to reduce the budget deficit and repay the debts.

At the same time, however, some recent developments give rise to concern. As seen in many cases, favorable short-term developments most likely result in the authorities' complacency, and their increased tendency to delay necessary structural adjustment that otherwise would have been implemented. Indeed, the staff noted that the authorities' implementation of the structural reform agenda was disappointing. The impact of surging oil prices and revenues clearly underscores the economy's vulnerability to external shocks, and serves as a blinking light for the risks Kazakhstan faces by basing its economic development on a single volatile export commodity and also on a single sector of the economy while FDI to the rest of the economy seem to be drying out.

The unfinished agenda in the areas of land reform, privatization, tax reform, and pension funds need to be addressed without delays in order for the current growth to become sustainable in the medium term. I would like to draw the authorities' attention to the problem indicated, possible problems with pension funds, in particular. Kazakhstan happened to be among the pioneers in pension reforms in the region, and failure, if any, may have not only local significance.

It is also regrettable that, alongside these delays in the implementation of structural reforms—though not that significant so far—the authorities have allowed backtracking in an important area of foreign trade liberalization. If I am not mistaken, such a backtracking on the side of the import tariffs has contributed to economic difficulties in small neighboring countries. We, therefore, join the staff in rightly calling on the authorities to persist with fundamental macroeconomic adjustments, while addressing actual and potential structural distortions of the economy.

Part of the now expected higher revenues should be used to enhance the country's resilience to possible shocks, and, at the same time, to emphasize the point in Mr. Kiekens and Mr. Burnashev's statement, the authorities may be even considering the staff's suggestions on creating the oil stabilization fund.

The evident importance of the oil sector in the economy clearly justifies a separate and thorough analysis of this sector. And, therefore, I welcome staff focus on the different linkages of the energy sector to the budget and to the current account in the Article IV staff report, and especially Supplement 1. I look forward to learn more on this issue in the next discussion on Kazakhstan. In this respect, it would be interesting to have an estimation of the 2000 macroeconomic performance using 1998, or better 1999, average oil price. What would have been the outcome in relation to program targets? I think such an exercise is worth doing if it has not been done yet.

In light of the increased foreign exchange inflows, the authorities' challenge in the short run remains the coordination between monetary and fiscal policies so as to avoid an acceleration of excessive monetary growth. Although I understand the authorities' concern that a more appreciated rate could have an adverse impact on the non-oil sector, I believe that continued central bank interventions to stabilize the nominal rate could eventually accelerate inflation, creating real appreciation of the exchange rate, and at the end of the day, the authorities may have more appreciated rate in real terms and high inflation, too.

Moreover, some managed nominal appreciation at this stage may, in my view, help attract non-oil related FDI, and may probably contribute to a much-needed reversal of capital flight. It will happen especially if such a move is underpinned by improved confidence in domestic financial institutions and prospects of large-scale privatization.

The exchange rate should be allowed to better reflect market forces, and monetary policy should then be directed to achieve the inflation target. In this context, more consolidated fiscal policy, which is quite likely given the good fiscal track record of the authorities so far, will help to reduce inflationary pressures and alleviate pressure on the currency.

I have also noted that due to weak financial market discipline on the corporate sector, enterprise arrears are still high, and a lot of unprofitable companies are probably getting preferential treatment from banks and those banks may, in turn, be involved in connected lending according to an FSAP paper. The authorities' challenge in this area may be more pronounced than in other transition economies, and improvement in this area in enforcement, as well as uniformity of treatment of banks by their supervisors and of clients by their banks, will not only foster investor confidence, but will enhance the effectiveness of the economy to improve resource allocation. The central bank will have to ensure that all banks are in full compliance with all prudential regulations. I hope that the authorities will be wise enough to expeditiously address these and other weaknesses identified in the course of the FSSA exercise.

Mr. Shojaeddini made the following statement:

Recent economic performance of Kazakhstan has significantly improved, reflecting strong recovery in regional demand, a major improvement in terms of trade, as well as prudent macroeconomic policy. The economy is now characterized by a brisk growth, subdued inflation, stable exchange rate, positive overall external balances, and improved fiscal position. It is encouraging to note that all performance criteria and indicative targets for end-March and end-June 2000 under the EFF were met, most of which with considerable margin. We welcome the early repurchase of all obligations to the Fund. The authorities deserve to be commended for these achievements.

The staff report's low and high oil price scenarios indicate that the economy remains vulnerable to external shocks in the medium term. The staff have rightly pointed out that the country is now facing a very different set of policy challenges. Addressing these challenges calls for sustained structural reform and flexible policy framework to respond effectively to emerging risks. Fiscal consolidation needs to be continued in close coordination with monetary policy in the new environment, characterized by substantial increase in external inflows and the need for exchange rate stability.

We concur with the well-focused staff appraisal. The overall fiscal policy stance has been cautious. Given the overperformance of the revenues, the authorities' decision to maintain expenditure in 2000 at budgeted level is commendable. This year's significant fiscal consolidation will certainly help contain inflationary pressures and facilitate sustained economic growth in the period ahead. For this year, staff have raised a concern that a rapid decline in local government deposits at the central bank would have complicated the conduct of monetary policy. Staff may wish to provide more detailed comments on the status of these deposits and on the National Bank of Kazakhstan's policy reaction.

The explanation of linkages between the budget revenue and oil sector developments in the staff report is useful. We agree that more information is needed to sharpen the understanding of these linkages. We encourage the staff and the authorities to work together to develop a better understanding of the determination of the budgetary oil revenue and its accounting on the expenditure side. More transparency is also needed in this regard.

We welcome the idea of establishing a national oil fund. This fund could insulate the budget from oil sector shocks and serve as an intergenerational saving instrument. It would also be helpful for exchange rate stability. To achieve these objectives, the fund should be part of the budgetary process and its operation governed by clear and transparent rules.

Looking forward, while the 2001 draft budget is appropriately cautious, the sharp increase in the wage bill is a source of concern. To ensure medium-term fiscal viability, the tax base needs to be widened, collection of VAT on imports strengthened, customs administration reform advanced, tax code revised, and tax evasion reduced.

It is encouraging to learn from the helpful statement by Mr. Kiekens and Mr. Burnashev that, while the authorities are rightly concerned about the adverse impact of exchange rate appreciation, they are committed to their low inflation objective and are prepared to allow the exchange rate to appreciate, if needed. Nevertheless, to achieve low inflation and exchange rate stability, fiscal policy will need to be better coordinated with monetary policy, and establishment of the oil stabilization fund expedited to sterilize a significant part of the inflow. There may be some scope for absorption of inflows through import liberalization. We are pleased by the general positive FSAP finding, and support the recommendation that supervisory and regulatory role of the National Bank of Kazakhstan should be enhanced considerably. To this end, the flow of information from the banks should markedly improve, and the central bank should be accorded final authority on bank licensing issues. Finally, the capital adequacy of the banks and the quality of bank assets need to be addressed.

With these remarks, we wish the authorities all the best in their endeavors and look forward to the Board discussion on a revived EFF for Kazakhstan.

Mr. Palei made the following statement:

One year has passed since the approval of the EFF-supported program for Kazakhstan. Although the program is off track, in 2000, macroeconomic performance of Kazakhstan turned out to be much better than envisaged under the program. Despite the major role of the higher petroleum prices in the outcome for this year, it would be hard to deny that the Kazakh authorities handled skillfully the challenges of much more favorable external environment.

The economic performance of Kazakhstan in 2000 is outstanding. Real GDP growth is expected to be about 10 percent. Inflation has declined from 18 percent in December of 1999, to around 9 percent. Interest rates on tenge instruments have declined, and now are also close to 9 percent. Fiscal revenues have increased from 18.6 to 24 percent of GDP, with only half of the increase coming from the petroleum sector. At the same time, expenditures have remained under the control of the authorities, and, as a result, the year is likely to end with an overall fiscal surplus instead of the 6 percent of GDP deficit expected under the program.

As far as external financing is concerned, in 2000, Kazakhstan continued to enjoy large FDI. Many large companies involved in petroleum sector finance their activities through foreign banks. In April this year, the Kazakh authorities issued a seven-year Eurobond in the amount of US$350 million, and soon after that, in May, they made early repurchases to the Fund. Indeed, this is precisely what the Fund expects from its other members in similar situations. In July, The Standard and Poor's upgraded Kazakhstan's credit rating. Currently, as the staff informs us, the state oil company and several commercial banks also intend to issue bonds in international markets.

Significant progress has been achieved in the banking sector. Access to financing from foreign banks by large companies is a source of stability of the financial sector in Kazakhstan. At the same time, the authorities continue to pay attention to domestic institutions since they view them as a necessary element of a more dynamic development of non-oil economy. Kazakhstan took a lead among the CIS countries in conducting the FSSA and now the authorities and the staff of the Fund have better understanding of the remaining gaps in this crucial area.

Yet, despite this positive economic picture, Kazakhstan's EFF-supported program is off-track. The staff lists three areas of disagreement. Firstly, it is the lack of agreement on a revised macroeconomic framework in May of this year, as well as, I assume, during the most recent mission. When justifying the need for revisions, the staff correctly refers to a much more favorable macroeconomic environment due to higher energy and mineral prices. The authorities, according to the staff, should, on the one hand, mitigate the destructive effects of the so-called Dutch disease and, on the other, prevent inflationary pressure stemming from substantial capital inflows.

In the situations of large temporary capital inflows, the usual immediate response is fiscal tightening. This is exactly what the authorities did in 2000 and I can hardly see how they could do better. I would like the staff to clarify whether the authorities' response corresponds to what the staff had proposed at the time of the negotiations or the staff had something different in mind with respect to the fiscal stance.

Besides fiscal tightening, there is always a question of appropriate exchange rate policy. The staff was appropriately concerned about the stability of the nominal exchange rate in the face of significant inflows. Such a policy could lead to inflationary pressures and the risks here should always be weighed carefully. However, currently there are few, if any signs of a danger on this front. The interventions conducted in the foreign exchange markets were accompanied by sterilization through issuance of the T-bills and through tying of the government deposits. Simultaneously, during 2000, the money demand function apparently has changed significantly. An increasing share of tenge deposits, low inflation and declining interest rates do not give reasons to be overly concerned about inflation in Kazakhstan. If the risks of inflation have been controlled for, the authorities' monetary and exchange rate policies, in my view, made perfect sense in terms of preventing the negative effects of real appreciation on non-oil sectors of the Kazakh economy. Moreover, interventions seem to have been efficient in mitigating the Dutch disease, which was a major concern of the staff at the time of the negotiations. The Kazakh authorities claim that they were prepared to allow for appreciation if the risks of higher inflation were to surface. They just did not have to do that. Again, as in the case of the authorities' fiscal policy, I do not see how the staff's advice would be different. I ask the staff to elaborate on the disagreement, if any, on the monetary and exchange rate policies.

I note here that the authorities not only followed prudent macroeconomic policies in the short run, when they did not have the necessary institutional basis to deal with higher capital inflows and had to apply ad hoc solutions. They also introduced an essential legislation aimed at addressing similar challenges in the future on a rule-based basis. I refer, of course, to the active work on creation of the oil stabilization fund in Kazakhstan. Given the central role of the oil revenues in macroeconomic policies, could the staff clarify whether the authorities have requested from the FAD technical assistance on the oil fund?

As far as the disagreement with the authorities on the macroeconomic framework is concerned, I am not able to detect it from the actual conduct of the policies in 2000 and I look forward to the staff reaction. Looking at the authorities' track record in 2000 I suspect that there was little disagreement on the required policies, but they probably were reluctant to formally revise the framework under the program, which is a different kind of problem. Since the economy of Kazakhstan is heavily dependent on oil, at the extreme, every time the Fund changes its WEO forecast on oil prices, there would be a need to reconsider the framework. In 2000, there would be such need in May and, again, in October. In the situations of uncertain projections of the balance of payments and fiscal revenues, the Fund-supported programs usually envisage adjustors or sets of contingency measures. Could the staff elaborate on the degree of flexibility in the adopted EFF-supported program and whether the flexibility could be improved to diminish the need for frequent revisions?

The second reason why the review of the program could not be completed was the slowdown in the structural reform. In the very introduction to the report the staff emphasize that "only one of the seven structural benchmarks established for end-March and end-June was observed unambiguously". In this context, the meaning of the word "unambiguously" is not clear to me. During the recent informal Board discussion on structural conditionality, the PDR staff used classification of implementation as fully implemented, partially implemented, and not implemented. Furthermore, the structural benchmarks are sometimes observed with delay. When I look at Table 2, as updated by the staff in Supplement 1, I see that most of the structural benchmarks had been observed some fully, some partially, and many with a delay. Only with respect to two structural benchmarks, number 5 and number 10, both of which refer to the electricity and heating tariffs, there seems to be little progress.

The authorities are certainly responsible for the delays, but in several instances it looks like the responsibility is elsewhere, in particular, with the legislature. In addition, the necessity to deal with the rapidly changing external environment probably placed serious constraints on the authorities' institutional capacity and limited their ability to implement the structural reform at the pace originally envisaged under the program. I would like the staff to say a few words about the institutional capacity of the Kazakh authorities and if, in 2000, due to unforeseen higher oil prices at the beginning of the program, it was strained.

It is broadly accepted that, in a general case, rapid privatization of large state enterprises is beneficial. However, as it was described in the recent Fund report "Ten Years of Transition", the privatization experience in the CIS region is rather controversial. Therefore, in evaluating progress in this area in Kazakhstan, I tend to discount the importance of speed and number of enterprises privatized. Instead, it is more important to foster the competitive environment for the state enterprises, to increase their transparency, and to improve corporate governance. It is also important to ensure an appropriate use of privatization revenues. From this latter perspective, large-scale privatization in 2000 would create an additional challenge for the authorities by forcing them to engage in politically heated discussions with the Parliament on the best use of privatization revenues. In light of the much higher fiscal revenues and the authorities' commitment to keep the expenditures at a low level, such a discussion was, probably, risky. Having said that, I note that Mr. Kiekens and Mr. Burnashev in their preliminary statement reaffirmed the authorities' intentions to rejuvenate the privatization process.

The third and last major barrier for the staff to proceed with a review was the lack of transparency with respect to the budgetary aspects of the oil sector operations. The essence of disagreement here is not completely clear to me and, since this issue plays such a central role in the program implementation, I would ask the staff to describe the conflict in more detail. Furthermore, the staff in Supplement 1 and Mr. Kiekens in his preliminary statement mention the improvements in this area. Could the staff tell the Board whether in its opinion the recent steps taken by the Kazakh authorities are sufficient to bridge the gap in the revenue projections and from the transparency point of view?

I was puzzled by the assertion, in paragraph 36 of the staff report, that larger foreign direct investments in Kazakhstan "mask the relative decline of foreign investment in sectors other than the oil and gas industry". Or, in paragraph 40, where the staff say that new projections based on higher oil prices and on new oil discoveries "sharply underscore Kazakhstan's high and rising vulnerability to external shocks". I may be unfair, but, to me, the notion of increasing vulnerability in Fund documents usually has some negative connotation related to policy mistakes, which is not the case with Kazakhstan. In fact, most countries would wish to have Kazakhstan's "increasing vulnerability".

The question is, of course, what the authorities are doing to mitigate this welcome vulnerability. They seem to be well aware of the risks. That is why they are following prudent macroeconomic policies, creating the oil stabilization fund, and promoting foreign direct investment. That is why they went ahead with the FSSA and are trying to make their banking sector more resilient. In the end, that is exactly why they want to have a functioning program with the Fund, although they apparently do not have a pressing balance of payments need. I hope that in the nearest future the Fund and the authorities will be able to improve their dialogue and to renew the appropriately revised program.

Kazakhstan could be a good example for many other CIS countries of how to progress with the reform and how to cooperate productively with the Fund. From this point of view, the EFF-supported program with Kazakhstan has systemic significance for the whole CIS region. The program, in my view, deserves extra attention, and, maybe, more flexibility from the staff. It is very unfortunate that it went off-track.

I wish the authorities success in meeting the current and future challenges.

Mr. Alosaimi made the following statement:

Economic developments in Kazakhstan this year are most encouraging. The fiscal and external positions strengthened markedly, growth rose sharply, and inflationary pressures eased. While the oil price recovery helped, due credit should be given to the authorities' policy actions. These achievements are impressive enough to warrant guarding and extending so as to achieve the desired sustainability.

Maintenance of balanced and sustainable growth following the shift to what staff calls "a relatively stable exchange rate regime" is predicated on attaining low inflation and improving productivity. To this end, the authorities need to maintain their prudent macroeconomic stance and accelerate structural reform.

In the fiscal area, the authorities are to be commended for their success in restraining spending despite the sharp rise in revenues. Here it is encouraging that both oil and non-oil revenues rose as detailed in paragraph 8 of the staff report. Under these circumstances, I found the authorities case for temporarily suspending excises on petroleum products convincing. I would like staff to elaborate on the perceived shortfall in VAT receipts. Would it have been more informative to assess performance by looking at the ratio of VAT receipts to non-oil GDP? That said, the authorities should remain vigilant in collecting non-oil revenues and maintain a cautious stand on spending while shifting the composition toward capital outlays. Such policies should improve growth prospects while creating a financial cushion for the future.

The fiscal stance will need to be supported by a tight monetary policy that aims at restraining liquidity and reducing inflation. Here, I can endorse the authorities' monetary policy. It is clear that the expected substantial increase in money demand should facilitate the conduct of policy at this stage. However, I agree with staff that if foreign exchange inflows continue at a rapid pace, it would be preferable to allow the nominal exchange rate to appreciate somewhat rather than risk an increase in inflation.

Turning to structural reform, addressing the banking weakness identified in the FSSA report is a priority. Emphasis on promoting private sector investment and restructuring public sector enterprises is also crucial. In this regard, accelerating regulatory reform is essential. I also share staff's concern regarding delays in establishing clear land rights in agriculture. This is a critical issue that needs to be addressed promptly.

On the issue of estimating oil revenues in the budget, I welcome the progress made so far. It appears from Paragraph 5 in the supplement to the staff report that many of the outstanding issues in this area have been resolved. Regarding staff's recommendation on establishing an oil stabilization fund, a recent study by staff (FAD) has shown that there was no empirical evidence so far to support that these kind of fund have improved the conduct of fiscal policy. Staff comment is appreciated.

Finally, I welcome Kazakhstan's early repayment to the Fund, which was made voluntarily and before the Fund's early expectations policy came into effect.

With these remarks, I wish the authorities continued success.

Ms. Steinbuka made the following statement:

The Kazakh authorities should be commended for their prudent fiscal and monetary policies. In combination with favorable external factors, these policies have led to remarkable results. However, it is regrettable that the favorable conditions have not been used for accelerating structural reforms. The structural reforms continue to remain the Achilles heel for the program in general, and for the completion of the first review in particular. As I agree with the thrust of the staff appraisal, let me make only a few comments.

The stabilization gains in Kazakhstan will remain fragile unless the high dependency of the economy on external factors is reversed. Up to now, the external factors have played a crucial role in economic downturns and upturns. Indeed, in 1996-1998, when the average growth was close to zero, the economic recession was explained by negative external factors. The economic achievements nowadays are explained by positive external factors. I have the impression that favorable conditions play not only a positive but also a discouraging role for the authorities, who feel no need to boost reforms. It is highly regrettable that all but one of the structural benchmarks under the program have been missed.

With oil-driven output and budget revenue rising, the danger is that structural issues will continue not to be seen as too pressing. However, the revenue-to-GDP ratio shows that the tax base is extremely narrow, and massive tax evasion remains a key problem. The authorities should urgently proceed with tax reforms, including strengthening tax and customs administration. If the government fails to broaden the tax base through comprehensive legal and structural measures, it could further reinforce its dependence on the oil sector, and ultimately on the highly cyclical nature of oil prices.

I support the intention of the authorities to establish the oil fund. The experience of our constituency (Norway) clearly demonstrates the benefits of separating the highly volatile oil revenues from the core budget and accumulating savings for future generations. However, the separation of the oil revenues does not mean isolation. The oil fund should become an integral part of the medium term fiscal framework. If the current lack of transparency of the oil sector's operation continues, the effectiveness of such a fund will be put under a question mark. Transparency and public accountability are absolutely essential for success in setting up an oil fund.

Finally, I hope that the staff's conclusions on the fiscal vulnerability, the key reasons for the worsening of external competitiveness and the much-needed improvements in corporate governance and capital market will not be taken too lightly. With these remarks I wish the authorities every success.

Mr. Charleton made the following statement:

There are many interesting aspects, both in this report and in Kazakhstan in general, but I will confine myself to a couple of brief points. These relate to the exchange rate regime, the role of fiscal policy, and privatization.

On the exchange rate regime, there is much to be regretted that the authorities are veering from the floating rate. It is the only appropriate regime for an economy so dependent on oil or other primary resource products. The Kazakhs have no choice but to ride the roller coaster of oil price, and a flexible rate provides the best chance of getting a smooth ride. The decision to effectively peg the rate of the tenge arises from the decision of the Russian Federation not to let the ruble rise. If, however, Russia makes a mistake, the Kazakhs should not feel obliged to replicate it. The real exchange rate in Kazakhstan has to rise with a nominal rate; otherwise the inflation rate will. Sterilization of intervention is only a short-term part of a cycle and, I think, technically sterilization itself reduces the rate of appreciation. Perhaps the Kazakhs have to worry about being flooded with Russian imports, but the Russian inflation rate is well above that in Kazakhstan. And, a firmer tenge rate can make that differential harder. Hard-won gains against inflation will not be sustained with the present monetary policy.

It is regrettable that even with the exchange rate being held back, the Kazakhs are reverting to their old bad habits with respect to trade policy as a substitute for pushing ahead with structural reform in the domestic markets. As the exchange rate leads to easier monetary conditions, the focus on restraining inflationary pressures rests with fiscal policy, and the country is running the danger of having the wrong attribution of policies—using monetary policy oriented toward the real economy and fiscal policy toward inflation.

The authorities should be given credit for keeping a firm restraint on expenditure this year and the effect of driving the budget toward balance, or even surplus. It is questionable whether this can be sustained. There seems to be a large potential drawdown of deposits in the general government at the central bank, and there is some feeling that this was going to happen soon.

The staff seem happy with the idea of a tighter fiscal stance, and the message in the Selective Issues paper seems to be that the underlying fiscal position deteriorates and appears relatively weak. These results, however, depend very much on a series of assumptions about oil prices and holding various other things ceteris paribus. On the other hand, the level of debt is low and falling, while debt dynamics are extremely favorable. This does not suggest that there is a history of weak fiscal policy, and I think fiscal policy should always be assessed in the context of the level of debt and debt dynamics.

A question arises as to what is the appropriate thing to do with the use of oil resources, when even more oil is being found and potentially large money is involved. The creation of a transparent fund is desirable, but I am not convinced that this fund should be invested entirely abroad. This is driven by the need for sterilization and the need for an appropriate exchange rate regime. This is a country of poor people sitting on potentially vast wealth and our advice seems to be: save for your children by investing abroad. There should be a higher real return in investing in Kazakhstan itself. Surely, the Kazakh authorities could justify a vigorous investment program to develop the economy and raise the living standards. The health and education systems have been allowed to deteriorate, and the quality of public services is poor. In many respects, I would probably prefer a tighter monetary policy and somewhat looser fiscal policy.

I have always been of two minds about the urgency of privatization in Kazakhstan. I did not favor a fire sale of assess at low prices two years ago. The real benefits to the economy of privatization are increased competition, efficiency, and transparency. In Kazakhstan, at present, there is neither a fiscal nor a balance of payments need for urgent privatization, especially if the FDI through privatization would only add more to the sterilization problem. Privatization is also tied with the question of corporate governance, accounting standards, and how to invest the growing pension funds. I am a bit concerned that privatization is seen primarily as a way to develop the capital markets. I see privatization in Kazakhstan as a complex issue and I think getting it right is more important than the urgency, which, I think, is a point my Russian colleague made.

Ms. Ocampos made the following statement:

We wish to compliment the Kazakh authorities for the very good performance of the economy that reflects prudent macroeconomic policies in a context of a strong recovery in regional demand and higher oil prices.

We agree with the staff that the favorable external environment generates challenges of its own. In particular, fiscal policy should be defined taking into account the revenue windfall, which should be handled so as to avoid creating excessive inflationary pressures and excessive demand expansion. In these conditions of abundance, fiscal savings should increase with a view to avoiding negative effects on the non-oil tradable sectors.

In order to stabilize the nominal exchange rate, and still attain the single–digit inflation target, we concur with staff that fiscal policy should be tighter than originally planned, the efforts to collect non-oil revenues strengthened, and expenditure restrained.

Monetary policy should also be consistent with the above-stated conditions, avoiding an excessive expansion of monetary aggregates. However, in view of the external capital inflows, the ability of monetary policy to contain the expansion of domestic demand is weak. Thus, more of the burden of adjustment falls on fiscal policy. We share the staffs view in that if the contribution of fiscal policy is less than the required, it would be preferable to allow for a nominal appreciation of the exchange rate, rather than reacommodate a real currency appreciation through higher inflation.

We agree with the staff on the convenience of making a more transparent determination of budget revenue from the petroleum sector and strengthen stalled structural policies, especially considering the delays in privatization, as well as to prioritize supervision of the still fragile banking system.

In sum, the present conditions are extremely favorable; however, we see some vulnerabilities that could become binding as external conditions deteriorate. Care should be given to save the oil windfall, and to complete the essential structural reforms in this favorable phase of the economic cycle. We wish the authorities success in their endeavors.

Ms. Sharipova made the following statement:

We are impressed with Kazakhstan's economic performance in the year 2000 and share the optimism expressed by Mr. Kiekens and Mr. Burnashev in their informative preliminary statement for a promising outlook for 2001 and beyond.

The signs of strong recovery are obvious. The decision by Kazakhstan to discharge all of its outstanding financial obligations to the Fund in May 2000 is proof of a marked turnaround in the economic situation. Both the preliminary statement and the staff report attribute this recovery mainly to high world prices for petroleum and minerals. We, however, would like to also note the important contribution of prudent fiscal and monetary policies to the very positive results in 2000. The continuation of such policies will be essential to ensure a stable macroeconomic framework in the medium term. We take note of the ongoing structural reforms that Kazakhstan has implemented under the programs supported by the Fund and multilateral development banks (MDBs), which have greatly improved the economy's growth potential.

The progress in privatization and structural reforms is already paying off. Despite the visible progress made by the Kazakh authorities during the year, these reforms, as they admit themselves, were proceeding slower than called for by the program. We understand that in implementing these reforms the authorities have had to deal with resistance and interference from vested interests. We urge the authorities to persevere. It is crucial that they remain committed to structural reforms, particularly at a time when reform fatigue and complacency due to favorable economic developments are setting in. We encourage them to resume their stance of previous years, in close cooperation with the Fund and the MDBs.

We also strongly support the intentions of the Kazakh authorities to revive the EFF arrangement and urge them to implement measures, in order to make the completion of the first review possible, thus bringing the EFF-supported program back on track. Should that happen, the structural reforms could facilitate also with the support by adjustment loans from the World Bank.

We support the authorities' objectives in the fiscal and monetary areas aimed at a further improvement of both the budget process and macroeconomic management. A particularly sensitive issue is the management of the large revenues stemming from the oil sector. The risks associated with such windfall revenues are well known. We urge the authorities and staff to work together to find a transparent solution that takes into account Kazakhstan's specific circumstances.

To conclude, we wish both the authorities and staff success in bringing the EEF-supported program back on track.

Ms. Saito made the following statement:

Introduction

In looking at developments since last year's discussion on the EFF program, the most notable is doubtless the significant improvement in Kazakhstan's economic situation resulting from favorable external conditions. As we agree with the thrust of the staff appraisal, and most points being made by other chairs, my comments will be for emphasis.

Fiscal Policy

On fiscal policy, we commend the authorities' prudent management of the windfalls from oil revenues. The heavy reliance on oil revenues is, nonetheless, evidence of the high vulnerability the Kazakhstani economy is facing. It is worrisome that, as mentioned in the selected issues paper, the fiscal position after adjusting the revenue numbers from the oil sector for deviations in the long run oil prices indicates deterioration in the fiscal stance. From this point of view, it will be incumbent on the authorities not to be complacent with this improved fiscal stance. Under the current economic situation, to prepare for possible adverse economic shocks, it will be important to move to a consolidated fiscal position. In this respect, attention must be paid to the increase in noninterest current spending, considering its potential effect on inflation. Also, over the medium term, adoption of a transparent fiscal system is especially important. In that respect, we concur with staff's opinion that failure to have a comprehensive understanding of the determination of budgetary oil revenue and its accounting on the expenditure side undermines the budgetary process and casts doubt on the appropriateness of fiscal policy and overall economic policy. Staff's supplement on this issue has been helpful, and we look forward to further discussions in this area. On the issue of the stabilization fund, we would like to reiterate the importance of having a transparent guideline for its operation. Also, it will be crucial to consider the utilization of funds resources in the context of a medium-term fiscal strategy. Concerning that strategy, we feel that it will be necessary to address the issue of poverty; we appreciate staff's comments on the discussions on measures of poverty reduction.

Monetary and exchange policy

In facing a different external environment and dealing with massive current receipts, prudence in the monetary and exchange rate policy will be increasingly important. Regarding the authorities' intervention in the market to stabilize the tenge, it will be important to watch for indicators of possible inflation and to respond by allowing a degree of currency appreciation; and we are encouraged to see in Mr. Kieken's and Mr. Burnashev's statement that his authorities are also acutely aware of this.

Banking sector

We welcome that some progress has been made in reforming Kazakhstan's banking sector, especially in the area of prudential regulation. Although there seems to be increased confidence in the banking sector owing to perceptions that the economy as a whole is performing well, according to the findings of the FSSA report, the system remains fragile and has only played a minor role in the economy. We would like to urge the authorities to cast light on the problems highlighted in the report, such as the opaque enterprise and bank ownership structure, where there could also be incidents of governance problems. The concentration of loans to weak enterprises is also cause for concern. The importance of a healthy banking sector is vital for industrial growth, and with Kazakhstan's need to diversify its industry base beyond the oil and gas sector, this can not be overestimated.

Structural Reform

It is disappointing that efforts at structural reform seem to be losing momentum. We believe that the authorities are facing a rare opportunity to promote necessary structural reforms and they must take full advantage of the current auspicious economic situation to do so.

Fostering of industries and the private sector through structural reform is paramount for transitional economies to achieve sustained economic development. With ownership, I hope maximum efforts will be made by all relevant parties in Kazakhstan.

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

Mr. Le Gal made the following statement:

The situation has undeniably improved in Kazakhstan, thanks essentially to a better external environment and to increased oil revenue, while macro-economic management has been appropriate: the authorities have maintained some expenditure restraint, thus sterilizing the foreign exchange inflows, while the devaluation of the tenge has proved to be positive. However, it seems that the improved environment has loosened the authorities' resolve to tackle the structural challenges the country faces and this might preclude the country's reaping the full benefit from its natural resources and might leave it exposed in case of a reversal of external conditions.

I would like to make three comments on oil revenue management, the pace of structural reforms and the need for creating a favorable environment for the private sector.

On oil revenue, the discrepancy between the staff's and the government's estimates, even after the staff's supplement, remains too large and more transparency is necessary. I would appreciate the staff's comments on the legal constraints faced by the authorities in terms of confidentiality and how they might conflict with the Fund's surveillance mandate.

The creation of an oil fund will certainly help insulate the non-oil economy from oil revenue fluctuation and, therefore, we support the staff's recommendation. It goes without saying that this fund should be transparent and subject to public accountability.

On the pace of structural reforms, one can only be disappointed by the slowdown in their implementation. I welcome the authorities' intent to preserve the program even though they rightly treat it as precautionary. But it is regrettable that they did not make sufficient progress on the agreed measures in the program to proceed with the review. As Messrs. Kiekens and Burnashev point out in their preliminary statement, strong interests certainly exist to slow down the reforms but the Fund's program should be seen as an instrument which sets the milestones for the reform that will help to consolidate the achievements reached so far.

Finally, the authorities should aim at improving the investment climate and the environment for private sector development. This means that reforms in the banking and financial system should continue and the central bank efforts to enhance its surveillance capacity should be supported through the appropriate legislation. This also means that clear and transparent regulations must provide the private sector with a level playing field and create the conditions for making privatization successful in bringing increased competition and better resource allocation throughout the economy.

Mr. Kranen made the following statement:

At this stage, just some remarks on three points. Firstly, on the issue of the oil stabilization fund, I fully share the view expressed by Mr. Charleton. Kazakhstan is still a poor country. Per capita GDP is below 3 US$ per day. Investments in the infrastructure and education are currently more needed than the creation of a stabilization fund which invests its assets abroad.

Secondly, regarding the priorities of public expenditures, I would like to associate myself with the remarks by Ms. Brukoff.

Finally, like other speakers, I would like to urge the authorities to take advantage of the comfortable macroeconomic situation by speeding up structural reforms where progress has been sluggish.

We are looking forward to supporting a renewed EFF-supported program with Kazakhstan.

Mr. Kiekens said it was clear that Directors had regretted the slow pace of structural reforms in Kazakhstan, and many Directors had also called for further progress in the particular area of transparency with respect to oil revenues in the budget. The Kazakh authorities were committed, in particular, to improving that aspect, as well as other structural reforms, with assistance from both the Fund and the World Bank. The World Bank was currently preparing a new country assistance strategy, but its ability to make progress with Kazakhstan in many areas of structural reforms was, to a large extent, also dependent on the ability of the Kazakh authorities to resume program relations with the Fund. Thus, the representative from the World Bank could brief the Board about its work with the Kazakh authorities on structural reforms, including the transparency issue and the relationship between the oil sector and other sectors of the economy.

The staff representative from the European II Department (Mr. van der Mensbrugghe) said that the staff was aware that it was unusual for a program country to observe all the performance criteria, yet not have a review completed. There were three reasons that explained the case of Kazakhstan. First, there had been some difficulties in reaching agreement on a revised macroeconomic outlook for 2000, and thus on the policies necessary to achieve the economic results. At the start of the discussions with the authorities in May 2000, the staff had detected that the revenue targets had exceeded the program targets by 50 percent, and the balance of payments targets would also be exceeded by large margins. Now that the year had nearly ended, it was clear that the reasons for the excess of revenue and the turnaround in the balance of payments were more than simply favorable commodity prices, in particular that of oil. The program for 2000 had been based on an average oil price of $20 a barrel. The staff’s current estimate was that oil would average $29 a barrel for 2000, which represented an increase of about 61 percent from 1999. That, together with a volume increase of about 10 percent, would translate into an expected increase of about 70 percent in oil revenue. However, in terms of oil budgeting revenues, the increase was about six-fold, from about $100 million in 1999 to an estimated $600 million in 2000. Therefore, oil prices and volume could only account for some of the increase in oil revenues. As had been agreed at the time of Board approval of the Extended Arrangement in December1999, the staff had explored further the determination of oil revenues in the budget in order to obtain a better understanding and assess its linkages to the rest of the economy. During the discussions, the authorities had initially been hesitant to revise the macroeconomic outlook and targets for 2000. While recognizing that the targets for the third and fourth quarters were indicative, economic difficulties in 1998-99 had made it difficult for the authorities to agree on a drastic change in the macroeconomic framework and outlook for 2000.

The authorities were indeed to be commended for their continued prudence on fiscal policy, and the revised budget approved by Parliament had led to virtually no increase in expenditure, the staff representative remarked. Part of the increase in expenditure had been brought about by interest savings, as the government's fiscal position had been different; both the volume and the price of credit had declined compared to the original budget.

On monetary and exchange rate policies, given the current context of a large surplus in the current account and large foreign exchange inflows, the policy of keeping the exchange rate relatively stable by sterilizing inflows was short-term, the staff representative related. In the event that the current account surplus remained very large, the central bank would come under pressure and would have to let the exchange rate appreciate in order to safeguard its inflation objective. Clearly, the central bank had been successful in achieving the inflation target in 2000. The staff expected inflation to be about 10 percent. Sterilization operations of the order of $430 million for the first 11 months of the year had been very large, and thus could not be maintained, if foreign exchange inflows continued at the present level. At one point in October, there had been concerns that reserve money was rising rapidly, and the central bank had issued a statement that the exchange rate might be overvalued—a somewhat unusual practice. This had led to nervousness in the market and the exchange rate had subsequently depreciated marginally. Under the circumstances, the central bank, instead of buying foreign exchange, had actually sold foreign exchange, which had helped bring reserve money back to the program target. The mix of fiscal and monetary policies had been appropriate and very successful for 2000. The concern was whether such a policy mix could be sustained.

On the issue of oil price assumptions, the program provided for some flexibility. Instead of relying only on the price assumption in the *World Economic Outlook*, the staff had been sympathetic to the authorities' use of conservative oil price assumptions in projecting revenue, given the volatility of oil prices. The discussions had aimed to reach a mutual understanding for the projection of oil revenues, so as to agree on a sensitivity analysis and the policy reaction to higher or lower oil prices. The program targets—the relevant fiscal and balance of payments targets—could easily accommodate automatic adjustors up to a limit, provided that the macroeconomic targets were being met. While it was more difficult to correct for a downward shift in prices rather than an upward shift, the program could be designed to take into account such price volatility and the policy reaction. In case of a downward correction, the program allowed for adjustment in government expenditure equivalent to half a percentage point of GDP as a contingency mechanism in the budget.

There were difficulties concerning the country's laws on confidentiality, which prohibited the authorities from providing information without approval of the partners involved—in the case of the oil sector, many partners in the oil fields and large foreign-run companies and venture companies—the staff representative acknowledged. The estimation of oil revenues in Kazakhstan was more complicated than in other countries as each oil field in Kazakhstan had a specific contract related to it, and one would need information on each oil field to come up with the most refined estimates. In some countries, such as Azerbaijan, product sharing agreements were used, which was a fairly standard model. To estimate oil revenues, the staff did not need to have access to each contract, but would need to reach an agreement with the authorities at the aggregate level. The staff was appreciative of the authorities' efforts over the past two or three weeks to provide more useful information, and welcomed the opportunity to continue to work closely with the authorities in this crucial area, in terms of budget formulation and overall macroeconomic assessment.

On the shortfall in value-added taxes (VAT), the staff representative explained that, based on the additional information recently obtained, part of the oil royalty payments had been classified as VAT payments, because oil companies had been able to offset their royalty obligations with VAT. Therefore, the VAT estimates in the budget had been overstated to the extent that they had been offset by royalty payments. VAT revenue as a percent of GDP had declined from 4.6 percent in 1999 to 3.8 percent in 2000, while, in nominal terms, VAT rose by 5 percent, and non-oil GDP rose by about 20 percent. This was an area of concern, and pointed to the importance of widening the tax base and reducing the dependence on a volatile commodity. With a statutory rate of 20 percent for VAT—though 10 percent for most food products—the staff would expect to see VAT collections on the order of 7-8 percent of GDP; about half of that amount was achieved for 2000, suggesting that tax administration needed improvement.

On the oil fund, the main recommendation of the Fiscal Affairs Department (FAD) was that oil revenues be fully integrated into the budget, the staff representative remarked. All the revenues and the expenditures—inflows and outflows—were an integral part of the budget, and thus must be cast in a medium-term fiscal framework. For transparency purposes, there should be regular auditing, and the authorities had discussed the issue extensively with both the government and the members of Parliament; the latter had visited Norway and the Netherlands to examine how they managed large resource-based revenues. The authorities, including the governor of the central bank, would also visit Norway, which the staff considered a good model and example. While this was an ongoing discussion, its importance had increased, with the latest development being that with the selling of 5 percent of a large oil field, there might be a large remittance of the order of $660 million before the end of 2000, and the authorities would like to see this initial payment into the oil stabilization fund. The staff would continue to discuss with the authorities on the creation and operation of the oil fund. It had been noted in the FAD background paper that there might be a politico-economic argument for an oil fund. It would be easier for the authorities to negotiate expenditure restraint with Parliament on the grounds of the two objectives of the oil fund—one for stabilization and the other for future generations, given the nonrenewable nature of oil.

Regarding the institutional capacity to embark on structural reforms, FAD and the Monetary and Exchange Affairs Department (MAE) had provided extensive technical assistance, the staff representative noted. Mr. Kiekens had rightly pointed out that the World Bank was involved in an extensive agenda of structural reforms, and had provided some technical assistance. In its draft country assistance strategy paper, the Bank stated that it was prepared to lend greater assistance in the areas directly related to poverty alleviation—most notably, the establishment of a social safety net.

On the question of the local budgets in the rundown of government deposits and the implication on monetary policy, the staff representative said that there had been a change that allowed the central bank to return reserve money to the targeted level for the end of the year. Overall revenue performance was expected to be better than initially projected, and thus the local governments' budgets were expected to be in balance or even slightly in surplus. Therefore, there might not be an overall rundown in government deposits that could complicate the conduct of monetary policy.

The staff representative from the World Bank remarked that, on the relationship between oil prices and government revenue, the Sector Manager in the Bank's Energy Department had been working closely with the Fund's staff in developing a model relating prices to revenues. In November 2000, a mission to Kazakhstan had worked with the authorities on those issues; their findings basically covered three areas—projecting budget revenues, the national fund of Kazakhstan, and recommended structural changes. The mission had devoted a considerable amount of time addressing the question of fiscal revenue projections from the oil sector. The mission had been advised of the assumptions and methodology used in preparing the budget. While the Bank had been able to confirm, through the use of the Bank's own model, that the government's projection of budget revenues attributable to the oil sector was consistent with the assumptions and method as advised, it believed that there were flaws in both the method and the assumptions. The Bank agreed with the Fund that the use of the revised and appropriate assumptions and method produced revenue forecasts that were consistent with those in the supplement to the Fund staff report. As the budget was calculated on a cash basis, it was important for the model to produce cash rather than accrual results. The government would benefit from an enhanced dialogue with key producing companies during the process of updating the 2001 budget and preparing the 2002 budget. The construction of a more dynamic model, capable of dealing with oil price volatility and able to accommodate a transition from accruals to cash payments, would be helpful. The mission had also noted the importance of the Ministry of Finance being able to obtain information from the Ministry of State Revenues concerning VAT and other tax amounts that could be offset against royalties. Without access to this type of information, it would be impossible for the Ministry of Finance to develop accurate projections of royalty revenues.

While the Bank's mission had touched only briefly on the subject of the national fund of Kazakhstan, the Bank would appreciate the opportunity to have further discussions with the government and the Fund regarding the structure of this fund and the associated objectives and controls that would be in place, the staff representative said.

On structural reforms, the mission had made a number of recommendations regarding Kazakhstan's oil sector, with the objective of maximizing future revenues, the staff representative stated. It had highlighted the importance of ensuring that adequate oversight was provided to protect state interest in the oil sector, and had also proposed the establishment of a competent authority with close ties to the Ministry of Finance. The mission had also suggested that certain functions currently performed by Kazakh Oil and other agencies could be transferred to this authority. In addition, it had proposed that regulatory functions for the sector be transferred from Kazakh Oil to an independent regulatory body, and that regulatory oversight of Kazakhstan Oil's activities be strengthened. Such a move would be positively viewed by private sector investors.

Mr. Kiekens made the following concluding remarks:

All Directors praised Kazakhstan for its disciplined fiscal stance this year. Most Directors recommended that this stance should be maintained next year. This will be done, as shown by next year's budget approved by Parliament last week.

One or another more critical Director echoed the staff's observation that the fiscal position was looser than before if the revenue increase due to higher oil prices is excluded. I would like to observe that it is neither politically realistic nor economically justified to tell Kazakhstan that it is irresponsible to use part of the higher oil revenues for public expenditures, and several Directors indeed expressed a more balanced view. The U.S. Director, Mrs. Brukhoff, was right to stress that the prioritization and the efficiency of public expenditures are more important than the sheer size of the fiscal balance. And given Kazakhstan's huge need to improve its public infrastructure and public services, Mr. Charleston saw room for a somewhat looser fiscal policy to be offset by a somewhat tighter monetary policy. In the same vein, he recommended that the monies in any oil stabilization fund should not exclusively be invested abroad. Part of these resources could be more productively invested in the Kazakh economy itself. The German Director also agreed with the need to increase public investment.

Mrs. Brukhoff confirmed that monetary policy was well run. This view was strongly supported by Mr. Palei. Having reduced inflation from about 20 percent last year to about 10 percent this year is indeed an achievement. As mentioned in my introductory statement, the central bank broadly agrees with the staff's balanced recommendation both to avoid excessive real appreciation but to let the nominal exchange rate appreciate if the amount of capital inflows becomes overwhelming and threatens to rekindle inflation. This was also the view of the Board. Obviously, establishing an oil stabilization fund, whose reserves would largely be invested abroad would help improve the management of capital inflows without overburdening monetary policy.

I think some Directors were too negative concerning Kazakhstan's progress with structural reform. Kazakhstan has achieved much in past years under Fund-supported programs and with the help of the World Bank and other MDBs. The country has made good use of external technical assistance. These reforms are now paying off, as shown by Kazakhstan's strong recovery.

Kazakhstan was the first CIS country to carry out comprehensive tax and pension reforms. It succeeded well with privatization and attracting foreign direct investment. It is illustrative that Kazakhstan was the first CIS country to conduct a Financial System Stability Assessment, which has shown that its financial sector is among the best developed and most stable in the CIS. I was pleased to read, in a recently published an IMF Occasional Paper entitled *"Setting Up Treasuries in the Baltics, Russia, and Other Countries of the Former Soviet Union,"* that Kazakhstan and Latvia are the two most advanced countries in this group.

Admittedly, the speed of the reform implementation fell somewhat short of the EFF's ambitious agenda. As our statement explains, this was due to well organized resistance in parliament rather than to a lack of commitment on the part of the government. And Mr. Palei was right when he observed that the real picture is better than the staff's conclusion that only one out of seven structural benchmarks had been met. Indeed, several other structural reforms had been at least partly implemented or implemented with some delay.

Many Directors urged the Kazakh authorities to increase transparency concerning the fiscal revenues from the oil sector. I would like to inform the Board that this morning, the Vice Prime Minister confirmed to me the government's commitment to work further on that issue. Indeed, last Friday President Nazarbayev called on the foreign companies working in Kazakhstan's energy sector to increase the transparency of their operations. And as we have just learned from the World Bank representative, the Bank is urging the government and the oil companies to collaborate more closely in producing more reliable fiscal projections.

It is quite paradoxical that last summer, Kazakhstan's EFF review could not be completed although all performance criteria were met. The staff justified the non-completion by the need to devise a new macroeconomic framework, on which no agreement could be reached at that time, and by delays in structural reforms.

But today the staff has recognized that Kazakhstan's "policy mix has been most appropriate and successful."

The need to reach a better understanding of the linkage between the oil sector and other sectors of the economy may have been an obstacle to the completion of the review. But today the staff confirms that the authorities have made good progress in the last two months, and now admits that the issue is more complex than was originally thought.

Mr. Palei observed that Kazakhstan's EFF program was of systemic importance for the whole region, and Mrs. Sharipova, another eminent representative from the region, took a similar view.

The Kazakh government is committed to accelerate structural reforms under a revitalized EFF-supported program. I think that today's Board meeting has laid a good basis for renewing discussions on the EFF between the authorities and the staff.

I thank Directors for their interest, support, and good advice. I also thank Management for its active interest, and the staff for its work.

The Acting Chairman welcomed the statement by the highest leadership of Kazakhstan on the importance of transparency in the oil sector, and voiced appreciation for Mr. Kiekens' personal efforts by traveling to the country and helping the authorities clarify their positions with the staff on that issue.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They observed that Kazakhstan's improved economic performance has been linked to a significantly more favorable external environment than in 1999 when the Extended Fund Facility (EFF) program was approved, as well as to the pursuit of prudent macroeconomic policies and past structural reforms. Economic growth in 2000 has been considerably more pronounced than anticipated, inflation has moderated, and the current account has been in surplus. In the period ahead, in light of the availability of much larger resources, economic policies need to be geared to avoiding excessive real exchange rate appreciation, promoting saving, opening trade, improving governance, and strengthening the supply side of the economy through structural reforms. Directors welcomed Kazakhstan's discharge of all its outstanding financial obligations to the Fund in May 2000.

Directors welcomed the monetary authorities' commitment to pursue the price stability objective, and to avoid excessive real exchange rate appreciation, while allowing the nominal exchange rate to appreciate should the monetary targets risk being exceeded. Directors observed that keeping the exchange rate relatively stable in the face of a strengthening external position has complicated the task of achieving single-digit inflation. They supported the staff's recommendation that the central bank avoid a further loosening of monetary policy.

Directors commended the authorities for pursuing a prudent fiscal policy, and urged its continuation. They welcomed, in particular, the authorities' expenditure restraint, which has helped keep inflation subdued despite large foreign exchange inflows. They recommended that the authorities prevent large windfalls in revenue from the oil sector from weakening efforts in collecting other taxes, as only a broad and resilient tax base will help minimize volatility in overall revenue. In this context, they urged the authorities to strengthen efforts to collect VAT on imports and to proceed with customs reform. Directors also stressed the importance of improved prioritization of public expenditure and better targeting of social expenditure.

Directors welcomed the authorities' recent provision of additional information on the oil sector, which has contributed to clarifying the linkages between the oil sector and the budget. Nevertheless, important technical and policy concerns remain outstanding, notably regarding budget projections and formulation, and the management of public resources. Directors, therefore, urged the authorities to ensure further transparency of the oil sector's operations and its linkages with public finance. This will strengthen the budgetary process, and facilitate sound macroeconomic analysis and public accountability.

Directors generally supported the authorities' objective of establishing an oil stabilization fund, which should help to insulate the budget from volatility in oil revenues, provide savings for future generations, prevent wasteful increases in government spending, and limit the impact of "Dutch disease." The fund should, however, be based on the principles of transparency and public accountability, and should be appropriately cast in a medium-term fiscal framework.

Directors welcomed Kazakhstan's participation in the Financial Sector Assessment Program and took note of the Financial System Stability Assessment report. They stressed the importance of continuing reforms of the banking and financial system, including, in particular, central bank efforts to require banks to submit consolidated financial statements and steps to assure that the central bank has full authority to revoke a bank's license.

Referring to the authorities' structural reform agenda, Directors urged the authorities not to allow the favorable economic climate to lead to complacency with regard to continuing structural reform. In particular, they noted that a major impetus is required in pressing forward with a well-prepared program of privatization of large-scale enterprises. Directors urged the authorities to open all sectors of the economy to international competition, noting that recent trade policy measures may be harmful to economic efficiency, regional integration, the investment climate, and sustained long-term growth. They also encouraged the authorities to take the necessary legal steps to strengthen property rights and land reform.

Directors welcomed the efforts by the authorities to improve basic macroeconomic statistics. They noted that inadequate coverage of the oil sector and its operations hamper the quality of aggregate statistics and the effectiveness of surveillance. They encouraged the authorities to continue to strengthen the national accounts and improve the compilation and coverage of the balance of payments.

Directors urged the authorities to take the steps necessary to complete the first review under the EFF. In particular, they noted the need to revive structural reforms, to ensure greater transparency in the linkages of the oil sector with the rest of the economy, and to agree with the staff on a suitable macroeconomic framework for 2001.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/00/120 (12/8/00) and EBM/00/121 (12/11/00).

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

The Executive Directors agreed to extend through December 31, 2000 the period for the fulfillment of the requirements for membership in the Fund by the successor states of the former Socialist Federal Republic of Yugoslavia.

The Executive Board took the following decision:

The period under paragraph 3(d) of Decision No. 10237-(92/150) of December 14, 1992, within which a successor may succeed to the membership of the Socialist Federal Republic of Yugoslavia in the Fund is further extended through December 14, 2000.

Decision No. 12540-(00/121), adopted
December 11, 2000

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

4. DEMOCRATIC REPUBLIC OF THE CONGO—OVERDUE FINANCIAL OBLIGATIONS—REVIEW FOLLOWING SUSPENSION OF VOTING RIGHTS—POSTPONEMENT

To allow the Congolese authorities more time to advance the peace process, further improve the security situation, and design and implement appropriate economic policies, the date by which the Fund was to review the Democratic Republic of the Congo's overdue financial obligations to the Fund, as provided for in paragraph 4 of Decision No. 11686-(98/30), adopted March 18, 1998, as amended, is postponed to a date no later than six months from December 8, 2000. (EBS/00/240, 11/28/00)

Decision No. 12354-(00/121), adopted
December 8, 2000

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 00/46, 00/53, and 00/66 are approved.

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/00/167 (12/6/00) is approved.

APPROVAL: October 26, 2001

SHAILENDRA J. ANJARIA
Secretary