February 13, 2002
Approval: 2/21/02

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 01/124

10:00 a.m., December 5, 2001

Contents

Executive Board Attendance

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

Executive Directors	**Alternate Executive Directors**
	A.S. Alosaimi
	A.S. Al Azzaz, Temporary
A. Barro Chambrier	D. Ondo Mañe
	N. Guetat, Temporary
	K. Kpetigo, Temporary
	P.R. Fenton, Temporary
	F. Vermaeton, Temporary
	P.H. Whitehall, Temporary
	N.J. Davidson, Temporary
	H.-H. Jang, Temporary
R.F. Cippà	F. Zurbrügg, Temporary
	N. Davleton, Temporary
	T. Skurzewski, Temporary
	R. von Kleist
	G.M. Blome, Temporary
	F. Haupt, Temporary
P.C. Padoan	F. Manno, Temporary
	D. Lombardi, Temporary
D.I. Djojosubroto	M.P. Bhatta, Temporary
	T. May, Temporary
V.L. Kelkar	R.A. Jayatissa
	R. Gauba, Temporary
	J. Prader
	C. Josz, Temporary
	M. Marques, Temporary
	J. Sipko, Temporary
	S. Kropas, Temporary
	A. Alber, Temporary
	I. Kupča, Temporary
	M. Lundsager
	A. Baukol, Temporary
	J.W. Ralyea III, Temporary
	E.S. Weisman, Temporary
P. Duquesne	B. Couillault, Temporary
	S. Boucher, Temporary
A. Mirakhor	M. Daïri
	S. Rouai, Temporary
	T. Hadded, Temporary
	J.K. Kwakye, Temporary
	A. Lushin
	L. Palei, Temporary
	Y. Lissovolik, Temporary
	I. Zakharchenkov, Temporary
	O.E. Garner, Temporary
	S. Alcaide, Temporary
	E. González-Sánchez, Temporary

	S.P. Collins
	A. Stuart, Temporary
	D. Merotto, Temporary
	V. de los Santos, Temporary
	A. Rambarran, Temporary
C.D.R. Rustomjee	I. Usman
	M.B. Chatah
	K. Sakr, Temporary
	N.H. Farhan, Temporary
	T. Koranchelian, Temporary
Wei Benhua	Liu F.,Temporary
	Tong Y., Temporary
	A. Kapteyn, Temporary
	A.D. Marinescu, Temporary
	M. Faulend, Temporary
	N. Yeritsyan, Temporary
K. Yagi	T. Komatsuzaki, Temporary
	L. Ocampos, Temporary
	D. Vogel, Temporary

S.J. Anjaria, Secretary
A. Mountford, Acting Secretary
Z.R. Ahmed, Assistant
P. Cirillo, Assistant
S. Maxwell, Assistant
J. Morco, Assistant
M. Schrader, Assistant

Also Present
IBRD: P. Arora, M. Barton-Dock, W. van Eeghen, Africa Regional Office. African Department: G.E. Gondwe, Director; C. Briancon, J. Cady, P. Khandelwal, R. Kibuka, M. Nowak, E. Sacerdoti, A. Scott, A. Tahari, M. Tjirongo. European I Department: J. Decressin, A. Leipold, M. Lutz. External Relations Department: L. Fouda, D. Hawley. Independent Evaluation Office: M. Ahluwalia, D. Goldsbrough, A. Mansoor, I. Mateos y Lago, M. Selowsky, T. Tsikata. Legal Department: Y. Liu. Policy Development and Review Department: T. Geithner; Director; M. Allen, Deputy Director; C. Delechat, M. Fetherston, R. Glenister, S. Kashiwagi, T. Lane, B. Loko. Secretary's Department: S. Bhatia, L. Hubloue, P. Ramlogan. Statistics Department: R. Krueger. Technology and General Services Department: A. Limarzi. Western Hemisphere Department: A. Jul. Office of the Managing Director: A.A.E. Bertuch-Samuels, Special Advisor; S.B. Brown, T. Diamond, P. McClellan, R. Moghadam, B. Potter, R.S. Teja. Advisors to Executive Directors: S.A. Bakhache, S. Boitreaud, B. Bossone, J. Milton, E. Nyambal, Y. Patel. Assistants to Executive Directors: A.A. Al-Nassar, T. Belay, V. Bhaskar, N. Joicey, P. Lathouly, T.P. Nguema-Affane, K.S. Oo, T. Segara.

1. INDEPENDENT EVALUATION OFFICE—BUDGET PROPOSAL FOR FY2002-03; AND INDEPENDENT EVALUATION OFFICE—WORK PROGRAM

Documents: Budget Proposal for the Independent Evaluation Office, FY2002—03 (EBAP/01/126, 11/29/01); and Proposed Work Program of the Independent Evaluation Office (EBAP/01/128, 11/30/01; FO/DIS/01/146, 11/21/01; and Cor. 1, 11/26/01).

Staff: Ahluwalia, IEO; Goldsbrough, IEO

Length: 2 hours, 20 minutes

The Acting Chair (Ms. Krueger) made the following statement:

I want to welcome the Director of the Independent Evaluation Office (IEO), Mr. Ahluwalia, as this is the first occasion on which he addresses the full Executive Board. I know that Board members will join me in welcoming your efforts to ensure that the IEO has made a good start in launching its operations. From management's side, we are strongly committed to cooperating with the IEO as well as to respecting its independence, and we look forward to the results of the evaluations. The Fund always has much to learn, and evaluations such as those that are undertaken by the IEO can obviously be very valuable to us in improving our policies and practices.

Mr. Cippà, may I call on you as the Chairman of the Evaluation Group to report or comment on the Group's discussion of the budget proposal and work program please.

Mr. Cippà made the following statement:

I would also like to take this opportunity to thank the Director of the IEO and his team for the very good start. The Board has invested a lot on this important and high-profile initiative. We are glad today to be able to approve the first detailed budget, and we are even gladder to see that the future activity of the IEO is taking concrete shape. I thank the Director for presenting to the Board an interesting and well-structured work program, and I am particularly pleased by his firm intention to finish the first IEO evaluation by the next Annual Meetings. As I said, it was a very good start, and I am particularly grateful to the Director for the excellent and constructive relations he has developed with the Evaluation Group. I am sure that this cooperation will continue into the coming years. On our side, we are all looking forward to providing all possible help to the IEO in its challenging future, of course in respect of its independence.

The budget proposal submitted first to the Evaluation Group and then in a revised form to the Board is well-documented and detailed. As you indicated, Madam Acting Chair, the budget proposal of the Director for both FY2002 and FY2003 has been discussed at length on November 20 by the Group members and by other Directors. What has been circulated for this meeting is a revised proposal that takes into account the consensus that was reached at that meeting. I was therefore asked by the Group to indicate to the Executive Board that the Group recommends approval of this revised budget for FY2002 and the proposed budget for FY2003.

I know that some colleagues would have been in favor of a lapse of time decision. However, I think that it is only right that a formal Board meeting sanction this important moment for the IEO. This does not mean, of course, that we should necessarily reopen the discussion, and this would indeed be a golden opportunity to prove that the Board can also have short meetings.

The Director of the Independent Evaluation Office (Mr. Ahluwalia) expressed his appreciation to the Acting Chair and Mr. Cippà for their welcoming remarks.

Mr. von Kleist made the following statement:

We had a long and fruitful discussion on today's topics in the Evaluation Group. Therefore, I can be very brief, and just say we very much welcome that the Director of the IEO has appointed most of the other members of the IEO, and that today we may officially grant the necessary budgetary resources for the future work of the IEO and take note of its work program.

I just have three comments on the budget; it was discussed, it is appropriate, and I just have one area where I feel that maybe we are going into an area we have not yet gone in other areas in the Fund, and that is the use of consultants. I think that the Fund has a tradition of relying on fixed-term staff or unlimited-term staff, and that strong reliance on consultants is something that other organizations have done and have not had the best experiences with, and we should be very, very careful about the Fund going down this path. I would request from the Director that we receive at the end of each fiscal year an ex post, detailed account of how and which way the money on consultants was spent so that we may in the budgetary discussions get a picture of how this area is developing.

The work program is, of course, the Director's choice, rightly so, and, as we said during the Evaluation Group meetings, it is appropriate. I have just one small comment which I already made in the Evaluation Group and just want for the record to make here as well. In the topic where we are looking at country cases, there is a list of three countries, Brazil, Indonesia, and Korea. I have the feeling that the inclusion of Brazil contradicts our decision of not looking at ongoing cases. Just in August we approved a new program for Brazil, which sort of took over from the old program. Therefore, I think the program that started in 1998 and the program that we approved in August of this year or September this year sort of continues this earlier program. Therefore, I feel we are basically looking at an ongoing program. If other Directors and if the staff and management do not feel the same way, I have no problem going ahead on this.

Finally, the Evaluation Group and the work of the Independent Evaluation Office serve a twofold purpose. One is, of course, for the Fund internally; we can always learn more about the Fund and try not to repeat mistakes we possibly made in the past. On the other hand, as everybody acknowledges, the IEO also serves an important public relations function, which is also necessary in today's world. I was therefore initially glad to see the Director of the External Relations Department here, but he has left in the meantime, because it just struck me yesterday evening during the Billboard awards on television that the boy group NSync actually mentioned the Fund and the World Bank in a positive way in their contribution toward fighting poverty, which I thought was a great thing. It seems our public relations efforts are gaining headway and the IEO is certainly part of that effort.

Mr. Duquesne made the following statement:

Let me first thank the Director of the IEO for all the progress already made. For the same reason as Mr. von Kleist, and as it was recalled by Mr. Cippà, because there has been a lot of discussion in previous meetings of the Evaluation Group, I will be very, very brief. We asked for a formal meeting, and we are very happy that this formal meeting takes place, really to indicate the importance that we attach to the IEO. I will limit myself to the three sets of points just raised by Mr. von Kleist.

First, on the budget, in general terms, we welcome the decision to provide the Executive Board with the first report before the next Annual Meetings. As was recalled, the creation of the IEO has been widely publicized, and there are high expectations about its activity outside this building. Therefore, it is of the utmost importance that some work be delivered rapidly. In that regard, the budget must not be too much of a constraint, from our point of view.

Second, on the work program itself, I would like to insist on the importance of prudential issues. We would prefer that Topic No. 5, financial sector restructuring, and No. 9 on the Financial System Stability Assessment (FSSA) and the Financial Sector Assessment Program (FSAP), be given some priority in the coming periods.

Finally, on the outreach program, if I may say so, we would like to know how the IEO would envisage its possible exchanges of views with civil society, nongovernmental organizations, and national parliaments, which are, at least in my country, very interested in its work. The Director has received some letters on that, I may guess.

Mr. Collins made the following statement:

Let me also begin by thanking the Director of the IEO and his team for preparing this very professional set of papers, and I look forward to an equally professional output, which I am sure there will be, as the reports come forth. For the record, we strongly welcome the creation of the IEO, which has the potential to make a significant impact on the Fund by highlighting the strengths and weaknesses of past policies and programs, by voicing independent criticisms and concerns, and by strengthening the Fund's accountability. Recognizing the independence of the IEO, I shall comment only briefly on the selection of topics and on the timetable.

On the selection, I think it right to give priority to topics that have been a subject of controversy or criticism, that have the greatest interest for the wide range of the membership, and where the potential for learning is the greatest. The report does a very good job of distilling down the original list of 40 to a list of 15 that meets these criteria pretty well. My only comments on the list are that Bank/Fund collaboration is an important and much discussed topic that is not explicitly included, although the FSAP and the joint IEO/World Bank Operations Evaluation Department (OED) Poverty Reduction Strategy Paper report will provide an opportunity to cover this in two very important areas. In addition, it would be worth extending Topic 5 to cover not only financial sector restructuring after a crisis, but also the effectiveness of Fund advice in helping member countries avoid financial sector crises, which I think was a proposal on the original list. All of the topics are high priority and of considerable outside interest. This makes a strong case for having a steady state of around five reports a year, although of course it would be sensible to retain a degree of flexibility, and we should not become hung up on targets for the number of reports. But, at the margin, we would urge the IEO to be more ambitious on the number.

Turning briefly to the timetable, which is implicit in the work program and budget proposal, there is obviously considerable interest in the IEO within member countries, both within governments and civil society. In this context, it is important to be seen as delivering results quickly. Of course, this does need to be balanced against the time that it will take to prepare high-quality reports and consult with all the interested parties. Therefore, I very much welcome the Director's commitment to produce the first report by the time of the Annual Meetings. However, it would be helpful to produce this as much as possible by the Spring Meetings. At the International Monetary and Financial

Committee meeting in Ottawa, Ministers asked for a progress report by the Spring Meetings, and I suspect they will be looking for as much concrete progress as possible. I am not suggesting that a partial report be put forward, but in some sense a pretty full description of the process that has been gone through with the first report would be helpful both in substance and for the image of the IEO. Also, the three reports that are scheduled in the first year, the one on the repeat use of Fund resources is perhaps the least time critical, and I wonder whether it would make more sense to press ahead with the capital crises report first.

Turning to the budget, we are keen to ensure the establishment of a strong and influential IEO, with the resources necessary to conduct detailed, rigorous, and effective evaluations. Therefore, given the preliminary nature of the original budget, and although we do have some slight reservations about whether the IEO is a bit top heavy, I can agree to the revised budget for FY2002. Looking ahead to FY2003, we are sympathetic to the figures in the paper, but would favor approving the budget in the context of the overall Fund budget discussions in the new year in the normal way. It is not intended, however, to use that as an opportunity to revisit the work program. The program will be set, and the focus would simply be on the budget required for its delivery, recognizing overall budget constraints.

Two final points in response to comments made earlier. On the use of consultants, we are more sympathetic than Mr. von Kleist. Clearly, a balance needs to be struck. It is a new departure for the Fund to use consultants to this degree, but I think this whole exercise is a new departure for the Fund and the use of outside expertise, if properly controlled, would be helpful and maximize the flexibility of what the IEO is able to do and actually would help also in establishing the independence of these reports in the eyes of the public.

Finally, I would just like to echo or repeat Mr. Duquesne's question about how the IEO will respond to requests by national parliaments, in particular, for appearances and so forth.

Mr. Prader made the following statement:

We appreciate the information given us, and the work of Mr. Cippà's committee.

On the proposed budget, we can agree only for the sake of consensus: we would prefer, as I have said repeatedly, to start with a small operation that would produce a single masterpiece that would establish the credibility and reputation of the Independent Evaluation Office (IEO). But our informal discussions have revealed a general preference for having the IEO present more projects. Today the IEO planning process seems geared to producing three or four projects a year, and the accent of its activities has changed from evaluation to communication and consultation. The envisaged extensive consultation process will not allow for the presentation of more than one project by the time of the next Annual Meeting.

Nevertheless, we welcome Mr. Ahluwalia's intention to present the first project at the next Annual Meeting. But we remain concerned about several issues. First is the budget planning, which has been on the generous side and till now does not conform to the spirit of "a lean Fund." The first exercise of this planning process has produced a budget for FY2002 that exceeds the original budget proposal by more than 25 percent. Two, the original promise that the IEO would produce up to four projects a year has apparently been overruled by reality: currently it does not seem possible for the IEO to complete more than one and a half projects in a year. We are worried that this means that further down the road we will be confronted by additional demands as the complex and lengthy consultation process consumes more and more time and resources. To avoid such an outcome, something has to give--either less evaluation or less consultation. Three, we are also worried by the replacement of the original plan to employ external staff on fixed contracts by a plan to employ consultants. On this matter, I share Mr. von Kleist's reservations, and I fully support his proposal regarding a transparent *ex-post* list of consultants.

As to the IEO's work program, we are generally satisfied with the list of proposed issues for evaluation. We would just like to emphasize that it is important for this list to be fair and symmetrical, by which I mean it must not focus solely on developing countries. It should not omit issues affecting the surveillance of industrial countries, and the Fund's heavy involvement in the transition countries should also be scrutinized at an appropriate time.

Finally, I encourage Mr. Ahluwalia and his associates to be more inclusive in his list of contacts. The list of contacts presented in the annex shows that important institutions such as the EBRD or the aid agencies of the truly generous and active Nordic countries, the Netherlands, and Switzerland have been ignored. Since the focus of the IEO is more or less on the developing countries, it would seem important to contact first of all the aid agencies that have really been engaged and whose commitments and deeds have been constant and consistently helpful to those countries. At any rate, I am confident that Mr. Ahluwalia will respond positively to the demand for an inclusive process.

Ms. Lundsager made the following statement:

We had extensive discussions in our Evaluation Group meetings, so I will not repeat all my comments. I just want to pick up on a few of the remarks of my colleagues.

First, we are very appreciative of the efforts the Director of the IEO has taken to talk to many different people in coming up with this comprehensive list in the work program going forward, which includes a good range of evaluation proposals in terms of the work the Fund has been undertaking. We think it is appropriate in terms also of the outside interest that has been expressed in the activities of the Fund, especially as one of the key roles of the IEO is to present a credible example of the Fund being able to take a look at itself and be very honest about evaluating how it is undertaking its work. So, I think the Director has set the stage to do a very good job of that.

In one Evaluation Group meeting we discussed outreach somewhat, and the Director mentioned in response to some of my questions that there would be extensive outreach in countries, especially when a particular country case is undertaken, because we were concerned that there would be too much focus on bringing people to Washington as we thought it really would be helpful to go to the countries where the matters are being investigated and talk to the people who are most affected. Therefore, we think that that is in the plan, and that is one reason why we are willing to support a larger budget than we had originally anticipated.

Regarding the use of consultants, as Mr. Collins, we are a bit more sympathetic to this. We are trying to keep this staff on the smaller side; it is not truly small, but we need enough people to do the work. I think in terms of the range of projects, we do need outside expertise to be able to undertake the work. It is a bit much to expect to be able, in this size staff, to have true experts in all the range of activities. So, as far as working with consultants, this is appropriate. Of course, it should be evaluated by the Director and the Deputy Director of the IEO as they go forward in terms of how it is working, but we think that this is an appropriate way forward.

Finally, I wanted to thank Mr. Cippà for the work he has done in the Evaluation Group. He has done a very good job of pulling us together and having us focus on what needs to be done, and I want to thank him for his excellent leadership.

Mr. Prader asked whether Mr. Collins and Ms. Lundsager could support Mr. von Kleist's request for the IEO to report in a transparent manner at the end of every financial year on its use of consultants.

Mr. Wei made the following statement:

At the outset, let me thank Mr. Cippà, Chairman of the Evaluation Group and the Group members as well as the Director of the IEO and his staff for their hard work in preparing the papers for the IEO FY2002-2003 budget and work program for today's discussion. Like others, we are glad that the

IEO is fully established and has begun to operate smoothly. A good start is half the battle.

I have a few additional comments on the work program apart from what we have expressed in the Evaluation Group meetings.

We support the proposed IEO work program for the next three years as presented in the paper, namely three projects to be completed in FY2003 and four to five projects per year for subsequent years. We learn from the Director that the topics in the proposed work program have been selected from a much larger list of potential topics after extensive internal and external consultations.

First, we understand that the first three projects for FY2002-2003 are firm. On the "fiscal adjustments in IMF-supported programs", we would just like to add one issue related to this subject—the fiscal impact of privatization. When a member is requested to privatize enterprises under a program, the member country will often suffer revenue loss in the short term owing to the sale of enterprises. It seems to me that sometimes the Board has not given sufficient attention to this issue in discussing a program. We would like to ask the IEO to examine this issue.

Second, on the project for "IMF's advice on exchange rate policy", we appreciate the inclusion of this topic in the IEO's work program. It should be emphasized that it is the authorities' prerogative to choose the exchange rate regime. The Fund should respect this. The staff is expected to provide constructive advice on the policies needed to support their choice.

Third, on the topic "the role of multilateral surveillance", we would emphasize the Fund's role in bilateral surveillance of the major industrial countries. To my knowledge, there are mid-year "staff visits" to member countries for surveillance purposes. I believe that all the major industrial countries should be the recipients of such missions.

Lastly, on the issue of using external consultants, while I understand the necessity of this issue, I would join Mr. Prader in emphasizing that a transparent procedure for recruiting consultants should be established.

With these brief remarks, we support the proposed budget and work program for the IEO and look forward to seeing the results.

Mr. Kelkar made the following statement:

Let me first thank the Director of the IEO and his team for the splendid work they have done, and for this work program and budget. We also welcome the formal Board meeting instead of a lapse of time basis discussion, because this highlights the importance that we attach to this work. I also thank Mr. Cippà and the Evaluation Group for the work they have done in connection with the IEO.

We approve the budget for FY2002 and also for FY2003.

Regarding the issue of consultants, we agree with Mr. Collins and Ms. Lundsager that, given the nature of this work, perhaps the use of consultants is desirable to ensure that we have the appropriate expertise at the high level that is required as well as the diverse expertise that is required.

Regarding the point made by Ms. Lundsager about the importance of outreach, perhaps for FY2003 it may be underestimated, but that can be looked into, because that year we may even have more studies that will require outreach, so maybe we can have a second look at that.

The point made by some colleagues about the response to parliaments requires very careful consideration, and we should perhaps discuss it with the Evaluation Group along with the Director before we come up with the final proposal. I am sure that management itself may have certain views on this, so perhaps this requires somewhat careful consideration before we take a final decision.

We are also grateful to the Director for his commitment to presenting the first report before the Annual Meetings. I think every one of us is sort of looking forward to this report.

Regarding the work program for 2002, the three studies certainly are important. But, for next year, I agree with Mr. Wei about the importance of multilateral surveillance, and that perhaps should be given appropriate priority.

Mr. Alosaimi made the following statement:

Let me join others in thanking the Director of the IEO and his team for their work and the useful papers before us this morning. As the issues have been extensively discussed in the two most recent Evaluation Group meetings, I can be very brief.

I endorse the proposed work program for FY2002-2003. I also agree with the relevance of the topics selected for future years. Here, however, it is essential to maintain flexibility. The environment is rapidly changing and the priority of issues to be evaluated would therefore likely change.

The budget proposals for FY2002 and FY2003 appear reasonable. I am not clear, however, why the IEO is paying for a consultant in connection with the internal PRGF/PRSP review as detailed in bullet 3 of paragraph 3. The staff's comments would be appreciated.

Mr. González-Sánchez made the following statement:

We join other speakers in commending the Director of the IEO on his work, and also Mr. Cippà. We have no problems supporting the proposed budget.

We welcome the inclusion of the multilateral surveillance topic in the proposed work program. We would also like to emphasize flexibility in this program and the desirability of possibly reviewing this program in two years.

One last comment is that we would have liked to see more representatives of emerging markets in the list of contacts in the IEO work program. Perhaps in the future more representatives from emerging countries can be included in this list of contacts.

Mr. Chatah made the following statement:

I will also be brief, being a member of the Evaluation Group. I, like others, thank the Director of the IEO and his colleagues, and Mr. Cippà on the work that has been done. We can agree with both the budget and the work program. I would add, of course, that the discussions in the Group have, in our view, been helpful, and I think the Director would agree that the consultative process has worked well and the outcome has reflected, in part, those discussions. I will touch very briefly on a few points.

First, on the issue of substitution and complementarity between the evaluation work itself and the outreach. Of course, from a budgetary standpoint one has to make choices to allocate resources in the best possible manner. In a substantive sense, the two are complementary. We believe that there is an important substantive value in evaluation, but an equally important value in a public relations sense. The effectiveness of the Fund will benefit from improved perceptions about certain elements of the Fund's work.

Resources are scarce, and with all the independence that the Evaluation Office has, we feel it is important to avoid issues that are self evident or have been addressed before. For example, some of the questions in the listed subtopics, such as, "does ownership help in the performance under a program?" may not warrant thorough examination. On issues that fall into the policy area, there are some basic issues we should stay away from. For example, the question of what should the role of the Fund be in low-income countries is a fundamental one that stems from the Articles of Agreement. The focus should be on the Fund's effectiveness in carrying out its role rather than what its role should be.

Finally, the Fund has very diverse and very rich processes of decision making within the staff and management, and we also have mechanisms to enrich that collective wisdom horizontally by learning lessons from experiences across countries. We believe that in some of these specific issues that the Evaluation Office will look at, whether they are specific country issues or specific policy issues, a useful question would be whether the collective wisdom is in fact being maximized; in other words, is the diversity in views and richness that exists being utilized efficiently, and is the learning process within the existing evaluation mechanisms working well? In a way, this question is already on the broad agenda of the Evaluation Office; that is evaluating whether the decision-making process within this institution is working well. That, to us, would be at least as productive or maybe more productive than the lessons learned from whether a particular decision was right or wrong or whether particular Fund advice was right or wrong. I think it is more productive to ask the question, has the process been a good one in reaching a decision, because the world changes and we want to be sure that the system is producing the best possible results in the diversity of possible cases.

Ms. Manno made the following statement:

We did not intend to intervene today as we have already made our views on the budget and the work program well known in the Evaluation Group, but we just wanted for the record to make one point on consultants. Although we are sympathetic with the view of Mr. Collins and Ms. Lundsager on the use of consultants, we want to strongly support Mr. Prader's request for transparency. We think that the Director of the IEO is well aware of the importance of having in place an impartial procurement process for identifying, short listing, and selecting consultants.

Mr. Rouai made the following statement:

I welcome the Director of the IEO and endorse the proposed work program. I have two comments.

First, on consultants, I have no problem with this approach in view of the diversity of the issues to be dealt with. I note that the Financial Sector Assessment Program exercise makes extensive use of outside consultants.

Second, regarding the work on fiscal adjustment in Fund-supported programs, it would be useful to review the treatment of privatization receipts under various Fund programs.

Mr. Rambarran made the following statement:

Like previous Directors, we thank the Director of the IEO and his team for the work thus far, and Mr. Cippà for his work and the leadership that he has shown in the Evaluation Group.

We endorse the budget for FY2002 and FY2003.

On the work program, we associate ourselves with the comments of Mr. Wei and Mr. Kelkar, and going forward we have a preference to see issues such as Fund surveillance in industrial countries, multilateral surveillance, and Fund policy advice on exchange rates looked at. We also believe that the IEO should avoid reviewing capital account crisis cases that are still unfolding.

In conclusion, we welcome the commitment to produce a report by the Annual Meetings.

Mr. Rustomjee made the following statement:

We, like many others, would like to commend the Independent Evaluation Office for preparing a well-elaborated work program, which we believe will be of great interest to a wide audience. We also share very much the sentiment of other colleagues that wide-ranging, extensive consultations have taken place, involving many parties within and outside the Fund, and we commend the Director of the IEO and his team for having done that. It was important that it was done, and it clearly goes on record as having been well achieved.

The topics that have been put forward for evaluation during the first year of the IEO becoming operational are clearly valuable choices, and we support them. We did mention in the Earlier Evaluation Group meeting that we would have had some preference for changing the order of some these, but we are pleased to see that they are all in there, whether it is in the first or second year, and so we can support that.

On the issue of the study of the repeat use of Fund resources, we imagine that the study is going to be rather valuable. However, we do want to make an additional point, which is that either in this study or in the PRGF/PRSP study, it would be helpful to analyze how the Poverty Reduction and Growth Facility (PRGF) instrument can be improved to enable and assist those members that have successfully gone through successive PRGF arrangements to move closer to accessing international capital markets and moving away from their substantive reliance on Bretton Fund resources, because we do not seem to have created an exit strategy out of the PRGF in its design. It is not only the issues that will be raised in the write-up on the study on repeat use of Fund resources that is of concern to us, but also how will these countries move into a different kind of a relationship with the Fund rather than simply having a number of successive three-year arrangements. So, it would be important to include this analysis in that study.

We share the concern expressed by Mr. von Kleist about the inclusion of Brazil in the group of capital account crisis cases, as it appears for all intents and purposes to be an ongoing case.

Regarding the issues to be addressed in each of the evaluations for the next couple of years, we find them adequate, comprehensive, and we look forward to the elaboration of the relevant terms of reference.

We generally agree with the communication procedures set out in Section 3. However, we have some concerns regarding the methods proposed in the third bullet of paragraph 34, where we feel that to preserve the independent character of the evaluations, it would be important to be very careful in the treatment of the interaction between the IEO and the Fund staff. It will absolutely need to be—and need to be seen to be—an arm's length relationship, in our view, the same that is used with all other parties that the IEO deals with in order to retain its independence.

For the same reason, we would have preferred a different approach for the circulation of the draft reports than the one being proposed. We would favor a simultaneous circulation of draft reports to Executive Directors, management, and certainly the country authorities, where applicable, with the comments of the latter being circulated at the time of the Board discussion.

On the procedures detailed in Box 2 to access Fund documents and other required information to carry out the evaluations, we find these to be quite reasonable.

We find the budget proposal, for FY2002 and FY2003 to be broadly acceptable. However, we wanted to understand a bit better the reasons for the projected amount of $101,000 allocated for outreach travel in the FY2002 budget. It seems that these expenses are linked to the organization of conferences to discuss the evaluation results. The first study is expected to be concluded just fast before the next Annual Meetings and therefore any expenses related to it would have to be covered under the FY2003 budget. Could staff clarify what the costs in this current allocation in FY2002 will actually cover?

Mr. Collins noted that the Evaluation Group would be returning to the issue of procedures at one of its future meetings. The procedures could be refined in the way Mr. Rustomjee had suggested.

Mr. Cippà confirmed that the Evaluation Group would soon discuss a short paper that would address all the procedural issues.

Mr. Palei made the following statement:

> I would like to join the previous speakers in thanking the Director of the IEO and his staff as well as Mr. Cippà for their work in preparation of today's discussion.
>
> On the use of consultants, we consider them to be a necessary source of outside expertise for implementation of specific projects by the IEO. We also hope that external experts will strengthen the independence of the IEO and the credibility of its reports. The personnel decisions and other organizational issues will show up in the final results of the IEO's work.
>
> In this respect, we look forward to the presentation, by the Annual Meetings, of the first "masterpiece". The chosen topic—on the repeated use of Fund's resources—in our view, has the right potential.
>
> We value the outreach exercises and the education of the general public about the work of the Fund as no less important than generation of insights on how the Fund could improve its operations. The balance between these two goals is clearly stated in the Terms of Reference adopted by the Board for the IEO. It seems to us that the Director has a well-balanced view of the IEO's priorities.
>
> Finally, on the content of the work program, we would like to support Mr. Duquesne in his call for an earlier evaluation of the FSAP. The FSAP consumes a lot of the Fund's resources, in addition to financial sector stability assessments, it produces about half of all the ROSC modules, and it also has multiple goals. An evaluation of the FSAP could be a very useful and interesting undertaking able to attract a lot of attention outside the Fund.

Mr. Djojosubroto made the following statement:

> I would like to thank the Director of the IEO for a good program and Mr. Cippà for leading the Evaluation Group, which has resulted in the proposed budget and the work program.
>
> I am quite happy that one of the topics chosen for the first year will be an evaluation of the Fund's past program with Indonesia. It will not be an easy one as most, if not all, of the Indonesian officials and political leaders have changed. However, I really hope that the result will be very useful for future deliberations.
>
> Like other speakers, I support the proposed work program and budget.

Mr. Wei agreed with Mr. Prader that the IEO should transparently account at the end of every financial year on how it used consultants. In addition, the IEO could in the future evaluate how the Fund hires external consultants to assist with Fund technical assistance projects.

Mr. Rustomjee noted that there was much benefit in the IEO staff speaking to legislatures. The Evaluation Group should look into that issue further before any decision was taken.

The Director of the Independent Evaluation Office (Mr. Ahluwalia), in response to questions and comments from Executive Directors, made the following statement:

> First, may I, on behalf of myself and colleagues, thank all the Executive Directors and yourself, Madam Acting Chair, for the very supportive statements that have been made in welcoming the establishment of the IEO. We are very conscious of the huge responsibility that is placed upon us. We are very keen to prove that we will do the best we can to live up to your very high expectations. As you suggested, Madam Acting Chair, I will just respond to a few points, because many of the points raised we have discussed before and will, in fact, be discussing in the future.
>
> On the budget, a number of issues have been raised relating to costing. I just want to reassure Mr. Prader that the budget does in fact present a cost not for one and a half projects per year, but for three and four as outlined. The confusion perhaps arises because expenditure in the first year is really a pipeline, start-up activity. So, it is based on unit costing for the capacity indicated in the discussions of the Evaluation Group. However, I would like to emphasize, as is brought out very clearly in the note, that we are subject to tremendous uncertainties. We consciously decided not to put in contingencies, which is one way of handling uncertainty, but to do the best we could with the information available. As I understand is the practice, if we need to do more—it is possible that on some items we have underpitched the costs as some Directors have pointed out—we will have to ask for supplementary resources, just as other Departments do, recognizing the disciplines that would apply in this context.
>
> I particularly want to mention that we are very aware that the cost of outreach is very minimal, as indicated here. Outreach can become an enormously costly activity, and I think that our focus at present is really on producing the output. I am sure that the Board will look kindly on subsequent proposals related to bearing the cost of outreach if it is clearly identified as being outreach. However, at the moment, it is true that we have planned only for one conference per study. By comparison, I believe, for example, the conferences that are currently being conducted by the Fund to consult on the PRGF involve a cost to the Fund, according to the information given to us by

the Office of Budget and Planning, something on the order of a quarter of a million dollars. We have deliberately not put anything on outreach until we have a product of such quality that the Board feels we should spread the message; when we have that, we will come back with the fuller cost.

We have noted the concern about timing. We will deliver the first product, as promised, before the Annual Meetings. I have noted the desire that we should have an as substantive as possible progress report on what has gone on by the time of the Spring Meeting of the International Monetary and Financial Committee.

I have noted carefully a number of suggestions made on the substance of the work program, comments made by some Executive Directors suggesting a different ordering of priority, and comments made by some suggesting new thoughts to be added and new dimensions to be put in. I would only say that, at present, we are treating the subsequent year's choices as being flexible. I recognize that new priorities will arise. We hope to have a continuing interaction with outsiders as well as with the Board through the Evaluation Group, and we will try to do the best we can to respond to perceptions of priorities a year later when next year's program is finalized.

Some Directors had mentioned the concern that studies we do should not conflict with any ongoing programs. We are very conscious of that. I want to assure you that we will only be reviewing programs that have actually been completed. We will not just try, but we will make sure that we do not in fact impinge on any ongoing program. I believe that in the specific cases mentioned, it is possible to conduct the studies in a manner that will not create a problem as perceived either by the staff and management or by the country authorities.

A point about parliamentary interaction. Different views have been expressed. It is a difficult area. On our part, we would certainly be willing--and we should be willing--to explain and defend the conclusions that we reach in any of our reports; I mean, that is, after all, part of outreach. However, I understand from the Legal Department that there are legal issues that would need to be resolved and, from my point of view we could pursue this matter further with the Evaluation Group, which would be perhaps the best way of going forward.

There were some points raised on procedural matters relating to reporting to the Board and management with draft reports. As Mr. Cippà has said, this issue is going to be looked into separately, and we will, of course, abide by whatever decision is taken.

Finally, may I just say, on behalf again of my colleagues, I would like to thank Mr. Cippà and the Evaluation Group. We have had not only

> constructive interaction, but also actually invaluable interaction with them. We hope to use that mechanism to produce a more continuous form of interaction with the Evaluation Group and, through the Evaluation Group, with other Executive Directors, so that in the formulation of not only our future program but also the finalization of the terms of reference for individual studies and determining the scope of individual studies, this mechanism could be a way of not only keeping Executive Directors informed, but also providing the Independent Evaluation Office with sufficient feedback at an early stage so that we can actually build in the relevant concerns of this very important constituency.

Mr. Duquesne inquired as to what kind of legal issues needed to be resolved with respect to the IEO's interaction with legislatures, especially as the External Relations Department apparently faced no legal obstacles in its contact with parliaments.

The Director of the Independent Evaluation Office (Mr. Ahluwalia), in response to Mr. Prader's comments on the use of consultants, replied that the IEO would transparently report to the Board both the expenditures and who the actual consultants were in whatever manner the Board requested. It was hoped that once Directors had seen some reports, the entire Board would agree on the use of consultants as a good strategy.

Some of the legal issues that needed to be addressed were whether the interaction between the IEO and parliaments would be informal or formal, whether it would be on the record and under oath, and how would such an appearance might affect the general provisions of immunity of Fund officials from legal processes, the Director remarked in response to Mr. Duquesne's question. Once those legal issues were resolved, there would be no constraints on the IEO's ability to communicate its substantive views to parliaments. The IEO would be willing to follow any decision of the Evaluation Group with respect to legal issues.

Mr. Duquesne asked whether there would be any legal constraints limiting the ability of the IEO to meet with nongovernmental organizations (NGOs) and other representatives of civil society.

The Acting Chair (Ms. Krueger) noted that the Evaluation Group would address the legal issues as the IEO's work proceeded.

The Director of the Independent Evaluation Office (Mr. Ahluwalia), in response to Mr. Alosaimi's question on why the IEO was paying for a consultant working on the internal PRGF/PRSP review, replied that the IEO had volunteered to hire a consultant to be responsible for reviewing the experience with submissions made by NGOs and other civil society representatives to the Policy Development and Review Department (PDR) in order to avoid any perception that a review carried out by a consultant hired by PDR could be biased. That work was a one-time event and would not be part of the IEO's work going forward. Nonetheless, it was a good opportunity for the IEO to become familiar with the concerns of

NGOs in advance of the PRGF evaluation planned for FY2004, which would be carried out together with the World Bank's Operations Evaluation Department.

Mr. Chatah asked why summarizing the views of NGOs required a specialized consultant from the resources of the Evaluation Office.

The Director of the Independent Evaluation Office (Mr. Ahluwalia) responded that a specialized consultant was not necessary but was hired because the IEO staff was focused on meeting the deadlines that had been set for its own work.

The Deputy Director of the Independent Evaluation Office (Mr. Goldsbrough) reiterated that the hiring of the consultant was a one-off event. The IEO was not evaluating the comments made by the groups, but was simply summarizing them. Consequently, the IEO was not passing any judgment on the comments, and was therefore able to maintain an arm's length from the entire process.

The Acting Chair (Ms. Krueger) observed that the Executive Board had approved the budget for the Independent Evaluation Office for FY2002 and FY2003, and noted that the Board had also reviewed the work program of the IEO. However, the implementation of the framework in Box 2 on page 15 of EBAP/01/128 remained in suspense, and would be discussed at a future date by the Evaluation Group and hopefully subsequently approved by the Board.

The Executive Board took the following decision:

> The Executive Board approves the budget proposal for the Independent Evaluation Office, FY2002—03 as set forth in EBAP/01/126 (11/29/01).

Adopted December 5, 2001

2. MADAGASCAR—2001 ARTICLE IV CONSULTATION; POVERTY REDUCTION AND GROWTH FACILITY—REVIEW, AND WAIVER OF PERFORMANCE CRITERION; AND ENHANCED INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—ADDITIONAL INTERIM ASSISTANCE

Documents: Staff Report for the 2001 Article IV Consultation, First Review under the Poverty Reduction and Growth Facility (PRGF), and Request for Waiver of Performance Criterion (EBS/01/193, 11/21/01; and Sup. 1, 12/3/01); and Selected Issues and Statistical Appendix (SM/01/354, 11/21/01; and Cor. 1, 12/4/01)

Staff: Sacerdoti, AFR; Fetherston, PDR

Length: 1 hour, 35 minutes

Mr. Barro Chambrier submitted the following statement:

Introduction

Madagascar continued to make good progress, in the first half of 2001, under the PRGF-supported program. Economic activity was buoyant, with all sectors registering significant growth. Madagascar also met all performance criteria and benchmarks under the program, except for tax revenue. My Malagasy authorities have taken corrective actions in this area, and are requesting a waiver for the missed performance criterion. They have adopted the supplementary budget decrees allocating interim debt relief obtained under the HIPC Initiative to priority social sectors, and have also made progress toward the HIPC Initiative completion point, including the preparation of a full PRSP. The authorities are committed to pursuing their adjustment efforts and are confident that the electoral process will not derail their commitment in the implementation of the program.

The growth prospects for 2001 as whole remain favorable, despite the global slowdown which has become more pronounced in the last few months. Real GDP growth is expected to reach 6.7 percent against 6 percent programmed. Inflation will be contained at 4.5 percent in 2002 and remain below 3.5 percent thereafter, from 5 percent in 2001. However, the global slowdown is expected to affect economic growth in 2002, in particular the tourism and textile sectors and GDP growth will thus fall to about 4.8 percent against 5.8 percent programmed. In this context, my Malagasy authorities are determined to implementing contingency measures needed to maintain macroeconomic stability. However, they do hope that they can count on additional international assistance, should the global slowdown lead to further deterioration in the Malagasy economy.

Performance Under the Program in 2001 and Policies for 2002

Real Sector

Madagascar's economy is responding well to the reform efforts of the authorities. After having registered growth of around 3 to 4 percent or lower, prior to 1997, the Malagasy economy has been growing steadily and firmly since then, and will most likely be above 6 percent this year. As noted above, all sectors contributed to the higher growth rate. However, it is worth noting the important contribution of the manufacturing sector, in particular textiles and garments, which received an important boost from the passage of the African Growth and Opportunity Act (AGOA) by the U.S. Congress. In this respect, Box 2 at page 9 of the staff report shows very well how this Act is benefiting Madagascar. Within a year, the export of textiles products and garments from Madagascar's Export Processing Zone (EPZ) to the United

States grew by 73 percent. At the same time it enabled a large inflow of foreign direct investment and the creation of more than 8,100 new jobs in 2000, resulting in a total workforce of more than 60,000 persons in the EPZ employed by 160 firms. The prospects for continued development of this sector remain favorable and AGOA is expected to foster a diversification of export markets as well as production.

Fiscal Policies and Reforms

In the fiscal area, although tax revenue and privatization proceeds were lower than programmed, in the first half of 2001, the overall fiscal performance continued to improve, reflecting the measures and the reforms introduced earlier. In this regard, it is worth noting that tax revenue which stood at 9.4 percent of GDP in 1997 has gradually increased and is expected to reach 11.5 percent of GDP in 2001, and that expenditure has been kept under control. The preparation of the budget for 2002 is well underway. The authorities are determined to address weaknesses in customs administration and stand ready to take corrective measures, should there be significant change in the privatization outlook for 2002.

On the revenue side, it should also be noted that revenue shortfall in the earlier part of the year were caused by lower petroleum consumption, the lowering of tariffs in the context of regional arrangement, and the appreciation of the Malagasy franc. The authorities are taking measures to strengthen domestic and customs administration. In this regard, they have reinforced their efforts this year by introducing a new computerized system for customs operations, which is beginning to produce some good results. The authorities will be extending the system to the smaller harbors where control has been less effective. They also intend to intensify large scale audit operations in order to improve revenue collection and transparency. To ensure the achievement of the fiscal targets, the authorities reduced outlays and petroleum retail prices were increased in October. In addition, the authorities, with external assistance, are taking steps to improve budget management, including treasury accounting, monitoring of budgetary execution, and auditing procedures. Nevertheless, the authorities agree that the revenue-to-GDP ratio should be increased to enable the government to meet the social and infrastructure needs of the country, and efforts to that effect will continue.

External financing and privatization receipts were also lower than programmed. As regards, privatization receipts, the sale of SOLIMA (petroleum company) storage facilities had experienced delays which are being addressed, and payments for the sale of the service stations have not yet been entirely completed. Delays in the privatization of Air Madagascar also caused a postponement of World Bank disbursement to 2002.

Monetary Policy and Financial Reforms

In the monetary sector, the expansion of money supply reflected the increase in money demand by the business sector and also the higher export. Credit to the economy from commercial banks was lower than expected, due to good liquidity position of the private sector. However, central bank credit to the economy rose sharply in connection with the financing of the petroleum imports of the state petroleum marketing company. These credits are being repaid. Also, reflecting the deceleration of inflation, the central bank reduced the discount rate from 12.5 percent to 10.5 percent at end of June, and to 9 percent in October. Interest rates on treasury bills also decreased.

Improving the soundness of banks and the financial sector have continued to be an important objective of the authorities. Following the recommendations of a technical assistance mission from the Fund’s Monetary and External Affairs Department, regulations and supervision standards for credit unions and microfinance institutions not previously covered have been adopted. The shortfall in privatization receipts have led to an increase in bank financing to the government which is expected to be reversed as privatization receipts come in. The authorities are therefore requesting a modification of related performance criteria for end-December 2001 and the quantitative benchmark for end-March 2002.

External Sector

In the external sector, developments were quite favorable, and as noted above the exports of textile and garments increased significantly, but exports of vanilla and cloves were also higher. There was also an increase in imports, mostly construction equipment and inputs for EPZ. With regard to external competitiveness, despite the significant appreciation of the Malagasy franc over the past two years, recent data indicate that Madagascar remains competitive, as labor productivity has been boosted by recent foreign direct investments and the abundant labor supply for the export sector. Madagascar also continued to simplify and to streamline its external trade regime. In line with regional arrangement, tariff rates have been substantially reduced.

Although external financing will be less than programmed, no financing gap is projected for 2001. External debt management is being improved with the installation of a computer system with assistance of UNCTAD. Madagascar is benefiting from interim debt relief under the HIPC Initiative, and negotiations are ongoing or have been concluded with Paris Club and non-Paris Club members.

Structural Reforms

Structural reforms have continued to be implemented. Besides the measures described above, the authorities have also been implementing structural reforms in other areas, with assistance from the World Bank and other international institutions. In this regard, a comprehensive program of privatization is being undertaken. While delays have occurred, the program of privatization is being steadfastly implemented. The selling of the storage facilities of SOLIMA have been completed, the call for bids for the telecommunications company, TELMA have been launched with the successful bidder to be announced at the end of the year. The preparation of the strategies for the privatization of the cotton and sugar companies is being finalized. As regards Air Madagascar, in view of the difficulties being experienced by the airline industry, the government, in consultation with the World Bank, is reviewing the strategy. However, the authorities have already proceeded with the restructuring of the management of Air Madagascar and a rationalization of the air routes. In the electricity sector, the government is working with the World Bank on a plan to open up electricity production to the private sector. Important reforms in the judicial sector are also being undertaken. With regard to decentralization, a new organic law governing the public finances is being drafted, and will be submitted to the National Assembly at the beginning of 2002. This is an important step, as the new law will define the fiscal relations between the central government and the autonomous provinces. Regarding the reform of public finance inspection and control agencies, a study was recently finalized and submitted to the Council of Government. Key recommendations of this study are being implemented, including increased funding for the State Inspectorate General and the recruitment of additional magistrates for the Audit Court.

Poverty Reduction

Important progress has been made in the implementation of the poverty reduction program. In the context of the HIPC Initiative, the government adopted the supplementary budget decrees allocating interim debt relief resources to education, health, justice, budgetary control agencies, water supply, public work and poverty monitoring. Thus, resources are being allocated to finance the recruitment of 4,000 additional teachers for rural schools and medical personnel for the regional health centers, most of whom have already taken up their posts. The monitoring of the expenditure process in the Ministries of Health and Education has been strengthened with the preparation of quarterly budgetary execution reports. For 2002, resources resulting from debt-service relief under the HIPC Initiative will be appropriately identified in the budget, and the monitoring procedure will be extended to four other Ministries. A comprehensive monitoring procedure benefiting the poor is also being put in place with World Bank assistance. Progress is also being achieved in meeting the completion point triggers, as outlined in Box 3 of the staff report. In particular, progress is being made in improving treasury accounting and budgetary execution reporting and the authorities are determined to taking the remaining steps to ensure monitoring of the physical outcomes for expenditure in the social sectors. The preparation of the full PRSP, with extensive consultation with civil society and the donor community has been completed. A first draft has been presented to a national seminar in November, and following the comments received, a final version will be prepared and presented to the Fund and the World Bank, after approval by the government.

Conclusion

Overall, except for the missed performance on tax revenue, for which corrective measures have been taken, Madagascar has met all the performance criteria and benchmarks for the period under review. The economic and financial situation is improving much better than expected and the outlook is for a continuation of the good progress achieved. In the circumstances, I would like to request Board support for the proposed decision.

Mr. Rustomjee submitted the following statement:

We thank the staff for their candid evaluation of policy performance and economic prospects in Madagascar and Mr. Barro Chambrier for his helpful statement which helps to underscore the progress and commitment of the authorities in pursuing prudent economic policies and tackling poverty.

Introduction

Since the last Board discussion on Madagascar, the authorities have made further progress in implementing prudent macroeconomic policies, deepening structural reforms and addressing poverty. Under the 2001 program, performance criteria and benchmarks were broadly met, except for tax revenue, for which corrective measures were taken and we support the request for the waiver. These policies have helped Madagascar to recover quickly from the devastating cyclones of 2000. Productive activity in all sectors has been buoyant including in the rapidly expanding export processing zones and the GDP growth rate is expected to be high at a projected at 6.7 percent for 2001. Despite the adverse external environment, the external current account deficit remains low at 1.5 percent of GDP, reflecting the authorities’ success in diversifying export markets. These policies, together with social and political stability are creating favorable conditions for private sector investment, as well as an increase in foreign direct investment; and these will all better position the country to address poverty which remains widespread.

Fiscal performance

On fiscal performance, although revenue fell short of expectations, due mainly to factors beyond the control of the authorities, the revenue effort has been strengthening, with the revenue-to-GDP ratio increasing from 9.4 percent of GDP in 1997 to a projected 11.5 percent of GDP in 2001. Measures have been taken in 2001 to address weaknesses in customs administration, including the introduction of a new computerized system for customs operations while petroleum retail prices were increased. We welcome the fact that the authorities used savings from debt relief to increase allocations to social sectors in line with the objectives under the PRSP. Privatization proceeds were also lower than expected, reflecting partly the impact of the global downturn, particularly on the privatization of the airline and limited administrative capacity to expedite other privatizations. Nevertheless, measures were taken to control other expenditures, allowing the authorities to maintain domestic financing of the budget deficit within the program limit during the first half of 2001. We welcome the intention to further strengthen the fiscal position in 2002, particularly the intention to improve budget management, including treasury accounting, monitoring of budgetary execution, and auditing procedures. It would be important to further increase the revenue-to-GDP ratio and to improve budget execution particularly in social sectors and rural infrastructure.

Monetary Policy

Enhanced labor productivity, improved weather conditions and fiscal prudence are contributing to declining inflation, which is projected at below 4.5 percent in 2001 and to decelerate further thereafter. This deceleration in inflation has provided room for lowering of interest rates, thereby giving an impetus to productive lending and leading to an increase in exports. We welcome the fact that the authorities are paying due attention to the soundness of banks and the financial sector and have adopted the recommendations of a technical assistance mission from the Fund's Monetary and External Affairs Department regarding improvements in the regulations and supervision standards for credit unions and microfinance institutions.

Structural Reforms

To avoid further shortfalls in privatization proceeds, that could lead to higher bank financing to the government, and to expand the role of the private sector in the economy as well as attract foreign direct investment, we encourage the authorities to accelerate the privatization process during 2002. In this regard we are encouraged by the adoption of a comprehensive program of privatization with assistance from the World Bank. We welcome that the sale of the telecommunications company is being finalized as well as preparations for privatizing the cotton and sugar companies. Delays in privatizing Air Madagascar are understandable, in view of the difficulties in the airline industry worldwide. In the meantime, we welcome steps being taken by the government to improve the operations of the airline. We also welcome reforms in the electricity and judicial sectors. Regarding decentralization we welcome the progress being made, however, we advise the authorities to proceed carefully given the enormous limitations on administrative capacity in the autonomous provinces.

Poverty Reduction

To consolidate the progress being made in alleviating poverty, it would be crucial to ensure that Madagascar reaches the completion point by end-2002 as envisaged. In this connection, we welcome progress being made in implementing the completion point triggers as outlined in Box 3 of the staff report and encourage the authorities to persevere. Progress is also being made in the preparation of a full PRSP, with extensive consultation with civil society and the donor community.

We are pleased to note that poverty alleviation programs are also being implemented, including increased outlays for education, health, justice, budgetary control agencies, water supply, public work and poverty monitoring. The authorities are encouraged to speed up the execution of poverty reduction expenditures, make further improvements in expenditure monitoring, ensure efficient distribution of generic drugs as well as improvements in rural roads.

Improved market access under the African Growth and Opportunity Act (AGOA)

External sector developments have been encouraging. Despite the recent appreciation of the exchange rate, external competitiveness has been broadly preserved and export growth remains strong. The authorities are commended for fulfilling the conditions for accessing and benefiting from AGOA. The case of Madagascar helps to illustrate the beneficial effect of enhanced market access of low income countries to industrial countries' markets. Under the AGOA, exports of textiles and apparel increased by 73 percent in the first half of 2001 and total exports to the United States increased by 122 percent during the same period. This market access not only facilitated the creation of 8,100 new jobs, providing income and helping to reduce poverty, but also diversified Madagascar's export markets and increased export revenues, thereby helping the country to partly offset the negative impact of the ongoing global slowdown.

It is encouraging that Madagascar stands to benefit more from increased market access under the AGOA as exports are poised to further increase by 20 percent during the second half of 2001. Foreign direct investment has been buoyed by this market access, macroeconomic and political stability, abundant skilled workforce and other investment incentives as textile and apparel firms from Asia have indicated their intention to boost their investments in Madagascar. We encourage the authorities to keep external developments under close scrutiny as demand for exports could falter if the global downturn is protracted and severe. In this connection, it is clear that Madagascar will make significant progress towards reducing external vulnerabilities and in reducing poverty if the country is accorded similar access for agricultural exports, particularly in the European Union market, and we urge industrial countries to reduce agricultural subsidies and other barriers on value added exports from low income countries. In addition, utilization of the duty-free access by Africa as a whole under the AGOA remains low at a projected 17 percent for 2001. It will be important for African countries to implement measures that allow them to make full use of the quota and for the U.S. authorities to continue reviewing conditions for eligibility under AGOA to allow more countries to benefit. We support the proposed decision.

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

We thank the staff for an informative report and Mr. Barro Chambrier for a substantive statement.

Madagascar's economic performance under the PRGF arrangement has been satisfactory in the first half of 2001, and there are good prospects for strong economic growth, low inflation, and additional external reserve gains for the year as a whole, despite the current weak global environment. On the structural front, the authorities are moving forward on a comprehensive privatization program and on strengthening the judicial system, and are taking steps to reform the civil service. Except for the tax revenue target, all other performance criteria and benchmarks were observed at end-March and end-June this year. We commend the Malagasy authorities for keeping the program firmly on track and for their record in meeting macroeconomic policy targets, which bodes well for their progress toward reaching the HIPC Initiative completion point.

The main slippage has occurred in the fiscal area, particularly on account of custom revenue shortfalls due partly to the appreciation of the Malagasy franc and partly to weak customs administration. The authorities, however, have responded decisively by strengthening customs administration, including through the introduction of a new computerized system for customs operations. They will need to closer monitor revenue collections and the execution of the expenditure program to permit the early prevention of deviations from the fiscal target. Adhering to the timetable for strengthening budgetary management, as outlined in Box 3, would also help the Malagasy authorities in meeting the completion point triggers.

On the financing side, privatization receipts programmed for this year are likely to be delayed into next year and the budgeted level of external financial support could fall short of projections. Although there is some room under the program to access the domestic credit market for bridge financing, we are reassured from Mr. Barro Chambrier's statement that the authorities would remain vigilant and implement corrective measures, if warranted, to ensure that fiscal policy remains prudent.

Over the medium term, Madagascar's external current account deficit (excluding official transfers) is expected to gradually worsen, as the deterioration in the global economic environment is likely to slow production in the export free processing zone and soften appreciably world prices for vanilla and cloves, two main agricultural exports. However, we are heartened that, on the basis of current projections, the external financing gap over this period can be fully covered, including through HIPC Initiative debt relief from bilateral creditors. Nonetheless, if the external outlook becomes more difficult, the multilateral agencies and international donors would need to help the authorities to ensure adequate and timely external assistance, including a possible increase in access under the PRGF-supported program.

In a relatively short time period the Malagasy authorities have established a good macroeconomic track record, but unfortunately social conditions still remain considerably below the average for sub-Saharan Africa. More than 75 percent of the rural and agricultural population live below the poverty line. In this context, the authorities are to be commended for their determined efforts to ensure that budgetary resources, including those freed by HIPC Initiative debt relief, are utilized in an effective and well-targeted manner for poverty alleviation. We look forward to the finalization of the full PRSP, which has benefited from extensive consultation with Malagasy civil society and the donor community.

In conclusion, we support the proposed decision and wish the authorities every success in their endeavors.

Mr. Kelkar submitted the following statement:

We thank the staff for a comprehensive report and Mr. Barro Chambrier for his helpful statement. The authorities deserve to be complimented for having not only met all but one of the structural performance criteria and benchmarks but for having done so by sizable margins in some of the key indicators. At 6.7 percent, GDP growth rate for 2001 is expected to exceed the target of 6 percent, the external current account deficit is projected to remain one and a half percent of GDP below programmed level and the increase in international reserves is likely to exceed the amount programmed by more than ten percent. We would, in particular, commend them for having reversed the rising trend of inflation since 1997 and having more than halved it from the high of 11.9 percent in 2000. We welcome Mr. Barro Chambrier's assurance that the ensuing electoral process will not impinge on the pace of program implementation.

We are happy to note that not only has Madagascar's GDP growth rate been steadily increasing over the last few years but also that it is no longer, unlike many HIPCs, overwhelmingly dependent on one or two sectors. Manufacturing sector has become a significant component, with the opening up of the U.S. markets to garments exports providing a major impetus. This underscores the importance of the demand by developing countries for greater access to developed countries' markets. The outlook for 2002 is also bright though we would have liked the staff to have included, in their projections, an assessment of the slump in prices of coffee, which is still the top foreign exchange earner.

On the fiscal front, both revenue and expenditure are projected to grow at rates less than programmed albeit by modest margins. Fiscal deficit in 2001 is consequently expected to be around 4 percent of GDP, within the program target but up from 0.6 percent in 2000. We are, however, happy to note that the authorities have already taken measures for effecting necessary improvements in the customs administration which was one of the main sources of shortfall in tax collections. The only delay in this field has been on account of late provisioning of software by UNCTAD. We would, therefore, urge the authorities to press ahead with the progressive simplification and liberalization of the external trade regime. The staff have noted that concerns over shortfall in customs receipts have prompted a temporary halt to this process. We are, on the other hand, concerned about the impact of shortfall in public expenditure, which was to increase to 20.5 percent of GDP in 2001, with social and capital investment as the prime beneficiary. We would have liked an elaboration of the reasons for shortfall in expenditure, including capital expenditure. How did it impact the progress in poverty reduction efforts? If this is due to shortcomings in implementation capacity, what are the proposed actions to overcome them? We are particularly anxious that the HIPC Initiative completion point triggers in crucial sectors like health, education and infrastructure are met in a timely fashion. While allocation of resources freed up by interim debt relief to priority sectors has started and significant actions like recruitment of four thousand teachers and their assignment to rural areas have been completed, there is still a lot of ground to be covered. We have noted, for instance, that functioning of the generic drug distribution system is not satisfactory and transfers to Road Maintenance Funds are irregular. Only six percent of the available funds will be used for rural roads in 2001. The figures in Table 11 of the staff report, indicate an increase both in the overall incidence and depth of poverty from 1993 to 1999. We would like to be assured that the marginal decline in these figures from 1997 to 1999 represents a continuing trend and that specific schemes have been designed to address the rural landless poor. We agree with the staff that a system for monitoring of physical outcomes in health and education sectors needs to be quickly put in place.

We are pleased with the progress made in improving budgetary management, treasury accounting, audit and procurement. We also commend the authorities for having taken further steps to strengthen the soundness of the banking and financial sector, including limiting insider trading, reducing lending concentration, implementing permanent internal audit system and limiting bank participation in non banking activities.

We recall that while concluding the Article IV consultations in June 2000, the Executive Board had stressed the need for prudent macroeconomic policies and accelerating structural reforms. We congratulate the authorities for having succeeded on the first count. Regarding the second, we have noted the falling behind of the privatization process resulting, inter alia, in substantial shortfall in receipts and the consequent increase in bank financing to the government. In fact, receipts from privatization were almost negligible in the first two quarters of 2001 and credit to government grew rather than shrink as programmed. We would like to know if this was at the expense of credit to private sector which grew but substantially less than programmed. We cannot overemphasize the importance of this factor in the present situation of a global slowdown, declining trade, and weakening commodity prices. We would encourage the authorities to strive to improve the tax collections and complete the privatization process on target so as to ensure higher spending on social and poverty reduction sectors without adversely impacting macroeconomic stability. We would request some elaboration of the impediments to privatization process and the roadmap for future so that the projections for the remaining quarters of 2001 and the next year do not turn out to be unduly optimistic.

Considering the overall good performance and the continuing efforts of the Malagasy authorities to promote growth and maintain stability and to address the weaknesses identified so far, we support the proposed decisions to complete the first review under the PRGF-supported program, waive the nonobservance of one structural criterion and grant of interim HIPC Initiative relief. We wish the authorities continuing success in their endeavors.

The staff representative from the African Department (Mr. Sacerdoti) informed that recent data for end-September indicated that the structural benchmark on domestic financing to the government had been met.

Mr. Sakr made the following statement:

Madagascar's economic performance has been broadly satisfactory thus far in 2001. For the year as a whole, real GDP growth is projected to accelerate to almost 7 percent and the inflation rate is envisaged to be less than half its level a year earlier. Exports and FDI have been buoyant, contributing to an increase in foreign exchange reserves. The overall fiscal deficit is projected to be somewhat lower than programmed. This generally favorable performance was underpinned by the authorities' continued wide-ranging reforms, as well as positive exogenous developments arising in an important part from the beneficial impact of the U.S. African Growth and Opportunity Act.

Notwithstanding the credible fiscal performance, revenue projections for 2001 are now smaller than programmed due to a shortfall in customs revenue. This is a matter of particular concern in view of the need to increase the relatively limited revenue base to provide financing for priority expenditure areas. The shortfall appears to be mainly related to a delay in the UNCTAD assistance to computerize the tax system. It is therefore assuring that work in this area has been expedited and that customs systems in all major ports have now been computerized. It would be important to proceed quickly to strengthen the system in all remaining ports in order to ensure the achievement of the programmed increase in revenue in 2002 and beyond.

Still on fiscal policy, we commend the prudent expenditure restraint implemented in order to preserve the budgetary target. Additionally, while the authorities have been implementing strong measures to enhance budgetary management as explained in Box 3 of the report, continued progress in this area is important in order to improve the effectiveness of expenditures, and meet the remaining conditions for the HIPC Initiative completion point.

Prudent monetary policy and the nominal appreciation of the exchange rate have contributed to the significant decline in inflation over the year. In view of the envisaged decrease in money velocity, we find the targeting of broad money growth slightly above nominal GDP growth to be appropriate. We also share the view that external competitiveness appears to remain adequate as evident by the buoyant exports growth and the favorable labor cost indicators. However, it is important to be vigilant regarding exchange rate developments while continuing the efforts to increase productivity and reduce costs in order to benefit fully from the country's export potential.

With regard to financial sector supervision, the authorities are to be commended for the measures they adopted over the last two years to enhance the soundness of the system in line with technical assistance recommendations from the Fund's Monetary and External Affairs Department. Strict enforcement of the new prudential regulation, including in relation to insider lending, lending concentration, and participation in non-bank activities, would help maintain the health of the sector.

Non-fiscal structural reforms, including privatization and civil service reform, are covered by conditionality under programs with the World Bank and the African Development Bank. We are encouraged that, with a few exceptions, important gains have been achieved in these areas. Of particular significance is the progress achieved in the privatization of the telecommunication company and the adoption of a new strategy to allow private sector's participation in the electricity sector. Increased private sector participation would facilitate an improvement in the country's infrastructure, which is needed to further reduce production costs. These and other structural reforms, including in the cotton and sugar sectors, as well as improving the procedure for exports and imports clearance, will help enhance productivity and alleviate poverty.

Like Mr. Rustomjee, we note that, the positive impact of the ongoing structural reforms has been complemented by the U.S. African Growth and Opportunity Act. The effect of this initiative on output, employment, exports, FDI, and poverty alleviation is well illustrated in the report. This highlights the role increased market access can play in the development process. We commend the United States for implementing this important initiative and encourage all industrial countries, to expand such initiatives and provide better market access for exports of all developing countries.

With these comments, we wish the Malagasy authorities continued success and support the proposed decision.

Mrs. Boucher made the following statement:

At the outset, I would like to thank the staff for their concise and interesting reports. We particularly appreciated the detailed information in the various boxes, including the one on progress in reaching the completion point triggers which was very helpful and could be used as a model for similar reports for other HIPC Initiative countries.

Despite some slippages and delays due to some extent to factors beyond the authorities' control, consistency and sustained progress appear to us as the main features of the authorities' performance under the present review, consolidating the satisfactory track record experienced since 1996. Adjustment efforts resulted in a relatively robust growth pattern. The competitiveness of the economy and its attractiveness to foreign investors enabled the country to increase their export market share and fully benefit from the opportunity offered by the AGOA. This achievement is very encouraging. Indeed, the greatest challenge for Madagascar remains to sustain over the long term a high growth rate pattern in order to fight against pervasive poverty, taking into account that the country remains highly vulnerable to adverse exogenous factors, such as climatic hazards or a deterioration in the terms of trade. Also, as indicated in the report, growth alone will not suffice and targeted actions are needed to address the widening gap between the rural and urban areas and enable the rural population to reap the benefit of growth.

Since I am in broad agreement with the staff's conclusions and recommendations and share most of the comments made by directors in their statements, I will comment briefly on a few issues for emphasis:

On the fiscal stance, we take note of the authorities' undertakings to address the weaknesses in customs revenue collection. We therefore support the request for waiver for non satisfaction of the corresponding performance criterion. We encourage the authorities to maintain a prudent fiscal stance, and noted their intention to adjust the level of expenditures in case revenues are lower than anticipated. We welcome indications in Mr. Barro Chambrier's helpful statement on the authorities' commitment to pursue their efforts in strengthening revenue collection and aim at a higher revenue to GDP ratio which are needed to enable the government to meet the social and infrastructure needs of the country.

We also find the authorities' determined efforts to improve budgetary management highly commendable. Nevertheless, we agree with the staff on the necessity to improve the monitoring mechanisms on social outlays and to expand the system that has been put in place to track the use of HIPC Initiative resources to all poverty related expenditures.

The authorities planned to rely on the decentralization process for the implementation of the social programs to be financed by HIPC Initiative resources. We would appreciate it if the staff could provide more information on progress in strengthening administrative capacity and budget control and monitoring at the decentralized levels.

On the structural front, we take note of the unfavorable market conditions which justify the postponement of Air Madagascar and welcome indications on the restructuring of management and rationalization of air routes. We encourage the authorities to rapidly finalize Air Madagascar's privatization when market conditions permit, since further delays could increase the cost of its financial restructuring.

Finally, we encourage the authorities to concentrate their efforts on achieving the completion point triggers in particular, on the production of physical outcome reports, the publication of information to ensure full transparency on the granting of licensing, the functioning of the generic drug distribution system and the allocation of funds for rural roads.

With these comments, I confirm our agreement with the proposed decisions and wish the authorities continued success.

Mr. Lushin made the following statement:

In the course of 2001 the Malagasy economy has shown robust economic growth, while keeping inflation at low levels. Economic activity is particularly dynamic in the export-oriented sector, which continues to benefit from high competitiveness of the country's labor force. The liberalization of the economy is anticipated to boost it further via greater inflows of foreign investment. At the same time, substantial imbalances remain in the macroeconomic sphere, most notably in the fiscal sector. A revitalization of structural adjustment is particularly pressing, given that the global economic slowdown could sap Madagascar's economic growth, which in turn has become increasingly reliant on exports in recent years.

We broadly share the thrust of the staff appraisal. Below we provide some remarks on the main aspects of the ongoing program.

Fiscal policy. Most of the fiscal problems are concentrated on the revenue side of Madagascar's budget, which was reflected in the non-observance of the performance criterion on tax revenue. The main source of weakness in the tax sphere appears to be customs duties, which decreased in nominal terms in 2000 and continued to under perform in 2001. One of the key ingredients in reversing the shortfall in customs duties is certainly the streamlining of customs administration. We wonder, however, whether there may be a need for further measures in rationalizing the country's tax system, most notably through the elimination of some of the tax exemptions. On a related note, while it is hard to disprove the success of the Export Processing Zones (EPZs) in boosting economic growth in Madagascar, we wonder whether there are tangible revenue costs associated with the favorable fiscal regime of the EPZs, which appears to be backed by the staff (paragraph 31 of the Selected Issues paper). On the expenditure side, the containment of the buildup in expenditures is to be commended, particularly given the mounting political pressures associated with presidential elections that are to take place this month.

Monetary and exchange rate policy. Throughout most of this year, broad money expanded at a pace that was much faster than programmed. The expansion in money demand has accommodated to some extent this growth in money supply and together with the real appreciation of the franc has contributed to lowering inflation. As the staff report points out, the appreciation of the exchange rate has not compromised the country's external competitiveness, which continues to be strong on the back of low labor costs in export industries. In this respect, while the real appreciation of the exchange rate may be consistent with the Balassa-Samuelson hypothesis, as the staff rightly points out, given the lack of data with respect to Madagascar's productivity and external competitiveness, due diligence is required in closely monitoring developments in Madagascar's external competitiveness.

Trade policy. Exports have been propelled by the success of the EPZs, which are predominantly oriented at exporting textile goods. Strong impetus to the expansion of exports via the EPZs was given by the country's accession to the duty-free status under the African Growth and Opportunity Act (AGOA), which served to raise the share of external trade with the United States and to diversify exports, which are traditionally mostly directed toward the European Union. Geographical diversification is set to be complemented by the commodity diversification of Malagasy exports, particularly as mining of gemstones is being actively developed. In fact it is widely speculated that Madagascar could prove to be the richest place in the world for gemstones. In this respect we wonder, whether there are any major implications stemming from the development of natural resources for Madagascar's export prospects in the short to medium term.

Privatization and private sector development. While signs of buoyancy in the EPZ sector are clear, there is a question of whether the rest of the economy is as well-off. In particular, the development of small businesses in the rural areas appears to be lagging behind, which results in rising income disparities across Madagascar's regions. While urban poverty levels are declining notably, rural poverty is rising, with three out of six regions witnessing tangible increases in poverty levels (paragraph 29). One of the ways to open business opportunities across a wide range of regions is to actively promote the development of market services and infrastructure through structural reforms, including privatization. The latter according to the staff report is "proceeding in a satisfactory manner", though the report also makes it amply clear that significant delays were experienced in the course of 2001.

Debt issues. As the staff report notes, in October 2000 Madagascar concluded an agreement with Russia that reschedules pre-cutoff-date debt, with the resolution of the post-cutoff-date debt still pending. We regret that this issue has remained outstanding for already more than a year. The new round of negotiations is taking place in Moscow right now and we expect it to finally resolve the issue of post-cutoff-date arrears.

On the whole, the implementation of the PRGF-supported program has been broadly satisfactory, which serves as a good reference point for further progress. With this in mind, and in anticipation of a swift resolution of bilateral debt issues, we support the proposed decision, including the granting of the relevant waiver, and we wish Malagasy authorities every success.

Mr. Baukol made the following statement:

This is an encouraging report to read: strong GDP growth, increasing exports, increasing investment, increasing reserves, and declining inflation and interest rates add up to an impressive picture, particularly given the problems Madagascar faces. The government and people of Madagascar are to be congratulated for these results. The United States is pleased to have contributed to this outcome via the boost in exports related to the African Growth and Opportunity Act. As noted by Mr. Rustomjee, we look forward for more African countries to implement measures that allow them to make full use of the AGOA framework.

The efforts to strengthen budgetary management, treasury accounting, and auditing are critical, not only in themselves but to ensure that Madagascar will be able to meet the requirements of the HIPC program for tracking the use of poverty-related expenditure. This includes steps at the regional level. We wholeheartedly endorse the staff's recommendation that improvements in accounting must be accompanied by stronger monitoring of physical outcomes in the priority sectors, and that the PRSP include a costing of the priority programs. We look forward to additional progress in these areas. As noted by others, improvements in customs administration are also a key part of ensuring that revenues are strong enough to provide resources for poverty reduction.

Like Mr. Kelkar, we are concerned that actual spending on the social sector may have lagged the targets in 2001. The staff report indicates that spending commitments are up relative to spending last year, but it is not clear if social spending is meeting targets for this year. It also appears that data for end-September are not yet available, which is quite a delay.

We were surprised that in a paper that repeatedly refers to the problem of revenue shortfalls, there was relatively little treatment of gemstone mining. There is significant economic activity in this area, amounting to the hundreds of millions of dollars, and the government cannot track the financial flows, much less tax them. This strikes us as a dangerous situation with the potential to encourage criminal activity or worse. We understand that the World Bank is working on the mining sector in some detail, and we encourage the authorities to work with the Fund staff as well on the revenue aspects of this issue.

Regarding structural issues, we would associate ourselves with the comments of Mr. Kelkar regarding privatization. We look for the improvement in this situation in 2002 as the divestiture of the telephone, cotton, and sugar parastatals are completed.

The performance in Box 3 regarding status of HIPC completion point triggers is somewhat disappointing, particularly in natural resource management, transportation, and health. For example, it is not clear why information on mining, forestry, and fishery licenses is not available to the public. One of the purposes of a license is to make clear who is benefiting from the exploitation of such sensitive resources. In addition, it is disappointing that only 6 percent of the available funds in the Road Maintenance Fund be used for rural roads this year. Since rural development is one of the priority sectors, more spending in the rural areas would be expected and needed.

Finally, regarding the status of the safeguards assessment, we understand from the staff that the staff has concluded the stage-one assessment and provided a number of suggestions to the authorities. We encourage the authorities to implement these recommendations, and we would ask the staff to report on progress in the next staff paper.

Despite these problems, we concur with the staff's conclusion that the overall performance has been strong. We support the review, agree that a waiver should be granted for the non-observance of the performance criterion on tax revenue, and concur in the request for additional interim relief under the enhanced HIPC Initiative.

Mr. Jang made the following statement:

I am pleased to learn from the staff report that Madagascar continues its satisfactory macroeconomic performance with a robust real GDP growth, a moderate inflation and favorable foreign sector developments, especially an increase of export and foreign direct investment in export processing zone. I also note that Madagascar observed all quantitative and structural performance criteria and benchmarks for end-March and end-June 2001, with the exception of the tax revenue target. As such, I support the staff's recommendation for the completion under the program and a request for waver of performance criterion on tax revenue. Since I broadly agree with the staff appraisal, I only wish to raise only a few points.

I note in the paper that the overall fiscal deficit is projected below the program target in 2001 because of lower government expenditure, although tax revenue and privatization receipts were lower than programmed. In any event, it is clear that the authorities need to increase their efforts to lift the government's revenue performance. On the tax revenue side, I welcome the authorities' efforts to strengthen customs administration through the operation of the computerized customs data system, and to strengthen the customs control in secondary harbors. Since these measures could help the tax authorities to intensify the exchange of information between the DGI (Directorate General of Taxes) and customs, in addition to the strengthening of domestic tax administration, I think the authorities could see an increase in tax revenue. However, projected tax revenue in 2001 and 2002 is still below the program target, even though the margins would be decreased gradually. Thus, I encourage the authorities to endeavor more efforts to facilitate fiscal consolidation in the tax revenue side in line with expenditure control.

I cannot overemphasize the importance of budgetary management, as loosening budgetary management would distort the allocation of resources and hamper the achievement of the program target. In this regard, I welcome the progress made in improving treasury accounting and budgetary execution reporting. However, as the staff noted, more effort needs to be made in the social sectors, especially in the health sector and the allocation of funds for rural roads, to ensure the monitoring of the physical outcomes for expenditure.

Improving the soundness of the banking and financial sector should be an important objective for the authorities, as a fragile financial system could undermine macroeconomic stability. In this context, I welcome the authorities' efforts to improve bank supervision, through limiting insider lending and requiring all banks to implement a permanent internal audit system.

I welcome the authorities' continuing efforts to implement key structural reforms, supported by the World Bank and other international institutions, focused on privatization of public enterprise, although some operations are delayed more than originally envisaged. Particularly encouraging is the authorities' determination to ensure civil service reform and to implement decentralization through submitting a new organic law governing the public finances. Adherence to these reforms is vital.

Poverty alleviation in rural areas should be the top priority on the agenda, as poverty in Madagascar is predominantly a rural and agricultural phenomenon as indicated in Table 11. It is encouraging that the authorities adopted the supplementary budget decrees allocating interim debt relief resources to priority sectors , such as rural education and regional health. Strengthening the monitoring of the expenditure process in the Ministries of Health and Education through the quarterly budgetary execution reports is also welcoming. I am pleased to know that the preparation of the full PRSP is smoothly underway in line with the extensive consultation. I hope the full PRSP will be submitted in time.

With these remarks, I wish the authorities continued success with these objectives.

Ms. Manno made the following statement:

We commend the Malagasy authorities for the progress they have made, which is very well explained in the comprehensive set of papers prepared by the staff and in Mr. Barro Chambrier's statement. Since we basically concur with the staff appraisal, in particular on the need to maintain a prudent fiscal policy and to strengthen the budgetary management and monitoring of poverty-related expenditures, we will make a few remarks for emphasis and clarification.

The authorities have shown strong commitment to reform. The key issue now is how to maintain the process of political and economic reform in the country. We are comforted by the statement by the staff and by Mr. Barro Chambrier that no major change in economic policy is expected to ensue from the presidential election scheduled in two weeks time.

The experience of Madagascar is a good example of the great benefits of opening industrialized-country markets to low income-country exports. As stated in Box 2, the positive effects go beyond direct trade impact, spurring foreign direct investment and employment. While all these positive developments generated higher that anticipated growth, it is not clear whether higher growth has benefited the poor. Could the staff elaborate on that?

As Mr. Rustomjee states in his statement, prospects for export performance should be kept under close scrutiny, since a slump in export earnings threatens to negate the benefits of debt relief for those who have undertaken the adjustment necessary to qualify under the HIPC Initiative. Demand for exports could in fact falter, mainly as a result of global economic slowdown. Manufacturing, particularly textiles from the Export Processing Zone (EPZ), will remain a solid performer, but will lose a little of its buoyancy owing in part to the weakening of the U.S. economy and the slowing growth in other markets. As explained in the Selected Issues paper, other reasons may be the sector's fast growth itself, red tape and administrative impediments; these factors generate concerns about Madagascar's ability to maintain competitiveness. Continuous vigilance in this area is warranted.

It is becoming more and more evident that there is a clear need to examine the impact of regional and multilateral initiatives when discussing a single country. I would go even further and ask the staff to evaluate the impact of specific policy action by one country on the region as a whole. In the Madagascar case a few are relevant and are rightly emphasized by the staff. I have mentioned the Africa Growth and Opportunity Act (AGOA), but also the Cross Border Initiative (CBI). In this context, it is not very clear how the process of trade liberalization is proceeding in Madagascar.

On structural conditionality, we find Box 1 in the staff report very helpful, but we have some concerns about the staff's view that the adoption of a medium-term expenditure framework is still premature. Although we understand the rationale of the proposal not to include the issue in the conditionality framework, we think this is a crucial aspect in particular in the PRSP context and technical assistance should be granted to build the capacity as soon as possible to correct this weakness. Without a clear medium-term framework it would be very difficult to program and monitor expenditures, in particular poverty-related ones which are crucial to donors. We believe that the aim toward such a framework should continue to be among the country's priorities. We would appreciate the staff's comments.

We understand that the decentralization process is one of the government's priorities and we share its main objectives of making the provision of heath and education services more effective as well as improving tax revenue collection. However, in consideration of possible negative implications for the fiscal discipline, we were wondering whether the staff has had a chance to assess the new law that is to be submitted to the National Assembly early next year.

The weak statistical base of Madagascar continues to be a source of concern and we were surprised by the staff's statement that such a weakness does not hamper the effective conduct of surveillance and the monitoring of performance under the PRGF arrangement. Could the staff elaborate on that and give us a more precise timetable on the participation of Madagascar in the GDDS.

As to the tax administration system, we acknowledge progress made, still we are concerned that, notwithstanding years of technical assistance devoted to this area, a lot remains to be done. In this context, it may be worth recalling the importance of having a clear legal and management system for controlling the use of the revenue the tax generates.

With these remarks we support the proposed decision and wish the authorities continued success.

Mr. Komatsuzaki made the following statement:

I commend the good policy performance and broad based economic growth occurring under decelerated inflation in Madagascar. With the uncertain global economic outlook, however, the authorities need to maintain a prudent macroeconomic policy. In addition, they should strengthen the medium-term growth base with structural policies. I broadly agree with the staff appraisal, and will make only a few comments.

The authorities' management of the external sector has had remarkable success for the last few years, underpinned by enhancement of the business environment, as in the relatively unrestrictive trade regime, the floating foreign exchange regime, and especially export processing zones (EPZs). Their success shows the importance for developing countries to establish an attractive environment for foreign direct investment.

The selected issues paper shows that Madagascar maintains international competitiveness because of the relative low wages of its workforce, and the favorable business environment, including tax incentives in export processing zones. The wage increase is welcome, if anything, from the standpoint of reducing poverty. To maintain this momentum of wage increases without hurting international competitiveness, foreign direct investment accompanied by productivity increase must continue. Maintenance of current stable institutions and enhancement of production factors, especially human capital, will be important to ensure this happens. In this context, it is encouraging to hear that HIPC Initiative resources have started to be spent on hiring 4000 teachers.

The number of employees in EPZs is only 74,000 out of a country with a population of more than 15 million, which means that poverty reduction within the vast population relies on development in other parts of the country, unless EPZs expand extremely rapidly. However, the staff paper describes very little of the development in other parts of the economy than EPZs. In this context, I support Mr. Kelkar's remark in his statement that an assessment of the slump in coffee prices should have been included. I also concur with Mr. Baukol's comment on gemstone. And as Ms. Manno just stated, I am not sure if or how EPZs have helped alleviate poverty. I would like to see more description in the next staff report.

With a fiscal deficit of around 8 percent of the GDP, the fiscal area is the authorities' one weakness. Performance has been mixed this year. The revenue shortfall, mainly through less than projected customs revenue, is a concern. With majority of population in poverty, sufficient revenue should be generated to allocate resources for social spending. The authorities have to strengthen the customs administration. I note that there were some exogenous factors, such as the delay in customs system improvement due to a delay in software provision, but there were shortcomings in other areas of customs administration as well. In this context, I welcome that the authorities are taking corrective measures, as specified in the letter of intent. Strengthening of operations in secondary ports and streamlining of operations in EPZs will be especially important in maintaining the integrity of the customs system without hampering economic activities.

It is encouraging to see that the authorities are implementing the measures that were pointed out to them by the technical assistance mission from the Fund's Monetary and External Affairs Department. I encourage them to make steady progress in their efforts.

On structural areas, I understand the postponement of privatization of Air Madagascar, in light of current unfavorable external environment. Nevertheless, I encourage the authorities to continue their preparation for the privatization of Air Madagascar and other public enterprises on the list.

With these remarks, I wish the authorities success.

Mr. Liu Fushou made the following statement:

At the outset, I would like to join the previous speakers in thanking the staff for the well-prepared set of papers and Mr. Barro Chambrier for his comprehensive and helpful statement. We are pleased that Madagascar's economic and financial performance in the first half of 2001 under the PRGF-supported program has continued to make good progress. Real growth this year is expected to be higher than the programmed target; the inflation rate is declining; and international reserves are accumulating. This is due mainly to the authorities' prudent management of the economy, a good agricultural crop, the rapid expansion in production and exports in the EPZ, and favorable export prices for traditional exports. It is also encouraging that, except for tax revenue for which we support the authorities' request for waiver given the fact that they have taken corrective actions in this area, all performance criteria and benchmarks have been observed. We concur with the thrust of the staff appraisal, and fully support the proposed decision, in view of the authorities' satisfactory track record, their progress in preparation for a full PRSP, and commitment to further strengthen the implementation of policies and reforms. That being said, I would like to make a few comments for emphasis.

On the fiscal front, we are encouraged that, although tax revenue and privatization proceeds were lower than programmed mainly because of factors beyond the authorities' control, the overall fiscal performance continued to improve. We are pleased to note that measures have been taken to address weaknesses in customs administration, and welcome the introduction of a new computerized system for customs operations and the authorities' intention to intensify large-scale audit operations to improve revenue collection and transparency. We are encouraged that the authorities have used savings from debt relief to increase allocations to the social sectors in line with PRSP objectives. We commend them for their efforts to improve budgetary management, including treasury accounting, monitoring of budgetary execution, and auditing procedures. Like Mr. Rustomjee, we stress the importance of further increasing the revenue-to-GDP ratio and improving budget execution, particularly in the social sectors and in rural infrastructure.

On structural reforms, we agree with others that continued reforms should be implemented for the state-owned enterprises, and we are encouraged by the adoption of a comprehensive privatization program with assistance from the World Bank. We agree with others that delays in privatizing Air Madagascar are understandable given the difficulties in the airline industry worldwide, and we welcome steps being taken by the authorities to improve airline operations. We also welcome the finalization of the telecommunications company sale as well as preparations for privatizing the cotton and sugar companies. On the banking sector, we welcome the authorities' adoption of the recommendations of a technical assistance mission from the Fund's Monetary and External Affairs Department to strengthen banking and financial sector supervision.

Finally, on poverty reduction, we welcome the important progress made in the implementation of the poverty reduction program, including increased outlays for education, health, justice, budgetary control agencies, water supply, public work and poverty monitoring. We look forward to the finalization of the full PRSP, which has benefited from extensive consultation with Malagasy civil society and the donor community.

With these remarks, we support the proposed decision, and wish the authorities all the best in their valiant efforts to reduce poverty and improve social conditions for their people.

Mr. Haupt made the following statement:

Developments under Madagascar's PRGF-supported program have been encouraging thus far. Notwithstanding a number of favorable exogenous factors, the authorities are to be commended for building on the favorable track record from previous years and for their commitment to meet program targets despite budgetary and privatization shortfalls. In particular, the acceleration of spending in high-priority areas despite lower than programmed overall expenditures and the ongoing efforts to improve budgetary management are welcome. The authorities should keep up the momentum here, including in the area of expenditure tracking.

That said, the renewed shortfalls of budgetary revenues and privatization proceeds, though not entirely unexpected, are regrettable. I shall be brief in my further comments, focusing on this pressing problem and on a few other issues.

Firstly, like in so many other HIPC Initiative cases, the weaknesses in mobilizing domestic resources are a key impediment to reaching debt sustainability and combating poverty in Madagascar. We strongly urge the authorities to further improve customs and tax administration along the lines suggested by the staff. In addition, I wonder whether further changes to the tax system could be explored to broaden the revenue basis. For instance, the tax holidays granted to enterprises of the Export Processing Zone could be put under review. The dynamism of this zone is heartening and its duty-free status, very competitive unit labor costs, and eligibility under the African Growth and Opportunity Act, should still make it attractive to investors, even with less tax privileges in place.

On privatization, we would urge appropriate corrective measures to contain the rise in domestic indebtedness, if the revenue shortfalls incurred this year should not be made up for in 2002. As regards the privatization program, we would encourage the authorities—besides the ongoing initiatives—to consider the eventual privatization of the electricity company JIRAMA.

Thirdly, on poverty reduction, as Ms. Boucher and Mr. Jang have pointed out, stronger efforts will be necessary to make sure that the benefits of economic growth are more evenly distributed between the relatively more prosperous urban areas and the rural areas. One important step in this direction would be the satisfactory implementation of the related completion point triggers on the drug supply system and the functioning of the Road Maintenance Fund. On the tracking of HIPC Initiative resources, like others, we look forward to further improvements in transparency in this area. A somewhat more detailed presentation of the resources to be allocated this year would have been helpful. More broadly, it will be essential to seek speedy further improvements in budgetary management.

Fourthly, like Ms. Boucher and Ms. Manno, we would be interested to learn about the possible impact of the planned decentralization process on the conduct of fiscal policy. The staff's comments would be appreciated.

Finally, like others we urge the authorities to step up their efforts to improve the management of natural resources. A policy shift in this area is vital for improving the prospects for the tourism sector and for longer-term sustainable economic growth.

With these remarks, I fully support the conclusion of the present review and the granting of the requested waiver and wish the authorities every success.

Mr. Alosaimi made the following statement:

I welcome the recent economic developments in Madagascar. The authorities' adjustment and reform effort is paying off. This year's sizable growth pick up is accompanied by a marked drop in inflation with further fiscal improvements as well as a continued rise in external reserves. With these favorable trends likely to continue, the outlook is also reasonably bright despite the weakening of global economic conditions. The authorities' continued policy commitment is also assured in Mr. Barro Chambrier's statement.

In the fiscal area, the improvements in spending management is evident as allocations to priority areas improved and the overall budget targets were met despite lower privatization receipts and the requested waiver for the shortfall in revenues. Indeed, as Mr. Barro Chambrier explains, the slippage in revenue goals reflected transitory factors as the tax revenues have in fact continued to rise relative to GDP. Going forward, the authorities have intensifies efforts for improvements in revenue administration, especially the customs. The ongoing further improvements in expenditure containment is also appropriate.

Regarding structural reforms, faster progress in privatization is important. Here, the strengthened policy resolve is important despite the reduction in expectations in view of the weakened external economic environment. Here, the importance of an efficient legal and institutional machinery for enforcement of contract and property rights cannot be overstated. I therefore welcome the authorities' priority for judicial reforms. The civil service reforms that are now in legislative process also need to be stepped up. The banking sector reforms, including extension of oversight to the micro-finance institutions, are welcome. While I also welcome the fiscal decentralization initiative, I agree with Mr. Rustomjee on the need to proceed in full view of the country's limited administrative capacity.

Finally, it is heartening that the poverty alleviation and PRSP process are proceeding well. The increased budgetary outlays to poverty-related areas are welcome. With the PRSP nearing completion, an accelerated approach to the recommended rural area improvements is crucial.

With these words, I support the proposed decision and grant of waiver, and wish the authorities success.

Mr. Rouai made the following statement:

I thank the staff for the informative report, and Mr. Barro Chambrier for his very helpful statement. I commend the Malagasy authorities for the progress achieved under the PRGF-supported program and I have no difficulties in supporting the proposed decision to complete the first review under the PRGF arrangement and to provide additional interim assistance under the HIPC Initiative.

I had the opportunity to visit recently Madagascar and I was really impressed by the seriousness of the authorities, their pride in showcasing their achievements, and their sincere dedication to do better. I have also observed the importance of poverty and the urgent need to improve infrastructure, in particular rural roads. The authorities are encouraged to build on their accomplishment so as to reach as soon as possible the HIPC completion point.

Like Mr. Rustomjee, I am impressed by the rapid and direct impact of the Africa Growth and Opportunity Act (AGOA) on Madagascar's exports. I commend the U.S. authorities for this generous and concrete initiative to grant duty-free access to exports from African countries and I encourage Madagascar and other eligible countries to make full use of the allocated quota. I encourage also other industrial countries to implement similar initiatives. The sizable increase in exports as a result of the AGOA has helped Madagascar to partly offset for 2001 the negative impact of the world economic slowdown. For the year 2002, I urge the staff and the authorities to monitor carefully economics developments and to recommend to the Board any increase in access under the PRGF, if warranted by the outlook in the financing need.

Finally, because of the recent role of the export processing zones and AGOA in the surge in exports, staff may wish to indicate if the last DSA analysis took into consideration these initiatives. With these comments, I wish the authorities success in their endeavors.

Mr. Vermaeten made the following statement:

We support the staff recommendations that the first review under the PRGF arrangement be considered complete, and, in view of the corrective actions taken to improve customs administration, we support a waiver granted for the nonobservance of the performance criterion on tax revenue.

The government of Madagascar should be commended for its strong economic reform efforts, particularly its success in building a competitive environment to start to attract foreign investment and enhance nontraditional manufacturing exports. We share the staff's views and those expressed by Mr. Sakr that continued efforts are needed to improve cost structures to ensure that these results are sustainable, particularly in light of the rising exchange rate. We have just a few questions for the staff.

First, we note that much of the success in attracting FDI and increased exports has occurred within the export processing zones, and we would appreciate more information on the EPZs. Specifically, we would like to know, given that low labor unit costs are an important part of the success of the export processing zones, what the prospects are of containing the wage demands. How much of the success in attracting FDI was the result of Madagascar providing concessions such as tax holidays? As Mr. Haupt pointed out, perhaps these could be scaled back now, and we would like to hear comments on that.

To what extent is the export processing zone providing benefits for the overall economy? It was not clear in the report whether the EPZ is generating significant tax revenues, what the extent of backward and forward linkages are, and whether the EPZs are reducing poverty, as Mr. Komatsuzaki also wondered.

The second question has to do with rural poverty. As a number of Directors, like Mrs. Boucher, Mr. Lushin and Mr. Jang, pointed out, reducing rural poverty is critical. As Mr. Baukol pointed out, only 6 percent of funds in the road maintenance fund were made available in 2001 to rural areas. Since this is a critical issue if cost structures are to be reduced and incomes raised, we would appreciate any information on why the share going to the rural areas is so small.

Third, we have a question on privatization. Given the market conditions, we also recognize the potential benefit of delaying the sale of the Madagascar Airlines, but we are concerned that, even after restructuring, there could be significant costs in keeping Madagascar's airline afloat. Is this, in fact, the case? What is the contingency plan if market conditions remain unfavorable in the medium term?

Finally, as Ms. Manno pointed out, it appears that the staff will cost and prioritize PRSP elements in the absence of a medium-term expenditure program. If this is, in fact, the case, then it might be a little problematic, and we are wondering whether this approach has been used in the past.

We wish the authorities continued success.

Mr. Skurzewski made the following statement:

I join the previous speakers in commending the authorities for a satisfactory macroeconomic performance of Madagascar in 2001. Both lower-than-expected inflation and higher international reserves have accompanied this strong economic growth, driven not only by the still dominating primary sector but also by the continued expansion of industrial production in the special export zone.

Real appreciation of the Malagasy franc did not harm the impressive export performance, thanks to the competitive unit labor cost levels. The recently introduced U.S. market access privileges also bolstered Madagascar's exports. However, in light of recent events in the world economy, exports and tourism will certainly be negatively affected in 2002, thus widening the current account deficit and limiting the growth prospects in the near term, possibly to an even greater extent in our opinion than currently predicted by the staff. This could, in turn, result in a financing gap which, as the staff admits, might require the increase of access under the arrangement or higher bilateral assistance.

We regard the fiscal side as the main weakness area, and I associate myself with the comments made by Mr. Komatsuzaki. Based on the overall positive achievements by the authorities, we grant the requested waiver, and we wish the authorities continued success in implementing the program.

Mr. Sipko made the following statement:

Madagascar has made significant progress with its PRGF-supported program. The authorities are to be commended for their consistently good macroeconomic performance, and Madagascar does not presently need additional financial support from the international community. But despite this good news, the Malagasy authorities now face several challenges. We will focus on issues that could hamper Madagascar's medium-term development.

Even though the fiscal deficit did not increase this year, revenues need to be increased. We urge the authorities to take additional corrective measures, inter alia by improving customs administration. Madagascar's new computerized system is just beginning the lengthy process of improving all fiscal operations. The authorities are determined to streamline all collections and increase their transparency. Next year's budget is under preparation, and targets for revenues and expenditures are being set. We would like to learn if the authorities have adopted corrective measures and increased their social expenditures.

The strategy for sustainable long-term growth will require further improvements in the financial sector. The technical assistance mission from the Fund's Monetary and External Affairs Department has suggested strengthening the soundness of the financial and banking sector by adopting the Basel Committee's core principles on banking supervision. The staff reports that the ratio of nonperforming loans to total loans held steady at about 9 percent for the first sixth months of 2001, slightly more than the 8.6 percent recorded in 2000. Could the staff tell us more about the likely outcome for the second half of this year, and about its budgetary implications?

The entire process of privatization needs to be accelerated. Mr. Barro Chambrier's statement noted that "comprehensive privatization" is being undertaken. We welcome these steps, but given past delays in the process we would appreciate more specific information about the near-term privatization schedule.

Even though the economy is growing at a more or less sustainable pace, poverty remains very high in the rural and agricultural areas. We are therefore glad that the authorities have adopted the supplementary decrees allocating resources from Madagascar's interim debt relief under the HIPC Initiative to pay for education, health, justice, water supply, public works, and poverty monitoring. We would like to stress that the authorities are committed to increased social expenditures next year, and to continued monitoring and streamlining of their distribution.

Finally, economic assessments will require improvements in the quality of Madagascar's statistical data. This is another area where comprehensive technical assistance can help.

We support the review, and wish every success to the authorities on their long journey to alleviate poverty.

Mr. Vogel made the following statement:

We thank the staff for the report on Madagascar's policies and Mr. Barro Chambrier for his comprehensive statement. We welcome Madagascar's economic performance with a strong real GDP growth, low inflation rates, development of the external sector and progress in budgetary management. However, we are concerned that the current deterioration in the world economic environment, with its effect on growth, could put pressures on the fiscal performance.

On the monetary side, we agree with the easing of monetary policy in view of the increase in money demand by the business sector and the deceleration of inflation. Despite the fact that the export sector remains highly competitive, the loosening of monetary policy will help to stem the process of appreciation of the exchange rate, which could undermine the competitiveness of the economy.

On the fiscal side, we welcome that expenditures at the end of the year will be below the programmed level. Furthermore, the acceleration in spending in high-priority areas is a welcome step. However, it is critical to maintain sound policies in order to avoid compromising macroeconomic stability. Therefore, the progress in strengthening budgetary management, including budgetary reporting, treasury accounting, and auditing is critical. The failure in meeting the performance criterion on tax revenue is related to the performance of customs revenues. In this regard, we welcome the authorities' efforts to introduce a new computerized system for customs operations and their intention to intensify large-scale audit operations as pointed out in Mr. Barro Chambrier's informative statement, all of which will improve revenue collection and transparency.

Turning to other structural reforms, we welcome the comprehensive program of privatization that is being undertaken, even though there are some delays from what was originally expected. We also welcome the adoption of measures by the Malagasy authorities in the financial sector following the recommendation of the MAE technical assistance mission.

With respect to the trade regime, we welcome its progressive simplification even though there will be no further scheduled reductions for

2002 due to the revenue losses that occurred in 2000 and 2001. In this regard, we ask the authorities to restart the process as soon as possible.

Finally, we welcome the reforms in the judicial sector that would lead to the strengthening of confidence of the donor and improving the business environment.

With these remarks, we support the completion of the first review under the PRGF arrangement and the request for waiver for nonobservance of the end-June 2001 performance criterion on tax revenue, and wish the authorities every success in their future endeavors.

The staff representative from the African Department (Mr. Sacerdoti) said that the fiscal program was quite ambitious, envisaging a sharp increase in capital expenditures. There had been some acceleration in budget execution in the second half of the year but total disbursement might fall below program assumptions. Fund staff were not overly concerned, however, as World Bank staff had made assurances that, with respect to project execution, the pace had been satisfactory. There was a need, nonetheless, to review the execution of projects funded by other major donors. The execution of the budget in the social sector in the first six months of 2001 had similarly been satisfactory and had in fact been much higher than the level in 2000.

The staff considered that it was appropriate for the Malagasy authorities to formulate an MTEF, the staff representative continued. The current program had placed emphasis on improving budgetary monitoring, treasury accounting, the efficient flow of information, and the quarterly execution of the budget. The authorities had expressed concern on doing more within a limited timeframe. The authorities intended to develop an MTEF once they had addressed the problem areas identified in the current program. The preparation of the PRSP was expected to be completed soon. It was important for key social ministries to develop priority action programs.

The main economic sectors that relied on bank credit—mainly the export sector—had been relatively liquid, and were only now beginning to access credit for the vanilla and clove export campaign, the staff representative said. There had been efforts to strengthen microfinance with assistance from a number of donors.

The staff did not yet have a copy of the draft organic law on public finance that was being prepared by the authorities, the staff representative remarked. The main issues to be addressed as the government decentralized would include the transfer of central government resources to the regions, including the criteria to be used in their allocation. The Fund and the African Development Bank had extended technical assistance in that area. There would be an interprovincial conference to discuss the sharing of resources. Relatively limited resources might need to be allocated at the start of the decentralization process and expenditures might continue to be carried out by the central government, especially in education and in health.

The staff had started to discuss with the authorities the fiscal costs of the incentives in the EPZ, the staff representative stated. The current profit tax rate in the EPZ was ten percent after a tax holiday of 3–5 years, to be maintained for a set period as agreed with investors. Some of Madagascar's neighbors that had successful EPZs, like Mauritius, imposed a profit tax rate of 15 percent.

The 2002 budget already had a framework encompassing the allocation of HIPC Initiative resources, the staff representative continued. The staff would review further the framework and the details of the budget during the next staff mission. The World Bank and the Fund's Resident Representative in Madagascar had been in close contact with the budgetary authorities, and the parliament would deliberate on the budget soon.

The privatization of the telecommunications sector was a priority and was expected to be completed soon, with the announcement before the end of 2001 of the winner in the bidding process, the staff representative explained. The next priority would be the privatization of the cotton company, the sugar company, and Air Madagascar. In the cotton sector, the priority was the ginning and plantation assets, inasmuch as a number of bidders—including a few large American companies and the largest ginnery and private weaving company in the country—were interested in a vertical integration of cotton production and export processing at the economic zones, which mainly processed textiles. Meanwhile, some difficulties might be encountered in privatizing the sugar company because of problems with land titles and because of the presence of villages in the plantations. Capital subscription for the sugar company would take place in 2002. With regard to the privatization of Air Madagascar, the process would be started as soon as the global economic situation improved.

There had been a survey on poverty showing that the urban areas had fared better in terms of poverty improvement compared to the rural areas, the staff representative said. There was an ambitious program in place on agricultural development to help the poor, which was being supported by a large number of donors. The World Bank was going to approve a $100 million rural sector credit to provide assistance to cooperative projects and local initiatives in rural sectors. The Bank and the authorities had agreed to initiate the programs in coffee-producing areas, which were heavily affected by the decline in coffee prices.

The impact of the EPZs on the alleviation of poverty in Madagascar should not be underestimated, the staff representative considered. The EPZs directly employed between 70–100,000 people. Many more were employed indirectly in related services. With the households in Africa being rather large, the EPZs probably affected between 1–2 million people—about 20 percent of the country's population. The growth of employment in the EPZs had also been quite fast, and had attracted people who had previously been engaged in subsistence agriculture. High employment in the EPZs meant that families experienced a greater than doubling of incomes. The staff could update the impact in the context of future reviews.

In the context of the Cross Border Initiative, tariff rates in Madagascar had been rationalized to five rate levels, with the maximum rate of 30 percent applying to a greatly reduced number of product lines, the staff representative explained. The pace of tariff rate reductions had been quite fast in 2001. With the projected revenue losses in 2002, the staff expected a slowdown in tariff reform, but the authorities' commitment to trade liberalization was evident.

The fishing licensing system that had been introduced in 2000 was quite transparent, with the transfer of licenses being based on an open bidding process, the staff representative considered. The public had been informed of the issuance of 68 fishing licenses for oceanic fishing. There was, however, a transparency problem in the forestry sector connected to licensing fees. Nonetheless, the World Bank had been confident that the authorities were moving toward a more transparent system, and that there would be changes in the government ministry responsible for forestry. In mining, World Bank staff had considered that the Bank-supported project on a mining registry, which had been introduced in 2000, had been proceeding well. There was a structural benchmark under the program to reduce the excise taxes on the first mining transactions by the end of 2001. The staff had considered that the 75 percent excise tax rate induced operators to transact business in the informal sector.

The valued-added from the cutting of gemstones had been an issue, the staff representative said. While gemstones were collected in Madagascar, they were shipped to and transformed in Sri Lanka, Thailand, and Burma. A World Bank study found that stones valued at, say, \$20 million would fetch almost \$1 billion after being transformed, with the value-added accruing to the countries where the cutting had been done. Training the workers in Madagascar to cut stones was being considered, but the project would take time.

Spending on rural roads had been inadequate, the staff representative considered. A reform of the road fund—incorporating better management and improved funding through higher tax collections from retail gasoline—would be considered by the Council of Ministers. The entire road network had deteriorated in the past 30 years, and even main roads needed improvement. The improvement of rural roads would contribute to fighting poverty, as many areas in the country did not have adequate access to the cities and the harbors.

There had not yet been data on nonperforming loans for the second half of 2001, the staff representative said. This was not a major problem, however, as the seven commercial banks in Madagascar, which were foreign-owned, were relatively well managed.

A Fund staff mission would visit Madagascar in March-April 2002, with a view to helping the authorities subscribe to the GDDS, the staff representative continued. Although there were weaknesses in the country's statistical system, data provision had been adequate for monitoring economic performance. Government data were relatively good, particularly the national accounts data. There were, however, some limitations on the balance of payments data. Madagascar had received extensive technical assistance in 2000, and there was a plan to revamp the whole system of surveys to improve the balance-of-payments data.

Mr. Barro Chambrier made the following concluding statement:

I would like to thank the Board for their support of Madagascar's adjustment efforts and for the proposed decision. I very much appreciate colleagues' recognition of the significant progress made by Madagascar, as well as their comments and policy recommendations. This is indeed an important change. We are very much encouraged, thanks to the strong commitment of the authorities, and the ingredient for the changes are very enlightening, and this is a good case for how to strengthen ownership.

The message was for the Malagasy authorities to pursue efforts to further consolidate the fiscal sector. The revenue side is one of the concerns of my authorities, and as you have noted, the measures they are contemplating with regard to the strengthening of customs administration will help achieve this goal. The impact of the reduction in tariff rates may have been underestimated, but as the economy starts to benefit from the outward-looking policy, the ratio of revenue to GDP will increase.

With regard to expenditures, we are confident that HIPC Initiative resources will be used in an efficient manner, and further progress will be made and additional resources will be allocated to other priority sectors that were mentioned, especially with regard to the rural areas.

I also took note of the issue of decentralization, and Mr. Sacerdoti has already indicated that there will be technical assistance from other multilateral institutions.

There was a concern with regard to the process of providing licenses in the mining, forestry and other sectors. There are clear measures in the completion point triggers on public and transparent information systems for granting licenses, and the list will be published. This should respond to the concerns on full transparency raised by Mr. Baukol.

The risk of a prolonged slowdown in the world economy will impact Madagascar in a deep way, especially its exports of textiles and its tourism industry. This is an area where the economy is still vulnerable.

Finally, the Board has noted that Madagascar's adjustment received an important boost from the opening of advanced countries' markets to some of its exports. In this respect, the impact of the AGOA is noteworthy. I think Madagascar gives us a good example of what trade can do for a low-income country. It is therefore important that the Fund continues to push for a wider opening of markets for low-income countries. It is to be hoped that advanced countries will also open their market to the other products of Madagascar, which will enable a diversification of the economy, as well as enable it to achieve a much higher level of growth.

In conclusion, I will again forward your comments, and I am confident that the authorities, whatever the outcome of the election, will persevere with the reform efforts because it is bearing fruit, and the social indicators are still weak, and there is a strong recognition from the main candidates of the need to pursue the process. Let me thank the Board once more for their support for the Malagasy authorities and the staff for its excellent report. The understanding advice of the staff are well appreciated by my Malagasy authorities.

The Acting Chair made the following summing up of the Article IV consultation discussion:

Executive Directors were in broad agreement with the staff appraisal. They observed that, since the time of the last Article IV consultation, economic performance has been favorable in many areas: economic growth has accelerated and the economy has become more diversified, inflation has abated sharply, the external account deficit has been lower than programmed, and the level of official international reserves has increased. Exports recorded a strong performance in the first part of 2001, and prospects for the year as a whole remain favorable, despite the global economic slowdown. With regard to public finances, results for the first half of 2001 were mixed: the overall fiscal deficit was lower than programmed, but the revenue target was missed.

Directors welcomed the strong performance of the external sector and the ability of the country to attract foreign investment—particularly in the export processing zone (EPZ), where investment and exports were spurred by the U.S. African Growth and Opportunity Act. They noted that, while this reflects Madagascar's strong competitive position, it also underscores the importance of increased access by developing countries to markets in industrialized countries. In order to maintain Madagascar's attractiveness to foreign investors, they stressed that further efforts are needed to streamline administrative regulations, improve the basic infrastructure, and press ahead with the progressive simplification and liberalization of the external trade regime. They considered these efforts to be all the more necessary in light of the projected adverse impact of the global slowdown on EPZ exports and tourism in 2002.

Directors expressed concern that weak revenue performance in 2001 may be impacting adversely on social and capital spending. They welcomed the actions underway to strengthen tax administration, emphasizing, in particular, the importance of implementing the customs reforms in a timely manner and of reinforcing domestic taxpayers' compliance. Directors noted that a shortfall in privatization revenue in 2001 has increased the need for domestic financing during the year, but that this situation should be reversed in 2002, when the sale of several public enterprises is expected to be completed.

On the spending side, Directors commended the authorities for allocating the resources released under the HIPC Initiative to the social sectors, as envisaged at the decision point in December 2000, and for committing them expeditiously. They welcomed the progress in strengthening budgetary execution reporting and treasury accounting, but noted that a significant overhaul of the budget expenditure monitoring system is still needed to broaden coverage and improve timeliness. They also welcomed the progress in auditing the 1998 and 1999 budget laws and the measures underway to strengthen the public auditing agencies, and noted that it was important that these efforts continue in the period ahead to further enhance transparency in budgetary management.

Directors commended the authorities for taking further steps to strengthen the soundness of the financial system, including limiting insider lending, requiring banks to install permanent internal audit systems, limiting bank participation in non-banking activities, and reducing lending concentration ratios. They also welcomed the adoption of regulations and supervision standards for credit unions and microfinance institutions.

With regard to the privatization of public enterprises, Directors welcomed the imminent sale of the telecommunications company, and urged the authorities to make sure that the cotton and sugar companies are sold in 2002 as planned. Directors expected that privatization would stimulate investment in these sectors, which would contribute significantly to the diversification of the economy and to overall growth. They also encouraged the government to persevere with the public enterprise reforms being implemented in the airline and electricity sectors. Directors considered that, to continue to attract needed investment, it was essential that the ongoing reform of the regulatory framework and judiciary system be vigorously pursued.

Directors noted that poverty remains one of the most daunting challenges facing the country. They welcomed the wide consultation process underway to prepare the Poverty Reduction Strategy Paper, and stressed that this document should include a costing of priority action programs and mechanisms for continuous monitoring of progress in the fight against poverty. Meanwhile, they encouraged the authorities to speed up the execution of poverty reduction expenditures, including the distribution of generic drugs and improvements in rural infrastructure. Directors urged the authorities to make every effort to ensure that Madagascar reaches the HIPC Initiative completion point by end-2002 as envisaged.

The statistical database is adequate for Article IV consultations and program monitoring. Nevertheless, Directors noted that statistical weaknesses remain in terms of data quality, coverage, and timeliness, and endorsed the efforts of the authorities, with the assistance of the international community, to resolve these weaknesses.

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

The Acting Chair made the following summing up of the discussion of the first review under the PRGF arrangement:

In considering the first review under the Poverty Reduction and Growth Facility (PRGF) arrangement for Madagascar, Executive Directors noted that Madagascar's economic performance has been satisfactory and that all of the benchmarks and performance criteria for end-March and end-June 2001 have been met, except the one on tax revenue. In light of the good overall performance and the authorities' commitment to strengthen tax administration to correct the revenue shortfall, Directors granted a waiver for the nonobservance of the performance criterion on tax revenue for end-June 2001 and completed the review.

Directors stressed the need to rapidly enhance customs and domestic tax administrations, especially at the secondary ports, and to sustain the revenue effort in 2002 so as to further reduce the overall budget deficit. They urged the authorities to accelerate efforts to establish a robust system of budgetary expenditure monitoring for all ministries, which would also improve tracking of poverty-related expenditure, and to push ahead quickly with the strengthening of auditing procedures and the preparation of the final budget execution laws.

Directors noted that the target for net bank credit to the government at end-2001 had to be revised upward substantially in view of the shortfall in privatization revenue; and stressed that net bank credit should be reduced in 2002 in order to contain the government domestic debt and allow adequate room for private sector credit. They therefore urged the authorities to press ahead with their privatization plans—in particular, to ensure that the cotton and sugar companies are sold as planned in 2002, since this would also boost investment and growth in these crucial sectors of the economy.

Directors looked forward to receiving Madagascar's Poverty Reduction Strategy Paper and commended the authorities for the wide participatory process pursued in the preparation of this document.

The Executive Board took the following decisions:

Poverty Reduction and Growth Facility—Review, and Waiver of Performance Criterion

1. The government of Madagascar has consulted with the Fund in accordance with paragraph 2(e) of the three-year arrangement for Madagascar under the Poverty Reduction and Growth Facility (PRGF) (EBS/01/20, 2/16/01) and paragraph 4 of the letter of the Prime Minister and Minister of Finance and Economy dated February 9, 2001.

2. The letter from the Prime Minister and Minister of Finance and Economy, dated October 30, 2001, together with its attached tables, shall be attached to the three-year PRGF arrangement for Madagascar, and the letter from the Prime Minister and Minister of Finance and Economy dated February 9, 2001, together with its attached memorandum and tables, shall be read as supplemented and modified by the letter of October 30, 2001.

3. Accordingly, paragraph 2(a) shall be modified to read as follows:

"(a) If the Managing Director of the Trustee finds that, with respect to the second disbursement, the data as of June 30, 2001 and, with respect to the third disbursement, the data as of December 31, 2001, indicate that:

(i) the ceiling on the domestic financing of the central government, or

(ii) the floor on the net foreign assets of the central bank, or

(iii) the ceiling on the net domestic assets of the central bank, or

(iv) the floor on government tax revenue, or

(v) the ceiling on external debt with a maturity of less than one year contracted or guaranteed by the government

specified in Table 2 of the Memorandum and in paragraphs 3 to 15 of the Technical Memorandum of Understanding attached to the memorandum with respect to the second disbursement and specified in Table 1 of the letter of October 30, 2001 and in paragraphs 3 to 15 of the Technical Memorandum of Understanding attached to the Memorandum with respect to the third disbursement, were not observed; or".

4. The Fund determines that the first review contemplated in paragraph 2(e) of the three-year arrangement under the PRGF-supported program for Madagascar has been completed, and that Madagascar may request the disbursement of the second loan specified in paragraph 1(c)(ii) of the three-year arrangement under the PRGF-supported program for Madagascar, notwithstanding the nonobservance of the end-June 2001 quantitative performance criterion on tax revenue, specified in paragraph 2(a)(iv) of the arrangement, on the condition that the information provided by Madagascar with regard to this performance criterion is accurate. (EBS/01/193, 11/21/01)

Decision No. 12634-(01/124), adopted
December 5, 2001

Enhanced Initiative for Heavily Indebted Poor Countries—Additional Interim Assistance

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

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

(b) that the Trustee shall disburse to Madagascar as additional interim assistance the equivalent of SDR 1,446 million, which shall be made available by the Trustee to Madagascar in the form of a grant that shall be paid no later than three business days after the adoption of this decision to the account for the benefit of Madagascar established and administered by the Trustee in accordance with Section III, paragraph 5 of the Trust Instrument; the proceeds of the grant shall be used by the Trustee to meet Madagascar's debt-service payments on its existing debt to the Fund as they fall due, in accordance with the following schedule: 53.3 percent of each repayment obligation falling due between January 1, 2002 and December 31, 2002. (EBS/01/193, 11/21/01)

Decision No. 12635-(01/124), adopted
December 5, 2001

3. SAN MARINO—2001 ARTICLE IV CONSULTATION

Documents: Staff Report for the 2001 Article IV Consultation (SM/01/352, 11/21/01; and Cor. 1, 12/4/01); and Selected Issues and Statistical Appendix (SM/01/353, 11/21/01; and Cor. 1, 12/4/01).

Staff: Decressin, EU1; Kashiwagi, PDR

Length: 50 minutes

Mr. Padoan submitted the following statement:

At the outset, I wish to convey my authorities' appreciation for the excellent set of papers prepared by the Fund's mission team. Since San Marino joined the Fund in 1992, it has enjoyed an extremely fruitful relationship with the staff.

San Marino is a small but highly dynamic economy that has achieved substantial growth in recent years, about 8 percent of GDP, well above that in neighboring Italian regions. With inflation subdued, the economy has been able to experience a steady employment growth of 4.1 percent in 2000 against an EU average of 2 percent, while unemployment has decreased to 2.8 percent compared with 8.1 percent recorded within the European Union last year. San Marino has been very effective in creating a favorable business environment conducive to growth and development, attracting substantial flows of workforce and capital from abroad. Despite its dimension, the economy is highly diversified and the manufacturing, the services and the financial sectors all share a substantial role in promoting the growth of the San Marino economy. In June 2001, a new government was elected with a mandate to implement appropriate policies designed to sustain the competitiveness and the development of San Marino in the years ahead.

The authorities share the staff's view that a budget deficit may be detrimental to the competitiveness of an economy with high mobile factors of production, by signaling possible future fiscal adjustment. In this regard and consistent with the aim of strengthening the competitiveness of our economy, some measures have been devised for 2002 since the new government has come into power, while more structural actions will be implemented starting from 2003. It is also expected that the budget will revert back to balance by 2003.

Immediate action has already been taken in the suspending of all new applications for tax relief by companies. Tax relief has been growing significantly over the last decade and is partly responsible for the deterioration of the fiscal stance, as the staff report correctly points out. Furthermore, a revision of the tax regime on financial instruments is under way, aimed at smoothing the fiscal pressure across the whole range of instruments held by investors in their portfolios, not only on bank deposits as the current framework envisages.

These measures will be coupled with other structural actions on current expenditures. A hiring freeze has already been put in place in the civil service, the size of which will also be streamlined. In addition, greater attention will be devoted to determining how to make the civil service more effective. In this regard, reforms are being implemented with the aim of encouraging mobility within the administration and streamlining procedures and red tape. In the same spirit, it is envisaged that, after the above-mentioned reforms have been implemented, public sector wages should be set in line with—and not above—market benchmarks.

Another important area of intervention is the pension system, which needs to provide entitlements more closely related to lifetime contributions. While a thorough reform will be presented later next year, the authorities have already increased the age limit for the retirement of new employees (currently 60 years of age) to 65 years of age. In addition, the management of pension contributions will be separated from that of the healthcare system. The move towards greater transparency is an important factor in fostering a pervasive market-oriented management of pension contributions.

As the Selected Issues paper points out, San Marino's banking sector compares very favorably with those of the Italian and the Luxembourg economies in terms of profitability and efficiency. The challenge ahead consists of implementing policies to maintain its traditional strength. In this regard, a more diversified ownership structure has been encouraged, allowing the establishment of two new banks with a more internationally-oriented shareholders base. Some domestic banks are already owned by major Italian players and have been integrated into their wide and diversified financial groups. Looking ahead, the development of a payment system for the San Marino banks would allow for a gain in efficiency.

Preserving the competitiveness of the banking sector requires changes in the legal framework. As of today, insurance companies and mutual funds may not be established in San Marino. In the near future, the authorities plan to change the legal framework to enable the banking system to gain substantial economies of scale and scope, while strengthening its customers base, by entering these profitable areas of business.

The growth of the financial sector has been accompanied, so far, by the development of an affective anti-money laundering framework. San Marino has signed all the relevant international agreements such as the 1990 Strasbourg Convention, the European Convention on Mutual Assistance on Criminal Matters and the European Convention on Extradition. San Marino is also a member of the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures. The authorities are firmly committed to continue supporting, in cooperation with other governments, major international initiatives aimed at improving and making more effective the fight against money laundering. The authorities stand ready to provide relevant support to the Office of Banking Supervision to improve further its effectiveness in carrying out these important tasks in an evolving financial system.

Given the restricted physical dimension of San Marino and the absence of formal borders, the compilation of statistics is obviously challenging. Nonetheless, since San Marino joined the Fund in 1992, the production of statistics has greatly improved, thanks also to Fund technical support in the form of several surveillance missions and a multi-sector assistance mission from the Statistics Department. The authorities share the staff's view that the statistical database needs to be improved further. In this respect, starting in 2002, consumer price data will be collected directly at the source and the results will then be published on a monthly basis. Improvements in the production of monetary statistics are currently under way and they will be made available on a monthly basis soon.

Importantly, San Marino authorities envisage substantial improvements in the production of government finance statistics with reference to the central government budget. Starting in 2002, the budget will be produced on an accrual basis and according to the EUROSTAT methodology. The authorities see the improvement in the production of their statistics as a pre-requirement for compiling the items prescribed by the International Financial Statistics guidelines.

Mr. Josz made the following statement:

San Marino continues to enjoy strong growth and employment because its labor costs are lower and its take-home pay is higher than in surrounding regions, and because it has a more efficient and business-friendly public administration and a stable political environment. It is therefore distressing that for 1999/2000, its fiscal deficit reached a level considered excessive in the euro area, once one adds the 2.75 percent central government deficit to the 0.25 percent deficit of the Social Security Institute. The authorities must halt this deterioration of their public finances lest in time the tax competitiveness of their economy should disappear.

The authorities should strive to balance their budget by 2003 and thenceforward set a clear medium-term objective in order to ensure that the comfortable fiscal position that is the basis of their economy's competitiveness does not disappear. Their efforts to increase the transparency and the international comparability of their fiscal accounts from 2002 onwards are welcome. This will not only improve the quality of information available to the Fund, but also will better inform San Marino's political debate about short- and medium-term fiscal issues.

There seems to be ample room for increasing tax revenues by phasing out exemptions, which staff estimated at 3 percent of GDP in 1996. Phasing out the system of negotiated tax relief would also increase the predictability of the corporate income tax system and reduce the temptation for political interference.

On the expenditure side, there is room to reduce the wage bill and health expenditures. Civil service wages should be brought into line with private sector wages. The introduction of targeted co-payments for health care services and incentives to use generic drugs should help to slow the rapid escalation of health expenditures while preserving the remarkable quality and universal access of San Marino's health care system.

In the medium term, San Marino's fiscal position will be greatly affected by the liabilities of the pension system. With the pay-as-you-go system already in deficit despite of fourfold preponderance of active population to retirees, it is obvious that the system needs reform, without which the deficit will increase greatly in the next fifteen years. The pension system has some very attractive features, such as its incentives to work beyond the minimum retirement age, and these should be preserved. But there is ample room for bringing worker contributions into better alignment of payouts, especially by raising the very low retirement age for civil servants, and increasing the retirement age in all sectors not just for new entrants but for current participants as well. The problems and prospects for introducing a fully funded pension system on top of or instead of the present pay-as-you-go pension system should be thoroughly studied during San Marino's next Article IV consultation.

San Marino's banking system is profitable, well capitalized, well provisioned and closely supervised. But the financial supervisor's staff should be increased beyond the present eight positions. This reinforcement is needed to keep up with the constant stream of new developments in the banking sector, especially the move to Basle's new capital adequacy rules; to strengthen efforts to eliminate money laundering and terrorist financing; and to supervise the insurance companies and mutual funds that will be allowed to operate in San Marino.

The process for reviewing applications to open new financial institutions is admirably thorough, but there may be room to streamline it by relying solely on the technical opinion of the financial supervisor while eliminating the additional reviews by the Credit and Savings Committee and the government, which inject political considerations into the approval of new entrants (see paragraph 38 of SM/01/353). The staff's comments about the reasons for these additional layers of approval would be welcome.

Finally, although bank confidentiality is listed among the comparative advantages of San Marino's banking system, the authorities would be well advised to capitalize on their other comparative advantages in developing their financial sector, since pressures for a level playing field in the area of bank secrecy will increase in the euro area and elsewhere.

Mr. Lissovolik made the following statement:

Let me begin by thanking the staff for a highly informative and enlightening set of papers on San Marino, and particularly the Selected issues paper on the banking system and the pension system of San Marino. We also thank Mr. Padoan for his helpful statement.

The economy of San Marino continues to benefit from high economic growth. Its financial system is strong with further measures envisaged for raising its competitiveness via streamlining prudential regulation. Important steps have also been undertaken by the authorities to address structural imbalances as well as to combat money laundering. At the same time, the fiscal situation has deteriorated somewhat in recent periods, whilst in the short to medium term structural fiscal policy issues are likely to become increasingly pressing. There also remain substantial shortcomings in the compilation of key statistical indicators, which hampers timely assessment of the economic developments.

Fiscal policy. As the staff report notes, problems in the fiscal sphere concern the revenue as well as the expenditure side of the budget. On the revenue side it is clear that the buildup in negotiated tax relief as well as loopholes in the existing framework of the tax system have retarded revenue performance (as has been noted by Mr. Josz). These weaknesses in tax administration need to be addressed in view of the downside risks in the fiscal sphere outlined by the staff in para 10 of the staff report. On the expenditure side we join the staff in advocating a strategic approach towards attaining fiscal sustainability in the medium to longer term. This implies that apart from containing the absolute level of expenditures, the composition of their reduction should rely primarily on cuts in current outlays. In this respect one of the key structural fiscal policy issues will be the reduction in the size of the civil service and we welcome the determination of the authorities of San Marino to address this issue. Finally, a fiscal rule would be instrumental in rendering greater discipline to the fiscal policy framework in San Marino, and in this regard a balanced budget rule may be appropriate. It is crucial that these steps are complemented by a major effort to improve fiscal reporting that would enable the staff to adequately monitor the evolution of fiscal indicators. In this respect it is encouraging that as Mr. Padoan notes starting from 2002 the budget will be produced on an accrual basis and according to EUROSTAT methodology.

Pension reform. As the staff report notes, San Marino's pension system is one of the most generous in Western Europe, which may exact its costs in the medium to longer term. In this respect the need to address the challenges associated with the reform the pension system is well articulated by the staff in the Selected issues paper, which presents two scenarios of the evolution of the current pay-as-you-go framework both the high-growth and the low-growth scenarios end up posting rising deficits in the medium term. The sequencing of the pension reform should first target the reduction in the generousness of the currently operating framework before moving ahead with a transition to a fully funded system.

Measures to combat money laundering. We welcome the vigorous steps undertaken by the authorities of San Marino to combat money laundering, and in particular the adoption of the new law on money laundering. We agree with the staff that the resources and the capacity of OBS need to be reinforced through additional staffing to confront the challenges associated with the implementation of the newly adopted legislative framework. This is particularly important given the need to address some of the issues that remain outside of the purview of the authorities - a case in point is the monitoring of the transfer of ownership of shares by the financial sector supervisors. Finally, we strongly welcome the strengthening of San Marino's international collaboration to monitor financial flows related to terrorist activities.

San Marino is making important progress in laying the foundation for sustaining the high economic growth rates observed in recent periods. The authorities will need to persevere in these efforts to overcome some of the daunting challenges in the medium to longer term associated with structural reforms, most notably in the fiscal sphere. The progress attained so far is encouraging.

With these remarks we wish the authorities of San Marino every success in their endeavors.

Mr. Faulend made the following statement:

Let me welcome today's discussion on San Marino. The staff report describes well the sound basis of the Sammarinese economy, but it also points to some of its weaknesses. I endorse the staff's appraisal and policy recommendations, and I intend only to touch on two issues, public finances and statistical issues.

On public finances, let me say that overall the fiscal stance seems to be generally sound at present, as evidenced by the very low and stable level of public debt. However, continuous fiscal deficits, which actually exceeded 2.5 percent of GDP over the last two years, combined with the fact that the current fiscal deficit occurred for the first time in 1999 and 2000, are definitely of some concern. However, I am glad that the authorities realize the need for more balanced public finances. This is an important starting point. But I also note that the positive overall performance does not seem to exert much pressure on the authorities to move more forcefully in this area at present. In my view, one should take advantage of positive macroeconomic developments and, thus, I strongly encourage the authorities not to wait with the needed fiscal consolidation.

Related to fiscal consolidation, I support the staff's views on the need to reform the overly generous social security, health care, and pension systems. Over the long term, these reforms are definitely a cornerstone of sound public finances. However, I would like to stress that in the consolidation process over some shorter period of time, I see more room for improvement on the revenue side. In particular, I note that the staff highlighted a decline in tax receipts from the self-employed and businesses, despite strong economic activity and profits. Excessive loopholes and the negotiated tax relief, which reached a peak in 2000, are directly responsible for this underperformance. Thus, I strongly encourage the authorities to avoid such practice in the future.

Finally, on statistical issues, I recognize the progress made so far, but the availability and quality of statistical data are still far from adequate. It is surprising that information on economic activity and public finances, for instance, is limited in such a high income country. I understand that the size of the economy is an impediment to adequate statistics. Nevertheless, inadequate statistics seem to hamper both fiscal policy and Fund surveillance. In this regard, I urge the authorities to increase their efforts and to bring their statistics up to international standards, as indicated in Mr. Padoan's statement.

With these remarks, I wish the authorities every success.

Ms. Stuart made the following statement:

I would like to thank the staff for a thorough set of papers. I will focus my comments on four points.

First, I agree with other speakers that the mobility of the tax base is a key risk for San Marino, so I concur with the staff that aiming at fiscal balance is sensible and will require actions both on the revenue side and, importantly, the expenditure side. In that respect, the staff assessment of the pension system was useful.

Second, the staff papers also contain a lesson for Italy; the ease with which San Marino has been able to charter labor force from southern Italy illustrates how demand for labor may increase within southern Italy if there would be more regional wage flexibility.

Third, I have considerable sympathy for the views expressed in Mr. Padoan's statement that the collection of statistical data is a difficult task for such a small country. I welcome any progress in this area, but wonder what the prioritization of the different statistical areas will be. For example, I note that there is going to be a collection of data for direct consumer prices, and I wonder whether this is the most important area for San Marino to collect data or whether some of the monetary statistics and other fiscal statistics might also be worth putting more resources into. Based on experiences in the United Kingdom, where regional price data collection has been considered, my authorities decided that regional prices were not particularly informative given the flexibility with which people can travel and buy goods from different regions.

Finally, I welcome the progress San Marino has made in taking more action on anti-money laundering and the financing of terrorism, and especially the actions the authorities have taken on international collaboration since September 2001. I note the staff's concerns about resources at the OBS; what level of resources is the staff currently considering to be adequate?

Mr. Kpetigo made the following statement:

We are grateful to the staff for the comprehensive set of papers submitted for discussion and to Mr. Padoan for his insightful statement, which underscores the progress and commitment of the Summarinese authorities in pursuing prudent economic policies. In the real sector, during 1999 and 2000, San Marino's real GDP growth remained robust, thanks to continued investment. Employment growth was strong and economic activity was buoyant, while the inflation stance was mixed. Overall, San Marino has continued to show a good track record since the time its Fund membership became effective about nine years ago. Indeed, its economic performance compared favorably with that of its neighboring countries.

On the fiscal front, the central government budget deficit reached 2.75 percent of GDP in 1999/2000, which was the highest level in over a decade. We are, therefore, pleased to note that the authorities are taking appropriate measures to reverse this trend and to curtail tax relief that has adversely impacted their fiscal position. Furthermore, a comprehensive set of structural reforms is under way to improve the financial system. On the revenue side, measures are aimed to reduce the number of tax relief beneficiaries. As regards expenditures, the new government is pushing ahead with the hiring freeze so as to mitigate the size of the civil service and contain outlays. We strongly encourage the authorities to persevere in their efforts aimed at containing expenditures and improving tax revenue, including on interest income. In Box 1, page 11 of the report the staff asserted that economic activity in San Marino and Italy has not been closely correlated, as supported by the linear regression of real GDP growth over the 1999–2000 period. During the present global slowdown, the economic activity in San Marino, contrary to Italy and the euro area, is expected to remain relatively buoyant. Can the staff elaborate on the cost of the resilience to shocks?

As regards mid-term and long-term growth, San Marino will likely be facing serious competition in the international environment and lose the lower level cost and foreign capital floor advantage it has so far enjoyed in attracting regional work force commuters. To alleviate the impact of these uncertainties, we concur with the staff that sound fiscal policy will be crucial to achieve growth objectives. For this to happen, we encourage the authorities to move forward to take without delay some broad action that could secure a sound central government budget and to set up contingent measures, if necessary.

Finally, despite some progress over the past two years, there is still room for improvement in statistical data provision for policymaking needs and Fund surveillance.

With these remarks, we wish the Sammarinese authorities every success.

Mr. Gauba made the following statement:

We thank the staff for a well-written report and Mr. Padoan for his candid statement. We are pleased to note that San Marino has continued to post growth rates well above those in the neighboring region as also low unemployment. However, we share the staff's concern at the deterioration of the fiscal situation, which may adversely affect future stability and growth prospects. The situation could get aggravated if the comparative advantages of lower labor costs and lower taxes enjoyed by San Marino gets gradually eroded. This imparts further urgency to the need for addressing the fiscal issue. We have noted that while concluding the last Article IV consultations in March 1999, this Board had recommended reforms in the pension and healthcare systems to maintain a sound fiscal position. The authorities have also been seized of this matter and as far back as 1995, a draft proposal to reform the pension system, which is admittedly one of the most generous in the European Union, was prepared by the government. Unfortunately, these proposals have not been implemented and the fiscal deficit has widened. We are, however, reassured that the authorities are now moving decisively and a number of measures have already been implemented or are on the anvil to remedy the situation. We are, therefore, sanguine that fiscal balance will be restored by 2003 as committed. We are also pleased that ahead of the proposed diversification and expansion of their financial sector, the authorities have put in place the requisite anti-money laundering framework. We urge them to now focus on the operational sphere as recommended by the staff.

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

Mr. Rustomjee made the following statement:

I would like to thank the staff for an excellent set of papers on San Marino for today's discussion. Apart from the useful Article IV staff seport, I found valuable the detailed Selected Issues paper, including the comprehensive treatment of financial sector developments and challenges in San Marino.

I would also like to thank Mr. Padoan for his detailed and candid statement.

I am in broad agreement with the overall approach and recommendations of the staff. However, I do have a few comments.

Firstly, it is clear that there is much for the Sammarinese authorities to be commended for. Economic growth has remained high and well above comparable levels in neighboring regions of Italy, for well over the past decade. Indeed growth rates have been comparable with those in Ireland and Luxembourg over the same period, which is no mean achievement. Employment growth has also been high throughout this period. The banking system is well capitalized and provisioned and the regulatory environment is strong. Taxes have been relatively low; and notwithstanding its status as a small economy, neighboring one with much more substantial resources, the authorities have successfully been able to limit the provision of investment incentives to attract foreign investment. It seems clear to us that the case of San Marino has something to offer other small economies in similar situations and we commend the authorities for their many achievements.

For us the value of the staff report on this occasion has been to flag some of the medium and longer-term challenges that the authorities can expect to address, if the high overall economic performance is to be sustained. We agree with practically all of the staff's recommendations, including those pertaining to the need to run fiscal surpluses, including the proposed timeframe for returning the central government budget to balance in 2003; and the broader set of reforms needed to place the pension system on a sound footing. We see these two sets of the staff's recommendations as being particularly crucial for San Marino.

As the staff report highlights, San Marino faces several challenges, including a highly mobile tax base, and the fact that fiscal policy is itself to a significant extent conditioned on factors beyond the authorities' control. We view with some concern the prospect of Italian workers who are commuting to San Marino, soon having their income taxed in Italy and would appreciate more clarity from the staff as to why the authorities appear unperturbed by this potential development.

The potential risks to the tax base are vividly brought into relief by the observation in Box 1 of the staff report that the number of commuters working in San Marino has risen from 14 percent in 1990 to 48 percent 10 years later; and that the labor cost advantage relative to Italy is now only 5 percent. Presumably, it is the lower payroll tax in San Marino that sustains the high share of commuter workforce. However, as noted, we remain concerned that both recent and proposed legislation in Italy could significantly adversely affect San Marino's uniquely positioned economy.

We welcome the authorities' recognition of the need to further build statistical capacity and urge both the authorities and the staff to work closely to secure the necessary expert technical assistance for these tasks.

Regarding the provision of non-essential health services, in view of the World Health Organization's ranking of San Marino's health care provision as being in the top three among countries in the world, we cannot agree with the staff's proposal that non-essential services should no longer be provided free. In our view, sound health care provision provides many positive externalities, which may not be fully taken into account through a simple budget costing process, including gains in worker productivity and savings in the long-term in the provision of health services.

On civil service reform, we consider the hiring freeze approach, which has been applied by the authorities, to be broadly appropriate.

We support an increase in financial supervisory staff; and we also agree with the staff that a fully funded component of the pension system is attractive, given the mobile tax and contributions base.

With these comments, we wish the authorities every success.

Mr. Weisman made the following statement:

We generally agree with the thrust of the staff appraisal, and would just like to make a brief comment with regard to paragraph 30 of the staff report. Like other speakers, we appreciate the efforts of the authorities with reference to the anti-money laundering measures that they have implemented and, more recently, with regard to measures directed at financial flows related to terrorist activities. Having said that, we agree with the staff that there are a few areas that are in need of improvement, and we would hope that the authorities would take seriously the advice provided by the staff in paragraph 30.

Mr. Zurbrügg made the following statement:

I would like to take this opportunity to support some of the messages that the staff and the authorities agreed upon.

The main message of the staff report seems to be that the comfortable position that San Marino has enjoyed over the last decade derives mainly from unfavorable characteristics of the surrounding economic area. We have to be very cognizant of the fact that the surrounding economic area is improving steadily, and that the comparative advantage of San Marino is steadily decreasing, as shown in the staff report.

I fully support the staff that the authorities have to address the medium-term fiscal issues, although it might be difficult to signal to the authorities the immediate need to tackle those issues. It is essential that San Marino is not caught in a situation in which these currently medium-term problems suddenly become very imminent problems.

I have a question to the staff regarding the tax administration, the existing loopholes, and the negotiated tax relief. The staff presented in the report a graph that exemplified the projected steady decrease in tax relief over the next couple of years. I assume that the suspension of the tax expenditure program is one of the measures that are being proposed for the 2002 budget. Have these suggested measures the support of the business and labor representatives? It seems that these measures do not have any adverse consequences because of the tax regime in the surrounding regions. As San Marino already has a comparative advantage, why was the tax relief necessary in the first place?

The last point concerns San Marino's endeavor to move into mutual funds and insurance. Switzerland always welcomes new and efficient financial centers, and we would like to highlight the necessity that this development must be accompanied by a sufficiently strong and active supervisory authority.

The staff representative from the European I Department (Mr. Decressin) explained that, on Ms. Stuart's question about the prioritization of statistical data collection, the main emphasis should be placed on statistical data in the fiscal domain. However, the staff also welcomed the development of some indicators of current economic activity, like indicators of industrial production or confidence indicators.

On the resources of the OBS, particularly with respect to monitoring issues regarding money laundering, the staff did not want to suggest in the report a specific number of additional employees, but one person should be responsible for the area of money laundering issues, including the follow-up on the reports by the Sammarinese banks on money laundering, the staff representative continued. Banks should also be made aware of available training options and should guarantee that adequate procedures were in place. Overall, however, the staff recommended that more than just one additional person was needed at the OBS to take care of necessary daily supervision tasks and the drafting of regulations.

On Mr. Rustomjee's question on the authorities being unperturbed by the prospect of double taxation, Italian commuters did not pay a substantial amount of personal income taxes to San Marino, because those commuters were mostly low-skilled and because of the fairly high exemption threshold for income taxes, the staff representative explained. Commuters mostly paid payroll taxes and social security contributions that were not subject to the double taxation agreement, which only covered personal income taxes.

On the question on whether data on prices could be particularly valuable, given the mobile work force, the staff saw merit in monitoring data on wages to see how San Marino's comparative advantage was evolving over the medium term, the staff representative said.

On Mr. Kpetigo's question on why San Marino was relatively resilient to shocks, it was due to the country's well-functioning labor market in which wages seemed to be set more in line with productivity than in other areas of Europe, the staff representative noted. As shocks hit the economy, wages adjusted more closely in line with productivity than in neighboring regions, such as the neighboring city of Rimini, which had a high unemployment rate that induced its people to look for employment in San Marino. Such a mechanism spurred economic growth in San Marino relative to neighboring areas. So, while economic activity in Italy has been softening, the prospects for San Marino were still reasonably positive.

On Mr. Zurbrügg's question on why tax relief was necessary, given that tax conditions in San Marino were more favorable than in surrounding areas, the destruction and creation of new companies were closely interrelated, because of shocks to the demand for products produced in San Marino, the staff representative noted. Whenever a company closed, the issue of how to treat the displaced workers had to be discussed. Therefore, the Sammarinese authorities had introduced the possibility of providing tax relief to companies that would take over companies encountering economic difficulties. However, the staff agreed that this provision was not necessary, as enough new jobs were being created.

On Mr. Josz's question on why the credit and saving committee was involved in assessing whether a bank or financial institution should be allowed to operate in San Marino, the OBS basically focused on the technical aspects of the application, the staff representative said. Politicians in San Marino were concerned about the image of the country abroad and, in that respect, were possibly more involved in such daily activities than they would be elsewhere. San Marino was also a more direct democracy than other countries, which meant that politicians were more accountable to the public.

Mr. Padoan made the following concluding statement:

On behalf of my Sammarinese authorities let me thank the staff for their continuing support and helpful work. My authorities in San Marino greatly appreciate their effort, and look forward to continuing the good relations with them. I would also like to thank Directors and colleagues for their encouragement and helpful suggestions. On behalf of my Italian authorities, I would like to thank Ms. Stuart for pointing out to Italy the experiences with Sammarinese regional labor market policies.

Going back to San Marino, let me just state that my authorities agree with the suggestions in the staff report as well as those made by Directors. There is a new government in the country which has just been established and most, if not all, of the issues where reform is needed are being addressed, including, measures to improve the fiscal position, both on the revenue and expenditure side. On the expenditure side, in particular, efforts are directed at improving health expenditure control by imposing much tighter controls over their nominal magnitudes. Pension reform, as was anticipated in the past, will be reorganized shortly in the coming year and containing public wage expenditure is among the priorities of the authorities.

My authorities welcome the indication to strengthen anti-money laundering efforts, including the efforts in having adequate resources at the OSB for the task ahead and we look forward to improving that area.

On banking supervision, the comments by the staff and Directors were also welcome. By early 2002, there will be a full alignment with Basel principles, so that full stability and transparency of the banking system will be assured, given its rapid evolution and growth in dimension.

On statistics, this issue is particularly relevant and difficult at the same time for a small and very open economy such as San Marino. In addition to improving the statistical base for the fiscal area up to European Union standards and methods of accounting, the authorities will start producing statistics related to labor markets, which will appear early next year.

The Acting Chair made the following summing up:

Directors agreed with the thrust of the staff appraisal. They observed that San Marino has enjoyed an extended period of remarkably strong economic performance, posting real GDP and employment growth well above the rates recorded in the euro area. Product and labor markets generally work efficiently.

Directors considered that in the immediate future, the factors that have driven the high growth—notably a low tax burden and a favorable business environment—will remain in place and augur well for near-term performance, even if the outlook is uncertain due to the global slowdown. However, the central government budget has moved into a larger deficit, due to weak tax collection and rapidly rising entitlement outlays, and Directors underscored that if left unchecked, this unfavorable fiscal performance could break the virtuous circle of a low tax burden and high growth. This risk has been heightened by the gradual narrowing of San Marino's labor cost advantage over neighboring regions, and further pressure on performance could emerge if surrounding countries reduce their tax burden or reform factor markets.

Against this background, Directors considered that fiscal policy is key to maintaining San Marino's attractiveness as a place to conduct business. They therefore welcomed the authorities' objective to return the central government budget to balance over the next two years. The revenue measures for 2002 are generally well targeted, notably the suspension of the tax expenditure program, which, Directors considered, should be made permanent. They emphasized that further action, focused on containing expenditure growth, will be needed to durably balance the budget in 2003. In this connection, Directors welcomed the authorities' intention to reform the public administration and the entitlement programs, and looked forward to implementation of their plans to gradually align public sector wages with those in the private sector, reduce the size of the civil service through attrition, and reallocate staffing to areas of greatest need.

Looking ahead, Directors encouraged the authorities to pursue a sound fiscal policy over the medium term, by committing to a central government budget in balance or in surplus, a low debt level, and a low tax burden. This would provide an important assurance to economic agents. In view of San Marino's mobile tax base, maintaining budgetary balance or a surplus—a target to which neighboring countries are already committed—would greatly contribute to supporting the long-term growth prospects. Directors also emphasized that the budget should present the intended fiscal policy clearly and be built on a fully specified macroeconomic framework.

Directors welcomed the steps under consideration for reforming the over-generous pension and health care systems. They agreed, however, that placing the pension system on a sound medium-term financial footing will require more ambitious and well-sequenced reforms, including strengthening the link between contributions and benefits, and introduction, over time, of a fully funded pillar. Directors commended the plans to improve management and reduce waste in the health care system, but saw a need for additional measures if the authorities intend to preserve free access to essential health care to future generations.

Directors noted that San Marino's financial sector appears profitable and strong, and they welcomed the authorities' plans to strengthen banking supervision. The adoption of the Basel capital adequacy framework will be an important step in this respect. Directors also encouraged the Office of Banking Supervision (OBS) to publish its periodic reports on the financial sector and move toward frequent and timely reporting of financial soundness indicators. The increasingly competitive environment, and the planned introduction of a legal and regulatory framework permitting insurance and mutual fund activities, will require changes in supervisory policies and practices that need to be supported with an increase in the staffing at the OBS. Directors commended the authorities on adopting a solid legal framework to fight money laundering, and their cooperation in international efforts against the financing of terrorism.

Directors encouraged the authorities to continue their efforts in the area of statistics by increasing resources to remedy remaining deficiencies and, in particular, by producing data on current economic conditions and a full set of public sector accounts in line with Eurostat's ESA95 standards.

It is expected that the next Article IV consultation with San Marino will be held on the 24-month cycle.

4. THE GAMBIA—POVERTY REDUCTION AND GROWTH FACILITY—REVIEW, AND WAIVER OF PERFORMANCE CRITERION; AND POVERTY REDUCTION STRATEGY PAPER PREPARATION STATUS REPORT AND JOINT STAFF ASSESSMENT

Documents: Staff Report for the 2001 Article IV Consultation, First Review under the Poverty Reduction and Growth Facility (PRGF), and Request for Waiver of Performance Criterion (EBS/01/193, 11/21/01; and Sup. 1, 12/3/01); and Selected Issues and Statistical Appendix (SM/01/354, 11/21/01; and Cor. 1, 12/4/01)

Staff: Kibuka, AFR; Allen, PDR

Length: 1 hour, 15 minutes

Mr. Rustomjee submitted the following statement:

Introduction

I wish to express the gratitude of my Gambian authorities to the Executive Board, management and the staff, as well as to the donor community, for the support they received over the years. They are hopeful that such support and close cooperation will be continued so as to address the many challenges that lie ahead, notably in the area of poverty alleviation. My authorities also take this opportunity to thank the staff for the advice and support rendered during discussions with the Government and for their effort, including in the recent resolution of a critical dispute over property with a foreign groundnut marketing company, and in the endeavor aimed at drawing up a comprehensive technical assistance program to improve macroeconomic policy formulation and implementation and to facilitate donor coordination in the implementation of the Poverty Reduction Strategy Paper (PRSP).

Within the past four months since the Executive Board last met to discuss The Gambia, some major developments have taken place. On the political front, the transition to democratic rule in The Gambia was further consolidated with presidential elections held on October 18, 2001, in which the President was reelected for a second five-year term. Parliamentary and local elections are due in January and April 2002, respectively. In the area of governance, the property dispute with Alimenta, which had represented a test of government commitment to economic reform in general and to improving governance in particular, was finally resolved and the last installment was paid by the government to Alimenta in August, under the terms of the settlement of the dispute. The dispute had constituted one of the most important issues of concern to donors and the investment community, and its resolution should, therefore, facilitate the restoration of investor confidence and help accelerate reforms in groundnut processing and marketing in the country. The groundnut sector is a means of livelihood to a significant segment of the population and an important source of foreign exchange. Notwithstanding the serious institutional capacity limitations and some unforeseen circumstances, progress with the implementation of the program under the Poverty Reduction and Growth Facility (PRGF) has been encouraging, as pointed out below, and a significant part of the work related to the preparation of the PRSP, which is now expected to be completed after some delay.

Implementation of the Third Annual Program

The real sector performance in 2001 continued to be strong. The growth of real GDP is estimated at 5.8 percent, benefiting from improved performance of agriculture, fishing, and construction. Inflation remained low at below 4 percent, but slightly higher than in 2000 on account of the petroleum product price increases earlier in the year, and the depreciation of the local currency (the dalasi). A number of important structural reforms were also implemented, which included those aimed at enhancing expenditure reporting and control procedures and promoting transparency and accountability, including the closing of government accounts for 1992-99. Moreover, key pieces of legislation that should help promote business efficiency and the private sector were drafted, notably a financial institutions bill and an insurance bill, which are expected to be approved by March 2002.

Indeed, the overall implementation of structural reforms has been broadly satisfactory, as the staff also acknowledge, with almost all of the structural benchmarks having been met. The reforms now in progress at the National Statistics Department, which has long been affected by an acute manpower shortage, are expected to accelerate the implementation of the only missed benchmark of improving the national accounts and price data so that it can be completed by April 2002.

The achievements in the monetary policy front have also been encouraging. The efforts of the central bank to mop up excess liquidity have led to a deceleration in the growth of broad money to about 16.5 percent at end-September, which was in effect a more than halving of the 35 percent growth in 2000. The sale of treasury bills has also been stepped up, contributing to a gradual rise in the treasury bill rate from 12 percent to 15 percent. Such tightening of the monetary policy stance should facilitate a further deceleration in the growth of broad money to about 11 percent at end-December 2001, and thereby enable the authorities to continue to maintain low inflation and to protect foreign reserves. In a related area, and to the benefit of the effort to improve the soundness of the banking system, the proportion of non-performing loans is on the decline, commercial banks' exposure to the public sector is relatively low, and borrowing by ailing enterprises is minimal. The Government has also continued to encourage banks to maintain their capital adequacy ratios above the Basel Committee requirement of 8 percent. The new department of rural finance at the central bank is to play a key role in improving the supervision and growth of the microfinance sector.

External sector developments are generally in line with expectations. There was modest growth in exports as well as some recovery in imports to finance investment. However, it has been difficult for the authorities to make any credible effort at reducing the current account deficit, as the recovery in re-exports and tourism continues to be at a very modest scale. Yet, through prudence and continued effort, the external current account deficit, which is now at around 12 percent of GDP, is substantially lower than the peak of 22 percent in 1987.

Until the disruptive developments of 1993 and 1994, caused largely by external factors, re-exports on average had accounted for 90 percent of total exports and 20 percent of budgetary revenue. Tourism has a long way to go to assume its past importance. In this regard, it may well be said that the continued slowing of the world economy and the recent security concerns may further constrain the authorities' effort to improve the external sector position. Within the external environment they are facing, the authorities are determined to protect external reserves and to maintain exchange rate stability. Owing largely to the accelerated payments to Alimenta and a delay in disbursement of donor grants, both the reserves and the exchange rate came under pressure in 2001 and, as a consequence, reserves are expected to decline to the equivalent of 5.2 months of imports from 5.9 months of import cover in 2000.

On fiscal policy, it has been difficult to maintain the momentum as expected. The fiscal outcome was largely influenced by shortfalls in customs revenue and donor grants. While the revenue situation was not as expected, there were developments, which the authorities had to address by all means. First, the dispute with Alimenta required immediate resolution; moreover, the Government had to make payments to commercial banks to cover the non-performing loans that were guaranteed by the central bank to finance the 1999/2000 groundnut crop in order to avert a major deterioration in the financial position of these banks. Subsequently, the authorities were striving to correct the fiscal slippages; however, as the recovery of customs revenue was limited and the expected donor grants were still not available, the authorities had to continue to make recourse to the banking system to finance important expenditures. This caused nonobservance of the performance criterion with respect to the net bank credit to the central government. In the face of the slippages, the authorities have, however, implemented corrective financial measures, including a tightening of monetary policy.

Furthermore, efforts are being made to accelerate the pace of the implementation of structural reforms, including the privatization of public enterprises such as the National Printing Service Corporation, the Gambian International Airline, the Banjul Shipyard, the Management Services Agency, and the assets that were owned by Alimenta. But major new requirements also emerged. These were the rehabilitation of the Alimenta assets to facilitate marketing of an anticipated large groundnut crop for 2001/02 and enhance their privatization, as agreed with the European Union, and the provision of a concessional loan, obtained by the Government from a donor, to the National Water and Electricity Corporation (NAWEC) on an onlending basis, to address a major bottleneck in the supply of electricity. Even with some recent recovery in customs revenue and improved control of recurrent expenditures, notably wages and salaries, the impact of these additional outlays is to lead to a fiscal deficit that will be wider than in 2000.

The Economic Framework for 2002

In the final months of 2001, the authorities have continued to strive to maintain macroeconomic stability and deepen structural reforms. This should auger well for the effort to make continued encouraging progress in 2002. Moreover, the expected reforms in groundnut marketing and the improved supply of electricity, together with the opportunity that may be available to ensure the continued recovery in the re-export and fishing sectors, should enable the attainment of robust growth and low inflation in 2002.

The budget for 2002, which was approved by Cabinet last month, as prior action to this Board review, is aimed at promoting the revenue effort and containing expenditures, while protecting the poverty and social sectors identified by the PRSP. Hence, the fiscal deficit should substantially narrow to less than 4 percent of GDP and domestic debt is expected to fall.

Measures aimed at eliminating budgetary cross arrears between the government and public enterprises will be implemented. Already, a program for the mutual settlement and elimination of these arrears by end-2002 is being implemented. Moreover, reforms focusing on improving the reporting and control of expenditures and the timely reconciliation and closing of public accounts will continue to be undertaken.

Monetary policy will continue to be aimed at maintaining low inflation and protecting and strengthening external reserves. Measures to further enhance competition among banks, strengthen financial sector supervision, and improve the operation of the money market, will also continue to be implemented. Exchange rate flexibility will continue to be promoted consistent with the foreign reserves objective. The ongoing Monetary and Exchange Affairs Department technical assistance mission should assist the authorities in strengthening these reforms.

On structural reforms, as already pointed out, the pace of their implementation, notably the privatization of public enterprises, will be stepped up. The Government will also start to implement the Trade Gateway Project, which was approved by the World Bank this month, to enable The Gambia to establish an export- processing center to promote private sector activity.

Trade policy, which has already placed the country at a rating of 2 on IMF's 10-point scale of trade restrictiveness, will continue to be liberal. The Gambia will also continue to pursue regional monetary integration with five other countries in West Africa.

PRSP Preparation

The interim PRSP was endorsed by the Executive Board in December last year. As regards the full PRSP, the aim was to complete the preparation within one year of the endorsement of the interim PRSP. However, due to delays in the completion of public sector expenditure reviews (PERs), it became necessary to re-adjust intermediate target dates for the submission of the PRSP. Completion of the full PRSP was given high priority and the Cabinet approved a paper in September directing the relevant sector ministries and institutions to collaborate with the office of the Strategy for Poverty Alleviation Coordination, which was created to facilitate PRSP preparation. It is to be pointed out that the preparation of the comprehensive PRSP is also putting considerable pressure on The Gambia's institutional capacity, which is already substantially limited.

The authorities were invited to Washington last month and during their visit they undertook work on costings of the PERs in education and health and benefited from other input from the Bank and Fund staff. Moreover, as suggested in the Joint Staff Assessment, the authorities have scheduled a National Validation Workshop to take place this month to review the document with full costings of priority action programs. On this basis, the PRSP is now slated to be submitted to the Executive Boards of the Fund and Bank in January 2002.

Technical Assistance

The Fund and the donor community have been providing valuable assistance to improve institutional capacity. In this regard, it is important to stress that The Gambia continues to need technical assistance from both the Fund and the donor community to improve the quality of data and to build institutional capacity necessary for effective policy formulation and implementation. In particular, the urgency has increased with the required articulation and implementation of policies to be set forth in the PRSP. It is thus hoped that the Technical Cooperation Action Plan now being considered will prove to be a useful instrument in this endeavor and in soliciting donor support.

Conclusion

Despite many difficulties, my authorities have continued to demonstrate their firm commitment to the adjustment process. They remain determined to continue their efforts beyond the current program to make a significant dent in poverty, given the fact that about 50 percent of the population is living in extreme poverty. They request the Executive Board to grant a waiver for the nonobservance of the end-September criterion related to budgetary performance so that Fund support, as well as the role of the donor community, can continue unabated.

My authorities have reached understandings with the staff on a macroeconomic framework for 2002/04, including indicative quantitative and structural targets, which could provide a basis for a new three-year PRGF arrangement and continuity in the implementation of the financial and economic track record of performance for purposes of the enhanced HIPC Initiative. They are hopeful that the Board will, as usual, be supportive to approve it.

Extending his remarks, Mr. Rustomjee reiterated his gratitude to the staff for their work during the period of the PRGF-supported program, and indicated that he was hopeful that negotiations on a successor program could be completed as early as possible. He also thanked the staff that had provided technical assistance to the Gambian authorities, particularly those involved in closing some long-delayed public accounts, which had contributed to strengthening the authorities' ownership of the program.

Mr. Shaalan and Ms. Farhan submitted the following statement:

> The Gambian authorities are persevering with their efforts to maintain macroeconomic stability consistent with the PRGF-supported program. Notwithstanding these efforts, the economy continued to display a mixed performance as reflected in the strong real GDP growth and the moderate inflation rate. However, there still remains a relatively large current account deficit and repeated fiscal slippages, as well as the weaknesses cited by the staff in the customs' administration, transparency and accountability of public expenditures. Additionally, the financial relationship between the public enterprises and the government need to be regularized. Addressing these shortcomings merits the authorities' priority attention. A determined effort to strengthen fiscal performance will be necessary to support macroeconomic stability and the reduction of poverty. The fiscal situation has, unfortunately, led policy makers to increase interest rates. We hope that an early improvement in the fiscal situation will permit some relaxation of monetary policy that is conducive to further developing the private sector and enhancing growth.
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> The strains on the budget during the first half of 2001 were associated with shortfalls in customs revenue, particularly from the National Water and Electricity Corporation (NAWEC), and by the settlement of the dispute with Alimenta. Additionally, the nonprogrammed concessional lending to a public enterprise has put more pressure on public finances. These factors resulted in a larger than programmed deficit for 2001. Along with some inefficiencies in the management of fiscal resources, there is also high dependence of the budget on foreign trade taxes and foreign grants, which in turn highlights the need for a broader tax base and improvement in revenue collection machinery. We commend the authorities for adopting an initiative to improve tax revenue collection and instituting the necessary measures to ensure that NAWEC resumes paying customs duty.
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> Looking ahead, the budget for 2002 appropriately aims at containing the fiscal deficit to the targeted level through a substantial increase in revenue and a further decrease in recurrent spending, while protecting expenditure on social sectors and poverty reduction programs. While the latter expenditures should be facilitated by debt relief, the authorities need to ensure that they are well prioritized and effectively implemented. The recently introduced accounting framework for expenditure tracking is a welcome step in this regard. We are hopeful that the government's commitment to undertake

substantive budgetary reforms will help prevent the occurrence of fiscal slippages in the period ahead.

The central bank's decision to raise interest rates will help mitigate the impact of the fiscal expansion on inflation. Monetary control should, hopefully, be facilitated further by the continued efforts to expand the use of indirect instruments. A reduction in government borrowing in the domestic market would create room for additional lending to the private sector. In this regard, we welcome the authorities' intentions to implement the recommendations of the Fund technical assistance mission to improve the functioning of the money market. However, there is still a need to increase banks' participation in the foreign exchange market, in order to further underpin the flexible exchange rate regime. Here, the introduction of foreign currency deposits and the initiative to integrate the interbank and foreign exchange markets are welcome steps. The efforts made to reform the financial system through a strengthened regulatory framework and supervision should be complemented with substantive judicial reforms that can help increase the willingness of banks to provide credit to the private sector. At the same time, to support these efforts, fiscal consolidation is also crucial in order to allow more room for future relaxation of monetary policy to relieve the pressure on the private sector.

To conclude, we encourage the authorities to adhere to their intended medium-term framework, and urge them to vigilantly implement the program in the period ahead. Given the corrective measures taken, we support the completion of the second review and the request for a waiver of nonobservance of a performance criterion. With these remarks, we wish the authorities every success.

Mr. Mirakhor submitted the following statement:

We thank the staff for a well-written paper, and Mr. Rustomjee for his comprehensive and informative statement. The Gambian authorities have done well in steering their PRGF-supported program on course. They have adhered to prudent macroeconomic policies while maintaining the momentum of structural reforms. With one exception, all performance criteria and structural benchmarks for September 2001 were met. As a result, growth is projected to remain strong at close to 6 percent, and inflation is under control, although the fiscal and external current account deficits are expected to be higher than programmed, largely on account of exogenous factors. The recent successful presidential elections, which will be followed by parliamentary and local elections early next year, mark an important chapter in the country's advancement toward democracy and would send a positive signal to donors and investors.

Overall, fiscal policy has been conducted prudently. The deficit, excluding grants, is to widen in 2001 due to lower customs revenue collection, new expenditure for rehabilitation of groundnut processing facilities, and the unprogrammed on-lending of a concessional loan for the acquisition of an electricity generator to face the energy crisis. Delays in disbursement of foreign grants and settlement of liabilities to Alimenta put pressures on budget financing, leading to increased bank borrowing. We welcome the measures taken to ensure resumption of customs duty payments by the National Water and Electricity Corporation and encourage the authorities to speed-up their efforts at achieving clearance of public enterprises arrears to the government. The authorities should be commended for holding the line on expenditures, including lower-than-budgeted spending on wages and salaries, even in an election year. Moreover, over the medium term, fiscal policy is to be tightened by reducing the overall deficit and increasing the primary surplus, which should allow the domestic debt to follow a welcome, downward trajectory. Revenue-enhancing measures have been planned, including strengthening tax administration, with Fund technical assistance. On the expenditure side, recurrent outlays are to be reduced, while increasing social and anti-poverty spending and essential public investment. We welcome initiatives to improve expenditure control and reporting, including timely reconciliation and closing of public accounts. We support the authorities' request for an extension of the services of the Fund resident budget advisor.

Monetary policy has been appropriately tightened in the fourth quarter of 2001 to stem earlier monetary expansion arising from higher net bank credit to government in face of delayed donor grants. The central bank's readiness to take further action, if necessary, to achieve its inflation target is commendable. Looking ahead, sustained budget consolidation should be pursued to ease the pressure on monetary policy. Moreover, if maintained, the high real interest rates—at a time when world interest rates are falling—could be inimical to The Gambia's competitiveness and economic growth. The staff may wish to comment. We welcome measures to improve the functioning of the money market, including introduction of a book-entry system and longer-maturity treasury bills, which should enhance liquidity management. The authorization of foreign currency deposits marks an important step toward liberalizing the foreign exchange market and will help to attract foreign exchange into the formal banking system. However, it needs to be supported by a stable macroeconomic environment to sustain public confidence and avoid a large-scale currency substitution. Efforts to promote integration of the bank and forex bureaus segments of the foreign exchange market, as well as the recent decline in the parallel market premium are welcome. While we join the staff in cautioning against excessive intervention in the market for the purpose of propping-up the rate, we are encouraged by Mr. Rustomjee's assurance that exchange rate flexibility will continue to be promoted consistent with the foreign reserves objective.

We welcome the measures aimed at strengthening bank regulation and supervision and improving the coverage and quality of financial data. While the banking system appears reasonably sound—with satisfactory capital adequacy ratios and declining non-performing loans—banks are encouraged to diversify their liquid asset portfolio to reduce the vulnerability to a possible decline in treasury-bill rates. By strengthening their credit management capacity, banks will also be able to minimize the risk of lending to the private sector. The establishment of the Department of Rural Finance at the central bank, with particular focus on enhancing the role of rural/informal finance and its supervision, is also a welcome development. In this respect, the village savings and credit associations (VISACAs) should be strengthened.

Structural conditionality has been appropriately streamlined in the current phase of the program. The authorities should be commended for advancing and deepening their structural reforms. The recent settlement of the Alimenta dispute—the most important governance conditionality and the source of considerable strain with the international community—should help reclaim investor and donor confidence and pave the way for major restructuring of the groundnut sector. The program to privatize Alimenta's assets in a transparent manner and eliminate government direct intervention in groundnut crop financing is laudable, and recent rehabilitation spending is well justified. Legislation in favor of private sector development, as well as the recent enactment of the Privatization Act, will contribute to enhance productive efficiency in the economy. The authorities are to be commended for extensively liberalizing The Gambia's external trade and exchange regime, and for reducing, simplifying, and rationalizing external tariffs, which contributed to significantly enhancing the country's rating in the Fund's trade restrictiveness index. Implementing the broad range of adjustment measures and reforms in the program will, undoubtedly, put enormous burden on The Gambia's limited institutional and administrative capacity. Therefore, initiatives to improve coordination of technical assistance, including the proposed Fund-supported TCAP to reinforce macroeconomic policy formulation and implementation, are well placed. Efforts to improve the quality and timeliness of economic and financial data with technical assistance, including by improving staffing at the Central Statistics Department (CSD), are also noteworthy. While we attach priority to completion of the rebasing of national accounts, we note that the Statistics Department's mission was completed only in September 2001, which made it impossible for the authorities to meet the relevant structural benchmark set for end-September.

Although there has been a delay in preparation of a full PRSP, this allowed the completion of expenditure reviews in the social sectors and costing of policy priorities, among other actions. Commendable progress has been made on the completion point conditions under the HIPC Initiative. All efforts should be made to meet all conditions on schedule, or earlier. There have also been encouraging efforts made to improve tracking of poverty-related spending and transparency in the public expenditure management, including by implementing a new accounting framework and setting up a special HIPC Initiative account at the central bank.

In view of the authorities' prompt corrective actions to put the program back on track, and their strong commitment to further adjustment and reforms, we support their request for waiver of non-observance of the performance criterion and completion of the second review under the Third Annual Arrangement, and look forward to a successor three-year PRGF arrangement.

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

We thank the staff for the well-written report and Mr. Rustomjee for his helpful preliminary statement. Although the achievements under the program have been mixed, we commend the authorities for the continuing progress. Given the progress made so far, and the authorities' continued commitment to strengthen their efforts towards macroeconomic stability and poverty reduction, we support the request for a waiver of non-observance of the performance criterion and the completion of the second review under the Third Annual Arrangement.

The progress made on the political front toward democratic rule and the recent settlement of liabilities to Alimenta, the Swiss groundnut-marketing company, would, no doubt, help to improve investor confidence and facilitate the mobilization of donor support.

Despite the somewhat expansionary fiscal policy stance, The Gambia is consolidating its overall achievement toward macroeconomic stability. A GDP growth rate of 6 percent, with inflation brought under control, is a welcome development. The more expansionary fiscal stance has been largely a result of one-off expenditures, including the settlement of compensation to Alimenta and other essential capital expenditures. The actions taken to ensure the payment of customs duty on petroleum products by NAWEC and the collection of arrears on customs duty by all public enterprises are encouraging. We welcome these and other measures including the planned technical assistance to improve the revenue side of the budget. We share the authorities' view that some of the additional expenditures would help to increase real output. However, we stress the importance of maintaining a strong fiscal discipline, particularly in the run-up to the forthcoming parliamentary elections to ensure that reasonably good macroeconomic achievements are sustained.

It is also encouraging that the budget for 2002 provides for a further strengthening of fiscal discipline toward greater macroeconomic stability and debt sustainability. We fully share the views expressed by the staff, particularly the need for developing a medium-term expenditure framework to cover all major expenditure programs, while continuing with reforms to enhance transparency and accountability of public expenditures.

We welcome the considerable improvement made in the conduct of monetary policy, and the measures being contemplated to improve the functioning of the money market. Given the sharp reduction of monetary growth and reasonably low inflation, we would appreciate the staff's views of the current interest rate structure. Could the authorities expect some downward adjustment of interest rates in the near future?

The creation of the new Department of Rural Finance at the Central Bank could help in the delivery of much needed micro finance at the early stage of development. However, we hope that this would not create unnecessary complications for monetary management by the Central Bank. Did the authorities consult the staff about this, and if so, what was the staff's advice? We welcome the authorities' efforts to enhance the supervision and monitoring of financial institutions, despite staff and administrative constraints.

It is encouraging that the authorities have been making good progress recently in the preparation of a PRSP, overcoming the earlier setbacks, and we hope that they would successfully complete it in early next year, as currently planned.

The authorities would need continuing technical support from the international community to improve their economic and financial data systems and in addressing other technical difficulties.

We wish the Gambian authorities success in their growth and poverty reduction efforts.

Mr. Oyarzábal and Mr. Garner submitted the following statement:

At the outset, let us thank the staff for an excellent set of papers on The Gambia, as well as Mr. Rustomjee for his helpful and informative preliminary statement.

We receive with satisfaction the recent presidential elections. This successful process indicates a positive step in the consolidation of the democratic system in the country, and we trust that the coming national assembly and local elections will be conducted in the same manner. The final payment by the government to Alimenta is another positive development in the area of governance, and given the fair measure of success in the execution of the economic program, this chair supports the completion of the Second

Review of the Third Annual Arrangement Under the PRGF-supported program, including the waiver of the Performance Criterion.

Since we agree with the general thrust of the staff report, we only have a few remarks on some of the most important issues.

On the fiscal front, we welcome the recent approval of the 2002 budget by the Cabinet, since it is intended to reduce the fiscal deficit by promoting the revenue side, containing expenditure without losing attention to the poverty reduction effort contemplated in the PRSP. The authorities must avoid further policy slippages, especially in relation with the custom revenue performance. The measures taken to ensure tax collection from the public enterprises need to be carried in a continuous way, as well as the other positive measures that are been taken by the Gambian Internal Revenue Department.

The Central Bank's scheme to guarantee any type of loans is a practice that needs to be revised and avoided as it could represent an undesired fiscal cost for the government. The presence of nonperforming loans, together with an outdated commercial law, have made the banks cautious in their lending policies. For that reason, the approval of the Financial Institution Bill and the Insurance Bill is of special importance, and we look forward to this new legislation. Perhaps, the creation of a deposit insurance mechanism will be a prudent complement to the envisaged legislation. The staff's comments on this will be appreciated. In the meantime, we welcome the bank supervisory actions that are carried by the CBG, as well as their recent activities in collecting quarterly financial returns from the village's saving and credit associations. This last aspect is of special importance given the future role of these institutions in the PRSP.

We concur with Mr. Mirakhor that monetary policy has been conducted wisely, and has helped to curtail the earlier monetary expansion that was produced by the higher net bank credit to the government as a result of the payments to Alimenta and the delays in donor grants. Furthermore, the decision of the Gambian authorities to maintain low inflation and strengthen external reserves by finding the appropriate balance between their fiscal and monetary policies, while providing adequate credit to the private sector and promoting exchange rate flexibility at the same time, are paving the way to sound economic growth and a successful development of their poverty reduction strategy.

Another area that required attention from the government is the privatization of public enterprises such as the national Printing Service Corporation, Gambian International Airlines, the Banju Shipyards, the Management Service Agency, and especially the two Alimenta processing plants. With relation to the last set of assets, it is our understanding that these two facilities were the largest purchasers and processors of Gambian groundnuts. Consequently, the spending that was required to rehabilitate the Alimenta assets needed to process the anticipated large crop groundnut crop for 2001/02 is well justified, and we concur with Mr. Rustomjee that this, in the end, will help to enhance their privatized value.

Finally, we commend the authorities for the advances made in improving economic and financial statistics and for the decision to participate in the GDSS. Nevertheless, it is important that this improvement continue, especially in the areas of national accounts and prices, and the fiscal and external sectors, as recommended in the staff report. With these remarks, we wish the authorities success in their future endeavors.

Mr. Ralyea made the following statement:

The authorities have undertaken some notable reforms in the past year, and we support completion of this review, notwithstanding the request for a waiver. In that regard, we think it is worthwhile to put the non-observance of the ceiling on net bank financing to the government in perspective.

One-off expenditures, coupled with poor customs revenue collection early in the year, and a delay in donor assistance were the causes of the larger-than-programmed budget deficit. However, those expenditures should help reduce sources of economic uncertainty and bottlenecks to growth. Customs revenue collection improved starting in July, and the authorities remain committed to further improving customs administration in 2002. Moreover, the government intends to pay off domestic debt when it receives the expected donor grants. Just as important in our decision to grant the requested waiver is the fact that the authorities kept wages and salaries below programmed levels and plan to tighten fiscal policy going forward.

In any event, the fiscal imbalance puts additional pressure on monetary policy to preserve economic stability and may have crowded out some private investment. While the real interest rate on Treasury bills is projected to be roughly the same at the end of 2001 as it was at the end of 2000, we suspect real interest rates may have fallen if the deficit had not grown. Thus, a quick return to fiscal prudence, as the authorities plan, is probably a necessary condition to allow a reduction in real interest rates in a sustainable fashion.

Like Mr. Mirakhor, we also caution the authorities against excessive intervention in the exchange market. The consistent pattern of past intervention leads this chair to believe that the authorities may be wasting resources rather than smoothing exchange market fluctuations.

With respect to structural issues, we believe that assiduous implementation of the divestiture program would provide resources for debt reduction and support a more efficient allocation of resources. In this regard, we were pleased to read in Mr. Rustomjee's helpful statement and the MEFP that the authorities are making efforts to accelerate the pace of privatization of public enterprises. We also welcome the plan to eliminate cross arrears between the government and the public enterprises by end-2002. In our opinion, privatization of Stage One enterprises will be key. We encourage the authorities to follow through on their plans to review the financial operations of all public enterprises. We believe such reviews should be conducted with an eye toward eventual divestiture. In a similar vein, it is absolutely critical that the former Alimenta assets are sold in a transparent and fair manner and the divestiture occurs as soon as possible.

We appreciate the authorities' efforts to improve the reporting and control of expenditures and the timely reconciliation and closing of the public accounts. The government's steps to improve their statistical base and coordination of technical assistance are also noteworthy. Moreover, we welcome the authorities' actions to improve supervision and regulation of the financial sector, including VISACAs, and encourage them to follow through on their plans in this regard.

Looking ahead, we think it is important not to sacrifice quality to speed in development of the PRSP. We encourage the authorities to allow sufficient time to complete the remaining Public Expenditure Reviews (PERs), the Medium Term Expenditure Framework (MTEF), and the full costing of priority action programs. We also believe it is important to link PRSP objectives to the budget. The 2002 budget proposals have benefited from the health, education, and agriculture PERs, but the MTEF will be crucial to ensure this linkage over the medium term. Overarching these issues is the need to maintain the focus on a growth strategy to reduce poverty.

We emphasize that it is important the authorities continue with their reform program in the interim between the conclusion of this PRGF arrangement and any follow-on PRGF arrangement. In that regard, we are pleased to see that a full Stage One safeguards assessment is in the works. We encourage the staff to complete this assessment as soon as possible so a Stage Two assessment, if necessary, can be initiated within the timeline provided in the Fund's safeguards assessment policy.

We also note the rapid growth in Treasury bills outstanding under the PRGF-supported program. We understand that a significant portion of that growth was to facilitate money market operations of the central bank. But a number of parastatals, which in the aggregate had arrears to the government, purchased T-bills as well. This strikes us a potential way to finance the government through the backdoor. The staff may want to consider conditionality in any follow-on program that covers both domestic bank and nonbank financing. We cite the planned conditionality in the Burkina Faso

PRGF-supported program as an example and recognize that the costs and benefits of such a condition, particularly with respect to development of the local money market, will have to be weighed.

To conclude, the authorities' economic policies under this arrangement have been broadly satisfactory. The authorities also have developed a medium term economic framework that appropriately focuses on the need to contain the budget deficit and domestic debt. We believe that framework, along with completion and implementation of the PRSP, will allow them to leverage past and prospective reforms for the betterment of all Gambians.

Mr. de los Santos made the following statement:

The Gambia's economic and social results under the PRGF arrangement continue to be encouraging in 2001. Real GDP growth has been strong and inflation remains low. Despite some slippages in the first part of the year, the authorities proved to be resilient and steadfast to bring the program back on track, and as a result, they observed most of the performance criteria and benchmarks under the arrangement to end-September 2001. The Gambian authorities demonstrated strong program ownership and commitment and consequently, we support their request for a waiver of nonobservance of the ceiling of net bank credit to the central government.

The authorities have made strides to contain spending, mainly in wages and salaries, and adopted some measures to increase customs revenues, for example, by fully implementing the ASYCUDA system. However, deviations from the program goals will lead to an estimated fiscal deficit by end-2001 of 2 percentage points of GDP higher than expected, partly due to the payment made to settle the Alimenta dispute, and shortfalls in customs revenues and donor grants. Medium-term fiscal consolidation should be a core objective of the Gambian authorities since this is a necessary condition for the country to achieve sustained macroeconomic stability and growth and to advance the agenda of poverty alleviation.

On the revenue side, the authorities should aim at enhancing tax collection and administration, especially by broadening the tax base and enhancing income tax collection. We are hopeful that the Fund's technical assistance in the area of tax administration and the World Bank's ongoing capacity building support will soon render visible benefits.

On the expenditure side, the medium-term expenditure framework should be adopted, including expanding the scope of the PER to include all major spending programs as a necessary step. Enhanced transparency and accountability in the budget process is also warranted.

On monetary policy, the authorities continue to perform well. The decision to tighten the monetary stance during the second half of the year has been instrumental in refraining inflationary pressures arising from the increase in petroleum prices and the depreciation of the exchange rate, and thus a more pronounced hike in the CPI was avoided. The authorities should continue implementing these cautious policies until inflationary pressures retreat. The prospects of a good harvest and lower oil prices would work favorably in countering inflation.

We welcome the encouraging advancements in the implementation of structural reforms and commend the authorities for their satisfactory record of observing most of the end-September structural benchmarks. The resolution of the property dispute with Alimenta and the payment of the final installment by the government is a case in point. We encourage the authorities to remain committed to the reforms agenda, and in that regard, we hope that the program of privatization of public enterprises will receive the necessary support. In this connection, we concur with the staff that Alimenta could be a good case to make a strong jump start of the privatization program. At the same time, further enhancement of the business environment is needed to stimulate private sector development. The external current account deficit remains high, propelled by a lower than expected inflow of private and official requisite transfers, and only modest growth in exports. The country's high external fragility could be worsened if the world economic downturn further deteriorates or lingers longer than projected. We would appreciate the staff's comments on what should be the response if such a scenario materializes.

Despite the country's external competitiveness and liberal trade regime, the export potential has not yet been fully exploited. The authorities should aim at improving the production and quality of agricultural and seafood products to improve potential for sales abroad. In his comprehensive statement, Mr. Rustomjee points out the need for improving reexports that already accounted for a large share of exports, and stresses the importance of a recently approved World Bank project to establish an export processing center. Similarly, although the international events that have taken place since September 11 significantly affected world tourism, it appears that the country could have good medium-term prospects to enhance tourism receipts.

We agree with the staff that the quality of The Gambia's statistics should be improved, and call for continued Fund and Bank support through technical assistance until the country becomes capable to produce high quality data in a regular and timely manner.

The macroeconomic framework adopted for 2002/2004 is a strong signal of the Gambian authorities' resolution to consolidate the social and economic gains attained with the implementation of the current PRGF arrangement. Like the staff, we also hope that the framework could lead to the negotiation of a new PRGF-supported program. The Gambians deserve praise and support for their achievements and we agree with the proposal that this second review be completed.

Mr. Merotto made the following statement:

We also support the proposed decision and in doing so, we thank the staff for its efforts in helping The Gambia's authorities to weather the various regrettable, but internally-induced storms, which have affected the country these past few years.

During what has been a difficult time for the donor community, we have particularly valued the consultative approach and the openness which the staff have shown, and this has been helpful in maintaining a dialogue in Banjul between the authorities and the international community. Since I share the staff's assessment and have had helpful answers to various detailed points in advance, I will emphasize just a few issues which the staff raise and on which we concurred, and then comment on key features which we would like to see reflected in the PRGF-supported program as the PRSP process develops.

Overall, as the staff shows clearly, The Gambia's performance under the PRGF arrangement has been mixed, but on balance, it is acceptable. Against the background of the recent presidential elections, much has been accomplished. In particular, the progress made on Alimenta's property dispute has been encouraging, as Mr. Rustomjee notes in his statement. We join the staff and Mr. Ralyea in urging the authorities to ensure that the privatization process for Alimenta is transparent and competitive. Similarly, closure of the national accounts for 1992–1997 and 1998–1999 is welcome. However, given the dismantling of the auditor general's office, there are no assurances that these accounts will be effectively audited. This is the government's concern and a serious weakness in The Gambia's public expenditure management framework, which we believe needs to be resolved in a timely and satisfactory manner. A detailed time frame for an effective audit is needed and we would encourage the authorities to provide this to the international community as a signal of their intent.

Like the staff and other Directors, we are also concerned about fiscal slippages, and in particular, the recent falling customs revenue and the cross debts of parastatals. We urge the authorities to give priority to addressing these issues under the program.

Turning now to poverty issues, we feel the PRSP priorities need to be properly integrated into the budget, and unless more attention is given to this by the authorities, we fear that weaknesses in public resource management capacity could result in a budget which has little to do with the priority areas identified in the PRSP. This is possibly something to be considered for the future and for the MTEF process to identify.

My authorities also feel that more needs to be done to reflect poverty issues in the PRGF-supported program as the PRSP process develops. I should add that this is a process with which the U.K. Aid Ministry is engaged. At present, we feel that PRGF key features are not sufficiently reflected in the PRGF-supported program, making it appear little different from an ESAF arrangement. We recognize that much of the work to develop the PRSP, with which the Fund is providing helpful assistance, is ongoing, but we recommend that future reports provide more detail in the following areas. First, further consideration could be given to the poverty and social impact of macroeconomic policies supported by the PRGF, including the effect of high real interest rates on crop financing and employment in the reexport business, a point which we felt was a little too quickly dismissed in paragraph 32 of the paper. As a general point on PRGF-supported programs, we do not think that the Fund should fully abdicate responsibility for poverty and social impact assessment to the PRSP process. I think this is something we have picked up in other fora, so we feel that the finding should be reflected in the PRGF papers as well.

Second, although health and education spending have been maintained, the aggregate masks the fact that too much is spent on tertiary education, and health is at the tertiary level too, relative to primary services. The PRGF-supported program should monitor disaggregated data once it becomes available from the sector PERs. It might also help to track nonsocial spending on poverty reduction, such as spending in rural infrastructure.

Third, on conditionality, while the Fund is streamlining, it is unclear how the Bank is going to take up the areas not currently covered by the Fund. Since Bank structural adjustment lending is not planned until 2003, we would welcome more clarity on how the Bank will, in practice, pick up in those areas from which the Fund is withdrawing.

Aid flow is very unreliable in the current environment. However, if and when aid commitments do pick up, it will be important for the staff to help the authorities map donor flows in order to assist the country in setting spending projections. This could be another issue for a follow-on PRGF arrangement.

But lest these general points for the future be taken in the wrong context, I should end by reiterating that we are grateful to the staff for the quality of their assessment which we share, and as a traditional donor, we strongly appreciate the consultative process, and the approach that they have adopted in conducting their work in difficult circumstances. I noted from

Mr. Rustomjee's preliminary statement and his opening remarks that his authorities are also appreciative of the staff's advice and support. I think it is quite an achievement to keep both the authorities and the donors happy in the current environment in The Gambia, and we should not let that go unnoticed.

Mr. Ondo Mañe made the following statement:

At the outset, let me thank Mr. Rustomjee for his helpful and informative preliminary statement. I would also like to thank the staff for an excellent set of papers on The Gambia's economy.

During 2001, The Gambia recorded a GDP growth rate of about 6 percent, while inflation remained under control and official reserve stood at an appropriate level. Progress has also been made in implementing a number of structural reforms. Moreover, all performance criteria relevant for completion of the Third Review have been met.

The successful settlement of the Alimenta dispute is a major achievement, for which the authorities should be commended. This will help build investor confidence and solve governance issues, as pointed out by Mr. Rustomjee. Given these circumstances, I support the completion of the review and the grant of waiver for performance criterion.

On fiscal policy, I welcome measures aimed at reducing the fiscal deficit. We are confident that the Fund technical assistance mission on tax administration, together with the World Bank capacity-building project, would further improve tax revenue performance. The authorities should be commended for having better control of wages and salaries despite the fact that it was an election year.

We take note of the reemergence of cross arrears between the government and the public enterprises (representing about 0.4 percent of GDP), and a program for the mutual settlement of these arrears, with quarterly targets leading to their elimination by end-2002. However, given the revenue constraints facing the country, would the staff elaborate on the plan to clear these arrears?

We are encouraged by the progress made on budgetary reforms, which was achieved with the technical assistance of the Fund and other donors, including the closing of the past government accounts, as well as the completion of the audit of the remaining accounts for subsequent years. We are also appreciative of the government's efforts in favor of the reporting and control of expenditures, as well as expediting the reconciliation and closing of public accounts.

With the forthcoming elections, like Mr. Kelkar and Mr. Jayatissa, we would like to stress the importance of maintaining a strong fiscal discipline in

2002. In that vein, we are pleased to learn from the MEFP that the budget for 2002 aims at containing the fiscal deficit at about 3.6 percent of GDP, and that it also incorporates poverty-reducing expenditures funded with interim relief under the enhanced HIPC Initiative.

Monetary Policy

The authorities should be commended for tightening their monetary policy stance, which helped to compensate for the expansionary fiscal stance. Tighter monetary policy and the expected receipt of donor grants should help moderate broad money growth. The steps taken to improve the functioning of the money market, including introducing longer-maturity treasury bills, is also encouraging.

We also welcome the measures taken by the central bank for a deeper and more efficient interbank foreign exchange market. In this regard, the authorities' intention to unify the foreign exchange markets, by encouraging commercial banks to deal directly with the foreign exchange bureaus, and the recent introduction of foreign account deposits are laudable.

Structural Reforms

The authorities should persevere in the implementation of reform measures to improve the investment climate, and set a regulatory framework that could enable the privatization of public enterprises. In this regard, the adequate privatization program for some public enterprises that includes the former Alimenta assets, The Gambia International airline, and the Banjul Shipyard is a step in the right direction. Given the bottlenecks that the electricity sector is facing, and the crucial role of energy for the improvement of the business climate, we would urge the authorities to press ahead with the privatization of NAWEC, the national electricity company.

On financial sector reforms, we are encouraged by the recent measures to improve the auctions for treasury and central bank bills, and the strengthening of banking supervision. In this connection, the final revisions to the Financial Institutions Bill and Insurance Bill to be submitted to the parliament next year are also a move in the right direction.

On the important groundnuts sector reform, given the extent of poverty in the rural area where at least 2/3 of the population are involved in activities related to the groundnut, we call for a gradual approach for liberalization. To this end, we would also like the staff to elaborate further on the comprehensive reform plan that would accompany the divesture of the government's remaining assets in Alimenta. Does this plan take into account a social safety net for the rural population, given the current low international price of groundnuts?

PRSP

The social and poverty database remains in great need of strengthening, in light of the objectives outlined in the PRSP. Like Mr. Mirakhor, we can go along with the delays in the preparation of a full PRSP. Mr. Rustomjee also stressed The Gambia's limited institutional capacity and the need for the completion of the expenditures review to update the document with full-costing of priority action programs as the major cause of the postponement. Therefore, we encourage the authorities to formulate a full-fledged and comprehensive PRSP early next year.

With these remarks, we can support the proposed decision, and we hope that the macroeconomic framework for 2002-04 will pave the way for a new three-year PRGF arrangement. We would also like to join Mr. Rustomjee and Mr. Kelkar in their call for technical support from the international community for The Gambian authorities. We wish the authorities every success in their endeavors.

Mr. Marques made the following statement:

The success of Gambia's presidential election illustrates the authorities' commitment to the democratic process, and it is hoped that the 2002 elections will be equally successful.

While Gambia's overall economic performance and its reduction of the fiscal deficit and progress with structural reforms are to be commended, I feel concern about the implementation of the budget, which could be stronger.

I am heartened by the recent approval of the 2002 budget and by the adoption of the macroeconomic framework for 2002–2004. In order to avoid future excessive recurrent expenditures and recurrent shortfalls in customs revenue, the authorities must continue pursuing their tight expenditure policy while broadening the tax base. Critical measures for increasing revenues include eliminating custom duty exemptions, and increasing the price of petroleum products, which are still heavily subsidized despite a first price increase last March.

Fighting financial misfeasance at all levels of public administration is also crucial. Some progress has been made with closing "below-the-line" public accounts and improving spending reports and control, but further reforms are needed to bring the transparency and accountability of public expenditure to satisfactory levels.

The authorities should also be commended for their sound monetary and fiscal policies, which have helped keep inflation low and strengthened external reserves.

The high level of the public domestic debt remains worrisome. To deliver on the authorities' promise to reduce their domestic market borrowing under the PRGF, the fiscal slippages that in the past have increased the stock of domestic debt must be stopped. The expansion of domestic credit to both the government and the private sector must not exceed the program targets.

I welcome the authorities' progress in preparing their final poverty reduction strategy paper (PRSP) despite the competing claims of the electoral timetable, and I urge them to finish as planned early in 2002. But they must strengthen their commitment to poverty.

The authorities must also focus on improving business legislation, privatization, and further reforms of the groundnut market. The commendable Alimenta settlement enables the authorities to privatize the processing plants previously owned by Alimenta. This will not only boost the government's proceeds from privatization, but should also put a stop to the government's direct intervention in crop financing. Other structural reforms are called for to settle cross-debts between the government and the parastatals and to prepare for the divestiture of the public utilities. Unfortunately Gambia's weak administrative capacity will slow these reforms.

Despite some improvements of Gambia's statistical data, there is more to be done. The central bank's efforts to improve the coverage and quality of financial data are steps in the right direction. I also applaud its efforts to strengthen the regulatory framework and the supervision of the financial sector, which will further improve Gambia's already relatively efficient banking services.

And finally, I commend the authorities' significant role in developing institutions and infrastructures to facilitate the launching of a full-fledged West African Monetary Union by 2003.

With these remarks, I support the proposed decision, including the requested waiver of a performance criterion.

Mr. Blome made the following statement:

At the outset, I would like to thank the staff for the informative papers, and Mr. Rustomjee for his helpful statement. I support the proposed decision, which includes the approval of the authorities’ request for a waiver on the nonobservance of one performance criterion, and the completion of the Second Review under the Third Annual PRGF Arrangement.

The staff rightly notes that The Gambia's performance under the PRGF-supported program continues to be mixed. While growth has remained strong and inflation relatively low, some fiscal and structural reform targets have not been reached, and the completion of the full PRSP has been delayed. On balance, however, the progress achieved thus far, sometimes under difficult circumstances, is encouraging.

I also welcome that the authorities have formulated corrective measures to keep the program on track during the coming months. In addition, they have articulated an adequate macroeconomic framework for 2002–2004, which may contribute to laying the basis for a possible new three-year PRGF arrangement. These steps should be complemented by an early completion of the full PRSP by strengthening governance, improving the timeliness and quality of data, and making better use of available external technical assistance.

The main tasks for the coming months will be to strengthen fiscal discipline, tighten monetary policy, and improve the implementation of structural reforms with the support of external technical assistance. The staff has made a number of recommendations in this regard, which deserve support, so I will thus limit myself to a few points of emphasis.

On fiscal policy, I agree that the improvement of customs administration remains critical and that the problem of the arrears of public enterprises to the government should be forcefully addressed. I would also underline the need to enhance the transparency and accountability of public expenditure. Further progress in this area is vital for the PRGF and HIPC Initiative process.

Regarding monetary policy, I note that the authorities have taken additional measures to combat inflation. The program for 2002 rightly aims at reducing end-period inflation to 3 percent, promoting exchange rate flexibility, and maintaining external reserves equivalent to about five months of imports. This policy stance should ensure sound monetary conditions in 2001. It will also support the ongoing financial sector reforms aimed at strengthening the sector. The difference between lending and deposit rates in this sector, which was approximately 12 percent in mid 2001, is still high and points to the need for further efforts to increase competition and efficiency in the banking sector.

On structural policies, I agree with the staff that a broadening of reforms remains key to stimulating private sector activity and accelerating a reduction in poverty. I wonder whether more ambitious reforms could also contribute to a reduction in the high deficit of the external current account. According to the authorities' current medium-term framework, the deficit, including official transfers, will increase from 3 percent of GDP in 1998, to 5.1 percent of GDP in 2004. Excluding official transfers, the deficit in the current account will remain at around 12 percent of GDP in the years 1998-2004. The staff has given me, on a bilateral basis, some explanations in this regard. Nonetheless, I would underline that one main objective of a PRGF-supported program is to considerably strengthen the balance of payments position in a sustainable manner. This should be reflected, in my view, in a downward trend in the external deficits.

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

Mr. Al Azzaz made the following statement:

The Gambia's continued commitment to the PRGF-supported adjustment and reform effort is encouraging. The program is broadly on track. The economy has remained responsive with robust growth and low inflation. Therefore, I have no difficulty in endorsing the requested waiver and supporting the completion of the second review.

The challenge now is to build on these improvements. The authorities' economic program for 2002 presents an appropriate framework for maintaining macroeconomic stability and achieving growth and poverty reduction goals. Timely implementation of the agreed policies is clearly critical.

On fiscal policy, I endorse the emphasis on promoting revenue growth and containing spending, as well as reducing budgetary arrears. The monetary policy focus is rightly on maintaining low inflation while protecting and strengthening foreign reserves. The prospects for market-led growth also depend on a faster privatization drive, as well as institutional infrastructure conducive to market-led growth. These efforts, together with the measures to protect expenditure on poverty alleviation and social sectors, bode well for achieving the PRGF goals.

With these remarks, I wish the authorities success.

Mrs. Boucher made the following statement:

At this stage of the discussion I would like to confirm our agreement with the staff's assessment and recommendations and with the proposed decision. I will just make a few comments on fiscal issues and regional integration.

As expressed at the previous review, public expenditure control and governance remain the priority areas under the program. We welcome progress made in creating an accounting framework to track poverty reduction expenditures, which is part of the overall strategy to improve transparency and efficiency of public spending and strengthen fiscal performance.

We are concerned by the still high level of government domestic debt and the larger than programmed recourse to net bank financing, which led to the nonobservance of the corresponding performance criterion. Indications in the report on public enterprises that have accumulated arrears to the government are also worrisome. I was somewhat reassured by indications in Mr. Rustomjee's comprehensive and useful statement on measures aimed at eliminating budgetary cross arrears between the government and public enterprises. Like Mr. Ralyea, I encourage the authorities to enter ensure implementation of these measures and the program for the mutual settlement of these arrears by end-2002, and I join other Directors in urging the authorities to maintain strong fiscal discipline going forward.

On regional integration, we noted the progress achieved thanks to the implementation of the external tariff reforms, and we welcome the country's positive role in the development of institutions and infrastructure to facilitate the launching of the West African Monetary Zone. We agree with staff that additional work is needed to assess the trade diversion effects of The Gambia's participation in this regional integration arrangement. The staff's comments in the last paragraph in Box 2 on the impact of trade reform in the WAEMU will need further elaboration, particularly as regards what measures could be implemented to further enhance The Gambia's position as a key regional trading center. I would welcome the staff's clarification of this matter.

The staff representative from the African Department (Mr. Kibuka), in response to questions posed by Directors, explained that political and economic conditions in The Gambia had recently changed significantly, not least with the lowering of world interest rates. The presidential elections had been concluded peacefully in October 2000, and if the Board granted the waiver to successfully conclude the review and donor grants were disbursed, it would result in a major boost in confidence and supply of foreign exchange in The Gambia. Moreover, parliamentary approval of the budget for 2002 was expected, which would help reduce the overall deficit considerably and bring about a reduction in domestic interest rates. During the next staff mission, scheduled for early 2002, the staff would review overall economic developments, and discuss the appropriate stance of monetary policy with the authorities.

The Department of Rural Finance had been set up to coordinate the central bank's efforts in supervising, regulating, and promoting rural finance, the staff representative continued. However, the new department would not engage in direct lending for such activities, as the Central Bank Act was clear in limiting the role of the central bank in direct lending to private sector activities outside of financial institutions. Microfinance institutions in The Gambia were financed by the Social Development Fund and the village savings and credit association, (VISACA) promotion center. These two organizations were funded by donors, NGOs, and by member contributions. There had been ongoing discussions between the authorities and the staff on the need to improve the supervisory and regulatory role of the central bank over rural microfinance institutions, which remained very important in the strategy to address poverty. Against that background, the staff had been supportive of the central bank's approach to bring its activities in this area under one umbrella outside of the Banking Supervision Department, which also needed strengthening, to adequately address issues in the formal financial institutions. Insurance companies would also be included in this group, after parliament approved the legislation. Thus, a separate unit for microfinance institutions was quite desirable.

The staff representative explained that the authorities' medium-term strategy to create viable rural microfinance arrangements to help alleviate poverty was supported by a tripartite structure: the VISACA promotion center, which should provide operational expertise; the Social Development Fund, which would be involved in mobilizing financing; and the central bank, which would supervise and regulate the subsector.

On the question of the creation of a deposit insurance scheme, the issue required further examination, the staff representative continued. It was important to address the underlying problems, which included legal and judicial reforms to modernize the financial system. In particular, there was a need to fully operationalize the commercial court, and to strengthen the asset management recovery company to extend its mandate to collect on all nonperforming loans. The banks also needed to strengthen their internal capacity to appraise and supervise bankable projects.

In response to a weaker external outlook as a result of the September 11 events, the staff had already worked on tentative projections that indicated a widening in the financing gap, which would likely require additional financing, the staff representative remarked. The staff would encourage the authorities to accelerate privatization, which would enhance private investment and, inter alia, improve port and utility facilities within the country. There were also important reforms envisaged in the agriculture sector, including efforts to privatize the former Alimenta assets. If the former Alimenta assets were privatized to competing firms, it would help to improve the price received by farmers. A number of measures supported by the European Union and *IFAD* aimed to significantly improve the quality of the groundnuts, so that the farmers could benefit from a major boost in the value of exports over the medium-term. The staff would also encourage the authorities to accelerate their access to technical assistance in a number of key sectors where it could be helpful to improve productivity.

Regarding plans to clear arrears between the government and the public enterprises, the staff had an estimate of how much was owed to each entity, the staff representative explained. Although there would be offsetting arrangements in some cases, it was preferable that enterprises made direct payments so that they could be recorded as revenue receipts by the government. In the case of NAWEC, which is the utility for supplying electricity, the staff expected that it should be in a position to make regular payments to the government to clear up some of its arrears because it was expected to earn more revenues from its activities as a result of improved supply of electricity and lower petroleum prices.

Regarding reforms in the agriculture sector, particularly in the marketing of the groundnut crop as well as in improved production, the staff believed that the reforms would improve the prices received by the farmers, the staff representative continued. It was expected that the reforms would make a significant contribution in the fight to alleviate poverty.

Although the authorities had taken a number of measures to reduce external tariffs and improve the external competitiveness of the country, there was increasing competition in the region, which had actually eroded The Gambia's competitiveness, the staff representative explained. To further improve The Gambia's external competitiveness, the authorities could continue to reduce external tariffs. However, this could require major reforms in the domestic taxation regime, and possibly additional budget assistance to offset the likely revenue losses. The authorities could accelerate privatization, including the port facilities and utilities in order to attract significant private investment in the country.

It was expected that the World Bank Board would soon approve the Trade Gateway Project in The Gambia, the staff representative concluded. If that project were to be implemented effectively and expeditiously, it would significantly help to improve the external competitiveness of The Gambia.

Mr. Rustomjee made the following concluding statement:

> I would like to thank colleagues for their welcome and constructive comments. I give my thanks for the support for the waiver and completion of the review, and for the many detailed comments. I have tried to write them all down, and I will certainly reflect all of these back to my Gambian authorities.
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> On fiscal policy, there were so many useful comments on the need to improve the tax base and improve tax administration. Other comments included adopting the MTEF, fiscal consolidation, public expenditure control and strengthening the authorities' work in this area, budget transparency, elimination of customs duty, exemptions and petroleum product subsidies, auditing public accounts, and the need for a detailed time frame in a successor PRGF-supported program. Also of note were the comments on the issue of resolving the cross indebtedness between the government and parastatals.
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> On monetary policy, I think it is fair to say that several Directors welcomed the continued cautious approach of the authorities, but noted that they should continue to pursue an approach that includes strong inflation reduction as well as reserves building and strengthening. I took from

Mr. Ondo Mañe's comments that he welcomed the steps taken to lengthen the treasury bill maturities, broaden the structure of the treasury bill market, and make progress toward an Interbank foreign exchange market. I understood from Mr. Blome that he welcomed the 2002 approach to monetary policy as set out in the macroeconomic framework, but that there were, nevertheless, still high interest rate differentials that needed to be corrected. I must agree with his point regarding lack of competition in the banking sector, which needs to be attended to by the authorities. I also concur with Mr. Blome on his point about the importance of the external current account deficit and the need to strengthen the balance of payments position of The Gambia in the context of a successor PRGF arrangement.

Several Directors mentioned they welcomed progress in structural reforms, including in particular, the assets of Alimenta that should be privatized. Several colleagues noted that this privatization process should be transparent, competitive, and quick. It is hoped that these will contribute to ownership and good governance, and it will be necessary to improve the investment climate and strengthen business legislation to make sure that this takes place. I thought Mr. Ondo Mañe's raised a very crucial issue about the need to strengthen social safety nets given the low price of groundnuts. I believe it will be important that this issue be taken into account in the design of the successor PRGF-supported program. I would also wish to underline that message to World Bank colleagues, because in the absence of strong social safety nets, it will be difficult for the authorities to make strong progress with poverty reduction efforts.

On the PRGF successor arrangement issues, I think it is fair to say that colleagues welcome the progress being made toward the final PRSP, and that this should hopefully be finished as planned. However, quality must not be sacrificed for speed.

I believe the issue about the Stage Two Safeguards Assessment is a fair point. The authorities will certainly work very hard to make sure that that is done with the full cooperation as they have been doing with the stage one assessment. I do want to mention that I believe it would be unfair if the authorities were led to understand that a successor PRGF arrangement could not come through until that Stage Two Safeguards Assessment is completed. I think that is part and parcel of the ongoing work of the authorities, and in collaboration with the Fund, they will get that done. I do not think there will be any difficulty in compliance. It is possible that it may not be necessary to do a stage two assessment in the first place. That is yet to be determined.

Many Directors commented on the need to integrate PRSP priorities into the budget, and to have it link to the MTEF process. I think the comments made on the need for poverty issues to be reflected more strongly in the PRGF-supported program are very valuable. I think this is a generic lesson;

our chair is keen to move away from the former ESAF into a more sensible PRGF framework.

The greater assessment of the poverty impact of PRGF policies would need to be incorporated into the new PRGF arrangement. My authorities will be pleased to hear the comment about the potential consequences of high real interest rates on crop financing because there is a trade-off involved. While high real interest rates can be appealing, they can result in severe consequences for crop financing.

I have taken note of Directors' comments on tertiary education, regional integration, the trade diversion effects of The Gambia's participation in the West African Monetary Zone, which is a work agenda for the authorities to consider, and the issues on data.

I would like to thank Directors for their comments, the staff for their valuable work they have done and for the detailed responses they have just given, management, and also the traditional donors, who are making a significant difference in helping improve the quality of the reform efforts of the authorities.

The Acting Chair made the following summing up:

Directors welcomed the progress that The Gambia has made under their program supported by the PRGF in maintaining high economic growth and low inflation, implementing key structural reforms, addressing major governance issues, and developing a poverty reduction strategy. The Board granted a waiver for the nonobservance of a performance criterion for end-September 2001, noting the authorities' intention to implement a sound macroeconomic framework for 2002/2004 and supportive fiscal and monetary policies.

For 2002, Directors welcomed the planned significant reduction in the budget deficit and in net government borrowing from the banking system. They urged the authorities to meet the indicative fiscal targets through a forceful implementation of the planned revenue and expenditure reforms, while protecting expenditures on the social sector and poverty reduction. Directors stressed the importance of maintaining strong fiscal discipline, particularly in the run-up to the forthcoming parliamentary elections. On the revenue side, they emphasized that it will be particularly critical to ensure a sustained improvement in customs administration. Directors called for speedier efforts to clear public enterprise arrears to the government.

Directors noted that progress toward reducing the current account deficit has been slow, and that the external sector remains fragile. In this context, they considered that continued sound financial policies and structural reforms would play an essential role in contributing to a strengthening of the external sector over time.

Directors urged the authorities to develop and adopt a medium-term expenditure framework, and welcomed the recently introduced accounting framework to track expenditures, especially those directed at reducing poverty. More generally, Directors called on the authorities to continue with reforms to enhance the transparency and accountability of public expenditures. Technical assistance, including from the Fund, will help the authorities in their efforts to improve fiscal performance. Directors noted that a sustained strengthening of the fiscal performance will help to put the domestic debt on a downward trajectory. Looking to the future, they considered that the budget should be more closely linked to the poverty reduction priorities under the PRGF-supported program.

Directors considered that monetary policy, tightened in the second half of 2001 in the face of fiscal slippages, should continue to be prudent in 2002. A few Directors observed that an improvement in the fiscal situation could permit some relaxation of monetary policy in the near term, which would help promote private sector development and spur growth. Directors welcomed the measures to promote closer interaction of banks and foreign exchange bureaus and the introduction of foreign currency deposits, which will help deepen the interbank foreign exchange market.

Directors noted that the Gambian banking system is reasonably sound, and welcomed the authorities' efforts to enhance the supervision and monitoring of financial institutions.

Directors stressed the need for The Gambia to continue to consolidate and broaden structural reforms. Key in this regard will be the implementation of measures to improve business legislation, as well as the framework for the regulation of public enterprises and pressing ahead with a transparent privatization process. Directors considered that the recent settlement of the property dispute with Alimenta will enhance investor confidence, and encouraged the authorities to privatize the former assets of Alimenta in a transparent and competitive way. They also called on the authorities to move forward with their plans to establish a sustainable marketing arrangement for the groundnut sector.

Directors commended the authorities for liberalizing the trade regime, which has enhanced The Gambia's role as a key regional trading center. They welcomed the initiatives taken by the authorities to better coordinate technical assistance, including the proposed Fund-supported Technical Assistance Cooperation Plan to enhance macroeconomic policy formulation and implementation.

Directors commended the authorities' decision to participate in the GDDS, and encouraged them to continue to improve the quality and timeliness of data.

Directors looked forward to the completion of Stage One of the Safeguards Assessment.

Directors considered that work toward the development of a full PRSP, as reflected in the PRSP preparation status report, is satisfactory and provides a sound basis for continued access to concessional Fund resources. They looked forward to the completion of the full PRSP early next year, which several hoped would pave the way for a successor PRGF arrangement. Directors encouraged the authorities to continue to make progress toward meeting the enhanced HIPC Initiative completion point conditions.

The Executive Board took the following decision:

1. The Gambia has consulted with the Fund in accordance with paragraph 2(e) of the third annual arrangement for The Gambia under the Poverty Reduction and Growth Facility (PRGF) (EBS/00/241, 11/28/01) in order to review program implementation.

2. The letter of the Secretary of State for Finance and the Governor of the Central Bank of The Gambia dated November 14, 2001, together with its attached Technical Memorandum of Understanding dated May 16, 2001, shall be attached to the third annual PRGF arrangement for The Gambia, and the letter of the Secretary of State for Finance and the Governor of the Central Bank of The Gambia dated November 27, 2000, as amended, shall be read as supplemented and modified by the letter dated November 14, 2001.

3. The Fund decides that the second review contemplated in paragraph 2(e) of the third annual PRGF arrangement for The Gambia is completed and that The Gambia may request the disbursement of the third loan in an amount equivalent to SDR 3.435 million, notwithstanding the nonobservance of the end-September 2001 quantitative performance criterion with respect to net bank credit to the central government specified in paragraph 2(a)(i) of the third annual PRGF arrangement, on the condition that the information provided by The Gambia on the implementation of the prior action specified in Table 3 attached to the letter dated November 14, 2001 is accurate, and on the further condition that, with respect to the disbursement subject to the performance criterion above, the information provided by The Gambia on performance under this criterion is accurate. (EBS/01/189, 11/19/01)

Decision No. 12636-(01/124), adopted
December 5, 2001

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/01/123 (12/3/01) and EBM/01/124 (12/5/01).

5. GUYANA—REPRESENTATIVE RATE FOR GUYANA DOLLAR

1. The Fund finds, after consultation with the authorities of Guyana, that the representative exchange rate under Rule O-2, paragraph (b)(i) of the Fund's rules and regulations for the Guyana dollar against the U.S. dollar is the rate determined daily by the Bank of Guyana on the basis of the average opening market exchange rate of the three largest market dealers in foreign currency.

2. The Bank of Guyana will inform the Fund of any changes affecting the definition of the representative rate. (EBD/01/110, 11/26/01)

Decision No. 12637-(01/124), adopted
December 4, 2001

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, by Advisors to Executive Directors, and by an Assistant to Executive Director as set forth in EBAM/01/143 (12/3/01) is approved.

7. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/01/130 (12/4/01) is approved.

APPROVAL: February 21, 2002

SHAILENDRA J. ANJARIA
Secretary