June 29, 2001
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 00/111

10:00 a.m., November 13, 2000

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Decisions Taken Since Previous Board Meeting

Executive Board Attendance

H. Köhler, Chairman
S. Fischer, First Deputy Managing Director
E. Aninat, Acting Chairman
S. Sugisaki, Acting Chairman

Executive Directors

A. Barro Chambrier
T.A. Bernes
M.J. Callaghan
R. Faini
K.-T. Hetrakul
O.-P. Lehmussaari
K. Lissakers
A. Mirakhor
M. Portugal
C.D.R. Rustomjee
Wei Benhua
J. de Beaufort Wijnholds

Alternate Executive Directors

A.S. Al Azzaz, Temporary
M.F. Melhem, Temporary
D. Ondo Mañe
P. Charleton
W. Szczuka
S. Bonomo, Temporary
B. Siegenthaler, Temporary
D.H. Kranen, Temporary
R. von Kleist, Temporary
Low K.M.
R. Djaafara, Temporary
R.A. Jayatissa
A. Jacoby, Temporary
C. Josz, Temporary
G. Bauche
S. Boucher, Temporary
M. Daïri
S. Rouai, Temporary
A. Lushin
J. R. Suárez, Temporary
S.P. Collins
O. Himani, Temporary
K. Sakr, Temporary
S.A. Bakhache, Temporary
Jin Qi
Liu F., Temporary
Liu Z., Temporary
E.J.P. Houtman, Temporary
I.C. Ioannou, Temporary
K. Harada, Temporary
S. Hinata, Temporary
R. Maino, Temporary
M. Pérez dos Santos, Temporary

S.J. Anjaria, Secretary
A. Mountford, Acting Secretary
M. Schulte, Assistant
R. Gudmundsson, Assistant

Zambia—Options to Smooth Debt Service Payments
Staff representatives: Sharer, AFR; Christensen, TRE

Guyana—2000 Article IV Consultation; and Poverty Reduction and Growth Facility—Second Annual Arrangement; Interim Poverty Reduction Strategy Paper and Joint Staff Assessment; and Enhanced Initiative for Heavily Indebted Poor Countries—Decision Point
Staff representatives: Yadav, WHD; Seade, PDR

Also Present
IBRD: S. Weber, Alternate Executive Director; M.K. Hollifield, Advisor to Executive Director; Y. Ansu, Africa Regional Office; A. van Trotsenburg, HIPC Unit; O. Kalantzopoulos, R. Nallari, Latin America and the Caribbean Regional Office; A. de Plaa, PREM HIPC Unit. IDB: G. Castilo. African Department: G.E. Gondwe, Director; P.A. Acquah, Deputy Director; A. Basu, Deputy Director; M.T. Hadjimichael, S.M. Hossain, R.L. Sharer, A. Tahari, K. Thugge. External Relations Department: W.W. Camard, F.A. Hardin, L. Mboto-Fouda. Fiscal Affairs Department: L.P. Ebrill, K. Mathai. Legal Department: B.D. Dmitrachkov, H. Elizalde. Office in Europe: R.H. Munzberg. Policy Development and Review Department: J.T. Boorman, Director; M. Allen, Deputy Director; L. Campbell, T.W. Dorsey, D.G. Jones, G.R. Kincaid, B.J. McDonald, S.S. Rizavi, D.C. Ross, J. Seade, S. Sekera, Q. Wang. Secretary's Department: A.S. Linde, Deputy Secretary, S. Bhatia, H. Hubloue, A. Mountford. Technology and General Services Department: M. Silva de Berta. Treasurer's Department: E. Brau, Treasurer; E. Budreckaite, B.V. Christensen, R.P. Hicks, J. Lin, D.J. Ordoobadi. Western Hemisphere Department: M.E. Bonangelino, P. Egoume Bossogo, E.A. Faal, E. Weisman, E.S. Williams, G. Yadav. Office of the Managing Director: A.A.E. Bertuch-Samuels, Special Advisor; A. Bauer, V. Farinas. Advisors to Executive Directors: M. Kabedi-Mbuyi, Y. Patel, J.N. Santos, P.H. Whitehall. Assistants to Executive Directors: G. De Blasio, T. Elkjaer, S.K. Keshava, W.C. Mañalac, T. May, L. Redifer, J. Sigurgeirsson, D. Vogel, M. Walsh, M. Yépez, I. Zakharchenkov.

1. MESSAGE OF CONDOLENCE

The Managing Director delivered a message of condolence on the death of Mr. Thomas Leddy, Deputy Director of the Policy Development and Review Department.

The Chairman made the following statement:

> It is my sad duty to inform you about the death of Tom Leddy. After struggling for six months with cancer and enduring a terrible regimen of radiation and chemotherapy treatment, Tom Leddy died at his home on late Friday evening. I am told that he died peacefully and not in pain, surrounded by his wife, Eileen, their two daughters, and other family.
>
> Tom Leddy's death is an enormous loss for our family here at the Fund, and for all his friends and admirers throughout the institution and outside. Before joining the Fund, Tom worked at the U.S. Treasury for nearly two decades. His distinguished career included service at the Fund as Alternate Executive Director for the United States in the second half of the 1970s. Tom joined the Fund staff in the Treasurer's Department in 1983. He moved to what was then the Exchange and Trade Relations Department—today's PDR—in 1989 as Deputy Director. He was in PDR ever since then, turning down several offers to head other departments.
>
> Unfortunately, I had only the briefest contact with Tom Leddy, as the beginning of his treatment last May practically coincided with my arrival, but he was identified to me as an outstanding staff member—one of the people on whose advice and guidance I could absolutely rely in leading this institution.
>
> Tom was regarded by everyone as a man of outstanding professionalism, who was completely dedicated to the Fund. He had a deep knowledge and understanding of the Fund matched by few, either inside or outside the institution. He was innovative, when that was appropriate, but was never quite comfortable when policy pressed against what he saw as the limits of the Articles of Agreement and tradition. But I know that Tom was also much more than this. Whatever he worked on had a precision and polish that was unmistakable. I know it was understood among the staff and in this Board that Tom's ratio of content expressed to the number of words spoken was as high as it gets. While Tom will be deeply missed by all who worked with him, the greatest loss inside the Fund will be felt by the less senior staff, who looked to him as a mentor and a guide. I know that there are numerous staff members now throughout the Fund who feel that it is from Tom Leddy that they learned how to work and how to approach problems.
>
> In so many ways, Tom was the model of what a colleague should be, and for that and for all his other qualities we will miss him greatly. I will

convey my sympathies and those of this Board to Tom's wife, Eileen. I would ask that we have a moment of silence in his memory.

2. ZAMBIA—OPTIONS TO SMOOTH DEBT SERVICE PAYMENTS

The Executive Directors considered a staff paper on options to smooth Zambia's debt service payments (EBS/00/219, 11/7/00; and Cor. 1, 11/10/00).

Mr. Rustomjee submitted the following statement:

In a couple of weeks the Board is expected to decide on Zambia's decision point under the enhanced HIPC (Heavily Indebted Poor Countries) Initiative. The staff has made extraordinary efforts to develop different scenarios in an attempt to smooth the country's debt service payments, for which we would like to express our appreciation.

Zambia's debt profile is distinctive as it portrays a situation in which the debt service obligations will be substantially higher than before, after debt relief assistance is provided under the HIPC Initiative. Such an outcome runs counter to the primary objective of the Initiative which was aimed at providing a sustained reduction in the debt burden of the eligible highly indebted low-income countries. Zambia's case also exposes the inadequacy of the existing approach under the Initiative that could have more widespread repercussion in the medium-term, given the high vulnerability of HIPC Initiatives to exogenous shocks. In this regard, it is worth noting that the staff in working out the various options appears to have been unduly constrained by the long-standing funding problems of the PRGF-HIPC Trust. In this connection, we would greatly appreciate having the bilateral donors move more swiftly in contributing the resources of the PRGF-HIPC Trust. We also continue to see merit in exploring the use of the Fund's own resources to fill the gap which has not been filled by resources from bilateral creditors. We see these actions as important steps, that would permit an approach which is more likely to place the debt burden on a manageable level.

In considering the options, we are against those that will result in a postponement of the problem, and which possibly could lock-in the country to a long cycle of prolonged use of Fund resources—even if they are on concessional terms—indebtedness and poverty. Option 2 and option 3 fall into this category.

Compared to the baseline scenario, Option 1, while entailing the front-loading of the Fund's relief to the extent of 75 percent, does not result in a meaningful decline in the amounts of debt expected to be serviced during the first three years after the decision point. At the same time, debt service payments under this scenario are reflected to rise substantially in 2004 and 2005 and would again result in the emergence of a new hump during these years. Hence, as it stands, this approach does not seem to provide an adequate answer to Zambia's debt problem or even to smoothen its debt profile. Should additional debt relief assistance materialize under this option, this could contribute both to reducing Zambia's debt service in the first three years following the granting of debt relief and address the postponed hump issue, thereby enabling a more smoothly declining debt service profile during 2001–2005. This would then represent an appropriate response to Zambia's case.

If such assistance is not forthcoming, my authorities' preference is for Option 4(b) involving a combination of HIPC Initiative grants and loans, which may allow a reasonable reduction in Zambia's debt service obligations in the period following the decision point under the HIPC Initiative. They remain convinced, however, that even this option still does not address the issue of sustainability in terms of improving the authorities' ability to meet the enormous demands of their poverty reduction programs. In this respect, we would like to propose that the loan component under this option carries a 20-year maturity with a grace period of 5 years, instead of the 10-year loan assumed in the projections. The key reason why we consider that this request would be reasonable in Zambia's circumstances is that the extension of the loan maturity, by allowing a more manageable profile of debt service payments than is currently projected will also increase the authorities' ability to enhance resource allocation to poverty reduction programs. The additional requirement for further smoothing of the debt service profile is especially needed in the case of Zambia given the ballooning of the debt service to the Fund starting from 2001, which originates from the clearance of arrears during the Rights Accumulation Program.

The resources freed with the debt relief provided under the HIPC Initiative will be made available for targeted budget support to priority areas, especially to health, education, water and sanitation and agriculture, which are the focuses of Zambia's Poverty Reduction Strategy. In addition, while all of these program areas will continue to receive the authorities' priority attention in their quest to substantially reduce the country's high poverty levels, it is important to emphasize the colossal challenge posed by the HIV/AIDS pandemic and the substantial resources that are required to assist the people affected by the disease and also for its prevention. My authorities are also taking measures to build and consolidate the institutional arrangements that will control and facilitate the allocation of resources made available through the HIPC Initiative debt relief to priority programs identified in the full Poverty Reduction Strategy Paper (PRSP) under preparation.

The reform program remains broadly on track despite the significant terms of trade shock due to higher oil prices and delays in disbursement in balance of payments assistance. Notwithstanding these adverse effects for the economy, the authorities remain committed to reach the targets set under the PRGF (Poverty Reduction and Growth Facility)-supported program. In this regard, the authorities have been pressing ahead as strongly as possible with the full range of macroeconomic and structural reforms. However, due to its importance not only from the perspective of economic management but also to ascertain that the resources released with the debt relief are adequately directed to poverty reduction programs, special attention is being paid to improving their public expenditure management. An important step taken in this regard has been the establishment of a Commitment Monitoring Unit in the Ministry of Finance to ensure improved reporting systems on commitments and expenditures.

Finally, it is important to emphasize that for a low-income country, such as Zambia, requiring substantial resources to successfully implement their reform program while addressing the huge task of poverty alleviation, the reductions in external debt service requirements achieved through the HIPC Initiative will only result in augmented levels of resources for the budget if financial assistance from the donor community remains at least at the levels accorded before the provision of debt relief and if there is a shift in its composition in favor of grants.

Extending his remarks, Mr. Rustomjee expressed his condolences to the family of Mr. Leddy with whom he had worked on numerous occasions. The news of his death had come as a shock.

With regard to the options for smoothing Zambia's debt service payments, Mr. Rustomjee requested that a modification be made to option 4(b) presented in the staff report. The Zambian authorities had requested that consideration be given to extending the loan period from 10 years, as currently proposed, to 20 years, while leaving the 5.5 year grace period unchanged. That request reflected the authorities' concern that the data presented in Table 1 of the staff report, which covered the period up to 2007, and in updated information provided on November 10, 2000 did not reflect the significant escalation in debt service payments that would occur after 2007. He had asked the staff to prepare the debt service profiles for Zambia reflecting the full period and based on a 10-year loan as well as a 20-year loan. The 10-year loan scenario, which was that presented as option 4(b) in the staff report, confirmed the authorities' concern that Zambia's debt service would significantly increase after 2007. The new data provided by the staff also entailed an upward revision to the debt service profile. While debt service payments had been expected to reach US$115 million in 2007, the most recent figures showed a number of $137 million. Debt service payments would rise to $158 million in 2008, $175 million in 2009, $173 million in 2010, and to $169 million in 2011, before declining again thereafter. That profile implied that Zambia's debt service payments in 2011 would be at the same level as in 2000 and that debt service payments for the period from 2009 to 2011 would be higher than in each year between 2000 and 2009.

The revised profile of debt service payments that the staff had prepared based on a 20-year loan would entail an increase in Zambia's debt service obligations between 2008 and 2011, with annual payments near $150 million, and thus somewhat higher than the

$145 million envisaged under the current version of option 4(b), but well below the current starting point of $169 million in 2000, Mr. Rustomjee said.

Mr. Daïri regarded the debt service projections presented by Mr. Rustomjee as disquieting, and agreed that those projections needed to cover a sufficiently large time horizon in order to provide the information that the Board needed to assess whether the actions envisaged would have the desired effects. The staff's confirmation of the data presented by Mr. Rustomjee would be welcome. Also, an explanation for the recent changes in the data needed to be provided, given that those changes had been rather important.

The staff representative from the Treasurer's Department confirmed that the figures presented by Mr. Rustomjee had been provided by the staff and covered debt service projections for a 20-year period both for the scenario of a loan with a 10-year maturity and a five and a half year grace period—option 4(b) as presented in the staff report—and that of a loan with a 20-year maturity and the same grace period. Those two options differed not only with regard to their maturity but also in terms of the respective loan and grant elements. While the original Option 4(b) had a loan requirement of $228 million, the option with the 20-year loan would require a somewhat larger loan of $288 million and a smaller grant element of $528 million. Under the original Option 4(b), debt service payments would decline until 2006, but rise to $175 million in 2009. However, if the staff's exports projections were correct, that level of debt service corresponded to 8 percent of export earnings under the option with a 10-year maturity and 7 percent in the case of the loan with a 20-year maturity. Therefore, at least in terms of the debt-service-to-exports ratio, those figures were not particularly worrisome.

The revisions to the staff report would not fundamentally change the overall picture, the staff representative said. They had been made to reflect the repayment of the different loan components in the debt service projections. The revisions also entailed some refinement in the figures for 2006 and 2007 as well as somewhat higher debt service figures for the options 4(a) and 4(b). It had been the staff's intention to provide the correct figures before the current Board meeting.

Mr. Daïri considered that, as poverty reduction was the main element and objective of the enhanced HIPC Initiative, it was no longer appropriate for the Board to address matters like the one currently under discussion solely with reference to debt service payments. Rather, the focus had to be on the level of resources that the country had left for poverty reduction. If the reduction of poverty was to continue, it had to be ensured that increasing resources would be freed up and made available for that purpose through debt reduction. While the staff's clarification was welcome that, at some point in the future, the debt-service-to-exports ratio would be lower than at the current stage, the main concern was to ensure that resources available for poverty reduction increased. The needs, in that regard, were of such large dimensions that everything possible needed to be done in the context of the enhanced HIPC Initiative to ensure that more and more resources were freed up. If that was not achieved, the credibility of the entire initiative would suffer.

Mr. Josz wondered whether the staff could provide comparative figures on debt service projections for the time after 2007 for the baseline scenario and for the projections before HIPC Initiative assistance. Table 1 showed a sharp reduction in debt service payments in 2006, and it would be important to know how those payments would evolve under those scenarios at a later stage.

Mr. Faini considered that the focus on absolute numbers of debt service was not appropriate. Also, the discussion was complicated by the fact that the extended projections were not available to all Directors. It would be useful, if that information could be circulated to facilitate the discussion.

The staff representative from the Treasurer's Department stated that the respective table would be circulated immediately.

Mr. Collins agreed with Mr. Faini and asked the staff to confirm that the extended projections were based on the original assumptions of the staff paper and did not imply any change in the net present value of debt and debt relief, but only showed the distribution of debt service over time. If that was the case, it appeared fair to say that no essentially new information was contained in those projections.

The staff representative from the Treasurer's Department confirmed Mr. Collins's assessment that all debt service projections considered in the staff paper—the baseline option, the four options for smoothing those payments, and the modified Option 4(b) advocated by Mr. Rustomjee—were all equivalent in terms of the net present value (NPV) of debt. The differences among those options consisted in making different levels of resources available to Zambia at different points in time.

Mr. Faini made the following statement:

> It is difficult to take the floor after the sad news that we have been given by the Chairman. I would ask the Acting Chairman to convey my personal sympathy to Mr. Leddy's family.
>
> Let me congratulate the staff for providing another paper on Zambia, which shows how difficult the situation is and how hard-pressed the staff is at this juncture, given the large number of countries coming to the Board in the next few weeks in the context of the enhanced HIPC Initiative. This chair's view on the matter under discussion is well known. We remain unconvinced that there is a large problem before us with regard to Zambia. If there is a problem—and the case can be made that there is one—it can be addressed by much simpler and more effective means than the ones suggested as Option 1 or Option 4 in the staff paper. Let me explain why.
>
> We should not forget that the notion of the debt-service-to-exports ratio is not a parameter used under the enhanced HIPC Initiative. The Board may, at any stage, decide also to use a country's debt service as one of the

parameters in the context of the initiative. However, if the Board chooses to do so, it would be appropriate to use the debt-service-to-exports ratio for its analyses, given that it is the most meaningful figure for assessing the burden of debt service payments on a country. One could also use the debt-service-to-revenue ratio or the debt-service-to-GDP ratio, but whatever the Board may decide to use for such assessments, it should be a ratio, not absolute value. It is apparent from the current discussion that the reference to absolute values of debt service payments can create considerable confusion. Table 1, for example, showed fluctuations in the absolute values of debt service payments from year to year. Establishing the smoothing of these absolute values as an objective would introduce extreme complications in the HIPC Initiative. The Board should, therefore, resist this temptation.

As shown in Appendix Table 1, the debt-service-to-exports ratio declines under the baseline scenario from 16.3 percent in 2000 to 15.9 percent in 2001, and that figure does not even include the likely additional relief coming from Paris Club creditors. As Ms. Christensen reminded us, even if we take a longer-run perspective, we find that the debt-service-to-exports ratio is in single digits. Therefore, the question arises whether there is any reason for concern. I do not think that the Board should try to smooth the debt service, because the absolute figure increases, while the debt-service-to-exports ratio is in single-digit territory.

Another important point is that we should not exclusively look at the debt service payments made to the Fund, nor should we look at total debt service. If the prime concern is the amount of resources available to the authorities for poverty reduction—and here I agree with Mr. Daïri—the net resource transfer is the relevant variable. However, net resource transfers to Zambia are projected to increase from 13 to 15 percent of GDP. While Mr. Daïri's premise is correct—that we should look at the resource transfer to the country and the amount of resources available for poverty reduction—I fail to understand his conclusions, given that those resources are set to increase both in absolute terms and relative to GDP.

It seems possible to narrow down the number of options from the four that had been initially proposed to two options—Option 1 and Option 4. Option 1, the full frontloading of Fund interim assistance, does not appear to be viable, given that it will create a hump in the debt-service-to-exports ratio in 2004, when the ratio will increase from 10.6 percent to 13.3 percent. Also, a decision for Option 1 would raise a moral hazard issue. Many Directors feel compelled to do something about an increase in the absolute debt service burden despite the fact that the debt-service-to-exports ratio seems to go down. Our concern is that, deciding to pay attention to absolute debt service payments would set a precedent. The consequence could be that, in 2004, there would be even more concerns about an increase in debt service payments and hence increased pressure on the Board to do something about that. We would not like to put the Board in such a position some time in the future. The third shortcoming of Option 1 is the fact that it requires an amendment to the PRGF-HIPC Trust instrument. In this regard, we believe that rules should not be changed unless there is a strong need to do so.

The HIPC Initiative loan envisaged under Option 4 not only requires a modification of the rules, but also the rapid mobilization of new loan resources and the confirmation by potential lenders to the PRGF-HIPC Trust that they would be prepared to provide them. We know that such a complicated process takes considerable time even under the most convenient circumstances.

Therefore, I conclude that we do not have a long-term problem in the case of Zambia and that debt relief under the enhanced HIPC Initiative will make Zambia's debt sustainable. Indeed, as Mrs. Christensen said, none of these options will change the net present value of debt. There may be a short-term problem, given that the resources that are made available by the HIPC Initiative are not sufficient to fight poverty. However, if this problem arises, none of the solutions currently proposed by the staff is the most effective one available. We remain committed to our earlier proposal that, if the resources are insufficient to fight poverty in the short run, the best way to address that problem is through an increase in access under the PRGF-supported program. That option has three advantages: it provides immediate resources for anti-poverty action, it does not require any change in the PRGF-HIPC Trust Instrument, and by providing concessional resources, it is perfectly compatible with the letter and the spirit of the HIPC Initiative. In the previous discussion on this matter, some Directors were concerned that this would increase Zambia's stock of debt. While that is true, the increase would occur in the stock of concessional debt. Also, Option 4(b) would also increase the stock of debt, and by a sizeable margin. Another advantage of increasing access under the PRGF-supported program is that the numbers involved are small. The absolute value of debt payment obligations increases by $29 million from 2000 to 2001. It would be sufficient to frontload the disbursement of the PRGF or to increase access by $29 million to resolve the problem. That would imply an increase in access of about 10 percent, given that overall access is $250 million. That appears to be the simplest, most effective solution to the problem, without bending the rules. We should bend the rules, when there is a need to do so, but not when we have better alternatives, as in this case.

Mr. Rustomjee considered that the Zambian authorities had a good case to focus on absolute figures of debt service payments, given that, on three occasions, the data provided to the Board and the authorities had changed considerably. The staff had to be commended for their efforts to provide the most updated and accurate picture based on a set of extremely complicated data. However, the changes seen in the data posed a considerable challenge for the authorities. The most recent change of $30 million had occurred as a consequence of refining the assessment of the obligations due to the Fund alone. The variability in the absolute numbers provided was of concern to the authorities. The authorities had also indicated that there were some concerns with regard to the assumptions about the projected additional resources. The staff paper had mentioned that there was uncertainty relating to those resources. On page 5 the staff had even talked about "considerable uncertainty." While the authorities were making strong efforts with regard to the program, they had to operate under considerable uncertainty.

Mr. Daïri responded to Mr. Faini's comment on the availability of resources for poverty reduction and stressed that it was important to look at overall net flows and at resource levels, including domestic resources, that were allotted to poverty reduction. However, it was also necessary to take a broader approach to the issue and not to focus only on resource developments, given that, otherwise, the conclusion might be that nothing needed to be done with regard to the debt service payments. The comprehensive framework for debt reduction aimed at increasing resources available for poverty-related programs, and, in that context, the effective cash burden on the authorities arising from the debt should also be addressed. Therefore, it was necessary to look at both criteria to ensure that the HIPC Initiative was successful.

Mr. Faini agreed with Mr. Rustomjee that the considerable uncertainty facing the authorities needed to be addressed, given that, at some point in the future, the result might be that the available resources would not be sufficient. However, some of the data revisions were caused by the considerable pressure that was put on the staff to provide solutions quickly. It should be recognized that there would have been fewer revisions, if the tasks involved were not so difficult and would not have to be addressed with such speed. However, if considerable uncertainty persisted with regard to the projection, flexibility should be retained in order to respond to unforeseen developments at a later stage. The proposal to use increased access under the PRGF-supported program would provide the capacity to respond flexibly to any short-term shocks that might occur. Therefore, in light of Mr. Rustomjee's comments, increasing the access under the PRGF-supported program provided the best, most effective, and most flexible solution to the problem currently under discussion.

Mr. Josz shared many of the views expressed by Mr. Faini, but objected to the proposal to use increased access under the PRGF-supported program to smooth the debt service payments profile. That was not the purpose of the PRGF, which had been designed to support poverty reduction and growth. While his chair would be ready to consider a request for an increase of access under the PRGF-supported program or a new PRGF loan for Zambia, such decisions had to be made on their merits, not with a view to erasing a small blip in the profile of debt service payments to the Fund in coming years. The context of the current discussion could therefore not serve as a background for initiating a proposal to that effect. While PRGF resources were supposed to support eligible countries in their reform efforts, opting for the solution proposed by Mr. Faini almost amounted to introducing an additional instrument for smoothing the debt service payments. While there might be good reasons for smoothing the debt service profile, absolute debt service payments had never been part of the framework of the HIPC Initiative. The initiative should be implemented as it was, and the framework should not be amended at every meeting, given that that would lessen the initiative's credibility and slow down its implementation.

Mrs. Boucher made the following statement:

> I share the views expressed by Mr. Faini, which were completed with the comments made by Mr. Josz and I have yet to be convinced that it makes sense to try and adapt the existing operational framework of the HIPC Initiative process in order to solve the problem of the hump in the debt service profile for the isolated case of Zambia. We want to ensure that countries, whose programs are on track and which implement the necessary reforms under the HIPC Initiative, receive net positive flows of resources from the donor community. While uncertainties remain with regard to the level of donor support, that has generally been anticipated in the case of Zambia. We should probably focus more on the issue of bilateral contributions, that are still not firmly committed, in the case of Zambia, and also with regard to the funding of the PRGF-HIPC Trust.
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> I would be able to go along with a Board decision on the smoothing of debt service payments for Zambia, if the Board decides to do so. However, I could only support Option 1, on the grounds that it will not require a major change in the HIPC Initiative framework, that it does not require additional resources, and that it can be implemented within the timeframe which has been set for Zambia's decision point. However, the levels envisaged for the frontloading should remain an absolute maximum, restricted to this exceptional case. I insist that, for all future cases, interim assistance be kept below the ceilings of 20 percent and 60 percent, as initially defined.
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> The suggestion made by Mr. Faini to increase access under the PRGF-supported program raises the issue of resources for the PRGF-HIPC Trust Fund. If a need for additional financing is identified in the future, and if additional donors' contributions are identified that could cover that need, we could consider such an option.

Mr. Maino made the following statement:

> We welcome the alternative options provided by the staff. The revised debt service figures received today show that the overall debt stock has increased slightly. A Fund loan would facilitate a decline in debt service payments after the HIPC Initiative decision point. The resulting strategy for Zambia should be evaluated in the context of all available additional financial debt relief, which means in terms of net foreign assistance. It is in Zambia's interests to ensure that freed up resources are used appropriately. As money is fungible, the HIPC Initiative assistance provided and the assistance under the

PRGF should be delivered under clear budgetary procedures to ensure that they are used for effective poverty reduction.

In considering the options before us today, and in view of Zambia's situation, which entails potentially significant delays in the inflow of balance of payments support this year, it seems appropriate to follow Option 4(b). Making use of a loan after HIPC Initiative assistance would help reduce the burden of debt service payments and allow for faster and more far-reaching progress with the poverty reduction strategy. We could support the proposal advanced by Mr. Rustomjee in his comprehensive preliminary statement and his suggestion at the beginning of this session of a loan with a maturity of 20 years and a grace period of 5.5 years to provide a more manageable profile of debt service payments.

Zambia should provide additional assurances to the Fund on the use of HIPC Initiative resources. In this vein, we would urge the reinforcement of institutional mechanisms, such as the commitment monitoring unit, to help control and facilitate a transparent allocation of freed up resources.

Mr. Harada made the following statement:

I welcome this opportunity to discuss options for smoothing the profile of Zambia's future debt service payments on the basis of staff's well-written paper and Mr. Rustomjee's helpful preliminary statement.

While there may be an increase in a country's debt service payments after the HIPC Initiative debt relief is provided, that debt relief still reduces the impact of the country's annual debt service payments significantly compared to a situation without assistance under the HIPC Initiative. We generally agree that the profile of debt service payments should be taken into consideration and that smoothing the payment profile is beneficial from the point of view of debt management as it can help avoid significant fluctuation in the amount of resources available for other uses.

However, the profile of debt service payments should only be smoothed when absolutely necessary, and there should not be any automaticity in determining that. It was necessary, in that context, to consider additional information, such as the profile of the recipient country's future debt service payments before the provision of HIPC Initiative debt relief, its capacity to pay, and its future profile of resource demand. A conclusion with regard to the smoothing of debt service payments should be reached on a case-by-case basis.

In Zambia's case, we should note that the most recent analysis shows that the country's future debt service payment profile is smoother than that contained in the preliminary debt sustainability analysis (DSA). Since in considering the necessity of smoothing the profile of debt service payments on a case-by-case basis, we should put a priority on the country's capacity to pay. Therefore, the country's future debt service ratio has more significance than the absolute amounts of debt service payments to be made. That has correctly been pointed out at the Board discussion in July. The most recent DSA shows a consistent downward trend in the debt-service-to-exports ratio from 2000 through 2007 even under the original scheme for HIPC Initiative interim assistance with the ceiling of 60 percent of the total relief. That means that the problem raised at the Board meeting in July has effectively been solved already.

Many Directors expressed their concerns about Zambia's poor track record in June. In this regard, according to the last report by the staff after the mission, the program is currently on track both in the macroeconomic and the structural aspects despite the high oil price. That outcome is commendable, and I welcome the authorities' efforts and ownership, and feel more comfortable with considering increased access to resources. Of course, I also recognize the country's significant needs to the poverty reduction.

On the other hand, in considering the smoothing of the country's profile of future debt service payments and in not focusing on the amount of the debt reduction itself, the country's high demand for public resources in 2001 is difficult to understand, particularly when compared with the coming years. Also, the disbursements under the PRGF-supported program are expected to increase in 2001. In this context, I cannot quite understand Zambia's specific needs for additional relief.

As Mr. Rustomjee's preliminary statement pointed out, the authorities are currently taking steps to improve their expenditure management. We cannot agree to the postponement the of debt service payments resulting in an additional burden in the future.

In this context, I have a simple question to the staff for clarification. According to the preliminary DSA presented at the informal meeting on October 30^{th}, higher debt service payments would be required from 2004 under Option 4a than would occur if only traditional interim relief would be provided. The most recent DSA, however, showed that both under the Option 4a and option 4b debt service payments would be lower each year than under traditional interim relief. Mr. Rustomjee's preliminary statement pointed out that Option 3 is not appropriate because it simply represents a postponement of debt payments. However, Option 4 seems have to have the same character.

In conclusion, although other options may have to be considered in more extreme cases in the future, I think we do not need to chose an option for smoothing the profile of debt service payments which requires a higher amount of resources. I can go along with Option 1. This option also contains a problem, as it will lead to a bump in debt service payments in 2001. However, given that under the most recent DSA the debt-service-to-exports ratio already appears to be lower even under the traditional interim relief, this option appears to be a reasonable choice and will significance by broaden the policy choices available to the authorities. So this chair can go along with Option 1 as the most realistic option.

Mr. Liu made the following statement:

First of all, I would like to thank staff for their well-prepared paper and Mr. Rustomjee for his helpful preliminary statement.

We appreciate staff's remarkable efforts in developing different scenarios to smooth Zambia's debt service payments. In considering the options, we join other speakers in preferring Option 4b, involving a combination of HIPC Initiative grants and loans, allowing a reasonable reduction in Zambia's debt service obligations in the period following the decision point under the HIPC Initiative. We also support the authorities' proposal that the loan component under this option carry a 20-year maturity with a grace period of 5.5 years, instead of the 10-year loan assumed in the projections. This option could significantly reduce Zambia's annual debt service payments, and, thus, enhance resource allocation to poverty reduction programs. However, under this scenario, we share the authorities' concerns as to how they could be fully supported in meeting the enormous demands of their poverty reduction programs.

We are encouraged that the resources freed by the debt relief under the HIPC Initiative will be made available for targeted budget support to priority areas, especially to health, education, water and sanitation, and agriculture. We welcome the authorities' measures to build and consolidate institutional arrangements to ensure the allocation of resources made available under the HIPC Initiative debt relief to priority programs identified in a full PRSP under preparation.

The authorities should be commended for their firm commitment to reach the targets under the PRGF-supported program with the full range of macroeconomic and structural reforms despite the significant terms of trade shock. We welcome the establishment of a Commitment Monitoring Unit in the Ministry of Finance and continue to see merit in the need to improve public expenditure management.

With these remarks, we support staff's proposal and wish the authorities every success in the future.

Ms. Lissakers made the following statement:

After much discussion, we have concluded that, given the revised numbers, the increase in debt servicing from 2000 to 2001 is not large enough to justify the problems created by the remedies proposed. We therefore support maintaining the baseline scenario, and not contorting the rules of the program to further smooth the profile. The fact remains that the HIPC Initiative will deliver enormous relief—of some $230 million in 2001—compared to the debt servicing burden without it. New net inflows into the country are expected to be at least 15 percent of GDP. In our view, this is a credible defense with the public.

As I mentioned, we think the options for dealing with this problem are undesirable. Specifically, Mr. Rustomjee, in his preliminary statement, favors Option 4(b). We believe there a number of insurmountable problems with this option. The constraining problem is that bilateral creditors appear unwilling to extend financing for the purpose of a HIPC Initiative loan, regardless of its maturity. We, similarly, will be unable to provide this financing.

However, equally problematic, from our perspective is the issue I identified at the informal Board, that is, it is not defensible to deliver HIPC Initiative assistance in the form of a loan. We will find this approach impossible to justify to our own Congress, which has been adamant that HIPC Initiative resources do not finance or support additional lending, and I suspect others will have similar difficulties.

Mr. Rustomjee notes that Option 1 solves the uptick in debt servicing in 2001, but really pushes the problem until 2003–04. It is a partial solution to the problem. However, our problem with Option 1 is that it delivers 75 percent of the intended enhanced debt relief—which is supposed to be tied to enhanced performance—before the Zambians reach the completion point. Notwithstanding how it does on the first review of the program, Zambia has not been a strong performer.

We do not think it makes sense to change the rules, which will then apply to forthcoming cases as well, when we are not sure the country in question will be able to use the resources effectively. I do take note of Mr. Rustomjee's remarks that the authorities are attempting to pinpoint how they will use interim relief, and have now established a Commitment Monitoring Unit in the Ministry of Finance.

But these attempts are not far enough along to justify front-loading resources into the country. We were quite surprised at the informal Board meeting when we learned that the country does not have strong enough tracking mechanisms to know whether the new inflows are largely earmarked or not. Nor that we had a sense of how much or on what they intended to spend new resources. The Zambians stand a better chance of using the bulk of the resources more effectively if they are delivered once internal control mechanisms are working well, that is after the completion point. Pumping financing in now could mean wasting it.

Mr. Houtman made the following statement:

Like others have done before me, I would like to point out that, notwithstanding the rise in absolute terms, HIPC Initiative Assistance alone suffices to decrease debt service ratios to levels that are generally considered sustainable. Furthermore, notwithstanding the increase in absolute debt service payments after HIPC, I would stress that it is of utmost importance to make public that the HIPC Initiative greatly benefits Zambia, as clearly demonstrated in paragraph 11 of the paper. In my view, the issue of Zambia's post-HIPC Initiative debt service is thus less urgent than previously suggested. This, combined with the origins of the increasing debt service (arrears under a previous IMF-supported program), makes me somewhat reluctant to give this case special consideration, as it will be hard to avoid creating a precedent vis-à-vis future (or past) HIPC Initiative cases.

However, due to the high public profile of the Zambia case, special consideration could prove inevitable. If this were to occur, I am open to choosing the least intrusive option that respects the existing legal framework for IMF operations as much as possible. Specifically, I suggest increased front-loading as the best available option, given that sufficient financing is available to make this option feasible. Besides this, it needs to be clearly established in the Board's decision that this increased front-loading is only applicable to countries in a situation similar to Zambia (increasing debt service after HIPC Initiative assistance) and that this measure concerns the IMF only. If we look at table 2, after possible additional bilateral relief, the lump in 2004 that Mr. Faini referred to is nearly gone. I oppose the creation of special facilities such as a HIPC Initiative loan account for the isolated case of Zambia. Not only do I foresee difficulties in financing such facilities, I also consider the provision of extra loans (albeit concessional) inappropriate to counter the effects of excessive debt accumulation in the past.

Finally, I think Zambia is a case that may deserve considerable bilateral donor support, and I am pleased to indicate that the Netherlands is considering an increase in its aid to Zambia, irrespective of what this Board decides.

Mr. Faini noted that, under Option 1, there would still be a hump in debt service payments, even if the additional bilateral debt relief would be provided. That hump would not occur in 2004, and it was likely that, by that time, the Board would be under strong pressure to present another creative solution to deal with that hump, which would likely be considered as unacceptable as the hump that the Board was currently addressing. Such a situation was undesirable.

Mr. Faini said that he fully shared the concerns expressed by Ms. Lissakers with regard to moral hazard. Given that there was no clear budget allocation of the resources to be used for poverty reduction, Option 1 was not appropriate, given the lack of a commitment and of a strong track record. With regard to the possibility of using increased access under the PRGF, he differed with the position expressed by Ms. Lissakers, given that the PRGF was a conditional facility and given that resources would only be made available in that context, if the program was on-track. Therefore, there was a major difference between Option 4 and the option of increasing access under the PRGF. Also, increased access under the PRGF should not be regarded as a way to smooth the profile of debt service payments. Rather, it was a way to ensure that sufficient resources would be delivered for poverty reduction. A general increase of access under the PRGF would not be acceptable, if it could not be demonstrated that those additional resources were needed in the context of a well-defined and budgeted plan.

Ms. Lissakers agreed with Mr. Faini that increased access under the PRGF would have the advantage of being conditional. However, it had not yet been established that Zambia would have fewer resources at its disposal, nor had it been demonstrated that the country would be able to deliver and adequately manage increased expenditures on poverty reduction in the next couple of years. Given that those questions had still not been answered, it appeared somewhat problematic to consider increasing resources for poverty reduction, particularly when there were doubts as to whether the authorities would be able to manage in an appropriate fashion the resources that had already been identified and committed. Also, it was problematic and appeared contradictory to address a problem of excessive debt by creating more debt, which would occur, if access under the PRGF were to be increased. While one could argue that the provision of grants was neutral in economic terms, the solution advocated by Mr. Faini would not be neutral, given that it entailed future amortization and interest payments.

With regard to the question of setting a precedent by opting for the front-loading of Fund interim assistance under the enhanced HIPC Initiative, it should be noted that Ethiopia was a similar case, given that it might also face a hump in the profile of its debt service payments. According to the information currently available, Ethiopia's debt service ratio would rise from about 140 percent in 2001 to 190 percent in 2003 and 2004. If Option 1 was adopted in the case of Zambia, the Board had to consider whether the same provision could also be made for Ethiopia and, possibly, for other countries in the future. Therefore, Board approval of Option 1 entailed a significant change in the rules.

Mr. Josz made the following statement:

> I continue to oppose Options 2, 3 and 4 for further smoothing Zambia's debt service payments after it reaches its decision point, probably at the end of this year, for the following reasons:

Option 2, which is to reschedule Zambia's SAF (Structural Adjustment Facility) obligations, would set a precedent for rescheduling PRGF obligations and increase the funding requirement for the Interim PRGF, which is still not fully financed.

Options 3 and 4 would entail delivering part of the Fund's HIPC Initiative assistance in the form of a loan, for which the PRGF-HIPC Trust does not have the required resources. In any case, the Fund should continue to deliver its HIPC Initiative assistance only in the form of grants, which unequivocally help reduce these countries' external debt. We need to stop continuously changing the framework of the HIPC Initiative. This creates many uncertainties and fuels demands for further changes. Incessant changes in the framework since 1996 have slowed the implementation of the HIPC Initiative and damaged its credibility.

Left to choose between Option 1 and the baseline scenario after HIPC Initiative assistance, I strongly prefer the baseline scenario. Further frontloading the Fund's Interim Assistance will not eliminate the increase in absolute debt service but only postpone it for three years. The baseline scenario is fully compatible with the primary objective of the HIPC Initiative, since it will sharply reduce the NPV of Zambia's debt stock from 400 to 150 percent of exports, cut by more than half Zambia's scheduled debt service payments in 2001 and beyond, and lower its debt service to less than 9 percent of exports from 2001 onwards.

Mr. Collins made the following statement:

I would like to ask the Chairman to convey our condolences to Mr. Leddy's family.

The issue of smoothing the debt service payments for Zambia is rather difficult, and I can understand why some Directors argue that there is no substantive but only a presentational problem. However, my authorities continue to believe that it is both a substantive problem as well as a presentational one. That view is a reflection of the belief that resources that ought to be devoted to poverty reduction in the early stages are going to be diverted, if debt relief is insufficient early on.

Could staff comment on the expected shortfalls in donor assistance in the near term and provide an assessment as to whether those shortfalls are significant in this context? While I recognize that some solutions involving additional loans or grants may pose practical problems, there has been a suggestion that some of the resources expected to be available for Zambia would not be available or would be significantly delayed. If there is a substantive problem of that nature, Option 1 will not provide an adequate remedy, given that it does not push the problem of the hump in debt service sufficiently far out. If we keep the net present value unchanged, the same amount of resources will eventually have to be devoted to debt service, and the only relevant question is to determine the appropriate profile over time. In view of these considerations, we continue to prefer Option 4(b).

With regard to Mr. Faini's suggestion that Option 4(b) would require an adaptation of the PRGF-HIPC Trust Instrument, it is my impression that the instrument already allows for loans or grants, or combinations thereof. Could the staff comment whether the instrument will need to be amended in any case, because of the revisions made when the initiative was enhanced? My question refers to paragraph 4(a) of the PRGF-HIPC Trust Instrument — the terms of assistance—and concerns two points: Does it need to be amended in any case, given that it currently makes references to the debt-service-to-exports ratio, and does it need to be specifically amended for Option 4(b), if it already allows for combinations of loans and grants? I would respond to Ms. Lissakers that I do not consider what has been proposed as extraordinary, given that it is already provided for in the instrument. While it may be the first occasion on which the provision is used in such a way, it is by no means extraordinary under the terms of the instrument. I would appreciate, if the staff could confirm that.

On Ms. Lissakers's comments about Option 1, that providing as much as 75 percent of interim assistance without any performance conditionality was unreasonable, I would like to ask the staff to confirm that there would be a performance check in any case. It should be an annual assessment of the performance along with the delivery of debt relief. Therefore, some kind of conditionality would be in place, and I would assume that the same applies also to Option 4(b).

While I regard Mr. Faini's idea of increasing access under the PRGF as ingenious, it addresses the wrong problem. While I can understand that he regards it as providing the resources for poverty reduction that otherwise would not be available, one has to bear in mind that this solution would do so by adding to the debt burden, which does not seem a rational response to the particular issue in question.

In view of all these considerations, Option 4(b) appears to be the best solution, available while non of them is ideal. The decision as to whether there should be a 10-year loan or a 20-year loan, depends on the provision of resources. I would be happy to go along with the 20-year loan, if that could be done. In that regard, I do not think that some of the difficulties raised by my colleagues are as great as they imply.

Ms. Lissakers, responding to Mr. Collins's comment that Option 4 would require modifying the PRGF-HIPC Trust instrument, noted that the second bullet point under Paragraph 10 stipulated that potential lenders to the PRGF-HIPC Trust would need to confirm to the Fund that they would be prepared to provide loan resources for the purpose of the HIPC Initiative. It would, therefore, be helpful to learn from Mr. Collins whether the United Kingdom would be prepared to commit loan resources for the purpose of smoothing the profile of Zambia's debt service payments. Mr. Collins might also want to state whether the United Kingdom would be prepared to make loan resources available for future cases, such as Ethiopia. If it was approved in the case of Zambia, then there would be no obvious reason not to do so in the case of Ethiopia and any similar case. The question had to be answered how any future humps in the profile of a country's debt service payments would have to be addressed, if there was supposed to be some degree of uniformity of treatment.

The Acting Chairman considered that the question of resource mobilization was of particular importance with regard to Option 4. It would, therefore, be welcome, if Directors could state their positions with regard to resource mobilization under that option.

Mr. Faini reiterated that the main concern of the current Board meeting was to ensure that sufficient resources for poverty reduction would be available. Mr. Collins had criticized the proposal to do so through increased access under the PRGF as that would increase Zambia's debt, while the purpose of the initiative was to reduce the debt stock. While that might be correct, it was difficult to understand how Mr. Collins could support Option 4(b), which would increase Zambia's debt by about $230 million, whereas the increase in debt under the proposal of flexibly using the PRGF loan was small and equivalent to only about one tenth of the increase that would be the consequence of the loan envisaged under Option 4(b). If one were to use PRGF access to tackle the problem, it would even be possible to avoid an increase in debt altogether by simply changing the time profile and by front-loading it. Therefore, Mr. Collins's position was difficult to understand.

With regard to the issue of additional resources, Mr. Faini noted that his authorities had made a commitment, on the occasion of the Annual Meetings in Prague, to provide increased loan resources. They were currently in the process of defining the precise modalities and the timing of the necessary measures and would complete that process rapidly.

Mr. Rustomjee supported Mr. Collins' position on Option 4(b) and stressed that the question regarding estimates of donor support was particularly important. The Zambian authorities had indicated that, of the programmed balance of payments assistance in 1999 of $307 million, only 57 percent or $175 million had been received. The authorities currently expected that the level of delivery would decline further to a share of 52 percent of programmed assistance. That was a rather significant gap and made the situation for the authorities rather difficult.

Mr. Rouai wondered whether his understanding was correct that the resources made available under Option 4(b) would be interest-free.

Ms. Lissakers considered that the shortfall in flows of assistance mentioned by Mr. Rustomjee appeared to be related to Zambia's performance, the quality of resource management, and a degree of uncertainty, if not disenchantment among the donor community. Therefore, the changes in donor flows were attributable to substantive reasons. If that was the case, it would not make sense for the Fund to come fill the gap by providing more resources, while it remained uncertain as to whether they would be adequately managed. The new monitoring system was not yet operative, the budget data were not yet available, and the Board lacked essential information with regard to Zambia's program. Those considerations highlighted that one of the problems with the options before the Board was that the discussion about the decision point was premature.

Mr. Rustomjee agreed that updated information on progress with the program and improvements in resource management would be useful in the context of the current considerations of the Board or at the next Board session. The authorities had indicated several areas where the provision of additional assistance could be absorbed in the short term. The issue of absorptive capacity had two dimensions. One was whether the cash systems were able to receive the resources and track them through the budgetary process. The other was defined by the projects for which the resources could be used. With regard to the latter, the authorities had indicated that, in the health sector, medical staff and health facilities were in place and that additional resources for essential drugs could be absorbed effectively through the existing system. Similarly, more resources for teachers, materials and books, could effectively be used throughout the existing primary school system. With regard to investment in roads, road maintenance equipment had been procured in the last quarter of 2000. What was required at the current stage was the provision of finance to make full use of the existing equipment.

It was important that Directors received further information with regard to improvements in the track record, Mr. Rustomjee conceded. However, it should be emphasized that there was a need to look forward rather than backward.

Mrs. Hetrakul made the following statement:

> We wish to thank the staff for their very helpful proposal of different scenarios in an attempt to smooth the country's debt service payment.
>
> We noted the comment made by Mr. Rustomjee on the long-standing funding problems of the PRGF-HIPC Trust. We can sympathize with his appeal for active contribution to the resources of the PRGF-HIPC from bilateral donors and the merit of the Fund to fill the gap by its own resources. We call on bilateral donors to expedite financial assistance to the PRGF-HIPC Trust for its sustainable support for Zambia as well as other poorest countries.
>
> With regard to the options to smooth Zambia's debt payment, the baseline scenario poses high service obligations for Zambia, in particular, during 2001 to 2003, while Option 1 poses humps in 2004–2005. The Option 4(b) involving a combination of grant and loan is likely to be a more desirable and manageable scenario. Under this option, the authorities proposal for an extension of loan component to a 20-year maturity with a grace period of 5½

years would provide a more manageable debt profile. We could therefore support the authorities' choice for Option 4(b) with modification.

It is important to emphasize the Zambia authorities commitment to channel the resources freed under the HIPC Initiative to support its reform and poverty reduction efforts agreed with the Fund and the Bank. Attention must be paid in particular to improve the public expenditure management. The authorities must try their best to utilize the resources in a way such that there is a substantial real increase in social expenditure aimed at poverty alleviation.

With these remarks, we support Option 4(b) with modification and wish the authorities every success in their difficult endeavors.

Mr. Kranen made the following statement:

As Mr. Rustomjee has reminded us again, it is indeed unfortunate that Zambia's nominal debt service will increase even after the HIPC Initiative Assistance next year.

But, as Mr. Faini and Ms. Lissakers pointed out, this development should not be a significant problem. Indeed, also from our point of view, it does not justify altering the existing HIPC Initiative framework.

Therefore, we do not support any of the four options and join Ms. Lissakers and other speaker's view that we should stick to the baseline scenario.

Since Mr. Collins and other speakers prefer Option 4(b) we are wondering if this indicates their willingness to provide means to the PRGF/HIPC Fund whose financing is still not secured yet.

And as long as the financing is not secured we should not discuss any option concerning how to spend its money.

We must not forget that this kind of discussion might have negative impacts on the willingness of potential contributors of the HIPC/PRGF Trust Fund to deliver.

Mr. Siegenthaler made the following statement:

I would like to associate myself with the remarks from Ms. Lissakers, Mr. Yoshimura, Mr. Josz, and others. Like them, we think that the problem at hand is not one that would justify taking the risks involved in any of the proposed options. We would find it particularly regrettable, if the rules of the HIPC Initiative would be changed and a dangerous precedent would be set by doing so. I would also like to underline that Option 1 would disburse a considerable amount of money without appropriate safeguards. We, therefore, cannot support any of the options presented, and strongly favor the baseline scenario.

Mr. Lehmussaari made the following statement:

I agree with many of the points raised by Mr. Faini, except his views on using the PRGF facility in this context. We do not support any changes to the HIPC Initiative rules. This implies that we strongly support the baseline scenario. As there do not appear to be sufficient resources, Option 4(b) seems irrelevant. The chairs supporting that option should address the issue of financing. With regard to the question of whether the maturity should be 20 years rather than 10 years, I would like to recall that, during the discussion on facilities and Fund lending, there was a consensus that the Fund should shorten lending maturities rather than lengthening them. The proposal to extend the loan maturity to 20 years is going in the opposite direction, which is another reason why it would be difficult for us to support Option 4(b).

Our main concern with regard to Option 1, is that it could undermine the quality of the HIPC Initiative. This chair has always stressed that we have to be able to withstand the judgment of external evaluators, who will come into this institution and assess whether this initiative has succeeded. Therefore, the quality issues involved in the front-loading of Fund interim HIPC Initiative assistance makes it impossible for us to support Option 1.

Mr. Callaghan made the following statement:

It will be difficult to explain to the public that the rise in Zambia's debt service obligations is simply a presentational problem. Having said that, we are sympathetic with the position in which Zambia finds itself. We are concerned about making any changes to the framework without knowing the full implications of such a move. On the basis of the current discussion, it appears that we still do not know what the full implications will be.

On Option 1, it will be difficult to ensure that an increased ceiling for front-loading of interim HIPC Initiative assistance of 75 percent will be regarded as a maximum rather than a target, even if that was stated clearly by the Board. We would like to know what the possible implications of Option 1 are, when assessing the situation of Ethiopia and that of similar cases.

On Option 4(b), we share the view that this could be regarded as a viable option, if the resources were available. If there is no sufficient certainty with regard to the necessary resources, even discussing the matter can be regarded as wasteful. Apart from that, Option 4 poses the problem of providing a loan in the context of measures aimed at debt forgiveness. That would come back to haunt the Board at some later stage. It is essential that we have a full understanding of the implications of a decision on those matters.

Mr. Charleton made the following statement:

I broadly agree with the views expressed by Mrs. Boucher and Mr. Houtman. When this issue first came up in September, we had gone as far as we possibly could have gone and bent over backwards to do as much as possible for Zambia. I did not think then, that we could do more within the framework. That position still stands, and I am reluctant and have not been persuaded to change that view now. All of the options presented entail considerable problems. I am uncomfortable with the notion of changing the rules in mid-game. This would open up a Pandora's box, and none of us know where it will lead. However, apart from the question of changing the PRGF-HIPC Trust Instrument and related issues, we simply do not have the necessary financing for Option 4, and this chair is not going to make a commitment in that regard. If, for reasons of public perception, we were ultimately obliged to be seen doing something, I probably could live with Option 1. While I am not supporting that option, I would not rule out agreeing to it eventually. I support the baseline as it stands, and, like Mr. Josz and others, I object to increasing access under the PRGF as a way to address the problem before us. I am opposed to solving these problems by creating more debt. On the basis of these considerations, I support the baseline scenario.

Mr. Barro Chambrier considered that the main issue was the lack of sufficient resources to finance the initiative and regretted that the Board seemed unable to fulfill what had been agreed in the case of Zambia. As Mr. Rustomjee had demonstrated, Zambia faced the situation of increasing nominal debt service payments after debt relief under the enhanced HIPC Initiative, which was unfortunate. The intention to smooth the profile of debt service payments had to be seen in the context of achieving positive net resource flows and as part of the philosophy of the HIPC Initiative to put the debt burden on a manageable footing. It seemed that the Board was not able to achieve that in the case of Zambia, which would reopen the issue of the credibility of the initiative as a whole. His chair supported Option 4(b) as put forward by Mr. Rustomjee—the combination of HIPC Initiative grant and loan including the lengthening of the loan maturity to 20 years. There did not appear to be any alternative at the current stage, that would provide larger resources for priority areas. However, an appeal should be made to bilateral donors with regard to the provision of additional resources. That was the main issue not only for Zambia but for the other cases that would come to the Board in the weeks ahead.

Mr. Melhem made the following statement:

It is clear that the HIPC Initiative will provide Zambia with substantial debt relief. I also share many of the concerns raised by previous speakers regarding the changing of the HIPC Initiative framework. However, Zambia's debt service profile in 2001–2003 is an important issue that needs to be addressed. In this regard, I agree with Mr. Rustomjee that Option 4b provides the best smoothing for the debt service of Zambia. However, this option faces the insurmountable obstacle of financing availability. Therefore, a realistic alternative will be Option 1, especially in view of the expected bilateral debt relief in 2004 and afterwards.

Mr. Bakhache made the following statement:

The HIPC Initiative objective is to reduce the debt burden of poor countries to sustainable levels. Debt relief provided under the initiative is intended to free resources initially allocated for debt service payment with a view to use these resources to finance poverty reduction programs. In all cases, this objective is being achieved. The relevant comparison that shows this, is debt service payment due in the absence of debt relief versus what is due with relief.

Comparing debt service payment over time before and after the decision or completion reveals different information. In the case of Zambia, the profile of debt service payments which results in higher payment after HIPC Initiative relief represents an oddity but is not necessarily incompatible with the HIPC Initiative objective.

Having said that, there is no doubt that this situation presents serious difficulties for Zambia and therefore needs to be addressed. The bunching of payments at a time when the country is in dire need for resources is highly problematic is not fully conducive for combating poverty.

We very much appreciate the staff's efforts to find a solution to the peculiar debt service payment profile for Zambia. While we see merit in Mr. Rustomjee's proposal, particularly given that it achieves the best smoothing, and we ideally would be willing to support it, we feel that the difficulties of mobilizing the needed loan resources will likely present it with major obstacles. We are therefore more inclined to support option one.

Mr. Keshava considered that, in view of the problem associated with the lack of financing for Option 4(b), his chair preferred Option 1. The baseline scenario did not address the problem.

Mr. Zakharchenkov shared the views expressed by Ms. Lissakers, Mr. Josz, Mr. Kranen, Mr. Siegenthaler, Mr. Lehmussaari, and Mr. Charleton and preferred the baseline scenario.

The Acting Chairman recalled that, at the last informal Board discussion on Zambia, the vast majority of Directors had regarded Zambia's debt service profile as problematic and had agreed that something needed to be done. After the staff had revisited the issue and had produced different debt service scenarios, it appeared that a number of Directors no longer regarded the debt service profile as sufficiently problematic to warrant a change from the baseline scenario.

The staff representative from the Treasurer's Department, responding to the question raised by Mr. Collins, whether it would be necessary to change the PRGF-HIPC Trust Instrument if the loan option were adopted, noted that an adaptation would be necessary. That need would arise given that the criteria for determining whether a country should receive grants, loans, or a combination of both needed to be clarified before such a decision was taken.

Mr. Collins noted that he had also asked whether the amendment to the instrument would be needed in any case, given that, currently, reference was made to the debt-service-to-export ratio.

The staff representative from the Policy Development and Review Department responded that there was no need to amend the instrument on the basis of what Mr. Collins had said. Paragraph 4a—the section of the instrument relevant to the issue of loans and grants arising under Option 4—contained a passage indicating that the objective was to bring the debt-service-to-exports ratio down to the debt sustainability target agreed for the member at the decision point. That target had been a characteristic of the original HIPC Initiative. Under the enhanced HIPC Initiative, such a debt sustainability target was no longer defined by the Board in that context. Therefore, as an earlier staff paper had explained, there was a need to clarify the conditions under which a loan or a loan-grant combination could be used to provide assistance. The particular provision would not need to be amended in the context of the issues currently discussed.

On the question of performance checks under the HIPC Initiative, the staff representative confirmed that such checks would occur annually. While the amounts placed in the accounts of a member would be used to pay debt service payments to the Fund on an unconditional basis over the next 12 month period, the payment of each annual tranche required a decision by the Board as to whether the program was still on track. Thus, there was conditionality in the context of these annual tranches of the Fund's interim assistance under the HIPC Initiative. The Board would review the situation annually.

With regard to questions on the possibility of cases similar to Zambia coming to the Executive Board in the future, the staff representative noted that the case of Ethiopia was different from that of Zambia. While preliminary calculations by the staff indicated that Ethiopia's NPV debt-to-export ratio would rise to about 190 percent three years after a possible decision point had reduced that ratio 150 percent in NPV terms, the ratio in question referred to the debt stock, and not to debt service. Ethiopia's debt service payments showed a decline after the decision point. That was different than in the case of Zambia, where the HIPC Initiative decision point coincided with the expiration of the grace period under the PRGF loans that had been used to clear arrears vis-à-vis the Fund. That coincidence had produced the problem currently under discussion. Had the expiration of the grace period occurred a few years earlier, the Zambian authorities would not now be faced with the hump in debt service payments after the decision point. The staff did not expect similar cases to come to the Executive Board in the immediate future. However, the Board was aware of cases of members with large arrears that the Fund had not yet resolved and whose resolution would require a thorough assessment. Those arrears cases were, however, separate from the issues currently before the Board, given that resources from the HIPC Initiative were not intended to address such cases. Among the countries where cases for which the staff was currently preparing in the context of the HIPC Initiative and for which resources had been identified, Zambia was the only one that faced such a hump in its profile of debt service payments.

The staff representative from the African Department, responding to questions from Mr. Rustomjee and Mr. Collins about the level of donor support and Zambia's performance, noted that there was still some uncertainty surrounding flows of assistance from donors, as had been indicated in the footnote on page 8 of EBS/00/219. Through the end of September, there had been a shortfall of $31 million compared to the quarterly amounts expected under the program. It was not clear, at the current stage, how large that shortfall would be for 2000 as a whole and what the rollover effect would be in 2001. The staff was in close contact with the authorities and the key donors concerned. There were a number of uncertainties with regard to the budget and other economic plans for 2001. That was also a consequence of the adverse developments in Zambia's terms of trade mainly caused by higher oil prices. Inflation was also higher than had been projected, largely for the same reasons. The staff envisaged to provide the Board with updated information both on program performance and macroeconomic aggregates when presenting the decision point document. The amount of external resources available to the country would affect its ability to conduct policies on poverty reduction, either directly through the budget or indirectly through a strengthening of the macroeconomic environment.

Mr. Collins, commenting on the question of whether unprecedented legal changes would need to be made in the context of Option 4(b), reiterated that, in his view, some changes would be needed in any case. It was, therefore, difficult to understand how the fact could be ignored that the debt-service-to-export ratio was no longer relevant in Paragraph 4a of the PRGF-HIPC Trust Instrument insofar as it related to grants only. The staff had stated that there would have to be an amendment if loans were to be provided. However, it should be noted that the provision in question applied equally to grants, given that Paragraph 4a of the instrument covered the grant-only case as well as the combination of grant and loan components. Consequently, there would be a need to amend the instrument also with regard to grants alone.

The staff representative from the Policy Development and Review Department noted that the objectives of the HIPC Initiative were defined in Paragraph 1 of the PRGF-HIPC Trust Instrument. The instrument defined debt sustainability as the achievement of a ratio of debt to exports of 150 percent in NPV terms. In the earlier version, that paragraph had also referred to a debt-service-to-exports ratio of 20 to 25 percent as a measure of debt sustainability. Before the reference to the debt-service-to-exports ratio had been deleted from Paragraph 1 of the Instrument, there had been a need for the Board to choose between the ratio of debt to exports and the ratio of debt service payments to exports as basis for its decision. Under the enhanced HIPC Initiative, only the debt-to-exports ratio in NPV terms was relevant. Therefore, grant assistance—the only assistance that the Fund had available in the context of the proposed options—could be provided under the existing Instrument and Paragraph 4 had no relevance, given that loans resources were not available. Once the staff began to explore the option of loans, or the combination of a grant and a loan, then Paragraph 4 required an amendment in order to clarify the criteria that the Board would use in that context. While the instrument contained the provision for loan assistance, a clarification of the criteria would be needed for its use.

The staff representative from the World Bank made the following statement:

> The importance of Zambia within the HIPC Initiative cannot be overstated. The sheer size of the debt overhang and the unusual bunching of debt service obligations has been noted by our Board but also attracted public attention, including the media and non-governmental organizations (NGOs). Public attention is now focused clearly on the need for debt service relief. If we cannot show that the debt service payments of Zambia, especially on a cash basis, will be reduced as a result of the HIPC Initiative, we fear that it could undermine confidence not only in the HIPC Initiative, but also possibly raise questions about the effectiveness of the Bretton Woods Institutions themselves as joint custodians of the Initiative.
>
> In last year's joint Modifications Paper we stressed that a detailed analysis of debt service indicators would need to include a comparison of debt service due and paid before and after HIPC Initiative relief in absolute and relative terms. This analysis would assist in assessing the potential impact of the relief on the balance of payments, the government budget and on social development programs. We are concerned that in the case of Zambia, the debt service on a cash basis before and after HIPC may not significantly change, and hence no additional resources would be available for poverty related programs. In this context, we would like to draw your attention to the fact that some of the multilateral debt service currently paid is covered by special contributions from donors which are likely to stop after HIPC Initiative relief is provided.
>
> Despite the difficult institutional constraints some creditors are facing in delivering debt relief in various countries, including Zambia, we must work together to ensure that a convincing case can be made that the Initiative is achieving its stated purpose. We would prefer to get to an outcome that shows overall debt service payments of Zambia falling after the decision point so as to allow the government to finance additional poverty reduction programs and also to avoid continued criticism from the international community regarding this case.
>
> We have had an excellent working relationship with the Fund's Zambia team and have also discussed the issue before you. On the Bank's side, we are considering a proposal to provide debt relief that could cover

about 80 percent of the International Development Association (IDA) debt service falling due over a 20 year period.

Mr. Rustomjee wondered whether the staff representative from the World Bank could provide additional details with regard to the amount of donor contributions currently partly covering Zambia's debt service payments. That question was of considerable importance, particularly if the HIPC Initiative decision point would bring about a situation in which one category of creditor would merely take over from another category of creditor, while there was no additional cash debt service relief. If that was the case, that issue would have an immediate bearing on the current discussion.

Mr. Josz noted that, before debt relief Zambia's total debt service in 2001 amounted to $434 billion and would drop with the provision of HIPC Initiative assistance to $198 million and considered that a good public relations department had to be able to utilize such facts in a positive way. Could the staff confirm that the interim HIPC Initiative assistance provided by IDA had a ceiling of 30 percent or one-third?

Mr. Faini considered that, with regard to the presentation of the impact of debt relief, it was important to focus on the comparison of the figures after debt relief with those that would have occurred without debt relief. It would not be appropriate to compare the situation after debt relief with some even more desirable scenario. The question whether debt service payments fell in absolute terms, in ratio terms, or in any other terms was immaterial in that regard. Could the staff indicate whether the statement had been endorsed by the Board of the Bank?

Mr. Rouai thanked the staff representative of the World Bank for the clarification with regard to the need to achieve a solution in the Zambian case. While Mr. Daïri had indicated his support for Option 4(b) as amended by Mr. Rustomjee, his chair could also support Option 1, if a consensus for that option were to emerge.

The staff representative from the World Bank, responding to Mr. Rustomjee's question about donor contributions covering multilateral debt service, noted that those were contributions made on an ad hoc basis. Over the past six years, Zambia had received a total of such contributions of about $120 million. The level of contributions varied from year to year, as they did not represented firm commitments. That fact had been taken into account in Zambia's budget.

With regard to the comment from Mr. Josz, the staff representative agreed that it was appropriate to compare a country's debt situation before and after debt relief under the HIPC Initiative. While that had been suggested in the modification paper, that paper had also stressed the need to look at the issue on a cash basis, particularly given the objective to spend additional budgetary resources on poverty-related programs. On a cash basis, Zambia's debt service payments were equivalent to about 4.5 percent of GDP. It was important to determine whether the government would have additional resources available for the type of programs to which Mr. Rustomjee had referred.

Responding to Mr. Josz's question on the ceiling for interim HIPC Initiative assistance by the Bank, the staff representative confirmed that such assistance was limited to one-third of the NPV of debt relief to be provided by the World Bank group.

With regard to Mr. Faini's question regarding the status of his earlier statement, the staff representative noted that the statement had not been endorsed by the World Bank Board. Also, owing to the short period of time between the request for the statement and the current Board session, the World Bank Board had not been informed of the statement. However, the statement had been coordinated with the responsible Vice Presidents and represented the view of the World Bank staff. Also, in an earlier meeting the Bank Board had noted the problem concerning the hump in Zambia's debt service payments and had recommended, in the summing up of that meeting, that the Bank and the Fund work together to find an appropriate solution to that problem.

Mr. Barro Chambrier requested that the Bank staff statement be distributed to the Board.

Mr. Collins recalled that the World Bank Board had expressed the concerns mentioned in the statement made by the staff representative from the World Bank, and that it was adequate for the staff to provide such a statement to the Board.

Ms. Lissakers requested that Mr. Collins clarify whether the United Kingdom would be prepared to make loan resources available for cases similar to that of Zambia, such as Ethiopia. Given that a decision on Zambia might create a precedent, further clarifications were needed with regard to Ethiopia. The staff had suggested that the figures obtained by her chair referred to the ratio of debt to exports rather than to the ratio of debt service payments to exports, both in NPV terms. While the figures did not present a problem similar to that of Zambia with regard to the profile of debt service payments, the rise in the ratio of NPV debt to exports for Ethiopia raised the more fundamental question of overall debt sustainability. An increase of the debt-to-exports ratio from 140 to 190 percent after the provision of debt relief under the HIPC Initiative would imply that sustainability would not be achieved.

With regard to the wider implications of the current deliberations, Ms. Lissakers considered that providing a smoothing of debt service payments through front-loading of interim HIPC Initiative assistance for Zambia would effectively add a new parameter to the HIPC Initiative, with the potential of setting a precedent for numerous similar cases in the future. The question of the availability of adequate cash resources for poverty reduction was also an important consideration in that context, given that the entire initiative had been based on the estimates of total resources needed to carry out adequate debt relief and poverty reduction. If any of the elements of the initiative were altered, other elements would probably have to be adapted as well, including the need to obtain additional financing and to offer similar standards to countries in other HIPC Initiative cases. That was a matter of considerable importance, as the required measures could be expensive. It might be possible to address such matters at a later stage in the context of what might be called HIPC III. However, currently, even HIPC II had not yet been fully financed. Therefore, it would not be prudent to set a standard for higher financing before it was certain that current financing targets would be met. In that context, it would be important for Mr. Collins to answer the question with regard to the United Kingdom's readiness to provide additional financing in future cases similar to that of Zambia.

Mr. Collins, responding to Ms. Lissakers's question, noted that the United Kingdom did not provide loan resources for various technical reasons related to public accounting, but preferred to provide such funds by way of a grant. He noted that he was not, currently, in a position to confirm any commitment to future provisions of such resources on the part of the United Kingdom. Ms. Lissakers had correctly pointed out that the enhanced HIPC Initiative was not yet fully funded, while the Board implicitly was committing certain amounts along the way, as it deemed appropriate. At some point in the future, the overall financing would have to be assessed with regard to the additional amount that might be implied in the case currently under discussion. The United Kingdom would, along with other potential donors, reassess the situation at the appropriate time. The question with regard to Ethiopia had been answered by the staff, and it appeared appropriate to address all such matters on a case-by-case basis.

Responding to Mr. Faini's question as to the seeming inconsistency of objecting to increased access under the PRGF while supporting Option 4(b), Mr. Collins noted that this position was supported by sound arguments. Thus, one had to bear in mind that the loan under Option 4(b) was interest free. Also, the combination of loan and grant elements under that option could, perhaps, be arranged in such a way as to reduce the loan component to a level that made the option preferable to increased access under the PRGF. The staff might want to comment on that possibility. One also had to consider that Mr. Faini's proposal, while addressing the substantive problem, would not provide a solution to the presentational problem before the Board.

Mr. Faini wondered whether the interest rate on the loan component would be at zero percent or at half a percent and considered that, in any event, the amount of the loans under both schemes would be so large as to make the option of increased access under the PRGF far more favorable from the point of view of Zambia. Consequently, it was hard to understand the British position on the matter. It appeared that presentational considerations had taken precedence over the substantive ones. Presentational considerations also appeared to have guided the statement made by the staff representative from the World Bank. However, the presentational aspects of the problem should not be the guiding principle of the Board's deliberations on those matters.

The staff representative from the Policy Development and Review Department clarified that he had not intended to suggest that the increase in the preliminary estimates of the ratio of debt to exports to 190 percent from 150 percent in NPV terms was not problematic. However, while that increase constituted a problem in the case of Ethiopia, it was a separate question from the question currently before the Board concerning Zambia's debt service profile. The staff representative's earlier statement had only addressed the question of the debt service profile. The question debated in the context of Zambia did not arise in the context of Ethiopia, because Ethiopia's debt service payments in U.S. dollar terms were projected to be significantly lower after the decision point. Consequently resources would be released for poverty reduction spending after a possible decision point in the case of Ethiopia. The situation was different in the case of Zambia, given the hump in debt service payments.

Ms. Lissakers wondered whether the staff representative's considerations implied that the resources required in the case of Ethiopia would be larger than forecast, but that the associated increase in the financing needed would not be effected through the same channel that some Directors proposed to establish in order to address the profile of debt service payments in the case of Zambia.

The staff representative from the Policy Development and Review Department noted that a preliminary HIPC Initiative discussion on Ethiopia was expected before the end of 2000 to consider the timing of the decision point for that country. If the decision point were to be reached during 2000, the target debt-export ratio of 150 percent would be achieved and the balance of payments projections for the following three years indicated that the debt ratio might rise from 150 percent to 190 percent. The decision of whether such a debt profile was appropriate had to be made by the Board. It would be premature to elaborate on the case of Ethiopia in the context of the current Board session, particularly as the staff was still discussing the matter internally. However, as far as debt service payments by Ethiopia were concerned, it should be clarified that those payments were projected to decline after the decision point and did, therefore, not present a Zambia-style problem.

Mr. Yépez considered that, based on the current discussion, Option 4(b) was not sustainable, given the inadequate mobilization of resources and supported Option 1.

Mr. Suárez declared that, while favoring Option 4(b), his chair could also go along with Option 1.

Mr. Collins noted that the marginal cost of Option 4(b) was zero in NPV terms, and considered that it was important to keep that in mind. The problem before the Board was a liquidity problem for Zambia that could translate into a liquidity problem for the PRGF-HIPC Trust. The issue was not one of incurring additional costs. Rather it was an issue of mobilizing resources earlier than might otherwise be the case in order to smooth the profile of debt service payments.

The Acting Chairman considered that, while Mr. Collins's remarks were valid, Option 4 would still require the mobilization of additional resources.

Mr. Josz noted that at least $100 million in additional bilateral loans would be required for Option 4, resources of the type that the United Kingdom would not be willing to provide for the reasons cited earlier by Mr. Collins.

Mrs. Hetrakul regarded it as more realistic to support Option 1, despite her preference for Option 4(b).

The Acting Chairman asked whether those Directors supporting Option 4(b) would willing to support Option 1, if no sufficient resources would be available for Option 4(b) and noted that all those Directors were willing to go along with Option 1 under such circumstances.

Mr. Liu Fushou supported Option 1.

Mr. Callaghan indicated that he could go along with Option 1.

Ms. Lissakers wondered whether the chairs expressing a preference for the baseline scenario but could go along with Option 1—the French, Dutch and Canadian position—were being counted as preferring the baseline scenario.

The Acting Secretary confirmed that they were counted as supporting the baseline scenario while taking into account their willingness to switch at a later stage.

Mr. Houtman indicated a change in preference and supported Option 1.

Mr. Charleton expressed an unchanged preference for the baseline scenario.

Mrs. Boucher stated that her chair would support Option 1 only if a majority decided to chose one of the options, but would, otherwise, support the baseline scenario.

The Acting Secretary noted that this would produce a majority for the baseline scenario.

Mr. Collins invited Mrs. Boucher to reconsider her position, as to whether she could support Option 1.

The Acting Chairman suggested to interrupt the meeting briefly so as to provide Directors with an opportunity to reconsider their positions.

The Board session was interrupted at 12:37 p.m. and resumed at 12:55 p.m.

Mr. Rustomjee requested the Board's consideration of a delay in finalizing the decision so as to provide an opportunity for his chair to consult with the authorities. Should a delay not be possible, the Board should consider the matter in the context of the recent deliberations. There had been three iterations of the proposal for smoothing the profile of debt service payments in recent weeks. Initially, the Board had requested additional work on two of the options. Those options and additional information subsequently been considered by the Board. From the current session, it appeared that some Directors were willing to consider Option 1 despite it not being their first preference. The authorities were deeply concerned to secure the necessary resources for poverty reduction as early as possible. They were intent on keeping their program on-track and on building the mechanisms that would address the receipt of additional resources from debt relief. It would not be fair to let Zambia bear the consequences of the sequencing of the discussions, which entailed that the Board decision was needed before full information about the outcome of the program was available. It had also been noted by the staff that bilateral assistance, required under some of the options, was not certain. The staff representative from the World Bank had also mentioned significant substitution effects to be expected after the decision point. Such effective cash flow relief was crucial for Zambia. Also, it was not appropriate for the Board to arrive at a decision that would imply that the authorities' efforts at planning increases in the amount of resources for education, housing, and health would have to be reassessed in view of the hump in debt service payments that would occur if the baseline scenario was adopted. That would not enable the authorities to implement a forward-looking plan for medium-term spending. It would be contrary to the expectation of the planned increases in social expenditure and consistent improvements in quality.

If Option 1 could not be approved by the Board at the current stage, time should be granted for consultation with the authorities, Mr. Rustomjee said. However, it would be preferable if chairs supporting the baseline scenario but able to go along with Option 1, could reconsider their position from the perspective of the Zambian authorities. In the spirit of compromise his chair was able to go along with Option 1.

Ms. Lissakers did not consider a delay to provide any benefit with respect to the state of the current discussion. Her chair had consistently expressed the view that the decision point discussion should be delayed until more information was available on Zambia's poverty reduction spending plans for the near term, and on developments during the performance period. Delaying the decision on the matter before the Board until mid-December would be helpful, as it would provide the Board with a clearer picture of the cash flow situation and the performance. It would also provide a better basis for reaching a decision on the entire package.

Mr. Faini considered that, as a matter of politeness and as part of procedures that had always been followed by the Board, Mr. Rustomjee should be given full time to consult with his authorities.

Mr. Collins considered it preferable to delay the decision on smoothing the profile of debt service payments until the Board discussion on the decision point document. That would be a more logical procedure and would give Directors additional time for consideration.

The Acting Chairman considered that the public relations aspect of the Zambian case had been a matter of concern for the Board throughout the previous and the current Board discussions. Given that the amount of resources provided in NPV terms would be identical under any of the options presented by the staff, the entire issue was, by definition, more presentational than economic. While his preference had been for Option 4, it had emerged, during discussions with potential donors, that their willingness to make resources available for a HIPC Initiative loan was insufficient and that Option 4 was hence unrealistic. Given that Option 1 was the only possibility remaining to smooth the profile of Zambia's debt service payments, the choice open to Directors was between Option 1 and the baseline scenario. Those Directors currently supporting the baseline scenario were Messrs. Bernes, Cippà, Esdar, Faini, Kiekens, Lehmussaari, Ms. Lissakers, Messrs. Milleron, Mozhin, and

Callaghan, which altogether constituted a majority of 54 percent. The Acting Chairman appealed to those Directors to consider their positions before making a final judgment. Following Mr. Faini's suggestion, there would be additional time to contemplate the issue, and the discussion could be delayed until the Board would convene to discuss the HIPC Initiative decision point document.

The staff representative from the African Department noted that the staff had prepared a draft decision point document based on the existing HIPC Initiative rules. A discussion of the impact of an option for smoothing debt service payments along the lines of Option 1 could be added to the paper, if the Board saw merit in that. It was however not certain that there would be much additional information on how the resources would be spent to address poverty, given that those matters were directly related to the budget.

The Acting Chairman suggested that the decision point document should include a profile of debt service payments on the basis of front-loading interim HIPC Initiative assistance. The Board would take the final decision on how much interim debt relief would be provided to Zambia when considering the HIPC Initiative decision point document.

3. REPORT BY DEPUTY MANAGING DIRECTOR

The Deputy Managing Director, Mr. Aninat, reported on his recent travel to Africa.

The Deputy Managing Director, reporting on his recent travel to South Africa, made the following statement:

> I would like to inform the Board of my participation, representing the Fund, in the Presidential Retreat on the subject of South Africa in the New Millennium. The retreat was organized jointly by the South African government and the World Bank. It was hosted by President Mbeki and Mr. Wolfensohn, with the participation of many of the key economic ministries and a number of overseas organizations and practitioners. The purpose of the retreat was to explore policy options to achieve accelerated growth, better job creation, and particularly poverty alleviation in South Africa.
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> The discussions, which lasted two and a half days, were extremely useful. Although they were not geared to produce specific initiatives at that stage, I was impressed with the willingness of President Mbeki and his full economic team to discuss economic problems facing South Africa in a very open, receptive, and constructive manner.
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> All participants were of the view that financial policies in South Africa had been sound, and that macroeconomic stability had largely been achieved. The growth response, however, has been inadequate, and unemployment has remained at an unacceptably high rate—between 25 and 30 percent, depending on the calculations.

I had the honor of being the guest lead speaker at the retreat. In my remarks, I stressed that South Africa would need to raise its growth potential from the current level of about 2 to 3 percent per annum, to 5 to 6 percent per annum, and that this would require a significant increase in new investment. However, investment alone would not be sufficient, because measures would also be needed to bring about greater flexibility in the labor market.

In addition, job skills should be enhanced by devoting more resources to education and training. Adopting new technologies in an open environment would also help to raise productivity and further enhance growth. I stressed, however, in my presentation that the adjustment process will necessarily take time, and that there would still be a need to address the important issue of equity and income distribution.

I drew on many of the Latin American country experiences, including the Chilean experience, which helped to crystallize the messages. The feedback I later received from various officials from the treasury and the central bank confirmed the fact that the messages had elicited much interest. My comments on the labor market seemed to energize the debate at the retreat on this very central issue. A consensus is emerging on the fact that unit labor costs in South Africa are indeed too high and would need to be reduced if substantive inroads are to be made in reducing unemployment.

More significantly, the Governor of the Central Bank, who was previously Minister of Labor, and also, prior to that, chief architect of the current labor laws, suggested that the legislation now may have gone too far, and that a number of the provisions should be reconsidered. This included the controversial requirement that collective bargaining agreements be extended by law to non-participating parties. The issue has become not whether labor market reform is needed, but rather, what its modality should be and the speed at which it should take place. Several Ministers expressed concern that undertaking such reforms too quickly could antagonize the organized labor movement and precipitate social unrest. They indicated instead a preference to effect reform in a more gradual manner.

The retreat also covered a number of very significant and relevant topics. Several of the economic participants advocated central bank intervention in the foreign exchange market as a means of limiting exchange rate fluctuations. The suggestion did not, however, carry much support, and alternative means of reducing exchange rate volatility were also discussed. These included, amongst others, the use of prudential safeguards on capital inflows. The participants found informative the comments that were made in relation to the Chilean experience in this area.

It was agreed that progress had been made in South Africa in liberalizing the foreign trade regime in recent years, but it was also acknowledged by participants, including the Trade Minister, that certain sectors, such as textiles, remained overly protected, and that further tariff cuts could be warranted in the future.

Policies to encourage the growth of small and micro enterprises were discussed, as were a range of social policies, including policies regarding AIDS and crime. Somewhat surprisingly, the issue of privatization attracted little interest, and on this occasion, the World Bank conference organizers did not give it special prominence.

President Mbeki concluded the retreat by emphasizing the important role that perceptions play in investor decisions. He conceded that this had to be kept in mind when formulating and implementing policy. He expressed frustration, however, with the media, who had in his view not always given certain policy matters the attention they deserved. As a case in point, he noted the support to the government's handling of the crisis in Zimbabwe expressed by large businesses. This issue had been largely ignored in the press and it had therefore failed to provide a stabilizing influence.

The President and his main Cabinet members expressed their appreciation for the contribution of the IMF and the World Bank to the quality of the debate at the conference. He was kind enough to have me join him and Mr. Wolfensohn at the press conference at the end of the retreat.

Mr. Rustomjee made the following statement:

We welcome your participation in the Economic Policy Workshop that was held recently and hosted by the President of South Africa, Mr. Thabo Mbeki. We would like to thank you, given your very hectic work schedule, for still affording the time to travel to South Africa and participate in this workshop. By participating in it, you were able to offer the authorities a series of valuable insights, based on your own vast experience, as well as on the combined formidable collective experience of our institution, on a whole range of actions that the authorities could take to boost the growth rate in the economy.

We concur with your findings and comments on the South African economy based on the first-hand experience that you have gained from the workshop. In particular, my authorities welcome your many comments on prudent flexibility in the South African labor market, improved training and many other areas, and look forward to discussions later this month with the Fund mission on how to address these issues, including the issue of instituting social safety nets.

My authorities also recognize, following the outcome of the workshop, a need for speedier land reforms as an important part of generating income among the poor in South Africa. Thank you for having participated. It was greatly appreciated by the authorities.

Ms. Lissakers stressed the importance of the Fund's participation in discussions held at such a senior level and on such a wide set of topics. This illustrated the positive relationship between South Africa and the Fund in recent years. It was a positive signal from the authorities and a positive development in terms of the quality and level of comfort in the dialogue between the Fund and South Africa.

4. GUYANA—2000 ARTICLE IV CONSULTATION; AND POVERTY REDUCTION AND GROWTH FACILITY—SECOND ANNUAL ARRANGEMENT—INTERIM POVERTY REDUCTION STRATEGY PAPER AND JOINT STAFF ASSESSMENT; AND ENHANCED INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—DECISION POINT

The Executive Directors considered the staff report for the 2000 Article IV consultation with Guyana and its request for the second annual arrangement under the Poverty Reduction and Growth Facility (EBS/00/213, 11/1/00; and Cor. 1, 11/8/00), together with an interim poverty reduction strategy paper (EBD/00/90, 10/30/00), the joint staff assessment of the interim poverty reduction strategy paper (EBD/00/91, 11/1/00), and the decision point document for the enhanced HIPC Initiative (EBS/00214, 11/1/00; Cor. 1, 11/8/00; Sup.1, 11/3/00; and Sup. 1, Rev. 1, 11/13/00). They also had before them a statistical annex (SM/00/247, 10/30/00).

The staff representative from the Western Hemisphere Department submitted the following statement:

> This statement updates information in the staff report. The 12-month increase in consumer prices through September was 5.5 percent. In the third quarter of 2000, nominal interest rates eased somewhat but the exchange rate was fairly stable, and the level of gross international reserves of the Bank of Guyana increased by US$5 million to US$287 million (equivalent to four months of imports).
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> In September 2000 the 12-month increase in broad money (18.5 percent) was higher than growth in private sector credit (6 percent). This was accompanied by a sizable build-up of net foreign assets of the banking system.
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> Preliminary data on government current operations for the third quarter suggest that relative to projections central government revenue was higher (0.6 percent of GDP) and current expenditure lower (0.8 percent of GDP). The stronger revenue performance was related to better tax collections on income and imports, while current expenditures reflect a postponement of certain expenditures, particularly election-related, to the fourth quarter. The weak Euro relative to the U.S. dollar continued to put pressure on the

profitability of the government-owned sugar company in 2000. A reappraisal of the sugar company's modernization plan by the World Bank will take into account the impact of a weaker Euro on the company's operations.

On other structural reforms, the authorities completed the separation of security guards from the civil service in October 2000. The authorities exceeded the benchmark set in the program (1,233 persons compared with 1,000 targeted in the program), effectively privatizing the provision of these services. These security guards have been hired by a private firm, which has been contracted by the government to guard public property.

On November 3, 2000, the CARICOM Multilateral Clearing Facility agreed in principle to provide debt relief for Guyana under the enhanced HIPC Initiative. As a result there are now sufficient financial assurances from creditors to allow the Fund to provide interim HIPC Initiative debt relief.

Recently, parliament unanimously approved a constitutional reform (on the system of proportional representation with geographical constituencies) needed to hold the elections in January 2001. This approval has reduced the risks of election delay and disturbances.

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

For nearly a decade now, Guyana has been implementing prudent macroeconomic policies and bold structural reforms. Sound policies and resolute economic management led to strong and sustainable growth, a major fall in inflation, diminution of external financial imbalances, and considerable poverty reduction. The strength of the policies and the commitment of the authorities allowed the country to qualify and benefit from debt reduction, reaching the completion point under the original HIPC Initiative program.

Since 1998 the country faced a series of exogenous shocks in the form of a sharp deterioration of the terms of trade, both drought and flooding, domestic political unrest, and an unfavorable wage arbitration judgment, all of which diminished production, weakened public finances, and threatened to derail the program. The authorities responded swiftly and decisively, keeping the program on-track. Growth resumed, inflation was contained and progress on poverty reduction continued. However, the country remains one of the poorest in the Western Hemisphere, and still needs the continued support from the international community to ensure that long-term economic stability, sustainable growth, and improvement in social conditions are attained. In this context, our Guyanese authorities and ourselves would like to express our appreciation to staff and management for their helpful advice, technical assistance and continued support, and for this well written and comprehensive set of papers.

Recent Economic Developments

After declining by 1.7 percent in 1998, the economy rebounded in 1999, with real GDP growing by 3 percent—faster than envisaged in the program—bolstered by a turnaround in sugar and rice production, the strong performance of the manufacturing sector, and improved weather conditions. Inflation, after rising to 8.7 percent in 1999 from 4.7 percent in 1998, was reduced to 6.5 percent last August as a result of the authorities' tight monetary policy. A two-month civil service strike in 1999, which virtually crippled the economy and forced the government to resort to independent and binding arbitration, ended with an unfavorable judgment for the government, mandating a wage increase of 31 percent retroactive to January 1999 and an additional increase of 26.5 percent in 2000. The government managed to contain to 12 percent the 1999 wage increase of categories not encompassed by the arbitration decision, reduced spending, and increased revenues by establishing an automatic adjustment of the customs valuation exchange rate in line with the market rate. With these measures, the overall public sector fiscal deficit (after grants) in 1999 was reduced to 1 percent of GDP, from 5 percent in 1998, significantly lower than the program target of 3 percent of GDP. It should be noted that social sectors were protected from expenditure cuts and, in fact, HIPC Initiative-related social expenditures were kept higher than the target set at the HIPC Initiative completion point.

On the external sector, the current account deficit, after narrowing to 11 percent of GDP in 1999 compared to a program estimate of 14 percent of GDP, is projected to increase to 18.5 percent in 2000, as the terms trade deteriorated sharply due to the fall in the international prices of some of the country's major exports and the increase in oil prices. This deficit was more than financed by foreign direct investment and concessional loans. As a result, there was an increase in the net foreign assets of the banking system and the international reserves of the Bank of Guyana, which remained equivalent to 4 months of imports. The Guyanese dollar depreciated in nominal terms from G$165 per U.S. dollar at end-1998 to G$180 per U.S. dollar at end-1999, but appreciated by 2 percent in real effective terms in 1999. The exchange rate at end-October 2000 stood at G$183 per U.S. dollar.

The structural reforms already undertaken by the authorities in the areas of price deregulation, trade liberalization, tax reform, privatization, and the financial sector have been impressive. As indicated in Appendix II of the Statistical Annex, 66 structural measures were adopted during the last decade. This effort has continued and the structural reform agenda for 1999 and 2000 contemplated 42 measures, most of which were accomplished as indicated in Table 2 of the decision point document.

Particular mention should be made of the privatization program where, in addition to the 18 enterprises that had been privatized or liquidated earlier, the government—in 1999—sold Guyana Airways, Guyana Electricity Company, a pharmaceutical company, and a large retail outlet.

As part of the prior actions agreed to with staff, our authorities have completed the full operationalization of the Revenue Authority; separated 1,000 public sector workers at the end of October; completed the diagnostic report on the National Cooperative Bank and extended the management contract with the terms of reference to prepare the bank for privatization; introduced the already mentioned system of automatic adjustments in the customs valuation exchange rate; and presented a budget for 2000 consistent with the agreed macroeconomic program. In addition, our authorities implemented reforms in the financial sector and in the regulatory framework aimed at creating an enabling environment for private sector activity.

The Program for 2000–2005

The program agreed with staff as the basis for the new PRGF arrangement envisages a growth in real GDP of approximately 2.5 percent in 2000, and 4 percent in 2001. Inflation is targeted to decline to 3.0 percent by 2003.

Fiscal policy will be predicated on improving public savings and keeping the public sector deficit financed by external concessional resources, without any domestic borrowing. The authorities intend to keep the wage bill constant in real terms over the program period and maintain the freeze in public sector employment, except in the health and education sectors, where there is a HIPC Initiative commitment to increase the recruitment of qualified health workers and teachers. The government will eliminate all vacant posts and is currently working with the Inter-American Development Bank (IDB) on reforming the civil service. The authorities are also working with the IDA on a program of voluntary severance, to be offered to temporary and unqualified public servants. It is expected that through this means, and as a result of natural attrition, another 1000 persons would exit the public service by end-May 2001. Public expenditure will be carefully targeted to enhance efficiency and the delivery of public services, expand social programs, and improve infrastructure. Total public sector expenditure is programmed to increase by approximately 3 percentage points of GDP in 2001 as a result of the increase in allocation to basic health and education services under the HIPC Initiative as well as increase in public investment. On the revenue side, tax collection is expected to increase with the commencement of the operations of the Revenue Authority and the implementation of the new mechanism to adjust automatically the customs valuation rate.

While the overall fiscal deficit (after grants) is projected at 6.5 percent of GDP in 2000, and at 9.5 percent of GDP in 2001 as a result of one-time expenditures associated with the privatization of the electricity company, the

Guyana National Cooperative Bank, and the restructuring of GUYSUCO, it will subsequently decline to less than one percent by 2005. Public debt is also expected to fall significantly from 179 percent of GDP in 2000 to 160.5 percent of GDP in 2005.

Monetary policy will be guided to achieve the inflation and balance of payments targets of the program. In this context, the operational capacity of the Bank of Guyana in the areas of banking supervision and monetary operations will be enhanced with technical assistance from the Fund. The Bank of Guyana will further intensify open market operations and step up its efforts to develop a secondary market for treasury bills. Interest rates will continue to be market-determined. The authorities will also adopt additional measures to improve the institutional framework of the financial sector and to deepen financial intermediation.

To facilitate and promote the growth of exports, the government will continue to enhance Guyana's competitiveness through structural reforms and a market-determined exchange rate. In addition, export growth would be supported by the restructuring of the sugar industry and an intensification of regional and international marketing efforts. The government will also keep the trade and payments system free of restrictions on current and capital transactions with all transactions taking place at a market-determined exchange rate. The Bank of Guyana's intervention in the foreign exchange market will be limited to meeting the international reserves target and smoothing out temporary fluctuations in the exchange rate that do not reflect fundamental economic trends. The external current account deficit is programmed to improve significantly to 12 percent of GDP by 2005.

The government is of the view that there is an urgent need to modernize the sugar company to reduce its costs to levels that would allow it to compete in the world sugar market following the elimination of preferential arrangements with the European Union and the United States. GUYSUCO is the biggest contributor to the Guyanese economy. It accounts for 35 percent of agriculture output, contributes 16 percent of GDP and approximately 25 percent of total export earnings. It is the State's largest employer with a total of 18,500 permanent and roughly 6,000 other workers employed directly in the industry, and it is indirectly linked to over 50,000 other jobs in the rest of the economy. It provides inputs to the distilleries industry, sub-contracts work to the construction industry, and plays a key role in wholesale and retail trade. For these reasons our authorities consider that any modernization plan for GUYSUCO must be implemented in a way that does not result in major disruptions within the economy. Implementation of the plan is likely to take several years. The government will decide on the scope and financing of GUYSUCO's modernization program by March 2001, for which it is currently receiving technical advice from the World Bank and the U.K. Department for International Development.

After the conclusion of the current extensive privatization program, the authorities intend to keep only three main entities in the public sector—Guyana National Shipping Corporation, GUYSUCO, and Guyana Oil Company. They intend to bring Guyana National Cooperative Bank to the point of sale by May 2001, while the remaining enterprises will be privatized, including the two bauxite companies. Net proceeds from the privatization program will be used to reduce government indebtedness. In addition, the government will continue to implement reforms aimed at reducing the size of the state and improve its efficiency, including continued implementation of the civil service reform program.

The Fight Against Poverty

The I-PRSP for Guyana expresses the government's strong commitment to reduce poverty in the context of accelerated economic growth and improved social conditions. The I-PRSP was prepared under extensive consultation and builds on the National Development Strategy for 2001–2010, which was prepared with the participation of 200 members of civil society. Long periods of economic decline and limited budgetary resources led to rising poverty and a deterioration in social services in Guyana. The proportion of the population living below the poverty line, as measured by a Living Conditions Survey completed in 1999, was found to be 35 percent with 19 percent living in conditions of extreme poverty, down from 43 percent in 1993–94. Most of the poor live in rural areas and the heaviest incidence occurs among the indigenous Amerindians. While the situation has been improving somewhat because of reasonably high economic growth in recent years coupled with the poverty alleviation efforts of the government, there is still a long way to go in the fight against poverty. The government is committed to reducing the number of poor to 31.5 percent of the population by 2003.

The social policies agreed under the original HIPC Initiative have been implemented and, indeed, the government has exceeded the social spending targets. As a result, central government expenditure in the social sectors increased from 8.5 percent of GDP in 1997 to 11.5 percent in 1999 and is programmed to reach 14 percent in 2000. In the 2001 budget, the authorities will include additional social programs that could be financed by possible interim assistance under the enhanced HIPC Initiative. In the education sector, 500 teachers have been trained this year and 500 more are expected to graduate next year, new schools have been built, and the program of textbooks has been strengthened with the aim of providing every child with free school books. Also, the government recently announced its goal to provide universal access to secondary education by 2003.

The government has drafted a four-year National Health Plan that seeks to strengthen and expand primary health care; improve secondary care services in regional and district hospitals; improve tertiary care at the Georgetown Public Hospital; and strengthen the general management of the health sector. These objectives are being supported by resources from the IDB and will address the physical, technological, and preventative aspects of health care in Guyana. A Nutrition Policy has also been developed. As accurately stated in the HIPC Initiative Decision Point Document, in addition to education, health, and direct poverty alleviation projects, the government also considers low-income housing, water, and sanitation as critical for poverty reduction and intends to spend part of the resources from the enhanced HIPC Initiative relief in these areas.

Conclusion

Despite significant progress in recent years, the Guyanese economy continues to be burdened by a narrow export base, heavy public debt, high unemployment, and widespread poverty. There is broad consensus for structural reforms in Guyana designed to make the economy more competitive, market oriented, and to place it on a path of self-sustained growth. Our Guyanese authorities are firmly committed to the implementation of policies and reforms agreed in the program. However, the international assistance envisaged in the enhanced HIPC Initiative will be essential to maintain the growth momentum and to make a sustainable impact on the level of poverty in Guyana.

Mr. Portugal, extending his remarks, communicated to the Board the authorities' concern over certain inconsistencies in the wording used in different sections of the decision point document that referred to the restructuring plan for GUYSUCO. In Box 2 of the document, the staff required the authorities to "...implement an agreed revised investment and restructuring plan of GUYSUCO...". In Table 3 of the document, however, the same condition was presented as the authorities should "...agree to a revised modernization plan taking into account recommendations of the World Bank...". The version that had been agreed with the authorities and which appeared in the letter of intent was that given in Table 3. The authorities were keen on the rapid implementation of the agreed plan. The only reason why they had not started implementing the plan was that they were waiting to obtain the needed financing from the World Bank. The period of four years that would be required for the full implementation of the plan meant that it would not be appropriate to require the full implementation of the plan as a trigger for the floating completion point. The wording in the document should therefore clarify that the trigger referred only to the need to make progress with the implementation of the plan. The new wording should be along the lines of: "...proceed with the implementation of an agreed revised modernization plan taking into account the recommendations of the World Bank study...".

On the publication of documents, Mr. Portugal informed the Board that the authorities agreed with the publication of the Interim PRSP. This should be made as soon as the discussions at the Boards of the Fund and the Bank had been completed. On the other hand, the authorities preferred not to publish the Article IV staff report under the Fund's policy on voluntary publication of such reports. They would publish the letter of intent and the memorandum on economic and financial policies as soon as this had been approved in the Parliament, as such approval was required under their legislation. It was hoped that the document would be published by January 2001.

With respect to the decision point document, Mr. Portugal reminded the Board that, according to the Fund's policy on publication of HIPC Initiative documents, the relevant Executive Director had, within 15 days of the Board meeting, the opportunity to delete from the document any data which the authorities might consider to be confidential. Alternatively, the authorities could also object to the publication of the document.

In this case, the authorities had identified two items that they would like to bring to the attention of the Board, Mr. Portugal observed. The first one was in Table 3 of the decision point document. It was a reference to the separation from the core body of civil servants of a group of one thousand temporary and unqualified public employees to be completed by the end of May 2001. The situation of civil servants was a contentious issue for the authorities. A recent general strike, which had resulted in a number of measures on the expenditure and revenue side, had hindered the adequate progress of the adjustment program. The authorities would not wish this kind of information to be made public in the months prior to the coming elections of January 2001 because the authorities' capacity to implement the adjustment plan might be jeopardized if this became an electoral issue. The authorities would nevertheless agree to a more general statement that called for the rationalization of the body of core civil servants, without making specific reference to the measures that should be taken.

The second item was in paragraph 31 in the document, which dealt with the macroeconomic assumptions on the public deficit used for the debt sustainability analysis, Mr. Portugal said. The authorities were concerned about the sentence that stated their intention to grant, up to 2005, wage increases above the inflation rate to highly skilled teachers and health workers. It would not be prudent to make the intentions of the authorities in this area public because it would reduce their bargaining power in the negotiations with these groups of specialized labor.

The views from the staff and from other Directors on the issues that had been raised would be welcome, Mr. Portugal concluded.

The Acting Chairman clarified that, although the window of 15 working days for the introduction of changes in the draft of the HIPC Initiative document existed, this could only be made with the agreement of the staff. The staff should share with the Board their views on the requests made by Mr. Portugal.

Ms. Lissakers asked if the document that would not be published was the Interim PRSP.

The Acting Chairman clarified that the Article IV staff report was the only document that would not be published.

The staff representative from the Policy Development and Review Department clarified that, under the new transparency guidelines, the authorities decided whether they wished to publish the HIPC Initiative documents and the Article IV staff report. However, the Interim PRSP had to be published before the staff could recommend that the Board should proceed with the decision on HIPC Initiative eligibility. In this case, the Interim PRSP had already been made public on the Fund's web site.

Mr. Faini supported Mr. Portugal's concern that the full implementation of the GUYSUCO restructuring plan, which would take over four years to be completed, should not be included in the list of triggers for the floating completion point. This would unduly delay reaching the completion point. However, some further specification would be required beyond the vague definition of progress in implementation suggested by Mr. Portugal if the Board was to provide a meaningful assessment on the achievement of the targets spelled out in the list of triggers. Perhaps the staff could comment on the possibility of developing a more specific benchmark for the implementation of the restructuring plan that would allow a meaningful assessment of progress.

Further clarification from the staff on the time frame for the agreement on the restructuring plan would also be welcome, Mr. Faini observed. On the one hand, the Article IV/UFR staff report stated that the date when the agreement should be reached was March 2001. On the other hand, the date given in Table 3 in the decision point document was November 2000, which meant that the agreement should have already been reached.

The staff representative from the Western Hemisphere Department clarified that the dates had been changed to allow the World Bank to review the modernization program. The definitive agreement should be reached by March 2001. The preliminary study had been discussed with the authorities as well as with all the major shareholders and the stakeholders—trade unions, NGOs and other parties—and it was currently being reviewed.

On the need to specify a benchmark for the implementation of the plan, the staff representative thought this would not be an issue, given the level of commitment shown by authorities in this matter. The authorities had already started partially implementing the plan with their own resources.

The staff representative from the Policy Development and Review Department did not consider that the inconsistency in wording implied by Mr. Portugal existed. The staff had not meant to imply, with the wording used in Box 2 of the decision point document, that implementation should be completed before the floating completion point could be reached. Nevertheless, the staff would not oppose the introduction of changes that could address the concerns raised by the authorities. The wording in Box 2 could be changed to make it consistent with Table 3 and to clarify that the target was that progress should be made in the implementation of the plan. As observed by Directors, the plan would have to include a set of benchmarks or signposts that could be used by the Board to monitor the progress made in reaching the target. These would have to be agreed between the authorities and the staff.

Ms. Lissakers agreed that some specification would have to be made on the progress in the implementation of the plan that would be required to trigger the floating completion point if the Board were to take an effective decision on this matter.

Mr. Portugal agreed with the need to be more specific on the progress to be made with the implementation of the plan. At this stage, however, it was not possible for the Board to agree on the specific measures that the authorities should implement to trigger the floating completion point because the plan would not be ready until March 2001. By then, the Bank and the Fund would have agreed with the authorities on a plan of implementation, including a schedule of the specific measures contained in the plan. The Fund would then have the opportunity to monitor the progress made by the authorities in line with the schedule of implementation.

Ms. Lissakers insisted on the need to provide some further specification on the degree of progress that would be required to trigger the completion point. Such a qualitative benchmark would allow the Board to conclude whether satisfactory progress had been made in the implementation of the plan.

Mr. Faini said he would approve a change in the wording in Table 3 to clarify to the Bank and to the authorities that the modernization plan should include verifiable benchmarks. This would provide an indication to the Bank that the plan should provide a schedule of commitments to partial measures, rather than an open-ended commitment to the whole plan.

Mr. Portugal agreed with the wording suggested by Ms. Lissakers—"proceed satisfactorily with the implementation of an agreed plan"—because this indicated that a certain degree of progress with the implementation of the plan would be required from the authorities. An investment plan, by definition, would provide a timetable that would allow the Board to monitor the progress made in the implementation of the plan. It was up to the Bank, the Fund, and the authorities to negotiate the specific timetable of the plan

The Acting Chairman welcomed the convergence of opinions on the wording to be used in the staff document. Perhaps the World Bank representatives could comment on this issue when responding to questions posed by Directors.

The staff representative from the Policy Development and Review Department observed that the other changes to the HIPC Initiative document—on rationalization of core civil servants in Table 3 and on wages for skilled education and health public employees in paragraph 31—requested by Mr. Portugal would be consistent with the Fund's policy on publication of HIPC Initiative documents.

Mr. Faini observed that the Board should be cautious with requests for changes in staff reports motivated by political considerations. The Board had recently decided that only market sensitive information should be deleted from the reports. In this case, the authorities were requesting modifications to information included in the report, rather than its deletion, and their motivations to request such modifications were understandable. Nevertheless, if the

Board endorsed such changes at this stage, it might set an unwelcome precedent that would go against the spirit of the recent decisions taken by the Board on the deletion of information from staff reports. This would be an unwelcome development because it was important that the Fund did not appear to be hiding the authorities' commitment to political measures, even if these were politically sensitive. Moreover, this approach would run against the basic purpose of national ownership of reform programs.

Mr. Wei acknowledged the concerns raised by Mr. Faini in light of the discussions recently held at the Board on the policy for deletions in staff reports. It had been agreed that market sensitive issues, including issues related to the supervision of the financial system, such as bank closures, could be deleted at the request of the authorities with the agreement of the Board. On Mr. Portugal's particular request, labor issues were very sensitive for the Guyana authorities. Given that the authorities were committed to the implementation of the reform agenda, regardless of the inclusion of specific measures such as the layoff of civil servants, the deletion of such specific measures from the report would not undermine the authorities' commitment to the implementation of reform. Consideration should therefore be given in this case to the political situation in the country. The changes requested by Mr. Portugal should be granted in this case.

The Acting Chairman asked the staff representative from the Legal Department to provide further clarification on the authorities' rights to request changes in the HIPC Initiative decision point document.

The staff representative from the Legal Department confirmed that the authorities could request that information they considered sensitive be deleted from the document. The Board should decide whether such deletions should be made.

Ms. Lissakers agreed with Mr. Wei's points on the need to take into account the political situation in this case. However, when the Board had agreed not to publish commitments from the authorities to specific measures in the past, these had not been met. In the last Fund-supported program, the Board had agreed that the authorities would state their commitment to the implementation of wage adjustments in a side letter. The authorities committed to a 6 percent increase, but the actual outcome was a 31 percent increase in 1999, followed by 26.5 percent in 2000. This example illustrated the difficulty of getting the authorities to commit to the implementation of measures when they did not have the mandate to implement them because they had not been openly presented to the electorate. Timing was also an issue in this case, given the elections shortly after the publication of the staff documents. The options were either to obtain the commitment from the authorities and make it public before the elections or wait until the elections had been completed to ask for the commitment because the authorities would then know if they had sufficient political support to meet such commitments. The option that was currently being considered—to obtain the commitment from the authorities before the elections without making such a commitment public before the next elections—would not be an appropriate course of action.

Mr. Bernes agreed with Mr. Wei's view that political considerations should be taken into account in this case. Beyond the example given by Ms. Lissakers, the overall context was one of strong commitment by the authorities to reform. The proven track record of reform could be illustrated by the compliance with fiscal targets set by the Fund despite a two-month civil service strike. Therefore, the Board should show the flexibility that Mr. Portugal requested.

Mr. Collins joined Mr. Bernes in calling for the flexibility to accept the changes requested by Mr. Portugal. These were minimal changes that did not alter the overall nature of the commitment to reform made by the authorities. It would be acceptable to replace the reference to the layoff of 1,000 temporary civil servants with a more general comment on the need to rationalize the core civil service. Publicizing the authorities' intention to grant higher wage increases to certain groups of workers could result in higher than expected increases being granted as a result of the loss of the authorities' bargaining power that making such information public would imply. The decision of what information should be considered as market-sensitive and allowed to be deleted should therefore be made on a case-by-case basis. In this case, the information affected the national labor market and the effect of the changes on the authorities' commitment to reform was so limited that the changes should be allowed. This alternative was preferable to the inclusion of such commitments in a side letter.

Mr. Jayatissa supported the inclusion of the authorities' commitment to the specific measures in a side letter.

Ms. Bonomo supported Mr. Faini's view that the changes should not be made. Although the authorities had shown their commitment in the past, their ability to meet the targets for reform would be compromised by their unwillingness to persuade the public of the need for reforms, as pointed out by Ms. Lissakers.

The staff representative from the Western Hemisphere Department noted that even if the changes were made in the decision point document, the specific measures were still listed as performance criteria for the PRGF-supported program in a footnote of the Article IV/UFR staff report. The information would therefore still be available to the public, even if somewhat more difficult to find.

Mr. Rustomjee agreed with Mr. Collins that the requested changes were minimal. The staff representative was also right in saying that the information would still be included in the Article IV/UFR staff report. For these reasons, the changes in the decision point document requested by Mr. Portugal should be accepted.

Mr. Faini enquired whether the Article IV/UFR staff report would be made public.

The staff representative from the Western Hemisphere Department observed that the authorities resisted publication of the staff report but the letter of intent would likely be published after the elections.

Mr. Faini noted that there was a statement on page 61 of the Article IV/UFR staff report that the central government wage bill to GDP ratio would be reduced, with minor exceptions for teacher and health workers. Mr. Portugal's concern on a weakening of the authorities' negotiating position vis-à-vis these groups of specialized workers would therefore also apply to the publication of the Article IV/UFR staff report.

The staff representative from the Western Hemisphere Department thought the authorities' concern was that the publication of such information should be withheld until after the elections to prevent it from becoming an electoral issue, as this could threaten the implementation of the measure.

The staff representative from the Policy Development and Review Department pointed out that the reason why the staff were in favor of introducing the changes requested by Mr. Portugal was that the publication of the information as it currently stood could compromise the implementation of the measures that the Fund was calling for. The changes were therefore not motivated by political considerations but by concerns over the effect that the information could have on the capacity of the authorities to implement the required measures. The implementation of the dismissal of civil servants and of the limited increase in wages could be jeopardized if the changes requested by Mr. Portugal were not made. In addition to this, the policy that was being considered was not the Fund's standard policy on publication, but the Board's decision from July 1998 in relation to the publication of HIPC Initiative documents. This decision was fairly generous, as it allowed the relevant Director a window of 15 working days to delete from the documentation any data that was deemed to be confidential, or to object to the document's release. The staff agreed with the authorities' request to withhold the publication of the staff report until after the elections.

Mr. Sakr, in the light of the additional explanations provided by the staff, agreed with Mr. Collins's view that the changes should be allowed.

Mr. Jayatissa submitted the following statement:

> The Guyanian economy has experienced major exogenous shocks during the period under review. These, together with increased wage pressures have become major policy challenges towards sustaining monetary stability. Under these difficult conditions, the authorities' commitment and efforts towards poverty reduction, promotion of economic growth and the containment of inflation under difficult conditions should be appreciated.
>
> The Guyanian economy has somewhat recovered from the depressed situation in 1998. However, we are concerned about the recent trends in inflation. There has been a significant pick-up of inflation in 1999 and 2000 compared to earlier years. The wage increases granted in 1999 have been excessive and has become a major contributor for higher inflation. The wage increase has in fact far exceeded the cumulative increase in consumer prices during the previous three years. While we are pleased to hear, as stated from the preliminary statement, that inflation has declined more recently, the monetary and fiscal policies will have to be sufficiently tightened and carefully monitored to avoid undue inflationary pressures. With relatively low

economic growth, if inflation continuous to be high it would seriously undermine the authorities' efforts to reduce poverty.

We share the staff's view that the public sector capacity to save and support investment has deteriorated and that increased domestic efforts are necessary to support poverty and debt reduction strategy. The authorities' response to fiscal and monetary policy challenges recently have been the curtailment of non-wage expenditures, including capital expenditures. Future resort to such curtailment of productive expenditure to accommodate ad hoc increases and current expenditure needs to be avoided for the poverty reduction strategy to be more effective. In addition to maintaining social expenditure in areas such as health and education, a certain degree of public investment in other areas will also have to be maintained to support economic growth. In this connection, we also support the authorities' two-pronged strategy mentioned in paragraph 42 of the staff report.

While it is clear that the modernization of GUYSCO would have a positive impact on employment and exports, given the domestic resource constraints it would be advisable for the authorities to move cautiously in the modernization program. The development of the sugar sector through private sector participation may be given serious consideration. We also support the recommendation to restructure the remaining inefficient operations and the privatization of the state-owned bauxite companies.

We endorse the staff recommendation on civil service, including voluntary cuts, if necessary, to maintain fiscal prudence. Action taken to privatize GNCB are welcome and we hope this will be effectively implemented.

We believe that Guyana has met the conditions for the decision point under the Enhanced HIPC Initiative and we agree that a floating completion point be reached after the conditions laid down in box 2 are met.

In conclusion, we wish the Guyanian authorities all success in their endeavors to reduce poverty and promote non-inflationary economic growth.

Mr. Milleron and Mrs. Mateos y Lago submitted the following statement:

Let me begin by thanking the staff for a well written and informative set of papers. I shall discuss them one after the other.

On the Article IV review and the 2nd annual arrangement of the PRGF, I generally share the staff appraisal and join them in commending the authorities for their determination to stick to the program targets in spite of sometimes unfavorable odds and for the significant progress achieved with respect to structural reforms. These are truly impressive given the limited institutional capacity of Guyana. Looking ahead, I would just like to make the following five comments.

Firstly, the determination of the authorities to contain the fiscal deficit within agreed limits in spite of the unplanned mandatory increase of the wage bill is to be commended. Nevertheless, this is by no means an optimal outcome, as it resulted in cuts in capital and non-wage social spending which are bound to hinder the progress of the poverty reduction strategy. Therefore, the authorities should do their very best to avoid getting into similar social conflicts in the future so as to effectively control the wage bill, and thus preserve the quality of social expenditure.

Secondly, and also in relation to the wage bill policy, while I agree with the strategy to contain it at its current level, I think the authorities should be mindful that downsizing, unless pursued within a broader strategy, could severely undermine the project and program implementation capacity of the administration, as well as impair the delivery of social services. Accordingly, they should probably refrain from across the board downsizing.

Thirdly, I note that the program involves a serious deterioration of the current account deficit in 2001/2002, to over 22 percent of GDP. This means that, in the next couple of years, Guyana will be extremely vulnerable to disruptions in foreign capital inflows. Thus, the authorities should be aware that they have very little leeway and that any delay in program implementation and in reaching the completion point could have very dramatic implications.

Fourthly, technical capacity seems to be a rather limiting factor in Guyana. If I read the TA review properly, the authorities have hardly been able to make good use of the technical assistance which has been supplied to date, thus discouraging further supply. It is critical that staff and the authorities work together to get out of this vicious circle. If Guyana is to be successful in implementing the agreed economic program and poverty reduction strategy, it will need a heavy provision of technical assistance. In coordination with other suppliers, we should be prepared to meet these needs.

Finally, I would like staff to clarify one point: according to paragraph 7, the authorities do not seem to rule out resorting to non-concessional financing to fund the modernization of the sugar industry. The staff mention that they have been "adamant that non-concessional borrowing would be inconsistent with the spirit of the HIPC Initiative." It was my understanding that it would be not just inconsistent with the spirit, but in violation of the program, which sets a zero ceiling on non-concessional borrowing.

On the interim PRSP and joint staff assessment thereof, I broadly concur with the joint staff appraisal of the interim PRSP. This is undoubtedly a solid document, which benefited from the reflections and consultations in which the authorities engaged even ahead of HIPC 1. We are confident that this interim PRSP will prove a sound basis for a full strategy.

The three aspects that most need to be further developed in the final PRSP, to my mind, are:

First, institutional arrangements to ensure that this ambitious strategy be implemented as closely as possible as intended on the paper;

Second, monitoring: the challenges posed by proper monitoring are well analyzed, but at this stage they are largely unresolved, especially considering what is described as significant data shortcomings;

Third, the elasticity of poverty reduction to growth. We learn in the I-PRSP that in the past decade, it took a 3.7 percent GDP increase to reduce poverty by 1 percent annually; under the hypotheses of the I-PRSP, it seems that in the near future, that figure will go up to 4.5 percent, implying a decline in the efficiency of poverty reduction efforts. It would be interesting to know to what extent this reflects the conservatism of poverty reduction goals or a perceived increased resilience of poverty to growth or other factors.

On the Decision Point Document, as often, there are some methodological issues related to the burden-sharing of the HIPC Initiative relief effort between bilateral and multilateral creditors, as well as within the former category.

These issues are of relatively limited magnitude and have begun to be addressed. We can therefore support the proposed decision and provide an affirmative answer to the four questions raised at the end of the document.

I would just like to add one consideration, related to the conditions for the floating completion point. I realize that they are already rather demanding and that it would be counterproductive to have an endless list of criteria. Nevertheless, I think it would be critical that, by the time of the completion point, Guyana made substantial progress in improving the quality and availability of data so as to be able to effectively monitor the progress of the poverty reduction strategy.

With these comments, I urge the authorities to remain focused on the execution of this wide ranging strategy, and hope the forthcoming elections will not result in a significant or sustained derailment, and that the future government will maintain the current commitments toward the international financial community, which are a key condition for the forthcoming delivery of the Fund's interim assistance.

Ms. Lissakers made the following statement:

Given its track record of performance, an early decision point for Guyana seems premature. Similarly, the content of the program looking forward is not sufficiently strong to merit our support. Therefore, we wish to be recorded as abstaining.

PRGF Track Record of Performance

Prior to its 1997 HIPC I decision point, Guyana had been a relatively strong performer. Since then there have been several problems with performance. A couple of examples:

Fiscal targets have been repeatedly thrown off course by larger-than-expected wage settlements and weak revenue collection. The 1999 target was met by one-off measures that pushed capital and other expenditures into 2000, resulting in a huge uptick in deficit. At the original HIPC Initiative decision point in 1997, the 2000 fiscal deficit before grants was supposed to be 0.1 percent of GDP; actually it will be 13.8 percent.

For 2001, the authorities have again committed to keep wage increases in line with program objectives, arguing that unions' appetites are sated with past increases. Wage settlements—1998: 9.5 percent program commitment, 19.5 percent actual; 1999: 6 percent program commitment, 31 percent actual; 2000: 26.5 percent actual. On the ground reports we have received indicate the unions may be seeking as much as 70 percent.

Increases in social sector spending over past two years touted by authorities have been the residual from wage increases. It may be necessary but does not reflect a fundamental reorientation in spending priorities.

Weak tax and customs administration caused debt to revenue ratio to slip from 280 percent at the first HIPC Initiative completion point to 415 percent. We were assured in mid-1998 that the Revenue Authority to fix the problem was already operational. At the completion point discussion, staff said it was not operational but would be by end-May 1999. Now we learn it only became operational in January 2000, and we have no information on how it will serve to improve revenue intake.

The authorities halted discussion of legislation to fix procurement procedures until after the election.

Looking Forward

GUYSUCO: The program assumes robust growth over the medium term, based on a large investment in GUYSUCO to expand capacity. These growth figures form the basis of the debt sustainability analysis for the decision point. However, it is a trigger for the completion point that the World Bank recommendation be implemented. It is not clear what the World Bank will recommend.

The decision point should come after World Bank recommendations on GUYSUCO are made available, as GUYSUCO is responsible for a large number of jobs and accounts for 16 percent of GDP and 25 percent of export earnings. It is clear that GUYSUCO will become a big issue in poverty reduction and growth in Guyana once the EU preferential tariff scheme is dismantled in eight years, and we have recently heard perhaps three years.

We join the French in asking for confirmation that there is a zero ceiling on the program which would prohibit any non-concessional borrowing to finance Guysuco modernization. The staff document is unclear about this.

Fiscal deficit: PRGF has to accommodate a higher deficit for increased social spending. However program targets for the fiscal deficit are huge. See Table 1 of the staff report (fiscal deficit, before grants = 16.3 percent of GDP; fiscal deficit, after grants = 9.5 percent; new net external inflows = 10.3 percent; new net domestic financing dropping slightly). This implies a very gradual reduction in the current account deficit.

There are several risks (potential expenses of Guysuco, delays in restructuring, and possible higher-than-expected wage increases, possible revenue shortfalls) that the deficit will be even higher.

Looking forward, increases in social expenditures are mainly accounted for by wage increases. While a case can be made for some increases in salaries, particularly for teachers and health providers, excessive increases draw resources away from other spending which directly addresses the HIPC Initiative objective of poverty alleviation.

Civil Service Reform: Commitment, according to Table 3 of the decision point document, is to separate 2,000 civil servants by May 2001. However, the staff supplemental indicates 1,000 security guards are being changed to a contractual basis, and the other 1,000 are not benchmark rather than a criterion because the authorities think it is not doable. The wage bill now accounts for 10.5 percent of GDP in Guyana—is there scope for more trimming?

Public Expenditure Review: This is not scheduled to be completed until after the elections. We assume the authorities plan to incorporate these results in the full PRSP.

IPRSP: This is fairly solid, and we appreciate the specificity of costing. There is a need to better outline consultation process for the full PRSP. Four months may be inadequate time for the consultation process and implementing completion point triggers.

CP triggers: We appreciate the trigger for "continuing to track the planned spending of HIPC Initiative resources in the budget," but it needs to be more specific. Look at the proposed completion point trigger for Gambia. We are pleased to see a completion point trigger that finally requires the authorities to bring the GNCB to the point of sale. This has been in the program for some time, and meanwhile the bank's losses have been draining public finances to the tune of almost 4 percent of GDP per year. This accounts for a large share of overall financial sector non-performing loan (NPL) ratio of 30 percent.

Mr. Bernes made the following statement:

Let me begin by thanking staff for a balanced and thorough discussion of developments in, and prospects for, the Guyanese economy. Many of my views are close to those expressed in the statement by Mr. Milleron and Mrs. Mateos y Lago. In particular, I join them in commending the authorities for their success in staying within the agreed fiscal framework despite the impact of a number of major exogenous shocks.

It is perhaps worthwhile dwelling on this point for a moment. It is often too easy to commend a member for a favorable outcome that is the result of good luck. It is similarly easy to express regret when a program goes off-track in the wake of a negative shock or shocks. It is distinguishing between what is due to actions taken by the authorities versus the impact of chance circumstances that is the real challenge of policy analysis.

What is much less ambiguous is how to assess the efforts of a member who is able to preserve a reasonably sound macroeconomic framework in the face of significant negative shocks. Here, while the outcome may not always be as numerically impressive as that in the face of more favorable circumstances, the effort is worth higher praise. It strikes me that this is—to an important degree—the case for Guyana over the last 24 months. Despite the impact of worse-than-expected terms of trade and weather-related disturbances, the authorities demonstrated a firm resolve to implement the wage policy contained in the program agreed with the Fund in the May 1999 program. This led, unfortunately to a lengthy civil service strike, the result of which was a large wage increase imposed on the government by binding arbitration.

The resulting increase in expenditure coupled with the direct and indirect loss in revenue associated with the two-month strike could have easily been used by the authorities as justification for a significant departure from the fiscal framework. However, to their credit, this was not the case, and they were more-than-able to accommodate the fiscal shock without eroding spending on basic health and education while at the same time, the fiscal deficit as a share of GDP fell markedly. Also, it appears that the authorities do not need to be convinced of the need to address the resulting imbalance between wage and non-wage expenditures in the social sector given their plans for public service reform.

It is this demonstration of responsible—and responsive—economic management that colors my approach to today's discussion, particularly with respect to the HIPC Initiative-related decisions, and in assessing the adequacy of the pace of structural reform.

On the structural front, the issue of GUYSUCO is clearly among the most complex facing the authorities given its significance to the economy, both in terms of employment and output. When it comes to reforming large state enterprises, faster is almost always preferable to slower. However, where the enterprise is not placing a fiscal burden on the budget (and thereby undermining macroeconomic stability), or is providing a channel through which good governance is undermined, the speed at which reform occurs could be moderated to take more directly into account the need to minimize the extent of disruption in the economy more broadly. This is the case with GUYSUCO, which continues to run at a profit, despite the significant scope to improve the efficiency of operations. Staff will need to remain monitor closely the authorities' progress in reforming GUYSUCO but for the very near term, I am comfortable that efforts are not proceeding at an unreasonable pace.

Turning to the interim PRSP, the authorities should be congratulated on the preparation of the paper in a relatively short period of time, and in the face of limited poverty data, institutional experience and capacity. The product of their efforts satisfies the requirements of the I-PRSP and provides a sound basis for Guyana's progress through the HIPC Initiative. I also join other Directors in urging Guyana to make progress in enhancing the quality and availability of its social indicators and data.

I welcome the fact that the public-sector wage bill policy is identified as a topic for public discussion in the full strategy. Clearly, the sustainability of responsible macroeconomic management will require a broad-based understanding by domestic stakeholders of the consequences for the whole economy if wage policy does not work in a complimentary fashion with efforts to generate adequate and sustainable economic growth. I can also support staff's call for the full PRSP to give more focus to public-sector modernization, including the strengthening of project design and implementation, improving evaluation and audit capacity, and improving judicial services.

In light of the above, I am prepared to endorse the PRGF and HIPC Initiative-related decisions. However, I would make a few comments on the proposed decision pertaining to the HIPC Initiative floating completion point. This chair had originally argued that—for retroactive HIPC Initiative cases like Guyana—no third track record should be required to obtain enhanced debt relief. However, we have consistently respected the Board consensus that a full PRSP would be the basic requirement for a floating completion point. At the same time, we need to guard against a drift away from this consensus position for the few remaining retroactive cases.

Therefore, and in light of the authorities' clear demonstration of responsible economic management over the past two years, I see scope to pare down the number of triggers required for Guyana to reach its second completion point. In particular, while the reforms envisaged for the governance, social and structural areas listed in Box 2 are clearly essential elements of the reform agenda, at least some of them should be retained only within the PRGF review framework to provide Guyana with a realistic chance of reaching its floating completion point by mid-2001. For example, civil service reforms linked to debt relief could include the first three actions in Table 3, page 26, which are slated to be completed by end May 2001. The September 2001 benchmark of completing staff audits, job descriptions and a performance appraisal system would be excluded from the HIPC Initiative process but would remain a benchmark for the PRGF arrangement. Such an approach would permit us to deliver faster debt relief without compromising the quality of reforms.

I ask Directors to give consideration to such an approach.

Mr. Faini made the following statement:

Despite major setbacks and large policy and exogenous shocks, the Guyanese authorities have shown a strong commitment to the program of stabilization and structural reforms. Moreover, the I-PRSP represents a sound basis for the development of a full PRSP. On these grounds, therefore, we stand ready to approve both the second annual arrangement under the PRGF and the enhanced HIPC Initiative decision point. Having said that, however, I have a few select remarks on 1) the issue of the wage increase awarded by an arbitration tribunal; 2) the PRGF-supported program; 3) the need to modernize the sugar industry; 4) what we expect from the full PRSP.

The story behind the large wage increase for civil servants awarded by an arbitration tribunal is quite instructive. It shows that even a government fully committed to abide by the letter and the spirit of the HIPC Initiative may be unable to resist to the pressure of interest groups whose negotiating power has been strengthened by that very same initiative. There is a general lesson from the Guyanese experience: HIPC Initiative debt relief may be hijacked by interest groups and will not automatically translate into better macroeconomic performance and higher social spending. To avoid such a devastating outcome it is essential that 1) the broad consultation process be allowed to run its full course to ensure that all stakeholders are brought into the process, thereby minimizing the risk that resources be diverted from their intended targets; and 2) appropriate assurances for an effective use of HIPC Initiative assistance be in place at the time HIPC Initiative resources are committed. These remarks should be kept in mind when the Board will soon be called on to judge countries with a less than impeccable track record. With respect to Guyana, I am somewhat concerned that the PRGF does not include yet specific targets for additional social spending that could be financed by enhanced HIPC Initiative relief (footnote 19). Doing so should be an utmost priority for the next review.

On the PRGF, I have a question for staff. The program targets an increase in public saving by 6.5 percentage points of GDP, a very ambitious target. Yet, we are told that the wage bill will decline by only half a percentage point of GDP (incidentally, how could this happen if the real wage bill is kept constant and income grows by 23 percent between 2000 and 2005?), that taxes are already quite high and cannot be raised much, and that non-wage spending has already been unduly compressed.

Modernizing the state-owned sugar company is a crucial issue, given the importance of the sugar industry in the country and the eventual erosion of the preferential export markets. On this issue, we welcome the staff adamant reiteration that non-concessional borrowing would be inconsistent with the spirit of the HIPC Initiative. We also note that a World Bank-led team is scheduled to complete a review of the GUYSUCO and we wonder whether the staff or the WB representative could brief the Board on both the major findings of the review and the authorities' reactions to it. This would be extremely helpful in the light of the fact that the PRGF arrangement embeds a performance criterion in the GUYSUCO restructuring plan that is supposed to take the World Bank recommendations into account.

The I-PRSP represents a good basis for the full-fledged document. However, for the full PRSP we expect more on a number of points. In particular we expect: 1) the announced wage policy to be discussed within the consultative process so as to gain support for it, and the exceptions envisaged for teachers and health workers to be clearly spelled out; 2) operational plans for the 2002 population census to be in place, and a means for the full PRSP to benefit from the population census findings to be envisaged; 3) the full PRSP to allow a shift from spending targets to actual outcome indicators, in line with the intention already expressed by the authorities and with the general policy of the enhanced HIPC Initiative.

Mr. Collins made the following statement:

Let me say at the outset that I support the decisions proposed for discussion. I share the concern over Guyana's uneven macroeconomic performance expressed by Ms. Lissakers, and over the slippages against the PRGF and HIPC Initiative related policy reforms. On the other hand, one does have to acknowledge the political sensitivity of the reform process in Guyana and the reasonable progress made in structural reforms. Mr. Bernes was undoubtedly right to point to the strong commitment of the government, which I think has been demonstrated.

Turning first to the Interim PRSP, this seems to provide a solid foundation for a full PRSP. Therefore, it presents a reasonable basis on which to proceed to decision point. The full engagement of civil society is obviously very vital for the implementation of any poverty reduction strategy. I am therefore pleased that the government is committed to further strengthening dialogue. This will be particularly important to keep the growth of the public sector wage bill in line with inflation over the medium term.

I broadly agree with staff that the Interim PRSP contains a satisfactory diagnosis of poverty, notwithstanding the limitations on available data. The delivery of improved essential services to poor communities in remote rural areas presents some particular problems that will need to be taken into account if assistance is to be targeted to those who are most in need in both rural and urban communities. Let me also underline the need to reinforce public policies to promote poverty-reducing growth, strengthen government institutional structures—by improving managerial incentives, for example—and address explicitly the possibility of further shocks. There is also a need to have a full discussion of environmental policies relating to sustainability issues in the forestry and mining industries, which are particularly important in an economy based largely on natural resource extraction. I also wish to endorse comments made by the staff on the risk from HIV/AIDS. The authorities' plans to implement HIV/AIDS public awareness programs need to be given high priority.

I would like to make a few points on the triggers for the floating completion point in Box 2 of the decision point document. I would just want to single out the importance of progress with civil service reform, in particular referring to new procurement legislation and to the GUYSUCO's restructuring plan that has been widely discussed. I agree with those who think that it is a pity that the plan has not yet been agreed at this point. I am aware that the discussions with the World Bank have been very prolonged. On the other hand, I agree with Mr. Bernes that, since GUYSUCO's operations do not currently represent a drag on the public budget, a further acceleration of the restructuring process is not urgently required. Although a good procedure would require a detailed plan that can be monitored to trigger the floating completion point, we can go ahead with the commitment to make progress in the implementation of the plan. Nevertheless, I urge the authorities to stick to their commitment of agreeing on a plan with the Bank by March 2001. Also, could the staff clarify if the procurement legislation will be considered by the Parliament in June 2001?

Turning to the PRGF arrangement, I agree that reasonable progress has been made on structural reforms. The vulnerability of the macroeconomic performance and the excessive public sector wage increases call for a comprehensive public sector reform rather than for an approach of gradual changes. I am concerned that redundancy plans have not been linked closely with public service delivery issues and may therefore reduce the effectiveness of public services. I welcome the additional revenue measures in 2000, but I would stress concerns over the desirability of the strategy to further increase the already high revenue-to-GDP ratio. This may further weaken business confidence to the detriment of private investment in nontraditional industries and overall growth.

Additional debt relief under the enhanced HIPC Initiative should help ensure the fiscal sustainability of Guyana's debt servicing obligations. However, debt sustainability could be threatened in the future if the assumptions on growth of revenue over the medium term turn out to be excessively optimistic, taking into account risks also posed by the negative evolution of the current account deficit in the short term that have been pointed out by Mr. Milleron. With these remarks, let me add that we support the approval of the second annual arrangement under the PRGF.

Finally, let me turn to a more general issue concerning weaknesses in Guyana's statistical data, which is a recurring theme throughout the staff documents. We welcome the assistance which the Fund has been able to provide in the past, and note that Guyana is interested in participating in the Caribbean Technical Assistance Center. I would also note that there is only one trained person working at the Bureau of Statistics at present. Clearly, for further technical assistance to be effective, there will need to be a much greater effort to train and retain competent staff.

Ms. Pérez dos Santos made the following statement:

First of all, let me express my support for the proposed decision and to congratulate the Guyanese authorities for their full commitment to the main thrust of the agreed policy framework under the PRGF, despite recently encountered economic shocks. Since I am in agreement with the staff analysis and conclusions, I will limit my comments principally to Guyana's need for an improved fiscal policy and express my concern about the wage bill policy, which recently has been very expansionary.

I agree with the staff, that the risks of the program are on the policy side. I urge the authorities to be vigilant that any derailment of their commitment on the macroeconomic adjustments and poverty alleviation efforts might reduce public acceptance of the proposed economic program; as well as jeopardizing official aid for financing the development projects and for the balance of payment support. In the longer term, the government should stress reduction in Guyana's reliance on foreign development assistance. Fiscal austerity measures and a steadfast attention to the rule of law, in all aspects of public administration, are important steps to reduce their dependence, improve the physical infrastructure, and the services of publicly owned utilities.

Since the Guyanese authorities are limited to increasing taxes, they should resort to a rigorous control of expenditures. I would like to emphasize the need to shift expenditures towards investment in physical and social infrastructure. But, looking at the expenditures' composition, to make these outlays effective, it may be necessary to cut other current expenditures, specifically outlays on wages, which just during the past five years have more than doubled as a percent of GDP. Regarding the staff's statement: "despite the large wage increase, the overall public sector deficit after grants fell" in year 1999, is accurate. However, it is important to take into account that in Guyana, investment was often treated as a residual in the process of budgetary resource allocation. This leads to an increasingly inefficient mix of public sector output, and persistent deficiencies in public infrastructure.

Although Guyana is bound to fiscal restraint under the PRGF, attempts to restore balance to the fiscal accounts will become increasingly difficult, primarily owing to higher expenditure demands. While I agree with staff in supporting, for the medium term, larger public sector deficits, financed by concessional loans and grants, I would like to know from the staff how expansionary this deterioration of the public finance would be. In this regard, it would be very helpful to our future assessment of this, if the staff would clarify the direction and the size of the fiscal impulse on the economy of Guyana. This estimate would acquaint the Board with the extent of discretionary changes in fiscal policy, after filtering out cyclical effects.

The HIPC Initiative assistance provides the financial basis to tackle the needed reforms, particularly, to alleviate the country's deficiencies in physical and social infrastructure. However, I am concerned that, instead of seizing such an opportunity, the authorities will use a lot of these resources to fund further general wage increases. Considering Guyana's debt burden, it is crucially important that as much as possible be used to produce a lasting improvement in the economic situation.

I welcome the I-PRSP and am encouraged by the commitment to reform, implied in this program. Like the staff, I deem that the attempt to widen ownership, by taking time to obtain a consensus around its main initiatives, is crucial. The authorities should stand firm in their intentions of reducing the public sector workforce and restraining wage adjustments in the public sector. The staff reports clearly identify the wage policy as an inherent weakness in the policy definition. Further wage increases could endanger not only the public finances, but also expand to the private sector, thus harming the competitiveness of potential export and import substitute goods. An increase in public sector wages could also become an important contributor to higher consumer prices, which until now seems under control. Might the staff be more specific about the government's strategy to keep wages constant in real terms during the envisage period? In this context, I would also like to hear from staff about details on the wage setting mechanism followed by the private sector. On the latter, I will encourage the authorities to move towards a decentralized system of negotiation with the private sector.

As regards table 3, page 73, of the staff report for the 2000 Article IV consultation, staff precludes any flexibility for debt management operations in the short term. Could the staff explain the rationale to limit the short-term external credits to a sum zero throughout the entire period?

On the Enhanced HIPC Initiative document, I share staff's and management's view that Guyana fulfills the requirements of eligibility for assistance under the enhanced HIPC Initiative. I also support the assessment that Guyana's I-PRSP provides a consistent basis for the development of a fully participatory PRSP. In this connection, and following staff's and management's recommendation, I agree that Guyana has met the condition for reaching the completion point under the enhanced HIPC Initiatives. However, as staff emphasizes, the authorities should work harder on some details of the strategy, particularly those regarding the cost of poverty-reduction measures and the links to the macroeconomic framework. Nonetheless, we encourage the authorities and the staff to continue working with the international financial community with the enhanced HIPC Initiative to achieve a more sustainable debt burden. Having ensured the financial needs of the enhanced HIPC Initiative, I can support staff's recommendation of providing interim assistance. I believe that the committed set of medium-term policies will promote sustainable and higher economic growth, and lower the incidence of poverty in the country. In this context, I agree that the areas exposed in Box 2 are suitable triggers for Guyana's floating completion point. At this stage, I would like to support Mr. Portugal's request for flexibility.

Finally, I encourage the Guyanese authorities to maintain their momentum of reform, and to raise public consciousness regarding the need for a sustainable adjustment and a structural reform process.

Mr. Jacoby made the following statement:

Despite a series of exogenous shocks and the regrettable decision to increase core civil sector wages by more than 50 percent between 1999 and 2000, the authorities have managed to maintain macroeconomic stability. We can therefore agree to their request for a second annual arrangement under the PRGF. This being said, however, we still have two specific concerns that are also relevant to Guyana's decision and completion points.

First, in order for social spending targets to continue being met there must be no further slippages in civil sector wages. The large share of wages in social spending could seriously damage the effectiveness of social programs if the projections in Table 4 of the decision point document should come to pass—that is, if capital expenditures fall short of their targets between now and 2005 at the same time that wage costs consistently overrun their targets.

Admittedly it can be debated whether capital expenditures are a more efficient kind of social spending than investments in human resources. But if Guyana is to make progress with education, health, and poverty alleviation, it must avoid the accumulation of unsustainable fiscal deficits by implementing a comprehensive civil sector reform as soon as possible. We can agree that under the present political circumstances it would be self-defeating to seek a drastic reform. But the structural agenda now proposed for 2000/2001 materially differs from the 1999 agenda by virtually abandoning all references to a comprehensive civil service reform or even to the introduction of a new pay structure. We are happy with any effort to downsize the public sector and keep the wage bill constant in real terms, but reducing the wage bill by half a percentage point of GDP over a period of five years (from 10.5 to 10 percent of GDP between 2000 and 2005) does not look very ambitious.

With this in mind, we see no room for the further weakening of the language of the authorities' Structural Reform Agenda that is being suggested by Mr. Portugal. We are particularly opposed to any further weakening of the program requirements for the restructuring of the civil service. The airy vagueness of the proposed language calling for "rationalization and streamlining of the public sector" only confirms our doubts about the authorities' commitment to a real reformation of the civil sector. The authorities seem more interested in downsizing their civil sector reform plans than in downsizing the civil sector itself.

Second, we commend the authorities for their remarkable progress with privatization. At the same time, we join the staff in urging them to keep up the momentum and complete the remaining divestitures. We would particularly like to know whether the authorities are likely to privatize GUYSUCO once its modernization is successfully completed. Let me say again that we understand that Guyana's complex socio-political landscape makes it impossible to speed up the structural reform agenda, but it seems self-evident that the ultimate reason for restructuring the sugar sector is to prepare it for public divestiture. Also, can the staff tell us whether the authorities plan to use commercial loans to finance the restructuring effort? What specific circumstances would oblige the authorities to turn to non-concessional borrowing? We tend to agree with the staff that using commercial loans seems to violate the spirit of the HIPC Initiative, but we would also point out that under certain circumstances it could be advantageous to bring the private sector on board by having it finance part of the modernization. In any case, it would be interesting to learn, from the staff or Mr. Portugal, what triggered the staff report's reference to non-concessional borrowing. Of course, it would also be interesting to know how much money is involved and how this would affect the sustainability of Guyana's debt?

All things considered, we think the conditionality for reaching the floating completion point should be strengthened to offset the failure of the decision point document to deal with the uncertainties stemming from developments in the civil service and the privatization program. Specifically, we would like to see the authorities' structural agenda include a clear commitment to freeze the civil service wage bill in real terms and limit job creation to the health and education sectors. To say the least, it is worrisome that they have so far failed to do this. As to the sugar industry, we do not categorically oppose commercial financing, but the viability of the modernization plan must pass muster with the Fund and World Bank, and there must be a clear timetable for privatizing GUYSUCO. On finalizing the PRSP, we understand that the requirements set forth in paragraph 2 of the Joint IMF/WB Assessment will need to be met before the PRSP can be deemed satisfactory.

To summarize, we do not think the proposed conditions for reaching the floating completion point are adequate. We have a lot of sympathy for the U.S. position. It may well be too soon to try to set the conditions for reaching the completion point, or for that matter, to agree that conditions for reaching the decision point have been met. It could make more sense to wait until after the upcoming elections rather than make a leap of faith right now by assuming that the authorities will and ability to carry out a structural reform agenda that is sure to involve some social and political turmoil. With these reservations, we can probably support the consensus view.

With these remarks, I wish the authorities well in meeting the many challenges that they face.

Ms. Bonomo made the following statement:

This Chair was very critical at the last review under the arrangement. At that time, slippages in fiscal policy intensified the problem of a deteriorating economic environment. Since then, economic activity has rebounded and the authorities have undertaken efforts to bring developments back in line with the objectives of the program.

My remarks will focus on the challenge of implementing expenditure policy. But first, on the revenue side, I welcome the fact that the new Revenue Authority has finally been made operational. This is an important step to improve tax administration. Further efforts to improve the efficiency of taxation and the customs are welcome. However, given the already high level of revenue to GDP, it is important to be active also on the expenditure side. In this area, the current situation in Guyana looks more disturbing.

The main risk ahead is wage policy, as the last episode illustrates: The government attempted to implement the civil service wage policy as envisaged under the program. However, since there was no broad support for this policy, prolonged strikes resulted, and in the end an arbitration tribunal granted significant wage increases.

Despite the increased wage bill, we recognize that the authorities have succeeded in containing overall public expenditure, and that they have even achieved a reduction in the public sector deficit below programmed levels. However, the restraint of expenditure has come at a cost: public investment has been significantly reduced to make way for the increase in wage payments. I would expect that such reductions in capital outlays have a negative impact on growth. They make the projected average growth rate on which the program and the government's poverty reduction strategy are based seem optimistic.

Moreover, while it is positive that social expenditure has been protected and is slightly higher than targeted, it is disturbing that this can again be attributed to significant wage increases. As staff, we urge the authorities to also provide adequate materials and supplies for the social sector.

A sound fiscal policy has to be implemented and fiscal sustainability must be achieved. Since this will be a precondition for a definite exit from Guyana's debt overhang, it will be important to lend monetary policy the support necessary to reach the inflation and balance of payments objectives, and will be crucial for effectively channeling the resources freed by debt relief into priority areas.

Therefore, the authorities are well advised to implement their two-pronged strategy and we urge them to stay within the bounds of the program's revised fiscal framework. We regard this and the related governance measures as an important part of the completion point conditionality and would have difficulty in granting any waivers in this respect. Moreover, as Mr. Jacoby, we would welcome seeing faster progress with respect to civil service reform.

Furthermore, in order for the two-pronged strategy to be successful, we fully agree with staff that it will be most important to gain public support for the measures necessary to increase public saving, foremost the gradual reduction of the civil service wage bill. In this context, I very much appreciated the comments by Mr. Faini on transparency. For that reason, I think it would be useful to keep the language to the language regarding the civil service reform in the decision point document. A change would show a lack of willingness to try to convince the public of the usefulness of such reforms.

With these remarks, I support the proposed decisions.

Mr. Hinata made the following statement:

Regarding the PRGF-supported program, I broadly agree with the staff appraisal and support the proposed decision, but would like to comment on a few points.

There were slippages after the last Board discussion on the mid-year review of the PRGF arrangement in May 1999, such as the increased wage ratio for public sector workers, delays in the point of sale of the GNCB, and in privatization of state-owned bauxite companies. In contrast, in 1999, real GDP growth reached 3 percent, which was beyond the program projection of 1.8 percent. The current account deficit has improved more than was envisaged. The overall fiscal deficit of the public sector after the grant was also narrowed to 1 percent of GDP despite a substantial wage increase.

Meanwhile, the fiscal balance is projected to worsen to 6.3 percent in 2000 and 9.5 percent in 2001, mainly due to increasing expenditures in public investment toward poverty reduction projects, as well as in restructuring costs for public enterprises. Fiscal pressure has been increasing because of the run-up to the general election early next year. Against this background, the authorities have been pursuing fiscal policy based on a two-pronged strategy of non-recurrence of domestic borrowing and improving saving on the part of the public sector. Staff endorses this strategy. Given that fiscal stabilization is necessary to reduce poverty over the mid-term, I share staff's view.

The revised PRGF-supported program was designed so that real GDP growth would reach over 5 percent and average consumer prices would be lower by 2 percent in 2003 than in the previous year. It also proposed rapidly narrowing the deficit by more than 7 percent of GDP in the fiscal and current account balances. On the other hand, as staff pointed out, Guyana is still vulnerable to external shocks, and room for maneuvering for additional expenditure restraints as well as for a revenue increase is limited. Having said that, these projections might be a bit too optimistic, although public investment for restructuring GUYSUCO will significantly be reduced.

Turning to the issue of the enhanced HIPC Initiative, there is a need to provide additional assistance to Guyana. Progress was made in tackling poverty reduction, such as increasing expenditures for the social sector and compiling the I-PRSP. Therefore, I support reaching the decision point of the Enhanced HIPC Initiative. I am also ready to support providing Guyana with Fund interim assistance once financial assurances are satisfactorily received.

With respect to the completion point, the conditions for the floating point described in Box 2 of the HIPC Initiative document seems to be appropriate. I also found promise in Table 3, which details an implementation timetable. I would urge the authorities to make further efforts in implementing economic reforms decisively as they have committed.

Regarding I-PRSP, according to the HIPC Initiative document, the authorities took steps to collect suggestions and opinions of civic society. The poverty reduction strategy in this I-PRSP highlighted the most vulnerable areas, and is well balanced. On the other hand, as staff pointed out, it is necessary to improve the linkage between the quantitative and qualitative targets for poverty reduction. Further steps will be needed to conduct a cost-benefit analysis as well as to prioritize the poverty reduction action plans. I hope the authorities will complete a full PRSP containing these points.

The poverty headcount is targeted to be reduced from 35.1 percent in 1999 to 31.5 percent in 2003. I do not intend to push the authorities to change the target, but was struck by the fact that poverty reduction would slow down, compared with the pace of poverty reduction between 1993–94 and 1999, which could reduce poverty from 43 percent to 35 percent. I am curious about the reason behind this slow pace. Staff comments would be appreciated.

The Acting Chairman invited the representative from the World Bank to comment on the issue of GUYSUCO's restructuring plan.

The staff representative from the World Bank replied that the restructuring plan for GUYSUCO had not yet been completed or discussed with the authorities. Nevertheless, the Bank staff were at an advanced stage in the preparation of the plan. The preliminary findings of the study had already been shared with various stakeholders, including the labor unions and all the donors. The government of Japan was to be praised for the sizeable amount of grant funds provided to help carry out the study. The DFID from the United Kingdom had also worked with the World Bank on this study.

The conclusions of the study, the World Bank representative continued, recommended a strategy of consolidation. While there was a clear comparative advantage in the production of sugar, there were areas where profitability was marginal which should be gradually abandoned. Most of these low value-added activities were carried out in lands around Georgetown, which meant that high prices could be obtained from the sale of these lands once the process of consolidation had been completed.

The change from GUYSUCO's current strategy of expansion to a strategy of consolidation advised by the Bank implied that the firm's investment plan would be greatly reduced, the World Bank representative said. Investment would be aimed at achieving increases in efficiency and profitability of the existing plants in order to increase GUYSUCO's competitiveness in the international markets. A strategy of outright privatization was not advised by the Bank in the current environment with a large number of sugar producers in the world economy, which meant that few buyers would be attracted by the potential sale. However, the plan envisaged increased private sector involvement in several activities of the firm over the long run. One of the options that the study had looked at was the production of gas out of sugar, which seemed to be a financially and economically viable option. The IFC had expressed interest for equity and debt participation in the initiative.

Ms. Lissakers welcomed the comments by the World Bank representative, given the prominence that the issue of GUYSUCO had in this case. However, there seemed to be an inconsistency between the staff report and the intervention of the Bank representative. The assumptions made for the debt sustainability analysis (DSA) in the PRGF staff report seemed to be based on a major investment undertaking in expanding capacity until 2003. On the other hand, the Bank, based on the likely disappearance of the preferential tariffs for sugar, would likely advise for a strategy of consolidation. The increase in sugar exports assumed in the DSA would be inconsistent with the strategy of consolidation advised by the Bank.

Mr. Faini joined Ms. Lissakers in stressing the apparent inconsistency between the analysis of the staff and the intervention of the Bank representative. The staff report projected an increase in the current account deficit from 18 percent of GDP in 2000 to 22 percent in 2001, which would reflect a large investment plan by GUYSUCO.

The staff representative from the Western Hemisphere Department confirmed that the PRGF-supported program assumed the implementation of a modernization plan by the authorities which incorporated a large investment from the World Bank. As the possibility of such large investment was currently being reviewed by the World Bank, with high expectations that it would be considerably scaled down, the fiscal and current account deficits would likely be lower under such alternative scenario.

Mr. von Kleist asked about the assumption on the price of sugar used in the projections. Whether this price was realistic or not would be key to the analysis given the pivotal role of the price of sugar for export earnings.

The staff representative from the Western Hemisphere Department explained that the assumption used by the staff in the analysis was that the price of sugar would continue to decline for some time from its current price of 6 to 7 cents a pound, and then it would start to increase gradually to 11 to 12 cents a pound in 7 to 8 years' time.

Ms. Lissakers was concerned about the effect on the program of the unrealistic assumptions that appeared to have been made in the activities of GUYSUCO over the short and medium term. The assumptions on investments to be carried out by GUYSUCO and the assumptions on capacity in the sugar sector would probably not be valid for the near term. The strategy proposed by the World Bank for GUYSUCO, which would be carried out by the authorities and monitored by the Fund as a trigger for the floating completion point, would likely be opposite to the strategy that had been assumed in the staff's projections.

The staff representative from the World Bank confirmed that under the World Bank's more modest investment plan, the investment requirements would be much smaller and the macroeconomic picture would be much better than those presented in the staff's documents.

The staff representative from the Western Hemisphere Department confirmed that the staff had focused on the worst-case scenario in its documents, so that any improvements from this worst-case scenario would have a positive effect on the overall program. If the plan approved by the Bank resulted in a lower, but more efficient, level of investment, the reductions in the fiscal and current account deficits, and the increased level of savings, would provide better results.

Ms. Lissakers asked about the impact of the lower investment on growth.

The staff representative from the Western Hemisphere Department answered that the impact on growth would be positive, because with a more efficient modernization program, the value added by a given amount of inputs and investment would be higher.

Mr. Ioannou made the following statement:

> Recently, Guyana has been hit by a series of exogenous shocks which, together with political discrepancies, resulted in the weakening of public finances and a slowdown of structural reforms. I broadly share the staff's assessment, and I will limit my remarks to a few policy areas and issues for discussion.
>
> The key to attaining program targets in the years ahead is prudent fiscal policy and the acceleration of structural reforms. Staff seem to indicate that the large recent increase in wages could pose a threat to fiscal sustainability. It is imperative for the authorities to be very cautious in

granting sizable wage increases both to safeguard fiscal sustainability but also for the credibility of the poverty reduction effort. Protracted wage increases will inevitably limit the resources available for social spending and will exacerbate living conditions for the poor by intensifying inflation pressures. Competitiveness and employment opportunities will also be deteriorated as a result of the increase in inflation.

To the extent that wage restraint is essential for the success of the program, I am somewhat skeptical that the authorities' efforts in this area are sufficient. In fact, wages as a percentage of GDP are expected to be reduced by only 0.5 percent of GDP over the course of the next five years, and to remain constant for three consecutive years. Furthermore, the prospects for a reduction in the wage bill via a large-scale downsizing of the civil service are slim, as are the prospects for a comprehensive civil service reform.

Having said this, it appears to me that the current level of wages, at about 10 percent of GDP, is not excessively high, even in comparison with other HIPC Initiative countries. In contrast, what appears to be excessively high in comparison with other HIPC Initiative countries is capital expenditure. The latter is expected to rise from 11.8 percent of GDP in 1999 to 16.2 percent in 2000 and 20 percent in 2002, contributing to the sharp rise in expenditure and the fiscal deficit during these years. Notwithstanding the immense social needs and the availability of financing, I consider the increase in expenditure in 2000 from 39 percent of GDP to nearly 49 percent of GDP to be excessive. An economy in which government spending constitutes 50 percent of GDP is, in my view, contributing to the stifling of private sector activity. I would therefore urge the authorities to reduce the level of expenditure in part by increasing their reliance on outsourcing.

Turning to the enhanced HIPC Initiative, I can agree that Guyana qualifies for additional assistance despite the recent lapse in economic performance. It is somewhat troubling, however, that today we agree that Guyana is eligible for debt relief without having secured satisfactory assurances by all creditors. This is a cause of concern, since non-Paris creditors not only have not provided any commitments to provide their share of assistance under the enhanced HIPC Initiative, but have yet to commit their share of assistance under the original HIPC Initiative. This means that debt sustainability might prove elusive even after the decision by the Board in favor of eligibility to the enhanced HIPC Initiative. Could the staff explain how the lack of provision of debt relief by non-Paris Club creditors under the enhanced HIPC Initiative could impact the attainment of the debt sustainability target?

As for the conditions for a floating condition point, I consider the list in Box 2 to be excessively long, especially for a retroactive country. Recently, the Board had a chance to discuss other HIPC Initiative cases with more streamlined conditionality. I prefer this latter approach, which focuses on a short and specific list of conditions closely related to poverty reduction targets. The triggers in particular appear to me to be excessively vague. I would have preferred that a presentation of a comprehensive set of indicators to monitor progress in poverty reduction was included in Box 2. This is important, since in the past a large part of the mandated social sector spending consisted of wage increases, which had little impact on the poor. I would have also liked to see measures that would safeguard the delivery of assistance to isolated pockets of poverty where many of the poor live.

With these remarks, I support the proposed decision.

Mr. Al Azzaz made the following statement:

Since I broadly agree with staff appraisal, I will limit myself to a few remarks.

The authorities' firm adherence to the agreed policy framework under the PRGF is reflected in last year's overall fiscal deficit being lower than programmed, despite the increase in wages. This was brought about by improved tax administration and cuts in non-wage expenditures. It is clear, however, that the room for further reduction in non-wage outlays is limited, especially given the need to reduce poverty. Therefore, I agree with the temporary relaxation of the fiscal stance programmed for 2000 and 2001. That said, it is essential that this relaxation be followed by strengthened policies in line with the medium-term fiscal program. To this end, the planned reduction in the ratio of the government wage bill to GDP over the next 5 years is critical. In this regard, I welcome the efforts to reduce the number of employees in the civil service.

On structural reforms, I welcome the impressive measures undertaken to strengthen the business climate, tax administration, and trade liberalization. I also commend the authorities' extensive privatization efforts and welcome their intention to use the net proceeds to reduce government indebtedness. However, the authorities are encouraged to further restructure the remaining inefficient operations including privatization of the bauxite companies.

On the enhanced HIPC Initiative, I can go along with the decision point as proposed. In this connection, I welcome the emphasis in the interim PRSP on enhancing education and integrating rural and interior economies into the overall development framework.

On the completion point, I agree with the recommendation that a floating point be reached after the conditions presented in Box 2 have been met. Here, I agree with the proposed change in the language of the condition regarding GUYSUCO. I also agree that Guyana should receive the proposed interim assistance.

Finally, I support the authorities' views regarding publication along the lines suggested by Mr. Portugal.

With these remarks, I wish the authorities success.

Mr. Liu made the following statement:

Continued prudent macroeconomic management and adherence to structural reforms over the past nine years had contributed to a remarkable improvement in Guyana's economy. The authorities' firm implementation of the adjustment program and their timely corrective measures has brought the economy out of a recession and maintained their poverty reduction efforts. The authorities deserve commendation. Particularly, I share the views expressed by Mr. Bernes. Nevertheless, the economy is still facing serious constraints, with deteriorating terms of trade and a continued large current account deficit. The comprehensive staff report and the preliminary statement of Mr. Portugal and Mr. Dhanpaul outline a responsive strategy and poverty reduction plan. I generally agree with the authorities' policy stance. I would like to make two points for emphasis.

I appreciate the authorities' fiscal target in the face of the large civil service wage bill increase and large interest cost of public debt. It is understandable that the authorities had no alternative but to cut capital expenditure under the current fiscal environment. However, the fact that public investment accounts for almost half of the national investment raises some concern over the effect of such reduction in public investment on future growth potential. This is particularly the case in the environment of uncertainty over GUYSUCO's investment plan. In this regard, the authorities are encouraged to do their best to increase their investment outlay within the constraint of available public finance.

Second, in line with control of the civil service wage bill, the government's plan to reduce the civil service and seek voluntary separation of temporary and unqualified workers is welcome. In addition to the severance package, we believe that it is important that the government should provide professional and practical skills training to encourage civil servants to separate. It should also facilitate their relocation process. It is clear that, in addition to the authorities' efforts, the feasibility of the program will crucially rely on timely availability of concessional funding by international financial institutions. Therefore, this chair supports, without any hesitation, the approval of the second annual arrangement under the PRGF.

As for the decision point document under the HIPC Initiative, based on Guyana's solid performance and firm commitment, and also on its comprehensive Interim PRSP, this chair supports the staff proposal related to the decision point interim assistance and the conditions for a floating completion point. With regard to creditor participation in the debt relief, we support the view that the staffs of the Fund and IDA should continue to work with multilateral creditors in securing their participation. Meanwhile, the Guyanese authorities are encouraged to proceed with their bilateral creditor negotiations.

With these remarks, I wish the authorities further success in their poverty reduction endeavors.

Mr. Djaafara made the following statement:

First, I support the proposed decision to approve the second annual arrangement under the PRGF.

Second, on the enhanced HIPC Initiative, I share Mr. Jayatissa's and other speakers' view that Guyana has met the conditions for the decision point, and the conditions laid down in Box 2 are appropriate as trigger points for the completion point.

Finally, I support Mr. Portugal's suggestions to change the language of the conditions regarding GUYSUCO in Box 2. I also support Mr. Portugal's view on publication of the staff documents.

Mr. Barro Chambrier made the following statement:

At this stage of the discussion, I will be brief. As described in the very interesting set of documents provided by the staff and in Mr. Portugal's helpful preliminary statement, I am favorably impressed by the swift reaction of the authorities to keep the program on-track on the proposed PRGF-supported program. I therefore support the completion of the second review under the PRGF arrangement. I would, nevertheless, put the emphasis on the need to improve the level of GDP growth. This level is not compatible with the poverty reduction agenda, and there is a need to foster and broaden growth in order to reduce dependence on the traditional sector. Maintaining fiscal discipline will be critical if the aim of fostering and broadening growth is to be achieved.

Speeding up civil service reform to reduce costs will also be a key to improve the government's debt management capacity. This will free more resources for the social sector. I also believe that it will be of the utmost importance to maintain the pace of structural reforms in the light of the upcoming elections. I stress in particular the need to make progress in restructuring the sugar sector and in privatizing the loss-making Guyana National Cooperative Bank.

On the PRSP process, I would like to highlight the quality of the Interim PRSP. We are pleased with the participatory process, but there will be a need to define a comprehensive set of indicators to monitor progress in poverty reduction. I believe that it will be necessary to stress diversification and the importance of growth prospects, given that the debt burden could increase, even after the HIPC Initiative, if a worsening of the terms of trade occurs.

On the floating completion point, I believe that the points described in the box are in line with the PRSP process, and we should have in mind that these are retroactive cases. This is why I would advocate for flexibility to adapt the specific conditions of the country in order to build the support of the civil society. This would help to avoid the stand-off which led to the civil service strike and mandatory salary increase.

With these remarks, I wish the authorities well in meeting the challenges ahead.

Mr. Rouai made the following statement:

I welcome the early consideration of Guyana's decision point document and support its eligibility for relief under the enhanced HIPC Initiative, as well as the amount of assistance and the conditions for reaching the completion point.

Since I am generally satisfied with the authorities' track record and their commitment regarding implementation of their poverty reduction strategy, my only comment is related to the I-PRSP. I commend the authorities for the quality and contents of the document. I note in particular that Guyana's interim PRSP is the first one that covers in detail the costing of the poverty reduction strategy as well as the allocation of debt relief to the social sectors. On the latter point, could the staff clarify why the budgetary allocation to the social sectors in the interim PRSP are limited to the debt relief under the enhanced HIPC Initiative amount to US$329 million, and why the interim PRSP does not include the already received assistance under the original HIPC Initiative framework in the amount of US$256 million?

Finally, I support Mr. Portugal's proposed changes to the text of the HIPC Initiative document.

Mr. Sakr made the following statement:

We would like to thank the staff for the comprehensive set of papers brought forward for today's discussion. While we appreciate the extensive information provided in the Article IV Consultation report and the request for a second annual arrangement, we feel that the report would have somewhat benefited at times from a more focused discussion particularly of recent developments. Having said that, we are in broad agreement with the staff appraisal and policy recommendations and will be brief in our comments.

Circumstances facing Guyana over the past year and so far this year have not been favorable. A multitude of shocks including a civil service strike and the subsequent wage increase, terms of trade shock, and flooding, coupled with the usual pressures that accompany the run-up to general elections have complicated policymaking and presented the authorities with major challenges. However, with the help of external financial assistance, the authorities' response to these challenges has been quite encouraging. They have made every effort to adhere to the program with a view to maintaining a stable financial environment. Commendable progress in structural reform including in the financial sector, and social sectors development has also been achieved over the past two years. This progress is a testimony to the authorities' strong commitment to the reform program. We can therefore support their request for a second annual arrangement under the PRGF to assist them in their efforts to reform and stabilize the economy.

Similar if not stronger commitment to the program is critical to ensure that the program succeed and financial stability is maintained in the period ahead. The current account deficit and the fiscal deficit are projected to increase significantly before returning to sustainable levels. A stable macroeconomic environment and strengthened confidence in the economy are critical assumptions underlying the rebound in the fiscal and external current accounts in the medium term, leaving little room for maneuver. This underscores the importance of not only showing strong commitment to the program at this time but also of making significant progress as the authorities move forward with the implementation of the envisaged reforms. This is also underlined by the heavy reliance on external concessional resources which are highly dependent on adherence to the program.

On the fiscal front, while the increase in the deficit was clearly unavoidable, the authorities seem to be sparing no effort to minimize deviations from the initial program. Given the constraints facing the authorities on both the revenue and the expenditure sides, we welcome the two pronged fiscal approach the authorities intend to follow. The emphasis on precluding any recourse to domestic financing is very well placed. In this regard, we are encouraged by the authorities plan to offset any shortfall in external financing by measures to curtail the fiscal deficit. Generally, we agree with the staff that current expenditures, particularly the wage bill, need to be restrained to the extent possible, given the high demands social sectors place on the budget. However, given the importance of maintaining broad support for the reform efforts as well as protecting the quality of public services, significant reduction in the civil service may not be feasible at this time. On the revenue side, we agree that the focus should be on further improving the tax administration.

On monetary policy, we believe that the primary objective of monetary policy should be to keep inflationary pressures in check and we are encouraged by the tight monetary stance followed recently to contain the inflationary pressures that have stemmed from higher wages as well as rising prices of oil and food products. Regarding the banking system, commendable progress has been made and we encourage the authorities to continue on this path by strengthening bank supervision.

Regarding the issues for discussion in the HIPC Initiative decision point document, we have only a few comments. We agree with the staff and management recommendation regarding Guyana's eligibility for debt relief, including the amount of assistance, under the enhanced Initiative.

The conditions to reach the Completion Point described in box 2 of the decision point document seem to be well designed and prioritized for Guyana. Like other HIPC Initiatives, weak implementation capacity particularly with regard to the capital spending appears to present significant difficulties for the authorities. In fact, while overall spending targets in the social sector have been exceeded mainly on account of higher wages, it is well to note that targets for capital spending have not been met. We therefore feel that special attention needs to be accorded to improving the implementation capacity and procurement procedures as the country moves closer to its completion point.

With these comments we wish the authorities success in implementing their economic program.

Mr. Suárez made the following statement:

At the outset, let me thank the staff for the excellent set of papers it has prepared on the occasion of this Article IV Consultation and Request for the Second Annual Arrangement under the Poverty Reduction and Growth Facility, the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative-decision point document, and the Guyanese authorities for their commitment to implementing a set of policies aimed at reducing poverty in the context of economic growth and improved social conditions, as set out in their Interim-PRSP.

From 1991 to 1997, the Guyana's economy performed extremely well. During that period significant structural reforms were implemented and adequate fiscal and monetary policies contributed to achieve faster economic growth, and significantly reduced inflation to rates of one digit. Since late 1997, a series of shocks have been affecting the country's economic activity. As a consequence, Guyana's economy entered into a recession in 1998, although some recovery was observed in 1999; in addition, inflation accelerated in 1999. In fact, taking aside these two years' output growth was reasonable. During last year, the authorities were faced with an unexpected sharp deterioration in the terms of trade and had to accommodate the large arbitration wage awards to the government employees. Although this was an adverse momentum, I would like to commend the authorities for formulating an economic program aimed at restoring macroeconomic stability and achieving faster economic growth. The actions implemented to maintain a small fiscal deficit and the tightness of monetary policy in the recent past, are clear indications of the Guyanian authorities' commitment to improving macroeconomic conditions and making the Guyana's economy more efficient.

On this basis, I support the approval of the authorities' request for the second annual arrangement under the PRGF.

As I fully concur with the thrust of the staff's appraisal, I will limit myself to making a few comments just for emphasis.

First, fiscal consolidation continues to be at the core of the program. We concur with the staff report on the difficulties for increasing tax revenue given the already tax efforts made by the Guyanese authorities; for that reason we urge the authorities to rationalize the wage bill and to move with their two-pronged fiscal strategy, as stated in the staff report. Given Guyana's widespread poverty, it is of the essence to ensure high quality public expenditure.

Second, I welcome the authorities' efforts in privatizing public enterprises, as this will reduce budget pressures and contribute to making the economy more efficient and competitive. We urge the authorities to continue with this process as they will generate additional resources to support poverty reduction programs.

Notwithstanding the progress achieved in pursuing prudent macroeconomic policies and structural reforms, the country still faces a significant debt burden that calls for debt relief under the enhanced HIPC Initiative. Considering the authorities' commitment to reducing poverty, as explained in the I-PRSP, and their willingness to maintain an appropriate macroeconomic environment, we share the view that Guyana meets the conditions for the decision point. On the trigger for the completion point, I associate my comments to those expressed by Mrs. Mateos y Lagos in her preliminary statement.

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

Mr. Rustomjee made the following statement:

I thank the staff for documents presented on Guyana and for the very useful and informative preliminary statement by Mr. Portugal and Mr. Dhanpaul.

I commend the Guyana authorities on their remarkable economic performance during the period 1991 to 1997, which included wide-ranging structural reforms to increase economic efficiency.

However, economic growth has slowed down during the period 1997 and 2000, due to inter alia, a deterioration in terms of trade, adverse weather conditions, domestic civil disturbances and a decline in investment.

With regard to medium-term planning I welcome the envisaged program of the Guyana authorities to reduce poverty through targeted social programs (including the provision of safety nets), structural reforms and the maintenance of financial stability. I concur with staff that the modernization of GUYSUCO as a potential generator of employment and export earnings will be to the benefit of the economy as a whole.

I welcome the input provided by the World Bank Representative this afternoon. And I agree with Mr. Portugal and Mr. Dhanpaul that the modernization plan of GUYSUCO should be implemented in a manner which avoids major disruption in the economy, particular since GUYSUCO'S downstream linkages with the distillers industry, the retail and wholesale sectors; and also because GUYSUCO occupies so important a role in the economy, contributing 16 percent of GDP, 25 percent of exports and 35 percent of agricultural output and as a significant employer. I would urge a cautious and steady program of reform for GUYSUCO.

The Guyana authorities have adopted fiscal policies to support social sector programs that will lead to a sizable deficit as percentage of GDP in 2000/2001. This is a matter of considerable concern. While I support the envisaged future fiscal policy strategy, which aims at reducing the budget deficit to less than 1 percent of GDP by 2005, the issue of wage restraints clearly counts as an urgent priority, as many directors have mentioned. This together with strengthened fiscal management will boost public sector savings in the medium term and enhance the overall investment capacity of the economy and for all these reasons we strongly urge the authorities to consider these issues as a high priority indeed.

I agree with Mr. Bernes' statement on the resolve of the authorities to stand firm on the structural and macroeconomic policy agenda. We are impressed by the fact that notwithstanding the highly mandated and large wage increases to the civil servants, the authorities contained to 12 percent in 1999, wage increases of categories not encompassed by arbitration decision. And the authorities have met the aggregate social sector spending targets directed against poverty.

I also take note of the staff report that the authorities have cooperated in pursuing policies to contain deviations from the program in 1999 and 2000. Staff notes that the authorities have also developed a medium-term policy framework, which is appropriate for achieving macroeconomic and structural objectives set by the authorities. I agree with Mr. Faini that it is important to insulate as far as possible policy development from excessive lobbying. The development of a medium term policy framework is an important, if not crucial element in this process and we therefore particularly welcome this medium-term framework.

A number of directors have noted the importance of establishing a strong program to address HIV/AIDS, and have noted to the deficiencies in statistical data capacity. I share these observations. I urge the authorities to address the HIV/AIDS issue early, promptly and comprehensively. And I support calls from other Directors for the Fund to augment and if possible strengthen the provision of technical assistance capacity building.

The staff paper also highlights the importance of improving Guyana's debt management capacity. The advent of the HIPC Initiative provides a natural focus for authorities to seize this opportunity so that debt management systems can be permanently improved and induce well into the future when HIPC Initiative relief will hopefully be a distant memory for Guyana.

In this regard the CS-DRMS debt management software, which has proved very valuable in many other commonwealth countries, will play an important role and I urge, through Mr. Kelmanson that the Commonwealth Secretariat to continue and further strengthen their assistance to Guyana in developing a sound debt management system for their country.

I welcome the success with the privatization of the State Airlines and the Electricity Company and urge the authorities to continue with these efforts and privatize the Guyana National Bank in 2001 (Box 2).

Penultimately, I share completely Mr. Bernes' comments regarding the retroactive HIPC Initiative cases and the need to provide a reasonably effective but comparably less diverse set of point triggers than those in Box 2. I note with great interest that the resources from the original HIPC Initiative relief seem to have been well spent with 500 more teachers already been trained and another 500 expected to graduate next year; new schools have been built and the program of training provision having been strengthened. All excellent developments showing money well spent. This is an encouraging sign for Guyana (it encourages what can be done in Zambia in the short term).

With these words, I support the proposed decisions as well the changes and adjustments requested by Mr. Portugal, and I wish the authorities every success with their future endeavors.

Mr. von Kleist made the following statement:

I support the request for the second annual arrangement under the PRGF. I agree that Guyana has met the conditions for reaching its decision point under the enhanced HIPC Initiative, even though I can only do so with some reservations. Since I share many of the points made by Ms. Lissakers and Mr. Faini, I have only one comment to add on the decision point.

We strongly emphasize the need for all creditors to participate fully in the exercise to maintain the credibility and effectiveness of the initiative. I have two comments on the excellent set of staff papers prepared for today's discussion. The I-PRSP is of very high quality and, in our view, easily exceeds the required standards for the I-PRSP. This being said, we want staff to make sure that this does not weaken the participatory process from which the final PRSP will result.

Second, my authorities found the statistical data and decision point document especially succinct and useful. Some fine examples are Table 4 on social expenditures, Table 11 on debt service payments with and without the HIPC Initiative , as well as Figure 3. We commend staff for this, and hope that future documents will follow this excellent example.

The Acting Chairman suggested that, following the discussions held by the Board, the wording in the sentence in Box 2 of the decision point document that referred to GUYSUCO's restructuring plan be changed to: "...proceed with the satisfactory implementation of an agreed revised modernization plan for GUYSUCO, taking into account recommendations of the World Bank study on economic viability of GUYSUCO's modernization plan."

The staff representative from the Western Hemisphere Department, in response to questions from Directors, observed that it had taken about 18 months to develop an adjustment program which could be considered for Fund support. Any further delays would seriously undermine business confidence and the authorities' ability to implement the reform program. The authorities' track record had to be viewed in the context of a poor country with high vulnerability to external shocks. In the previous decade, the democratic authorities had made substantial and rather successful efforts to strengthen the production base through market-oriented policies in reaction to external shocks. Despite some inconsistent performance, the authorities had made good progress.

In the program for 1999 in particular, the authorities had reacted to a shock by taking measures to help offset its effects and to continue to meet their commitments with the Fund, the staff representative continued. The authorities took measures both on the revenue and the expenditure sides and they succeeded in reducing the overall fiscal deficit. As a result of this, inflation and the nominal interest rate fell, and the exchange rate stabilized in 2000. If the upcoming elections went smoothly, the authorities would be on their way toward achieving even better results in the near future.

In response to a question on the fiscal results in 2000, the staff representative pointed out that the staff had provided the best estimate that was available at that moment, which was based on the central government's operations above the line. There was no data available on capital expenditures or on the results of public enterprises. Judging from the available data, it would appear as if the authorities would outperform their targets, but staff were projecting that would not be the case because investments which had been previously postponed would have to be undertaken in the last quarter of 2000. Nevertheless, the staff did not have a strong basis to predict that the targets would not be met, even after the additional investments were taken into account.

On the evolution of the wage bill, the staff representative acknowledged that this was a delicate issue that partly explained the long time it had taken to develop the program. The authorities were seeking advice from the Fund on this issue, and the staff had discussed with the authorities possible mechanisms to determine wages in the public sector. They had agreed to limit the wage bill growth to the inflation rate, but, as Mr. Faini had pointed out, the key to achieving this objective was that the authorities be transparent with the other stakeholders on the process of poverty reduction. As a result of this emphasis on transparency, the authorities had outlined their wage policy in the I-PRSP for full discussion with the stakeholders. This should contribute to widen the ownership of their wage policy and prevent the problems experienced in the past, such as the failure to restrain the wage bill, from reappearing. While the recent demands from the unions for a 70 percent wage increase would appear to challenge the possibility of the stakeholders embracing a policy of wage restraints, the authorities were of the view that such demands would not receive wide public support, contrary to what had happened in the past. The reason for the expected change in public support was that the huge gap between civil service and private sector salaries that had existed in the past had been largely closed. It might have even been reversed at the lower end of the scale, although the available evidence for this was not conclusive.

Turning to the issue of the effectiveness of the Revenue Authority, the staff representative reassured Directors that, in 2000, revenue was running ahead of the staff's projections. This was largely the result of the increased efforts of the Revenue Authority.

On the expenditure side, the review by the World Bank had already taken place and its recommendations were reflected in the I-PRSP and in the staff documents, the staff representative pointed out. The basis for increased public sector savings, in spite of the constraints that the government was facing, had been a significant restraint on current expenditure, which the staff envisaged would continue over the medium term. In addition to this, with the privatization of loss-making enterprises, an additional drain on public savings would be eliminated. In fact, there would only be three public enterprises after the current round of modernization. There were also projections of a sizeable increase in social security contributions. All these assumptions provided the basis for the strong savings performance projected by the staff over the medium term which would be supported also by the favorable effect of the Revenue Authority on the revenue side. An additional positive effect on the revenue side over the medium- to long-term would be the expected introduction of a VAT within a few years.

On Mr. Collins's question on procurement legislation, the staff representative observed that the date of June 2001 given in Table 3 was the correct date. The intention of the authorities had been to have the legislation approved by the ministry at an earlier date, but the opposition party had requested that such legislation be approved by the parliament after the elections.

On the ceiling on external borrowing to finance GUYSUCO's restructuring plan, the staff representative explained that a zero ceiling on non-concessional borrowing had been agreed with the authorities. The agreement had been reached on the understanding that, if concessional borrowing were not available to carry out GUYSUCO's restructuring plan, the issue would be revisited jointly with the staffs of the Bank and the Fund. The staffs' and the authorities' main concern was that the debt burden should not get out of control. If this happened and arrears started to accumulate, market confidence would be greatly damaged.

Regarding the comprehensive reform of the civil service and the remuneration structure, the staff representative informed that the Inter-American Development Bank had already started providing technical assistance in this area. The expectations were that the reform would begin to be implemented in 2001.

On the question raised by Directors on the use of resources made available under the original HIPC Initiative, the staff representative responded that since those resources had already been budgeted, they had not been included in the I-PRSP document. The document only provided detail on the use that would be made of the resources made available under the enhanced HIPC Initiative, as this was the aim of the document.

On the pace of poverty reduction, the staff representative admitted that the authorities had been conservative in aiming to reduce the poverty rate from 35 percent to 31.5 percent of the population. The authorities were concerned that a more aggressive target could not be achieved, given the tenuous relationship between growth and poverty reduction. The elasticity of poverty reduction to growth depended on several complicated factors, which were not completely under the control of the authorities. Some of these, such as the participation of poor people in improved education training and health resources provided by the authorities, were to a certain extent within the control of the authorities. Others, such as the extent to which the private sector would create new jobs to absorb poor people with improved skills, while also absorbing those who would leave the public sector under other reforms, were not under the control of the authorities. Perhaps the staff could work with the authorities to revise the poverty reduction targets, but the difficulties in setting targets such as the reaction of the private sector had to be acknowledged.

Regarding the level of assurances obtained from creditors, the staff representative noted that 70 percent of the creditors had already agreed to take part in the initiative. The staff was uncertain as to when the formal assurance from the Inter-American Development Bank, which held 20 percent of the debt, would be received. However, it was important to note that non-Paris Club creditors represented a very small proportion of the total debt. Nevertheless, both the authorities and the staff would discuss the matter with non-Paris Club creditors, as some might be forthcoming in providing their assurances of debt relief sooner than currently expected.

Mr. Jacoby reiterated his concerns on the issue of wage policy and transparency. He could not find a clear reference in the I-PRSP on the authorities' commitment to curb the wage bill to GDP ratio or to freeze the wage bill in real terms. Such commitment seemed to have only been mentioned in the preliminary statement of Messrs. Portugal and Dhanpaul. Further clarification would also be welcome on the recommended use of commercial loans by GUYSUCO.

The staff representative from the Western Hemisphere Department pointed to the section in the I-PRSP where the macroeconomic projections used by the authorities had been spelled out—page 43 in the document. Such projections indicated that the growth of the wage bill would be restrained in line with projected inflation over the medium term in order to maintain the gains that had been recently achieved in public sector wages.

The Acting Chairman pointed out that there was also a mention of the wage policy in the staff report.

The staff representative from the Western Hemisphere Department observed that the inclusion of the issue of wage restraint in the I-PRSP was more relevant than the inclusion in the staff report. The reason for this was that the I-PRSP would be discussed with stakeholders, which meant that the issues of transparency and ownership raised by Directors would be addressed.

On the use of commercial loans by GUYSUCO, the staff representative noted that the staff were not recommending that GUYSUCO should borrow on market terms. The World Bank was looking at ways to redefine the restructuring plan in such a way that an arrangement could be made to obtain concessional loans to finance the level of investment that would be needed. If such loans were not available, the Bank would reconsider its strategy. The plan could include more privatization of assets, for example, if it were required. These would be issues for discussion in future rounds of discussion between the Bank and the authorities.

After some brief discussion, the Acting Chairman indicated that the Board agreed to introduce the changes requested by Mr. Portugal in the decision point document. Most Directors agreed to the proposed change in the wording used in Box 2 of the document to refer to the GUYSUCO's restructuring plan. Directors also agreed to delete the references to the authorities' intention to grant wage increases above inflation for highly skilled teachers and health workers—paragraph 31—and to separate 1,000 temporary and unqualified civil servants from the core civil service—the section on civil service reforms in Table 3. All these changes would not be made in the documents for the internal use of the Fund and the Bank, but only in those for external publication.

Ms. Bonomo disagreed with the deletion of the sentence in Table 3 on civil service reform.

Mr. Jacoby also stated his disagreement with the deletion of the sentence in Table 3 on civil service reform.

Mr. Kelmanson encouraged the staff, on a more general note on changes to documents, to comply with the decisions adopted on transparency and changes in documents and publications of documents. The staff should consistently apply the guidelines set in that decision and they should communicate to the Board the reasons for any deviations from those guidelines.

Mr. Portugal thanked the Board for the support given to Guyana. This was a very poor country that was in great need of support from the Fund. Such support was also deserved on the basis of the strong commitment and the impressive performance shown by the authorities in recent years. Many changes had taken place between the beginning of the 1980s and the end of the 1990s. The country had moved from an economy where 80 percent of value added was controlled by the state to one where only three enterprises were controlled by the state. The inflation rate had fallen from 100 percent in 1991 to 5.5 percent as of September 2000. The public sector deficit had fallen from 54 percent of GDP to 1 percent of GDP. The poverty ratio had fallen from 43 percent to 35 percent of the population.

There had also been a series of exogenous shocks, Mr. Portugal continued, such as a sharp deterioration in the terms of trade, droughts, flooding, political unrest, and strikes. These external shocks had led to sharp fluctuations in the performance of the economy. Nevertheless, the overall track record was one of strong performance. That was the reason why the country had qualified for the earlier HIPC Initiative, which required a track record of three years at the decision point, and an additional year to reach the completion point. For these reasons, the country deserved the support of the Fund.

The legitimate concerns that had been raised by the Directors would be conveyed to the authorities, Mr. Portugal observed. The advice given by the Board would undoubtedly be taken into account by the authorities. On the issue of the wage bill, the strike of two months, and the outcome of the arbitration that was set up to put an end to the strike, from an initial offer of a 4 percent increase, the authorities had to accept increases of 31 percent in 1999 and

26 percent in 2000. Those civil servants that were not included in the arbitration process, like teachers, had only received an increase of 12 percent. Despite these large increases in the wage bill, the authorities managed to achieve their commitments on fiscal deficit through the introduction of compensatory measures in the revenue and expenditure sides of the budget. The effects that this had had on the quality of some public services had to be acknowledged, but this was an unavoidable side effect of this exogenous shock. Looking forward, as the staff had noted, the authorities had committed in their letter of intent to limit the growth of the wage bill to the projected increase in consumer prices. While the aim of reducing the wage bill as a percentage of GDP would also be desirable, the growth of GDP was not directly under the control of the authorities.

On the question of GUYSUCO, Mr. Portugal explained that the sugar industry accounted for 35 percent of agricultural output, 16 percent of GDP, 25 percent of exports, and a very large proportion of employment, with 18,500 direct employees and over 50,000 additional jobs in the economy. The unit cost of production was 16 cents per pound of sugar, compared to a world price for sugar of 6 cents per pound. Sugar could only be exported from Guyana as a result of the production-support schemes in Europe and in the United States that increased the domestic price of sugar. But such schemes were bound to be phased out in the context of the WTO agreement. This left GUYSUCO with a window of opportunity of four or maybe five years in which they could work to reduce the unit cost of production. The authorities were strongly committed to restructuring the industry without resorting to commercial loans. If this could not be achieved, the economy would lose 25 percent of its exports, and all the assumptions used to perform the debt sustainability analysis would be invalidated. The effects of the restructuring plan on the rest of the economy would also have to be taken into account if major disruptions were to be avoided in the short term. Seeking the highest possible rate of return on sugar in the short term would imply the dismissal of large amounts of employees with negative consequences on the economy as a whole. Land and labor did not appear to be factors in limited supply in the economy, as would be the case with finance. The reutilization of resources released as a result of the restructuring process would therefore have to be carefully studied. These kinds of issues were being discussed with the Bank.

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

> Executive Directors agreed with the thrust of the staff appraisal. They observed that since 1998, real GDP growth has recovered; but inflationary pressures have increased, reflecting currency depreciation, increases in utility rates and fuel prices, and the large wage increases to civil servants. Directors expressed concern about these wage increases, but commended the authorities for their efforts to reduce the overall public sector deficit while protecting spending on social services. Directors welcomed the progress made in structural reforms, particularly the recent privatizations of large public enterprises.

Directors considered that the authorities' economic program has set realistic objectives to achieve higher real GDP growth, reduce inflation gradually, and maintain a reasonable cushion of international reserves against shocks. They noted that the pursuit of a prudent fiscal policy is crucial for achieving these goals. Directors noted that public expenditures, excluding wages, were curtailed to a minimum level in 1999 and that a temporary recovery in these expenditures was needed particularly to accelerate the implementation of poverty reduction programs. They encouraged the authorities to expedite improvements in the new Revenue Authority. At the same time, they recognized that room to increase taxes was constrained by the already high tax effort in Guyana. Directors encouraged the authorities to remain steadfast in their two-pronged fiscal strategy of refraining from domestic borrowing and improving public saving performance over the medium term. In this context, Directors urged the authorities to monitor fiscal developments closely, particularly the wage bill and nonpriority spending, and to stand ready to take corrective fiscal actions if slippages emerged.

Directors commended the authorities for their success in privatizing public enterprises, including the state airline company, the electricity company, and a retail outlet. Directors encouraged the authorities to persevere with efforts to restructure the remaining public enterprises, especially the modernization of the sugar company (GUYSUCO), and welcomed their intention to privatize the bauxite companies. Directors noted that these efforts are necessary for increasing public saving to support poverty reduction programs. The authorities should also strengthen their project implementation capacity, particularly the procurement system, to achieve the projected level of public investment needed to reduce poverty and generate growth.

Directors welcomed the authorities' prudent monetary policies, aimed at achieving the inflation and balance of payments objectives. They also welcomed the authorities' efforts to strengthen the supervision of financial institutions and encouraged the authorities to implement the new Securities Law. They urged the authorities to increase their efforts to reduce the high level of non-performing loans, to continue to enforce adequate provisioning, and to bring the Guyana National Cooperative Bank to the point of sale soon. The current exchange rate regime has served Guyana well, and Directors noted that interest and exchange rates should continue to be allowed to reflect market conditions.

Directors welcomed the authorities' efforts to improve their debt management capabilities. They noted that while Guyana provides the core minimum data needed for surveillance and program monitoring, there are significant deficiencies with respect to the quality, timeliness, and coverage of economic statistics that hamper a more comprehensive assessment of economic developments. Directors strongly urged the authorities to enhance their efforts to improve data collection and dissemination for program monitoring and promoting transparency; in particular, there was an urgent need to improve fiscal data collection.

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

The Acting Chairman made the following summing up of the discussion on the request for the second annual arrangement under the Poverty Reduction and Growth Facility (PRGF) and the decision point under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC):

Executive Directors generally considered that Guyana has established a satisfactory track record in implementing a comprehensive program of macroeconomic, structural, and social reforms, and they endorsed the thrust of the program to be supported by the second annual arrangement under the PRGF. Directors considered that the Interim Poverty Reduction Strategy Paper (I-PRSP) provides a sound basis for a full PRSP. They also agreed that Guyana is eligible for debt relief under the enhanced HIPC Initiative and that it meets the conditions for reaching the decision point now.

Poverty Reduction and Growth Facility

The program aims at reducing poverty through targeted actions, growth-oriented structural reforms, and maintenance of financial stability. Directors noted that the pursuit of a prudent fiscal policy is crucial for achieving these goals.

Directors supported the authorities' objective to raise public saving to shore up public sector investment that benefits the poor and emphasized expenditure restraint, especially on the wage bill. They stressed that the authorities should avoid curtailing productive expenditures, as this would undermine the effectiveness of their poverty reduction strategy. Directors urged the authorities to explore alternatives to reach broad consensus with stakeholders on a wage policy that is consistent with national macroeconomic objectives. This was particularly important to garner widespread support and ownership of the program.

Directors supported the authorities' efforts to rationalize the civil service, and suggested that the authorities be prepared to make compulsory cuts if needed. Directors stressed the need to implement a comprehensive civil service reform in the medium term. At the same time, they cautioned that civil service reform should not weaken the capacity of the authorities to deliver social services and to implement the poverty reduction program.

On other structural reforms, Directors underscored the need to modernize the public sugar company (GUYSUCO) to enable it to compete internationally, given the expected phasing out of preferential export markets. They stressed the importance of ensuring that the modernization plan is economically viable and technically sound.

The authorities should continue to pursue prudent monetary policies to achieve their inflation and balance of payments objectives, and intensify efforts to strengthen the supervision of financial institutions.

Interim Poverty Reduction Strategy Paper

Directors agreed that the I-PRSP provides a sound basis for the development of a full, participatory PRSP and for reaching the decision point under the enhanced HIPC Initiative. They welcomed the authorities' efforts to reduce the incidence of poverty and the increase in government expenditure in priority sectors, including health and education, especially in the rural areas. Directors noted that the full PRSP would need to include a more complete discussion of the macroeconomic framework and the costing and priorities among various projects. The full PRSP will also need to specify detailed institutional arrangements to monitor progress as well as to ensure that the poverty reduction strategy is being implemented as intended.

Enhanced HIPC Initiative—Decision Point

Directors agreed that Guyana is eligible and qualifies for additional debt relief under the enhanced HIPC Initiative. The country's track record in social and structural reforms, the policy commitment presented in the I-PRSP and the thrust of the PRGF- and IDA-supported programs provide a satisfactory basis for reaching the decision point under the enhanced HIPC Initiative. A few Directors considered that the decision point was premature, given the lack of specificity on plans for modernizing GUYSUCO and some concerns about the track record of performance.

Directors agreed that the external debt sustainability target for Guyana be 250 percent for the NPV of debt-to-government revenue ratio (based on end-1998 data).

Directors generally considered that the implementation of the set of measures as described in Box 2 of EBS/00/214 would trigger the floating completion point for Guyana. Directors also considered that by the time of the completion point, the authorities should make improvements in the quality and availability of data to monitor progress with their poverty reduction strategy.

The Executive Board took the following decision, with one abstention by Ms. Lissakers:

Poverty Reduction And Growth Facility—Second Annual Arrangement

1. Guyana has requested that the second annual arrangement, in an amount equivalent to SDR 17.92 million, under the three-year arrangement for Guyana under the Poverty Reduction and Growth Facility (EBS/98/101, Sup. 3) be approved.

2. The Fund has reviewed the Interim Poverty Reduction Strategy Paper ("interim PRSP") submitted by Guyana and concludes that it provides a sound basis for the development of a fully participatory PRSP and for Fund concessional assistance.

3. The Fund decides to approve in principle the second annual arrangement set forth in EBS/00/213, 11/1/00. This approval shall become effective on the date on which the Fund decides that the World Bank has concluded that the interim PRSP provides a sound basis for the development of a fully participatory PRSP and for Bank concessional assistance. Upon the approval of the arrangement becoming effective, Guyana may request the first disbursement specified in paragraph 1(a)(i) of the arrangement, on the condition that the information provided by Guyana on the implementation of the prior actions specified in paragraph 36 of the Memorandum on Economic and Financial Policies attached to the letter dated October 30, 2000. (EBS/00/213, 11/1/00; and Cor. 1, 11/8/00)

Decision No. 12323-(00/111), adopted
November 13, 2000

Enhanced Initiative for Heavily Indebted Poor Countries—
Decision Point

1. Based upon the updated external debt sustainability analysis for Guyana (EBS/00/214, 11/1/00), the Fund as Trustee ("Trustee") of the Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations (the "Trust"), established by Decision No. 11436-(97/10), February 4, 1997, decides in principle that:

(i) in accordance with Section III, Paragraphs 1 and 2 of the Trust Instrument (the "Instrument"), Guyana is eligible and qualifies for additional assistance under the enhanced HIPC Initiative as defined in the Instrument;

(ii) the completion point for Guyana will be such date when the Trustee determines that:

(a) Guyana has prepared a Poverty Reduction Strategy Paper (PRSP) and is making overall progress in poverty reduction that is broadly acceptable;

(b) Guyana has a stable macroeconomic position and is satisfactorily implementing its Fund-supported program;

(c) Guyana has satisfactorily implemented the policy reforms described in Box 2 of EBS/00/214 (11/1/00);

(iii) the external debt sustainability target for Guyana is 70 percent for the net present value of debt-to-exports ratio, which results in reduction of the net present value of debt-to-revenue ratio to 250 percent;

(iv) in accordance with Section III, paragraphs 3(a) and 3(b) of the Instrument, the equivalent of SDR 30.68 million of additional assistance shall be made available by the Trustee to Guyana in the form of a grant to permit a further reduction in the net present value of the debt owed by Guyana to the Fund, subject to satisfactory assurances regarding the exceptional assistance to be provided under the enhanced HIPC Initiative by Guyana's other creditors;

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

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

(b) the Trustee shall disburse to Guyana as interim assistance the equivalent of SDR 6.14 million to an account for the benefit of Guyana established and administered by the Trustee in accordance with Section III, paragraph 5 of the Instrument; and the proceeds of the grant shall be used by the Trustee to meet Guyana's debt service payments on its existing debt to the Fund as they fall due, in accordance with the following schedule: 49 percent of each repayment obligation falling due until November 2001.

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

2. The Fund has reviewed the Interim PRSP submitted by Guyana and concludes that it provides a sound basis for the development of a full,

participatory PRSP, and for receiving additional assistance under the enhanced HIPC Initiative.

3. Paragraph 1 above shall become effective on the date on which the Fund decides that the World Bank has concluded that the Interim PRSP provides a sound basis for the development of a fully participatory PRSP, and for World Bank additional assistance. (EBS/00/214, Sup. 1, Rev. 1, 11/13/00)

Decision No. 12324-(00/111), adopted
November 13, 2000

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/00/110 (11/10/00) and EBM/00/111 (11/13/00).

5. COMPENSATORY FINANCING FACILITY—AMENDMENT

Decision No. 8955-(88/26), August 23, 1988, as amended, is hereby amended to read as follows:

Compensatory Financing Facility

Section I. General Provisions

1. The Fund is prepared to extend financial assistance, in accordance with the provisions of this Decision, to members that encounter balance of payments difficulties arising out of (i) temporary export shortfalls or (ii) excess costs of cereal imports.

2. Purchases under this Decision and holdings resulting from such purchases shall be excluded for the purposes of the definition of reserve tranche purchase pursuant to Article XXX(*c*).

3. Except for the purpose of determining the level of conditionality applied to purchases in the credit tranches, the Fund's holdings of a member's currency resulting from purchases under this Decision shall be considered separate from the Fund's holdings of the same currency resulting from purchases under any other policy on the use of the Fund's general resources. In cases of concurrent requests for purchases under this Decision and for purchases in the credit tranches, purchases under this Decision shall be deemed to be made first.

4. In order to carry out the purposes of this Decision, the Fund will be prepared to grant a waiver of the limitation of 200 percent of quota in Article V, Section 3(b)(iii), whenever necessary to permit purchases under this Decision or to permit other purchases that would raise the Fund's holdings of the purchasing member's currency above that limitation because of purchases outstanding under this Decision.

5. The Fund shall indicate in an appropriate manner which purchases by a member are made pursuant to Section II or Section III of this Decision, as well as the export shortfall component and the cereal import cost component of each purchase under Section III.

6. When a request for a purchase is made by a member under either Section II or Section III of this Decision on account of circumstances that have already been taken into account in calculating the amounts of purchases made or to be made under the other Section, double compensation shall be avoided when calculating the amount of the requested purchase.

7. In providing financing pursuant to this Decision, the Fund, as under other policies of the Fund, shall pay due attention to the member's capacity to service its financial obligations to the Fund, and, having regard to the outstanding financial obligations of the member to the Fund, may reduce the amount of financing accordingly, notwithstanding any other provision in this Decision.

8. Wherever used in this Decision, the expression "arrangement" will mean an upper credit tranche stand-by arrangement, an extended arrangement, or an arrangement under the Poverty Reduction and Growth Facility (PRGF).

9. Without prejudice to the other limitations on purchases specified by this Decision, the Fund's holdings of a member's currency resulting from purchases under this Decision shall not exceed any of the following access limits:

(a) 45 percent of the member's quota for purchases on account of an export shortfall under Section II or Section III;

(b) 45 percent of the member's quota for purchases on account of an excess of cereal import costs under Section III; and

(c) a combined limit of 55 percent of the member's quota for purchases on account of an export shortfall component under Section II or Section III and an excess cereal costs component under Section III.

Section II. Compensatory Financing of Export Fluctuations

Qualification and Timing of Purchases

10. The Fund is prepared to assist members, particularly primary exporters, encountering balance of payments difficulties produced by temporary export shortfalls and such members may expect that their request for purchases under this Section will be met, subject to the provisions of this Decision, where the Fund is satisfied that the shortfall is of a short-term character and is largely attributable to circumstances beyond the control of the member, and

(a) at the time of the request, the members' balance of payments position apart from the effects of the export shortfall is satisfactory; or

(b) at the time of the request, the Fund approves an arrangement, or, in the case of an existing arrangement, either completes a review under such an arrangement or determines that the member's policies are such as would, in the Fund's view, continue to meet the criteria for the use of the Fund's resources in the upper credit tranches.

11. With respect to compensation under paragraph 10(a), a member may expect that the full amount of compensatory financing, subject to the provisions of this Decision, shall be made available in one purchase, unless estimated data are used for 9 months or more of the 12-month period referred to in paragraph 15, in which case the amount of compensatory financing shall be made available in two purchases, in accordance with the following provisions:

(a) the first purchase shall not exceed 65 percent of the amount of compensatory financing; and

(b) the second purchase request shall not exceed the difference between the amount of the compensatory financing recalculated at the time of the request for the second purchase and the amount of the first purchase and shall not be approved until actual statistical data becomes available for at least 6 months of the 12-month period used for the purposes of the first purchase; if the policy implementation or external circumstances of the member differ materially from that originally anticipated at the time of the request for the first purchase, the Fund may decide not to approve, or to reduce the amount available under, the second purchase.

12. With respect to compensation under paragraph 10(b), a member may expect that the amount of compensatory financing, subject to the provisions of this Decision, shall be made available in more than one purchase, which shall normally be for equal amounts, unless recalculated pursuant to this paragraph, and that

(a) its request for a first purchase will be met immediately, subject to the provisions of this Decision,

(b) its requests for subsequent purchases will be met, subject to the provisions of this Decision, if, at the time of the request for the purchase,

— the member continues to have an arrangement, and

— The Fund decides that the member has met the conditions for the purchase or disbursement under the associated arrangement, including the observance or waiver of any applicable performance criteria or other conditions specified therein;

provided that the last purchase shall not take place earlier than six months from the first purchase, and any actual statistical data that has become available for the shortfall year shall be used to recalculate the amount of any subsequent purchases under this paragraph.

13. A purchase under paragraph 11 or the first purchase under paragraph 11(a) or paragraph 12 shall not be approved under this Section later than six months after the end of the 12-month period referred to in paragraph 16, provided that it may be approved up to seven months after the end of such period if the delay beyond six months is the result of circumstances external to the member.

Calculation

14. If, in the opinion of the Fund, adequate data on receipts from services other than investment income are available, the member requesting a purchase under this Section shall specify whether the receipts shall be included or excluded in the calculation of the shortfall. The choice by the member to include such receipts shall continue to apply for a period of three years.

15. The existence and amount of an export shortfall for the purpose of any purchase under this Section shall be determined with respect to the latest 12-month period preceding the request (or, in the case of paragraph 11(a) or paragraph 12, the first request) for which the Fund has sufficient statistical data, provided that a member may request a purchase in respect of a shortfall year for which not more than 12 months of the data on merchandise exports and on receipts from services are estimated.

16. In order to identify more clearly what are to be regarded as export shortfalls of a short-term character, the Fund, in conjunction with the member concerned, will seek to establish reasonable estimates regarding the medium-term trend of the member's exports based partly on statistical calculation and partly on appraisal of export prospects. For the purposes of this Section, the shortfall shall be the amount by which the member's export earnings in the shortfall year are less than the geometric average of the member's export earnings for the five-year period centered on the shortfall year. In computing the five-year geometric average, the Fund, in conjunction with the member, will use an estimate based on a judgmental forecast for the period of the two post-shortfall years, provided that any amount by which the forecast for the period of the two post-shortfall years would exceed the member's export earnings for the period of the two pre-shortfall years by more than 20 percent shall not be included in such computation. When the Fund allows a member to purchase under the proviso in paragraph 15, the Fund may use such methods as it considers reasonable for estimating exports during the period for which sufficient statistical data are not available. If, in the opinion of the Fund, adequate statistical data are available for this purpose, the calculations and estimates under this paragraph of earnings from an export item shall, with respect to a purchase on account of an export short-fall under this Section or Section III, be made net of the value of imported intermediate inputs, where such value exceeds 50 percent of the gross earnings from the export item and the exclusion of the value of the export item would increase or reduce by at least 10 percent the amount that could otherwise be purchased on account of the export shortfall.

Over Compensation

17. When a member has made a purchase under this Section on the basis of estimated data and the amount of the purchase exceeds the amount that could have been purchased on the basis of actual statistical data, the member will be expected to make a prompt repurchase in respect of the outstanding purchase, in an amount equivalent to the excess. The calculation of such an excess with respect to a purchase shall be made on the basis of the same post-shortfall year projections used for the calculation of the purchase, provided that if the member has made more than one purchase with respect to the same 12 month period, the calculation of any excess with respect to all such purchases will be made on the basis of the post-shortfall year projections used for the latest of such purchases.

18. Provision shall be made in all arrangements for the suspension of further disbursements under the arrangement whenever a member fails to meet a repurchase expectation pursuant to paragraph 17. Furthermore, the Managing Director shall not recommend for approval, and the Fund shall not approve, a request for the use of the Fund's general resources by a member that is failing to meet such an expectation.

19. If a member requests financing under this Section in relation to a shortfall year that in whole or in part is included in the period of the two post-shortfall years concerning any earlier purchase under this Section, the amount of the requested purchase shall be adjusted so as to take into account any amount by which such earlier purchase differs from the amount that could have been purchased on the basis of the data available at the time of the request.

Section III. Compensatory Financing of Fluctuations in the Cost of Cereal Imports

Qualification and Timing of Purchases

20. The Fund is prepared to extend financial assistance subject to the provisions of this Decision to members that encounter a balance of payments difficulty produced by an excess in the cost of their cereal imports.

21. For a period of three years from the date of a member's first request for a purchase in respect of cereal imports under this Section, any purchases by the member in respect of its export shortfalls shall be made under this Section instead of under Section II of this Decision. The same provision shall apply if, after the end of the three-year period, the member makes a new purchase in respect of cereal imports under this Section.

22. A member with balance of payments difficulties may expect that its request for a purchase under this Section will be met if the Fund is satisfied that any shortfall in exports and any excess costs of cereal imports that result in a net shortfall in the member's exports are of a short-term character and are largely attributable to circumstances beyond the control of the member, and

(a) at the time of the request, the member's balance of payments position, apart from the effects of the net shortfall in the member's exports, is satisfactory; or

(b) at the time of the request, the Fund approves an arrangement, or, in the case of an existing arrangement, either completes a review under such an arrangement or determines that the member's policies are such as would, in the Fund's view, continue to meet the criteria for the use of the Fund's resources in the upper credit tranches.

23. Paragraphs 11, 12, and13 shall apply *mutatis mutandis* to this Section. The applicable 12-month period shall be the period referred to in paragraph 25.

Calculation

24. (a) Subject to the limits specified in paragraph 9, a member may request a purchase under this Section for an amount equal to the net shortfall in its exports calculated as the sum of its export shortfall and the excess in its cereal import costs.

(b) (i) For the calculation of the net shortfall in exports, an excess in exports shall be considered a negative shortfall in exports and a shortfall in cereal import costs shall be considered a negative excess in cereal import costs.

(ii) An export shortfall shall be determined in accordance with Section II.

(iii) An excess in cereal import costs shall be determined in accordance with paragraphs 25 and 26.

25. The existence and amount of an excess in the cost of cereal imports shall be determined, for the purpose of purchases under this Section, with respect to the latest 12-month period preceding the request for which the Fund has sufficient statistical data, provided that the Fund may allow a member to make a purchase on the basis of estimated data in respect of a 12-month period ending not later than 12 months after the latest month for which the Fund has sufficient statistical data on the member's cereal import costs. The estimates used for this purpose shall be made in consultation with the member. The calculation of a member's shortfall or excess in exports and its excess or shortfall in the cost of its cereal imports shall be made for the same 12-month period.

26. In order to identify more clearly what are to be regarded as excess costs of cereal imports of a short-term character, the Fund, in consultation with the member concerned, will seek to establish reasonable estimates regarding the medium-term trend of the member's cereal import costs. For the purposes of this Section, the excess in a member's cereal imports for the 12-month period referred to in paragraph 25 shall be the amount by which the member's cereal imports in that 12-month period are more than the arithmetic average of the member's cereal imports for the five-year period centered on that 12-month period.

27. The amount of a purchase under this Section, as defined in paragraph 24, may be either on account of an export shortfall or on account of an excess in cereal import costs, or the amount may consist of two components, one on account of an export shortfall and the other on account of an excess in cereal import costs. A member shall allocate the amount of its purchase under this Section between the export shortfall and cereal import components, each as limited by paragraph 9(a) or paragraph 9(b), provided that in no case the combined amount shall exceed the limit in paragraph 9(c).

28. (a) The part of a purchase relating to an export shortfall, subject to the limit in paragraph 9(a), shall not exceed the lesser of the export shortfall defined in paragraph 24(b)(ii) and the net shortfall in exports defined in paragraph 24(a).

(b) The amount of a purchase relating to an excess in cereal import costs, subject to the limit in paragraph 9(b), shall not exceed the lesser of the excess in cereal import costs defined in paragraph 24(b)(iii) and the net shortfall in exports defined in paragraph 24(a).

29. (a) Subject to paragraph 31, when a reduction in the Fund's holdings of a member's currency is attributed to a purchase under this Section, the member shall attribute that reduction between the outstanding cereal import component and export shortfall component of the purchase.

(b) When the Fund's holdings of a member's currency resulting from a purchase under this Section or Section II are reduced by the member's repurchase or otherwise, the member's access to the Fund's resources under this Section will be restored *pro tanto*, subject to the limits in paragraph 9.

30. (a) After the expiration of the period referred to in paragraph 21, the total amount of the export shortfall components of a member's purchases outstanding under this Section shall be counted as having been purchased under Section II.

(b) The provisions of Section II shall continue to apply to the export shortfall component of a purchase under this Section after the expiration of the period referred to in paragraph 21.

Over Compensation

31. The provisions of paragraph 17, 18, and 19 shall apply *mutatis mutandis* to purchases under this Section. The applicable 12-month period shall be the period referred to in paragraph 25.

Section IV. Other Provisions

32. All references in other Fund decisions to the Compensatory and Contingency Financing Facility shall be read as the Compensatory Financing Facility.

33. The Fund will review this Decision not later than August 30, 2002. (EBS/00/215, 11/3/00)

Decision No. 12325-(00/111), adopted
November 10, 2000

6. POVERTY REDUCTION AND GROWTH FACILITY TRUST INSTRUMENT—AMENDMENT

The Instrument to Establish the Poverty Reduction and Growth Facility Trust, annexed to Decision No. 8759-(87/176) PRGF, as amended, is hereby amended as follows:

In Section II, paragraph 1(e), the reference to subparagraphs 16(a) or 33(a) of Decision No. 8955-(88/126) on the Compensatory and Contingency Financing Facility is hereby revised to read "paragraphs 17 or 31 of Decision No. 8955-(88/125) on the Compensatory Financing Facility. (EBS/00/215, 11/3/00)

Decision No. 12326-(00/111) PRGF, adopted
November 10, 2000

APPROVAL: July 9, 2001

SHAILENDRA J. ANJARIA
Secretary