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# INTERNATIONAL MONETARY FUND
Minutes of Executive Board Meeting 98/42
10:00 a.m., April 8, 1998

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**Executive Board Attendance**
M. Camdessus, Chairman
A.D. Ouattara, Acting Chairman
S. Sugisaki, Acting Chairman

| Executive Directors | Alternate Executive Directors |
| --- | --- |
| A.A. Al-Tuwaijri | A.S. Alosaimi, Temporary |
| T.A. Bernes | M. Askari-Rankouhi, Temporary |
| | W. Szczuka |
| B. Esdar | W.-D. Donecker |
| E.R. Grilli | F. Mercusa, Temporary |
| D.Z. Guti | J.P. de Morais |
| K.A. Hansen | O.-P. Lehmussaari |
| A. Kafka | |
| | J. Prader |
| K. Lissakers | M. Sobel, Temporary |
| | R. Fernandez |
| | M. Daïri |
| A.V. Mozhin | A. Vernikov |
| | J. Shields |
| A.S. Shaalan | G.M. Iradian, Temporary |
| M.R. Sivaraman | A.G. Karunasena |
| G.F. Taylor | O. Kwon |
| J.J. Toribio | J. Guzmán-Calafell |
| J. de Beaufort Wijnholds | L.B.J. van Geest, Temporary |
| | B. Konan, Temporary |
| | D. Fujii, Temporary |
| Zamani, A.G. | S. Joyosumarto |
| | Han M. |
| A.G. Zoccali | J.A. Costa, Temporary |

R.H. Munzberg, Secretary
A. Mountford, Acting Secretary
M. Cuc, Assistant
S. Soremenho-Ramos, Assistant

**Uganda—1998 Article IV Consultation; Enhanced Structural Adjustment Facility—Review Under First Annual Arrangement; and Initiative for Heavily Indebted Poor Countries—Completion Point**
Staff representatives: Kirmani, AFR; Boote, PDR; J. Adams, IBRD

**Implementation of Initiative for Heavily Indebted Poor Countries—Draft Report of Executive Board to Interim Committee**
Staff representative: Boote, PDR

**Evaluation of Enhanced Structural Adjustment Facility (ESAF) and Status of Funding for ESAF and Heavily Indebted Poor Countries Initiatives—Draft Report of Managing Director to Interim Committee**
Staff representatives: Gupta, TRE; Boorman, PDR; Schadler, PDR

**Draft Code of Conduct—Fiscal Transparency**
Staff representatives: Tanzi, FAD; Hemming, FAD

**Also Present**
African Development Bank: A. Mwaba. IBRD: J.W. Adams, J.A. Katz, M. Klutstein-Meyer, and A. van Trotsenburg, Africa Regional Office. African Department: E.A. Calamitsis, Director; A. Basu, Deputy Director; G.E. Gondwe, Deputy Director; P.A. Acquah, Z. Brixiova, J.D. Crowley, S.N. Kimaro, N. Kirmani, A.C. Kouwenaar, W.S. Rogers. Asia and Pacific Department: B.B. Aghevli, Deputy Director; A. Singh, Deputy Director; M.R. Kelly, S. Nolan, C.J. Ryan. European I Department: H.M. Flickenschild. European II Department: J.R. Márquez-Ruarte. External Relations Department: S.J. Anjaria, Director; P.-M. Falcone, M.E. Hansen, C. Hellemaa. Fiscal Affairs Department: V. Tanzi, Director; P.S. Heller, Deputy Director; W.A. Allan, K.-Y. Chu, R. Hemming, B.H. Potter. Legal Department: W.E. Holder, Deputy General Counsel; R.C. Baban, H. Elizalde, H.V. Morais. Middle Eastern Department: M.M. Lazare. Policy Development and Review Department: J.T. Boorman, Director; T. Leddy, Deputy Director; D.J. Andrews, A.R. Boote, N.L. Happe, K.H. Kang, K.J. Langdon, A.T. MacArthur, R.H. Nord, D.C. Ross, S.M. Schadler. Research Department: A.J. Tweedie. Secretary's Department: P. Gotur, B.A. Sarr. Treasurer's Department: D. Williams, Treasurer; D. Gupta, Deputy Treasurer; J.C. Corr, D.M. Hicks, F.M. Lakwijk, P.R. Menon. Western Hemisphere Department: P.D. Brenner, H.H. Chua, S.D. Hussein, S.P.O. Itam, G.A. Peraza. Office of the Managing Director: M. Russo, Special Advisor; M. Cross, Personal Assistant; B.V. Christensen, O.J. Evans, H.L. Mendis; Office of Internal Audit and Inspection: E. Brau, Director. Advisors to Executive Directors: O.L. Bernal, S.S. Farid, P.M. Fremann, A. Giustiniani, K.M. Heinonen, A.R. Ismael, E. Jourcin, M.F. Melhem, S. N'guiamba, J.-C. Obame, H. Ogushi. Assistants to Executive Directors: S.K. Brownlee, D. Chen, M.A. Cilento, H.W. Cocker, D.A.A. Daco, C.K.E. Duenwald, J.C. Estrella, K. Kask, K. Kpetigo, K. Lai, J.P. Leijdekker, C.A. Lucenti, M.Z. Maatan, W. Merz, J.A.K. Munthali, A.R. Palmason, Phan M.H., Qi J., H. Rosni, J.N. Santos, O. Schmalzriedt, R.J. Singh, M. Vismantas.

## 1. INDONESIA—REPORT BY MANAGING DIRECTOR

The Managing Director reported on recent developments in Indonesia.

The Managing Director made the following statement:

I would like to give you the latest news from Jakarta. During the night, the authorities announced the cabinet's agreement on a letter of intent to be forwarded to the Fund. The Director of the Asia Pacific Department has issued a statement, which has been circulated to Board members, explaining that the Fund mission and the authorities have concluded their discussions. The statement also notes that the program requires approval by Fund management as well as a submission to the Executive Board, which will review the program and make a determination on the next disbursement, following implementation of agreed prior actions. Several of those actions have already been put in place, while others are expected to be implemented shortly. The government will publish their economic memorandum shortly, but not before it is received by the Board, probably in the next two days. The statement concludes that a resolute and sustained implementation of the agreed measures should gradually restore market confidence and bring the Indonesian economy back to health.

I would like to say a few words on the developments of the past 48 hours. The mission continued to work with Mr. Ginandjar and his team to fine-tune the agreement. It has now been decided that the monitoring committee on monetary policy will be installed in the Bank of Indonesia as soon as the international experts are in place. Therefore, I would like to ask our colleagues from Germany and the United States to hasten the arrival of those experts. On the Fund's part, we will also send our own expert. You will recall that this monitoring committee will follow the implementation of monetary policy on a daily basis.

In his statement, the Director of the Asia and Pacific Department mentioned that there would be daily monitoring by the Executive Committee of the Resilience Council, in close cooperation with the Fund, the Bank, and the Asian Development Bank. He also mentioned that the Fund Executive Board would conduct frequent program reviews, i.e., monthly, at least during the first part of the new program.

The government has agreed to adopt a presidential decision establishing a committee that will define the new central bank law, which will in turn grant its independence. That committee will also include foreign advisors. It is understood that parliament will be provided with a draft of the law as soon as it is finalized by the experts.

The Fund mission also discussed petroleum price increases—a sensitive issue that has been settled. In particular, the gasoline premium will be raised significantly in May or June—prior to the end-June review. The authorities will say that, in conformity with their policy, the price will reach international market levels before the end of this fiscal year.

On its own accord, but within the framework of these arrangements, the government will announce its intention to move toward ratification of the remaining ILO conventions on workers' rights, in consultation with ILO experts. That means that there will be an introduction of changes to several existing laws and regulations currently in contradiction with ILO conventions, particularly the right to form unions.

Yesterday, we discussed the subsidy mechanism for those foodstuffs that are no longer subject to the BULOG monopoly, but which are nevertheless eligible for subsidies. A comprehensive description of the scheme will be provided by the minister of trade, in cooperation with the Bank, for the Board's consideration. It will be included in a supplement to the staff report.

Negotiations were complicated yesterday by an unfortunate last-minute announcement, which has since been retracted, according to which a person close to the President was setting up a retail chain of shops throughout Indonesia's islands, which would have the special use of BULOG facilities. Such a scheme would have been contrary to the spirit and the letter of our agreements. The mission was instructed to take the issue up with the authorities prior to any final decision on the overall arrangement, as this would have obliged us to withdraw all our agreements in other areas. However, it is now clear that the scheme will not involve any special privileges—taxes, credits, subsidies—whatsoever. The main feature will be to allow domestic or foreign traders in remote parts of the country to reduce costs through the use of BULOG warehouses. Local cooperatives will probably benefit most, but the scheme will be open to all, including foreigners. The initiative will be described in a note sent to the Fund, together with the letter of intent. I have let the authorities know that I will not submit the letter of intent to the Board if the authorities' explanations are not in line with the spirit of the agreement. Minister Ginandjar has discussed the issue with the President and has assured our mission that they understand the situation perfectly, and that the initial announcement reflected coordination problems for the new government in non-core areas.

We were careful in saying that the authorities had to announce the program themselves, as they have to assert their ownership of the program. We have been somewhat restrained in our own comments. The next step is for the Fund to receive the letter of intent and the accompanying documents. Then, if management is satisfied, the letter will be transmitted to the Board and issued publicly by the authorities. It is their intention to have a clear announcement, and to let the markets know what the letter contains.

Once the Board has the letter of intent, our resident representative and the representatives of the World Bank and the AsDB will have a joint press conference to explain how the three institutions have worked together, and how they intend to work with the authorities in the following months to make sure that the program succeeds.

This is about all I can tell you about the last 48 hours, other than the fact that we have enjoyed continuous, open, friendly, and professional cooperation with our interlocutors.

I see the need for strengthening the central bank. We will have a new law soon, but we should not forget that the central bank has lost many of its best officers. It will soon be reinforced by Mr. Joyosumarto, which is important, but I am sure that he would join me in urging that high priority be given to the strengthening of the institution, as independence depends as much on the quality of the staff as on the wording of a law.

We will continue to press those involved in the corporate debt arrangement to speed up the process. They will meet on April 15, 1998, in New York, and we will suggest that they also meet soon after, to finalize the details of the FICORCA-like scheme and allow it to proceed. Along with progress on trade credit lines and interbank credit operations, it is important for the credibility of the staff to have the corporate debt scheme put in place. If the government continues to signal its determination to stick to the letter and the spirit of the arrangement, then we may be successful. The authorities know that they can count on our three institutions, particularly on the Fund, to help them at this juncture. Indeed, I want to express my appreciation to the governments represented around this table who are ready to extend their support at this stage of the arrangement.

Mr. Joyosumarto made the following statement:

First, I thank the Managing Director for arranging this meeting. Tonight in Jakarta, the negotiations have already concluded. There will be a request to the Board to consider a disbursement in the coming weeks, and I would appreciate a favorable response. On behalf of my authorities, I would like also to thank the Executive Directors of those countries who have helped to address the Indonesian crisis, especially the United States, Germany, Japan, Australia, and others who supported the resolution of the crisis.

I would like to report to the Board that the implementation of this program will be handled by new teams. There are new people in the cabinet and central bank—today it was announced that two other managing directors will resign to be replaced by new people. That has nothing to do with this agreement, it is simply to allow an inflow of fresh blood, so that the team can work more efficiently.

Regarding the central bank, the draft of the law has been completed, and is now being translated into English so that the mission might discuss its content. Hopefully, it will be enacted soon, even before December. Today's announcement of the appointment of two new managing directors will ensure that all seven Board members are new people, and will make the team more compact.

The retail chain company mentioned by the Managing Director is a cooperative, and 60 percent of its shares belong to smaller cooperatives. The son of the President also has shares, but his stake is very small. Given that the company wanted to help with the distribution of nonessential commodities, and that it has a considerable distribution network throughout the country, it seems unreasonable to discriminate against it. It is a cooperative, and has nothing to do with the first family.

Mr. Shields remarked that he was encouraged by the Managing Direcot's comments, but was concerned about the central bank. It was important to establish central bank independence as soon as possible. It would be useful, therefore, for the staff to elaborate on the implementation of prior actions and on a potential timetable—which would have implications for the timetable of Board decisions.

The Managing Director commented that he was unable to provide a precise date for a Board decision, as it was not yet known when management would be able to forward the letter of intent and the staff report. Given that the Interim Committee meetings were also on the immediate horizon, a possible date was late April or early May, 1998. Still, the management would need to see all prior actions in place—something that had been made clear to the authorities. Also, because the authorities had not asked for a precise date one may conclude that the disbursement was not essential, as reserves were currently at an acceptable level. Management would take care not to give the impression of a loss in momentum, but it was important that the process be conducted in an orderly manner, and that prior actions be checked properly.

The Deputy Director of the Asia and Pacific Department remarked that a presidential decree had been issued to establish a committee on the central bank law, and that it had been instructed to proceed as rapidly as possible. Every effort was being made to ensure enactment of the new legislation before the end of the year, if not earlier, but it was difficult to establish a precise date when considering legal matters.

Mr. Ogushi praised the negotiation efforts of the staff and management. He hoped that the authorities and the Fund would maintain the current momentum, and that all necessary prior actions would be implemented soon, so that the Board might discuss the case of Indonesia at the earliest opportunity.

The Managing Director noted that, following the recent takeover of some major banks by the Indonesian Bank Restructuring Agency (IBRA), there had been no further financial market difficulties or loss of confidence. That takeover had addressed a major source of recent credit expansion.

Mr. Wijnholds welcomed the news, as well as the strengthened implementation process and the establishment of monitoring groups. He asked whether he was correct in assuming that the monitoring groups on monetary policy and structural measures would have to be in place before the Board could proceed. He also noted that the Board would need a clear outline of the schemes that would be implemented to address trade credit and the restructuring of corporate debt.

The Managing Director commented that, although those elements were not explicit conditions, the authorities knew that the details of such schemes were required before the Board could properly decide on further action.

The Deputy Director of the Asia and Pacific Department, responding to a question from Mr. Toribio, commented that the markets' reaction to news of the takeover had been muted. The markets appeared to have already taken into account the prospect of a takeover, and were waiting to be persuaded of the authorities' commitment. It was hoped that the rupiah would soon start to appreciate.

The Managing Director pointed out that April 7 was a significant Muslim festival, and that many markets had been closed. Also, it had to be noted that developments in those markets were greatly affected by news about the Japanese economy.

Ms. Lissakers asked whether the Fund headquarters would issue a statement during the day, or whether it would wait for tomorrow. She also asked the staff to elaborate on those prior actions that were needed before the Board could proceed, but which had not yet been completed, as well as on the subsequent phasing of disbursements. In addition, she asked whether there had been any public statements made by the authorities on labor issues, and whether the initiative on the retail chain company had been retracted publicly by the minister involved.

The Managing Director replied that, on the issue of a possible statement from Fund headquarters, he was satisfied with the statement made by the staff in Jakarta. However, he had insisted that the first announcement be made by the Indonesian authorities. As for the retail chain company issue, Minister Hasan had corrected the comments of the minister of cooperatives during Minister Ginandjar's recent press conference. It was not known whether the minister of cooperatives had also issued his own correction.

On the issue of workers' rights, it was expected that the authorities would publicly declare their intentions before the Board meeting, and that work with the ILO would start at that point, the Managing Director continued.

The Deputy Director of the Asia and Pacific Department commented that most prior actions were almost complete, and there were no outstanding issues that needed to be negotiated. There were still some details to be finalized regarding subsidies for BULOG food imports. Also, the new schedule of taxes would be announced very shortly.

On the question of statistics, monetary aggregates would now be published on a weekly basis, the Deputy Director continued. As for tax policy, although previous decrees proscribing local taxes on the transfer of goods had not been observed, new instructions had been issued to local governors, and it appeared that the imposition of those taxes had ceased.

On the phasing of disbursements, the initial purchase of $3 billion, which would be made upon conclusion of the review, would now be split into three monthly installments, the Deputy Director said. Following those three months, the decision on whether to return to the original quarterly schedule of purchases would depend on the evolving situation.

The Managing Director commented that the authorities had been made aware that the monthly schedule might be continued after the initial three months. The question was whether the performance criteria should be monthly or quarterly, and the solution would be finalized with the authorities at the next review.

Mr. Prader said that he shared Mr. Wijnholds's sentiments, as well as Ms. Lissakers's point on Indonesian labor laws. Further, he would have preferred a specific timetable on the independence of the central bank, as that aspect had been raised months ago as an important prior action. In addition, given two recent, highly visible program failures, it was important not to rush a decision to the Board prematurely. Instead, the Indonesian program should be treated like any other Fund-supported program, and the authorities should first establish a satisfactory track record of prior actions in the so-called testing period.

The Managing Director pointed out that implementation of the prior actions had started already and was being pursued with determination. For example, the restructuring measures for the banking sector were impressive.

Responding to a question from Mr. Taylor on when the Board would receive Indonesia's letter of intent, the Managing Director commented that he would pass on the letter to the Board as soon as it was received, assuming that it was satisfactory. Also, the authorities would probably circulate the text of the letter to the press.

Mr. Esdar thanked the staff and management for their efforts in securing a new Fund-supported program for Indonesia, and stressed the importance of tighter monitoring. Also, the decision to wait for completion of a critical mass of prior actions was appropriate, given the Fund's past experience. However, while the forthcoming law on central bank independence was welcome, it was important to note that the monitoring committee on monetary policy, which would include experts from the United States, Germany, and the Fund, would provide an immediate assurance of independence.

The Managing Director, responding to a question from Ms. Lissakers on whether the prior actions included new anti-monopoly legislation, commented that President Habibie had taken the initiative on a competition law. It was not, however, a required prior action, and it would be unfair to insist on that measure before the first disbursement, as drafting such laws was a complex and time-consuming exercise. The World Bank would help the authorities prepare the law, and it would be part of the letter of intent, but there was no definite date for its enactment.

Mr. Bernes congratulated the staff and said that he supported the sentiments of others who had stressed the importance of prior actions and central bank independence. He welcomed remarks from staff and management to the press verifying that previous discussions on the Fund's communications strategy had been absorbed. Furthermore, he echoed the Chairman's remarks in stressing the significance of developments in Japan.

Mr. Joyosumarto thanked Directors for their comments, but urged moderation when considering the issue of prior actions. Too many such requirements might delay the disbursement, as well as the program's implementation, and might prolong the crisis as a result. He also noted that the new managing directors of the central bank were not unknown to the Fund. Of the two managing directors that had just been appointed, one had been the alternate IMF Governor for Indonesia, and the other had been with the Fund in the 1980's as an assistant with the Executive Director's office.

The Deputy Director of the Asia and Pacific Department commented that there were a number of other prior actions that he wanted to mention—although events in Indonesia were moving so rapidly, that some might have been completed already. The actions included the announcement of minimum capital requirements for banks with assets over 250 billion rupiah, after loan loss provisions; regulations making loan loss provisions fully tax deductible; the issue of an 18 trillion rupiah tranche of indexed government bonds; provision of historical data on the accounts of the reforestation funds; regulations to amend the bankruptcy law; and establishment of a special commercial court. One prior action that had been implemented, and would be continued, was an increase in interest rates. The SBI overnight rates had been raised from 22 percent to 40 percent, so that the overnight JIBOR rate had increased from 44–45 percent to 50 percent.

Ms. Lissakers questioned whether a JIBOR rate of 50 percent represented a positive real rate of interest, given that the Fund was projecting inflation at 47–70 percent.

The Deputy Director of the Asia and Pacific Department replied that the inflation rate observed over the past three months had reflected exchange rate developments, in which the rupiah had not appreciated as had been hoped. If the currency were to simply stabilize, the inflation rate would fall.

Ms. Lissakers remarked that the SBI issue was supposed to absorb the excess liquidity associated with an overshooting of Indonesia's net domestic asset position. She suggested that it might make more sense to offer a substantial interest rate premium, thus ensuring that such excess liquidity was actually removed. Interest rates had been set too low throughout the program so far, and it might be preferable now to err on the side of interest rate overshooting.

The Deputy Director of the Asia and Pacific Department commented that striking the right balance was difficult, but there was a cost to the banking and corporate sectors in setting interest rates too high.

Ms. Lissakers remarked that Indonesian monetary policy had not been successful so far, and the staff only seemed to be advising more of the same. On the subject of corporate debt, while there were valid reasons not to insist that the issue be part of the letter of intent, it was nevertheless a considerable balance of payments challenge. Therefore, it was important that the Board have a clear and detailed outline on the corporate debt restructuring scheme before it discussed a program for Indonesia.

The Managing Director commented that Ms. Lissakers's remarks on the staff's monetary policy in Indonesia were not fully warranted, as the previous overshooting of that country's monetary aggregates had not been the result of staff advice, but had instead resulted from the authorities' failure to apply the policies as outlined in the letter of intent. The overshooting had also been associated with the dismantling of the institution responsible for monetary policy, and an unsound injection of liquidity into insolvent banks.

Although, in the midst of such turmoil, it was difficult to determine whether real interest rates were positive, the policy stance of the staff was quite firm, the Managing Director continued. Assuming faithful implementation by the authorities, there was every reason to expect that it would produce the desired results, in terms of price disinflation and an appreciating rupiah.

Ms. Lissakers stated that she agreed with the Managing Director's analysis of the root cause of the stabilization effort's failure, but noted that the staff's advice had seemed to be somewhat ambivalent as to the proper balance between supporting the banking sector and supporting the currency. She had considered the issue settled in the context of the current program, and the sole priority to be the stabilization and strengthening of the rupiah. However, the comments of the Deputy Director of the Asia and Pacific Department had suggested a return of the previous ambivalent stance, and confusion as to what the suggested monetary policy was intended to achieve.

The Managing Director then concluded the meeting.

## 2. EXECUTIVE DIRECTOR

The Chairman welcomed Mr. Karunasena as Alternate Executive Director for Bangladesh, Bhutan, India, and Sri Lanka.

## 3. UGANDA—1998 ARTICLE IV CONSULTATION; ENHANCED STRUCTURAL ADJUSTMENT FACILITY—REVIEW UNDER FIRST ANNUAL ARRANGEMENT; AND INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—COMPLETION POINT

The Executive Directors considered the staff report for the 1998 Article IV consultation with Uganda and the midterm review under the first annual arrangement for Uganda under the Enhanced Structural Adjustment Facility (ESAF) (EBS/98/58, 3/24/98; and Cor. 1, 4/7/98), together with the completion point document, prepared jointly by the staffs of the Fund and the International Development Association, on the Initiative for Heavily Indebted Poor Countries (HIPC) for Uganda (EBS/98/55, 3/20/98). They also had before them a background paper on selected issues in Uganda and a statistical appendix (SM/98/76, 3/25/98).

The staff representative from the African Department made the following statement:

> The following information has become available since the issuance of the staff report on the 1998 Article IV consultation with Uganda and the midterm review under the first annual ESAF arrangement (EBS/98/58, 3/24/98).
>
> On March 31 the Minister of Finance signed and issued the requisite statutory instrument to remove the bans on imports of beer, soft drinks, and automobile batteries effective April 1, 1998, thereby implementing the prior action for the completion of the midterm review.
>
> The return of more seasonal weather has resulted in a decline in food prices and a slowing of inflation. Consumer price inflation fell to 4.8 percent in March 1998 on an end-year basis, down from a revised 9.7 percent in February and 10.5 percent in January. However, the damage done to Uganda's road network by the recent heavy rains (associated with El Niño) will take time to repair and could continue to have a constraining effect on economic activity during the remainder of fiscal 1997–98 (July June).
>
> The authorities and the staff had expected adverse weather to result in a revenue shortfall in January–February of about U Sh 10–12 billion, which would be made up in the remainder of the fiscal year by improved collection of income taxes and better control of smuggling of petroleum products through the new meter-sealing system. In the event, the revenue shortfall in January

February appears to be on the order of U Sh 15 billion (0.2 percent of GDP), with the shortfall in February being smaller than that of January. The authorities believe that these weather-related effects on revenues could still be largely offset.

Revenues would also be adversely affected by the recent decline in world oil prices, given that excise taxes on petroleum products account for one quarter of total revenues. The authorities have responded by temporarily converting the ad valorem excise duty on petroleum products into a specific excise tax effective April 1 to mitigate the short-term negative impact on revenues. There are also some technical factors which should help mitigate the negative impact this fiscal year (for example, the depreciation of the Uganda shilling against the U.S. dollar, the existence of certain fixed costs which limit the short-term response of domestic petroleum product prices to fluctuations in world product prices, and the fact that the petroleum tax base in Uganda is based on a moving average of world petroleum product prices). While the timing and magnitude of the negative revenue impact cannot be precisely estimated, the staff shares the authorities' views that the revenue loss owing to weaker oil prices could be contained to a modest amount during the remainder of this fiscal year, though the impact is likely to be larger next year.

Under the above circumstances, the authorities have reaffirmed their commitment to make best efforts to achieve the original program target for the overall fiscal deficit (excluding grants) for 1997–98 through additional revenue and/or expenditure measures as needed. Accordingly, the staff considers the appraisal in EBS/98/58 still valid, and recommends that the Board complete the midterm review of the first annual ESAF arrangement.

Extending her remarks, the staff representative said that on April 2 the World Bank Board had endorsed the recommendations in the completion point document for Uganda under the HIPC Initiative. A few days earlier, it had approved the education sector adjustment credit, the ESAC, which was frequently mentioned in the staff's reports.

Mrs. Guti made the following statement:

My Ugandan authorities wish to thank the staff and management of the Fund, and the international community, for the support they have continued to provide to Uganda over the long period of reform, and for the assistance in reaching the stage of completion under the HIPC Initiative. The country has reached a crucial stage in its economic adjustment and reform process as the authorities now prepare for the eventual exit from the debt rescheduling process within the context of the HIPC Initiative. The authorities' commitment to reform, and the successes they have achieved so far under successive programs supported by the Fund, need no further emphasis.

Economic performance remained strong in 1997/98, despite the negative impact of adverse weather conditions, which forced the authorities to revise their growth and inflation targets. All economic policy and structural reform measures as envisaged under the program were implemented, and the quantitative performance criteria and structural benchmarks for end-December 1997 were observed with very comfortable margins in most instances. However, the ceiling on net claims on the government by the banking system was exceeded mainly on account of the timing of check issuance, as cash releases for ministries were being made early in the month to smooth operations in accordance with the recommendations of a Fund technical assistance mission. It should be noted that this reflects technical factors but not slippages in policy implementation and the authorities have stepped up the monitoring of below-the-line developments.

The impact of the adverse weather has once again underscored the extreme vulnerability of the Ugandan economy to exogenous shocks. It has also served to sharpen the authorities' focus on the reinforcement of their economic adjustment and reform measures with a view to promoting early diversification of production and exports. The present consideration of the assistance under the HIPC Initiative is therefore timely as it should support the ongoing efforts to deepen the authorities' structural reforms. More significantly, the delivery of this assistance at this crucial stage would release resources to address more vigorously the problem of poverty.

In this regard, the staff document on the updated debt sustainability analysis concludes that the NPV of debt-to-exports ratio falls well within the target range that was agreed upon and specified when the HIPC document was considered by the Board in March 1997. Moreover, Uganda's economic performance under the ESAF remains impressive, despite the less-than-predicted growth and inflation performance in 1997/98. In addition, the authorities have intensified their structural reforms in areas of privatization, the financial sector and the civil service while increasing budgetary resources to priority social sectors such as education and health. Indeed, my Ugandan authorities believe that they have met all the conditions set out at Uganda's decision point under the HIPC Initiative in April, 1997. Accordingly, they are requesting consideration of Uganda's completion point.

As already stated, the implementation of economic policies remains strong, with the fiscal program—the centerpiece of the adjustment effort—remaining on track, despite serious disruptions to revenue collections resulting from weather-related factors. With total expenditure being held within the program's limits and revenues remaining broadly as anticipated, especially with the additional actions being taken to compensate for the recent shortfalls, the authorities are confident that the fiscal target for the whole year will be achieved. Nevertheless, developments in the first half of the year have underlined the need to reinforce the authorities' efforts in a number of important areas.

On the revenue side, the focus is to improve revenue performance in the light of the recent shortfalls in receipts. In the first instance, income tax receipts would increase as the tax base was expanded following the passage of the new Income Tax law; moreover, steps have now been taken to increase collections as indicated in the staff buff statement. Secondly, under the new Act, all discretionary tax exemptions were cancelled and, despite the emerging political pressures, the authorities are determined not to rescind any of the provisions of the new Act. Recognizing the initial problems associated with the introduction of VAT, the Ugandan authorities have implemented a wide range of measures to improve performance, including updating and verifying all the tax payers, with special emphasis on the large ones; requiring government agencies to purchase goods and services only from VAT-registered suppliers; stepping up VAT audits; and strictly applying a penalty rate on outstanding taxes. In addition, action has been taken to improve tax administration by strengthening the Uganda Revenue Authority (URA). In that connection, the Department of Customs and Excise is also focusing on the enforcement of tax compliance and controlling smuggling with the recently established, flexible antismuggling teams. In response to the greater-than-estimated shortfall in revenue during January and February, the ad valorem excise duty on petroleum products has been converted to a specific duty to halt further revenue losses due to the decline in international oil prices.

To complement these revenue-enhancing measures, steps have been taken to reduce non-priority recurrent expenditure which had deviated from program expectations during the first half of the financial year. In addition, further staff reductions will be effected in the second half to reduce the wage bill. To ensure effective control, the Government has decided that any additional expenditure will be evaluated by the Minister of Finance in terms of cost, priority and affordability. My Ugandan authorities believe that this will be an important safeguard to protect the integrity of the fiscal program and to ensure that priority spending, including expenditure related to the Universal Primary Education, is protected against undesirable cuts.

Monetary policy continues to be geared toward containing inflation and, in the light of the recent weather-induced pressures on food prices, the targets for the growth of broad money and credit have been tightened moderately. The authorities are mindful that any precipitate action in this regard could unduly constrict the strong economic growth already underway. Nevertheless, price developments are being monitored closely to ensure that these temporary pressures do not spillover to non-food items. Meanwhile, the monetary authorities are deepening their structural reforms with a view to improving the efficiency of the financial sector. Thus, the final recapitalization of the Bank of Uganda should facilitate the future conduct of open market operations. Also, steps have been taken to improve the Bank of Uganda's supervision of commercial banks while enforcing the prudential regulations. In any event, commercial banks are already increasing the provisioning for non-performing loans and are also strengthening their capital bases.

Despite weather-related shortfalls in coffee and other agricultural export volumes, the overall performance in the external sector remains as predicted under the program. Improved international coffee prices together with strong inflows of private transfers and lower imports will permit the attainment of the overall balance of payments objective. The exchange rate remains appropriate and is still determined by market forces, while developments in external competitiveness are being monitored closely. The external reserve target for the whole year is well within reach, given substantial accumulation in the first half of the year. As already indicated, the updated debt sustainability analysis shows that the debt-to-exports ratio calculated for 1996–97 falls well within the agreed target under the HIPC Initiative. The projections also reaffirm that external debt indicators would be favorable after the proposed delivery of all the assistance under the initiative. Uganda's debt would become sustainable and the country would be reassured of its successful exit from the debt-rescheduling process.

One of the key elements of Uganda's adjustment process is the implementation of structural reforms, which remains solid, albeit with inevitable technical delays in some cases. The focus is on the restructuring and privatization of state enterprises, civil service reform, the financial sector, and trade and capital account liberalization. In the first instance, trade reforms which involved further reduction of import tariffs and the elimination of three of the four remaining import restrictions, have made Uganda's trade regime one of the most open in sub-Saharan Africa; the capital account was liberalized at the beginning of the program period. In the second instance, civil service reforms have involved the reduction in its size without jeopardizing the requirements under the Universal Primary Education program. In addition, the Government has already adopted a plan to streamline government ministries with the aim of reducing and rationalizing their functions in a comprehensive manner. Thirdly, financial sector reforms have involved the sale of government shares of the Uganda Commercial Bank (UCB) and this is in addition to the restructuring efforts already mentioned. There is also substantial progress being made in the privatization of other state enterprises. The Second National Operators license has already been awarded and the sale of the Uganda Telecommunications Corporation is expected soon. Also, efforts are being made to restructure those corporations that remain under government control in order to improve efficiency.

Finally, in their efforts to address the widespread problem of poverty, the Poverty Eradication Action Plan (PEAP) is now being finalized. The emphasis is to maintain macroeconomic stability while raising rural incomes and improving the living conditions of the poor through, among other things, the development of rural infrastructure, the promotion of micro-enterprise, and improving health and education. To this end, the program is on track in increasing budgetary resources to such priority sectors.

To conclude, I would like to stress that, despite difficult circumstances, the strong economic performance and an impressive track record in program implementation demonstrate the authorities' commitment to successful completion of their economic adjustment and structural reform program. The proposed support under the HIPC Initiative marks an important, historic point in Uganda's economic adjustment and in its relations with creditors, including, in particular, the Fund.

Ms. Lissakers made the following statement:

This is an important day. A benchmark for this institution as well as for Uganda, one it well deserves. It was less than four years ago that this Executive Director first dared to suggest to the Board that bilateral official debt relief and commercial debt relief by themselves were not going to solve the problem of debt overhang for many of our poorest member countries and that the two primary multilateral official institutions, the World Bank and the IMF, should face up to the fact that they too were going to have to contemplate the option of debt reduction, which had been considered absolutely beyond the fringe.

It has taken a lot of wrangling and debate and enormous hard work on the part of the staff of both institutions to deliver the mechanisms and the methodology to add a "Washington Club" to the already existing Paris Club and London Club debt relief mechanisms. First of all, the staff deserves a lot of credit. We now have our first debt delivery, and I think we can all be pleased. It was a difficult decision, and it was even more difficult, as I said, to put together the mechanism.

But, obviously, most of the accomplishment and credit belongs to Uganda which has, as we have recognized, pursued diligently, persistently and determinedly a broad reform effort in a steady and often bold manner during this past decade. We are demonstrating the readiness of the international community to provide exceptional relief and financial support to heavily indebted countries that help themselves through persistent reforms.

In some ways the most important achievement today is that Uganda provides a clear repudiation of the myth that a second lower standard is required for Africa. The Fund has continued to insist on rigorous policies and high reform standards in Uganda, and Uganda has met and indeed often surpassed these expectations.

The completion point, as the name suggests, is, we hope, an end to an unsustainable debt burden for Uganda, but not an end to the reform effort and the need for continued persistent and dedicated effort. It is really the beginning of a new stage for Uganda's economic trajectory. The staff report for the Article IV and the ESAF discussion highlight the very real risks that remain in Uganda. It is still extremely vulnerable to external shocks, it still has notable weaknesses in its internal fiscal situation, and it still has a great deal of work to do to solidify current reform efforts.

The papers present one example of the Universal Primary Education program, which is a very bold and complex initiative of central importance to Uganda's long-term economic path, but it is a program that has encountered significant difficulties since its initiation last year. As the staff points out, concerted efforts, some of which do appear to be under way, are necessary to resolve the problems and to ensure that resources are efficiently and transparently employed in this Initiative so that the program can continue on a sound footing.

More generally, during the next year, we look for continued strong adherence to the existing ESAF-supported program, understanding that this will require stronger efforts in the context of the adverse weather developments in 1997. We also look for the negotiation of a very ambitious second-year program, a "Super ESAF" indeed, including substantial structural commitments.

Just a couple of points on the current program. I am quite pleased that the authorities have gone beyond the structural criteria for this year in areas such as civil service reform and power sector reform and, of course, by progress on the trade front. There also seems to be significant progress in terms of greatly needed revenue collection improvements and the anti-corruption efforts since our last discussion. We have stressed for some time, and indeed Mrs. Guti points out in her statement, the need to address Uganda's still very low tax revenue base and its heavy reliance on excise taxes, which can be a drag on growth. The authorities' commitment to resist calling for new exemptions is critical both to raising revenues and to signaling a clear change in the direction of tax policy.

On the privatization program it appears that, despite some delays, there continues to be satisfactory progress. While I appreciate the Selected Issues report and, in particular, the exposition of some of the hurdles that the Ugandan authorities have had to face to keep this program on track, I would have liked greater detail regarding the timetable for the next steps. The staff notes that "timetable has been agreed" for finalizing the partial UCB sale and I wonder if the staff could tell us what that time table is. Similarly, what is the time line for the proposed telecom sale and what is the current thinking about the timing of the energy sector reforms outlined in Paragraph 29 of the staff report. This, I think, is particularly important given the point the staff makes on the need to improve the power supply along with broader improvements in the physical infrastructure as key impediments to growth and expansion and to diversification of the export base, in particular. I also wonder if the staff could tell us a little more about what efforts are under way with regard to World Bank assistance in this area.

I was also troubled by what appears to be a lack of clarity regarding the budgetary accounting for divestitures. I would urge the authorities to push the required legislation through to allow for fully transparent budgetary reporting on both the costs and the proceeds of this divestiture process within the budget.

On the banking sector, the staff report highlights a good deal of progress, while the Selected Issues paper demonstrates the importance of continuing the agenda, for example, to enhance banking supervision, improve statistics and strengthening monetary instruments, as well as to support the development of an interbank market. These are all areas that relate directly to the broader, more universal debate we are having on international architecture. I understand that IMF technical assistance and World Bank programs have been quite instrumental in moving policies along in this area, and I wonder if the staff could just tell us what the current status is of technical and World Bank assistance in the banking area. Also, if they could add a little more information on the Fiscal Affairs Department's mission on pension reform.

Let me close by reiterating my strong support for today's decision with regard to the ESAF review and the HIPC completion.

Mr. Konan made the following statement:

Last year, when deciding on Uganda's eligibility to the HIPC Initiative, the Board proposed to shorten the second phase in recognition of the country's past strong adjustment record. It was also requested that Uganda pursue the implementation of additional reforms, before reaching its completion point.

Today's assessment of Uganda's performance under the first annual ESAF-supported program reveals two important findings.

First, Uganda's economic activity continued to expand strongly in 1997/98, despite the adverse weather conditions. Second, apart from the ceiling on net claims of the domestic banking system on the government which was exceeded as a result of technical factors, all policy and reform measures were successfully implemented and all quantitative criteria and structural benchmarks for end-December 1997 were observed.

Mrs. Guti's statement has been very helpful in shedding additional light on the strength of Uganda's adjustment efforts during the last twelve months. We are particularly pleased to note that the Ugandan authorities have intensified their structural reforms in areas of privatization, financial sector and civil service, while allocating more resources to priority sectors of health and education.

In the fiscal area, which has been the centerpiece of Uganda's adjustment efforts, we are encouraged that performance has remained in line with program requirements, despite the existence of weather related factors which have made revenue collection difficult at times. The authorities deserve to be commended for taking additional actions in order to compensate for the shortfalls and achieve the program fiscal target for the year as a whole.

On the revenue side, it is encouraging to learn that income tax receipts are expected to increase following the broadening of the tax base. Equally important is the fact that all discretionary tax exemptions have been canceled and that a wide range of measures have been implemented to improve the performance of the VAT. Efforts to strengthen the administration of Uganda Revenue Authority are also welcome. We note in the statement (Buff/98/42) by the staff representative that the revenue shortfall in January-February was higher than anticipated by both the staff and the authorities. At the same time, it is suggested that "the weather-related effects on revenues could still be largely offset by the authorities." We wonder how this optimism could be justified if the additional measures were intended to offset a smaller shortfall? Staff comments would be appreciated.

On the expenditure side, steps taken to reduce nonpriority recurrent expenditure represent a move in the right direction. Staff recommendations to reduce the wage bill and efforts to strengthen the control of government spending are actions that will ensure that outlays in priority sectors are protected. The combination of these actions and efforts to strengthen revenue performance will enable Uganda to meet the overall fiscal target of the program.

In the monetary area, we agree with the overall policy objective of achieving price stability. To that end, some tightening is required in the light of the recent pressures on food prices. The authorities should maintain such a tightening despite the decline in food prices recorded in March. We welcome the deepening of financial reform by the Ugandan authorities and welcome actions they have taken to improve the Bank of Uganda's supervision of commercial banks while enforcing prudential regulations.

On structural reforms, the focus on the restructuring and privatization of government-owned units, civil service reform and trade and capital account liberalization is well placed. Here, we are encouraged to learn that Uganda's trade regime has become one of the most open in sub-Saharan Africa. In addition, Uganda had liberalized its capital account at the beginning of the program period. Efforts in other areas of reforms are also impressive. Particularly noteworthy is the authorities' initiative on public sector reforms, downsizing government employment, and the substantial progress achieved in the privatization of public enterprises.

On the basis of the above record of adjustment, there is no single doubt in our mind that Uganda has already met all the requirements of the HIPC Initiative and should reach its completion point now. As has been argued during previous occasions, these resources are crucial for Uganda's future success in its ongoing economic and structural adjustment efforts, thereby contributing to poverty alleviation. In addition, it is hoped that Uganda's debt burden will fall to a more sustainable level enabling it to exit from the cycle of debt rescheduling.

Therefore, we strongly support the proposed decisions and wish the authorities continued success in their difficult economic development efforts.

Mr. Rodríguez made the following statement:

First, I would like to commend the staff for their work on Uganda. The economic performance of this country in the last several years under consecutive ESAF arrangements has been very satisfactory, achieving high real GDP growth rates with declining inflation, and implementing important structural reforms. Recent performance has remained positive, even though inflation and output growth have been affected by weather related factors.

Almost all performance criteria under the new ESAF have been met. Thus, having successfully reached the HIPC completion point, Ugandan authorities are commended for their efforts and accomplishments.

In general, I share the thrust of the staff appraisal and I would like to emphasize several points. On the fiscal front, it is reassuring to learn that several actions that have been taken to enhance tax collection, as well as the new Income Tax Law, seem to paying off, especially because, as mentioned in the previous Board meeting on Uganda, administrative measures are essential in this program. In fact, as the staff had acknowledged, there are more risks than usual in this case. Thus, it is noted with some concern that there are additional risks now associated to weather conditions, declining oil prices and to pressures to undo the Income Tax Law. Therefore, the staff's call for "no complacency" is adequate and the authorities seem to be reacting accordingly. As mentioned in Mrs. Guti's helpful statement, they have already taken several corrective actions to prevent any deterioration of the fiscal situation.

With respect to the government's initiative of purchasing goods and services only from VAT-registered businesses, it would be highly convenient to do so. It would enhance consistency in government policies, sending a clearer signal about the commitment to improve VAT collection. Perhaps the policy could be more general, i.e., by limiting purchases of goods and services only from businesses that are in full compliance with respect to all tax duties. This would also serve to level the playing field among government suppliers.

On the expenditure side, the program contains a welcome shift in the composition of expenditures, from defense and other recurrent expenditures to education and health, which makes it challenging. In this regard, it is encouraging to note that expenditures on defense and on non-wage priority program areas were kept within programmed levels. Also noteworthy, the cuts in the civil service were larger than expected, resulting in savings, which contributed to offset some overruns on other non-wage recurrent expenditures. The efforts to protect and enhance social programs, such as the UPE and the PEAP, which is being finalized, are commendable. As mentioned by Mrs. Guti, it is expected that, as HIPC relief frees some government resources, these programs will be considerably strengthened.

Regarding the definitions of fiscal balance, the authorities' suggestion to improve the fiscal analysis by adding other definitions is well taken, because they may precisely contribute to the assessment of long-run fiscal sustainability. For instance, an excessive importance on the public sector borrowing requirements may over the years induce an unsustainable reduction in externally financed capital outlays, because these expenditures may be cut more easily. Therefore, this situation could be improved, using other definitions, such as the domestically-financed deficit or the primary balance. This is not necessarily the case of Uganda, even though development expenditures this year are expected to be 40 percent less than they were six years ago.

Monetary policy has been broadly on track. For the program year, the revised monetary objectives indicate a slight tightening, which is adequate, in light of the uncertainty about the persistence of the effect of weather on food prices. However, given that inflation fell to only 4.8 percent in March, this effect may have already receded completely. In consequence, it may be necessary to revise again monetary policy objectives.

In the area of structural reform, there has been a lot of progress, but much more needs to be done. In the previous Board meeting, it was mentioned that the privatization program was especially ambitious with a large number of public enterprises to be privatized in a relatively short time. In fact, there have already been some delays with respect to the December 1997 targets, because of legal and technical problems in the privatization process, delays in negotiations and the persistence of differences between ministries.

It is acknowledged that a common recommendation in this Board is to accelerate structural reforms and privatizations, which could give the impression that speed is the most important dimension by which to judge the success of a program. This is not the case. If a rushed privatization process effectively reduced public sector participation in the economy, but did not contribute to enhance transparency or economic efficiency, then it has not been truly successful. I tend to sympathize with the strategy considered by the World Bank staff. It is necessary to set priorities and to ensure that legal, technical and social considerations are taken into account and handled appropriately. The staff's recommendation, maintaining the pace of the privatization program while strengthening the unit in charge of it, would not be enough to solve some of the problems associated with the negotiations. Therefore, some flexibility with the timing of the number of privatizations might still be needed.

With these comments I support the proposed decisions and wish the Ugandan authorities all the success in their future endeavors.

Mr. Shields made the following statement:

Ms. Lissakers set the right tone at the beginning of the meeting this morning. The decision on the HIPC Initiative that we will reach today does indeed mark a major milestone for the debt relief process, for the international financial institutions, and for Uganda. We have traveled together a long four-year road to reach this point, creditors and debtor alike. It has been long, it has been complex, and often at times it felt pretty arduous. However, I am sure that when we look at the increased resources now available for education and health in Uganda, and the enhanced investor confidence after removal of part of the debt overhang, we will all agree that it has been worth it and that we did indeed make the right decision on Uganda when we decided to shorten its completion period, despite the concerns that were expressed and the exceptionally rigorous examination of Uganda's record and commitment.

Indeed, true to form, the Ugandans have chosen to mark this point in their usual style by outperforming the program in a number of areas. Most noticeable is their performance on expenditure. For instance, at the decision point, there was concern about the level of defense spending. Many Directors stressed the need to reduce it. In fact, it has been cut by a quarter, despite the continuing unsettled situation in the north of the country, bringing it down to 9 percent of recurrent expenditure, compared with 16 percent for the priority social sectors. It is particularly welcome that even the relatively ambitious target that was agreed with the authorities has in fact been outperformed.

Moreover, the targeted level of expenditure on education and health has also been exceeded, and there has been plenty of progress on the ground. The enrollment rate for primary education has risen from 56 percent of the relevant population to 85 percent, in response to the universal program for primary education, and the reallocation of debt resources to education should allow further progress in this area. Of course, it is not just the enrollment rate which matters; it is also the completion rate for primary school education. This still remains at a very low level.

Much also remains to be done in health and in infrastructure. Improvements in the rates of child immunization and access to clean water, which is still below 50 percent of the population, should be seen as priorities. I am impressed by the government's determination to achieve progress in these areas. The authorities are also to be highly commended for the recent measures on trade liberalization. These bring maximum tariffs down to 20 percent, from a 30 percent level, making the trade regime in Uganda one of the most open in sub-Saharan Africa.

There are, of course, disappointments, the downturn in growth and the small, hopefully temporary, rise in inflation, although as others have mentioned there were special factors, including the exceptionally disruptive rains, which had effects on crops and on transportation and distribution routes. If we look at underlying inflation, Uganda's performance is still one of the best in Africa. I note that the staff confirms that the end-March inflation figures show it to be just below 5 percent.

It is reassuring that revenue levels have not suffered more than they have from the downturn in growth. That is a promising feature in terms of the importance of strengthening revenue performance in the future. The fiscal position is still fragile, and it is right that there is a medium-term strategy to broaden the tax base and increase revenue by 1 percent a year. It is a tough challenge but necessary, given the fact that there is a substantial impact from the trade liberalization measures and the need for further finance for urgent development needs.

It is right that there is a further reduction being achieved in the fiscal deficit this year, of just over a half of a percent, leaving the fiscal deficit after grants at 1.3 percent. However, in light of the recent review of the ESAF, I would like to welcome the flexible attitude of the staff in ensuring that unanticipated budget support flows do not result in the forcing down of spending to meet credit targets, especially when these are grants. I also note the observation by the authorities that there is now a surplus on the overall fiscal balance, excluding grants and externally funded development investment.

On privatization, as others have noted, there have been small delays. These do seem to be the results of unrealistic expectations regarding the time that is needed to finalize deals on privatization. It is a technical problem rather than one of lack of resolve, as others have said. I do understand that approvals to proceed with privatizations were all completed within the programmed time, but I do agree that it is important for the credibility of the whole privatization process that slippages are kept to a minimum. It may be worthwhile for the authorities to consider additional resources in the privatization unit so that they can raise their administrative capacity to a higher level.

On governance issues, I was pleased to see references in the staff report in Paragraph 24 to the additional measures that are being taken to fight corruption. However, as that paragraph says, more needs to be done, particularly at the district level.

In conclusion, I would like to congratulate the Ugandan authorities for a job extremely well done. Their exceptional efforts over what is now 10 years deserves not only the significant debt relief that is being granted today, nearly $350 million in net present value terms translating into 700 million in cash debt relief over time, but also our continued strong support in the years to come. Uganda has made impressive strides in building the foundation for a strong and prosperous economy in the medium term, as it indeed was 20 or so years ago. With that prospect, there are also promises for significant poverty reduction.

Finally, I would like to thank the staff, both in the Fund and in the Bank, for their enormous efforts to bring us to the point where we are at today. I look forward to their continued commitment as we move forward with other eligible countries.

Mr. Han made the following statement:

I welcome today's discussion on Uganda, especially on the first case of an HIPC reaching the completion point. I join Ms. Lissakers and others in saying today is a special day for Uganda and also for international institutions, it is a day to celebrate. I would like to thank the staff for the set of well-prepared papers for today's discussion and for the tremendous efforts they have made in implementing the HIPC Initiative in Uganda. Despite the unfavorable weather conditions last year, the authorities' performance in managing the economy and implementing the ESAF-supported program was very impressive. I support the recommendation that we complete the midterm review under the first annual ESAF arrangement and agree with the proposed decision contained in the completion point document. I would like to make a few comments for emphasis.

First, like others, I commend the authorities for their unbent commitment to the process of economic reform and adjustment and for their determination and courage in implementing the adjustment programs. By taking wide-range measures for economic and structural reform, Uganda has made significant progress in the fiscal, monetary and external fronts in the past ten years. Most importantly, the economy has grown at a relatively fast pace and the people of Uganda stand to get direct benefits from the reforms. These achievements, in turn, have become a strong incentive for the authorities to take further reform measures. It seems that Uganda is entering into a beneficial cycle.

Second, despite the progress achieved by the authorities and the fact that the criteria of the programs were met, it is well recognized that Uganda is still one of the poorest countries in the world. The physical, human, and social infrastructure is very backward, not to mention the extremely low income per capita. The waiver the authorities are requesting with regard to the net claims on government by the banking system highlights the necessity of further financial deepening. On this point I can understand and agree with Mrs. Guti's explanation in her helpful statement. For the Ugandan authorities, the road ahead is still long and difficult. There is no room for complacency on the part of the authorities.

Third, by implementing the HIPC Initiative, the international community should help the HIPCs free up more resources for the imperative infrastructure strengthening as soon as possible, so as to eradicate the incidence of severe poverty, while making sure that programmed reform and adjustment remain on track. As for Uganda, being the first country to reach the completion point, should be honored for what it has done in the process of reform and adjustment. Uganda's performance witnessed the success of the program conducted by both Bretton Woods institutions and may set a model for the future implementation of the entire HIPC Initiative.

With these remarks, I would like to ask Mrs. Guti to convey our sincere congratulations to the authorities and wish them every success in their future endeavors.

Mr. Fernández made the following statement:

Like Mr. Shields, I agree with what Ms. Lissakers had to say on Uganda, so I can be brief.

I share the staff's appraisal regarding the midterm review under the first annual arrangement under the ESAF. It makes it clear that, while a lot has been achieved, a lot remains to be done, therefore leaving no room for complacency. Important efforts are still warranted on the fiscal side and on structural reforms. On this point, I, like Mr. Rodríguez, would appreciate the staff's additional comments on the ongoing discussion with the authorities and the World Bank regarding the privatization strategy mentioned in paragraph 28. I would also be interested to know if the Ugandan authorities are planning to carry out a project to create export-processing zones, or to return to tax holidays, which seems implied in the staff report.

On the whole, while I fully recognize the progress of reform implementation, I would stress that these achievements have to be looked at in the context of an ESAF program, which this chair and others had considered to be somewhat insufficiently ambitious in October 1997. As a consequence, I think it is critical to call the Ugandan authorities' attention to the specific responsibility which is theirs at this historical moment, as was stressed by previous speakers. Indeed, this is the first country to reach the completion point under the HIPC Initiative one year only after the decision point, and it is thus the first time that multilateral creditors provide debt relief under the new initiative. This is a highly welcome time and an important step toward efforts made by the international community to help alleviate poverty in Africa. The determination of Uganda to continue and increase its reform efforts will therefore be of the utmost importance and provide a strong signal to those other countries eligible to the Initiative. Given the overall impressive track record of Uganda, I am confident in the authorities' capacity to fully implement the remaining agenda.

With these comments, I support the proposed decision and wish the Ugandan authorities well in their future endeavors.

Mr. Iradian made the following statement:

Uganda continues to deliver on its policy reform commitments. The 1997/98 program remains on track with most targets met so far and achievable for the remainder of the year. It is regrettable, however, that net claims on the government by the banking system at end-December 1997 were slightly above the program's target.

While the fiscal deficit (on a commitment basis, excluding grants) is to be contained to the original target of 5.8 percent of GDP, we are concerned about the size of this deficit, which did not improve significantly since the early 1990s. This is mainly attributed to the weak mobilization of government revenues which at about 12 percent of GDP is still one of the lowest among low income developing countries despite 7 years of annual arrangements under ESAF. We wish to underscore that the fiscal consolidation effort needs to be strengthened. In this regard, increased efforts at fighting fraud, improving tax administration, and broadening the tax base are clearly needed. Much remains to be done to enforce compliance and control smuggling. In this connection, it is encouraging to note that a new internal audit reporting system was implemented at the Department of Customs and Excise, and tax arrears are being more vigorously pursued. On the expenditure side, we note that the overruns on nonwage recurrent spending were largely offset by lower wage payments caused by delays in placing teachers hired under the UPE program. The authorities are urged to tighten expenditure commitment control and to avoid the accumulation of arrears.

Monetary policy should continue to aim at containing inflation. In light of the upward revision of the estimated end-year inflation rate and the risks of a slower-than-expected decline in food prices, it would be prudent to reduce the targeted growth of broad money. Here the downward revision of the benchmark on net domestic assets of the banking system is appropriate. We encourage the Bank of Uganda to continue to develop its monetary instruments with the help of the Fund's technical assistance.

Over the medium-term sustained, high, and broad-based economic growth and poverty reduction will be achieved by continuing to emphasize macroeconomic stability, economic liberalization, and diversification, and by nurturing an environment conductive to a dynamic private sector. To tackle the identified impediments to growth, policies should be geared to improving physical, human, and social infrastructure, promoting a sound financial sector, and strengthening administrative, technical, and statistical capacity. While there have been some positive developments in these areas, the shortage of technical and administrative capacity has constrained the manner and speed of implementation of the wide-ranging reform agenda.

As to the HIPC completion point document, we fully share the staff's view that Uganda's economic performance under the ESAF has been satisfactory. We also agree that the conditions for reaching Uganda's completion point under the HIPC Initiative have been fulfilled. With these remarks, we support the proposed decision and wish the authorities every success in addressing the challenges they still face.

Mr. Fujii made the following statement:

It is impressive that the Ugandan authorities have maintained their solid commitment to the adjustment program. It is commendable that economic performance during the first half of 1997–98 was broadly satisfactory, although economic growth was slower and inflation higher than expected owing mainly to unusually heavy rains caused by El Niño. Assuming that the authorities will continue their strong policy implementation under the second-year ESAF arrangement, I support the completion of the midterm review of the first-year ESAF arrangement.

I also agree with the staff that the conditions for reaching Uganda's completion point under the HIPC Initiative have been fulfilled. I encourage the authorities to maintain their adjustment momentum even after the completion point, and to make further efforts toward achieving sustainable growth.

Like Ms. Lissakers and others, I am pleased and impressed to see Uganda be the first country to reach the completion point since the HIPC Initiative began two years ago. I would like to commend all multilateral and bilateral creditors for their exceptional efforts in addressing the heavy debt burden of HIPC countries. I strongly hope that this Initiative will continue to be an effective mechanism for HIPC countries to exit from their debt burdens.

I would like to comment now on three issues. First, despite the negative impact caused by the recent heavy rains and the recent decline in world oil prices, I am encouraged by the steady progress in the fiscal area, including completion of the substantially larger number of VAT audits than programmed and the implementation of the new Income Tax Act. In order to further increase VAT revenues, it is necessary to strengthen the technical capacity of the VAT administration, as well as to overcome resistance. In this regard, various measures should be taken, including the reduction of exemptions, the rationalization and simplification of complicated administrative procedures, the use of modern taxpayer numbering systems, the improvement of ineffective computer systems, and the strengthening of collection monitoring systems and enforcement programs. Moreover, better coordination among the customs, income tax, and value-added tax administration is needed to enhance revenue performance. I also join the staff in urging the authorities to resist emerging pressures to undo the new income tax act's beneficial effects.

Second, I would like to join Mr. Rodriguez and Mr. Fernandez in asking for further clarification on the Bank and Fund staff's approaches toward privatization described in paragraph 28 of the staff report.

Third, in the selected issues paper, the staff provides a very interesting and challenging analysis on the evolution of social expenditures on health and education following the recent recommendation by the external ESAF evaluators. The change in real per capita expenditures on health and education were broken down into four factors, real per capita GDP growth, changes in the expenditure share of GDP, changes in the health and education shares of total expenditures, and changes in the prices of health and education goods and services relative to all goods and services. Such an analysis on the evolution of social spending is very useful in considering appropriate social policies for addressing poverty issues. I, therefore, encourage the staff to extend such analysis to the cases of other countries.

According to the staff, most of the improvements in social spending on education and health during the period from 1988–89 to 1996–97 resulted equally from the increase in real per capita GDP and from a broad increase in government expenditures as a share of this higher GDP. While the increase in the health and education shares of total expenditures was small, any changes in the relative price of goods and services in the health and education sectors had a negative impact. Given that the level of government expenditures has already reached about 18 to 20 percent of GDP, it is difficult to assume that this factor will continue to contribute to the improvement of social spending. In order to further strengthen social spending on health and education, it is therefore critical to maintain higher real per capita GDP growth by implementing appropriate macroeconomic and structural policies, as well as to give higher priority to increasing the health and education shares of total expenditures. I would appreciate any comments by the staff on this point.

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

Mrs. van Geest made the following statement:

I would like to join the chorus of Directors that welcome today as a momentous day, thanks to the first completion point. That this completion point is for Uganda is very fitting and epitomizes the country's strong and sustained track record. It has been appropriate not to let Uganda become a hostage of the financing problems we still face regarding the initiative.

I would like to raise one more substantive issue on the Fund's side of the HIPC Initiative. There is a strange difference between the SDR rate we use to discount a country's debt and the SDR rate a country might hope to earn in the escrow account.

The initiative uses the so-called CIRR to discount a country's debt. For the SDR this amounts to roughly 6 percent. I have no problem with the choice of the CIRR, which has been accepted by all creditors. It would also pose no problem to the Fund, if we disbursed the Fund's contribution to a country at the completion point in one go. It would then be up to the country to invest the money and make sure to get the appropriate return or alternatively to retire the appropriate amount of debt. However, this is not what we are doing. The Fund will place the money in an escrow account and the country can draw on the account according to a pre-specified scheme. As a consequence, the interest rate to be earned in the escrow account takes on a certain significance. According to the paper on Uganda, an interest rate of only 4.5 percent is projected. Actual payments made from the escrow account will amount to $81 million, if the 4.5 percent interest rate is used. I understand this could increase to $89.8 million, if a 6 percent rate is applied—roughly ten percent higher.

While there might be technical reasons for the spread, it remains uncomfortable and I would appreciate the staff's comments on the same. In any event, one thing should be clear. As we require the country to invest their money in our escrow account, we carry a responsibility to be absolutely sure that we invest it in an appropriate manner. As you will be aware, we have asked for a review of the Fund's investment policy in the past. And to be honest, we had hoped this issue would be reviewed before we set up the umbrella account. I therefore hope that the Board will soon have an opportunity to review the paper on this topic, as promised in the staff report on the umbrella account.

Mr. Shields considered that the rates of return should be looked at, and that they should be higher. What Ms. Van Geest had pointed out was rather anomalous, and although somewhat late in the Initiative to change it, the Fund should make sure that countries were not penalized because of the quite large difference in terms of the interest rates to be used. He hoped that the Treasurer's Department would see what could be done to expedite an improvement in this regard.

The staff representative from the African Department made the following statement in response to questions and comments from Executive Directors:

Regarding the question that Ms. Lissakers raised on the timetable for the UCB sale, it is likely that the new investors will be managing the UCB fairly soon. As Directors know, $11 million was agreed as the total amount to be paid by the foreign investors; $5 million has already been paid, and the investors have until the end of this month to pay the remaining $6 million. I understand that they have initiated proceedings in that regard, and new information that we received very recently indicates that the new foreign investor has agreed to manage the 15 rural branches that are not part of the investor's bid. This is not formal or official news, but we do understand that the new investors are asking other foreign investors to take up the remainder of the shares.

On the Uganda Telecommunications Corporation, the authorities announced in December an offer for sale. In January, they issued the information memorandum and held an investors forum to acquaint investors with the company, and now the authorities are waiting for the pre-qualification bids. If everything goes smoothly and if there are buyers with reasonable offers, the sale could be completed within this fiscal year. However, at this moment I have no information as to what interest there might be or what kind of offers are likely to come. You will recall that, in the case of the Uganda Commercial

Bank, there were five initial bids of interest, but four were eventually withdrawn. Therefore, one has to be prepared for some oddities that are not under the control of the Government. As far as the Government is concerned, it is fully committed to the sale, and it has done everything in its control to further that goal.

As to the Uganda Electricity Board, the authorities have overperformed on our benchmarks. They have plans to do further financial and staff restructuring in the coming fiscal year, and the main question is to get the funds for the planned staff retrenchment, which is a very important part of the restructuring. The authorities have also agreed to the privatization of the distribution and commercial services, and are preparing to issue the invitation for bids in that regard. We expect the bids to be issued in the early part of the next fiscal year. Before the end of this fiscal year the electricity reform act is likely to be passed. It is awaiting at parliament, which is rather overloaded with legislation at this moment. The authorities also have to make a decision on the sector regulation, and negotiations on a strategy are under way with the World Bank. The World Bank and the ministry of natural resources are discussing whether it is better to have an overall regulatory body which cuts across sectors, or to have one just for the energy sector. The World Bank representative, Mr. Adams, can comment further on this issue. Overall, there are a number of plans to move, but there appears to be some room to move faster.

Ms. Lissakers asked about the integration of the divestiture accounts into the budget. We are also of the view that it would be a good idea. However, I want to make it clear that the divestiture accounts are very transparent. They are published and debated in parliament. Nonetheless, when the privatization program began, some elements of the government felt that the multiple budget demands made it reasonable to keep privatization proceeds separate, so that they could be used for the privatization process, and not taken up by demands unrelated to privatization. That was the motivation for having these separate accounts. However, we are now seeing that, with the bigger enterprises being up for privatization, the proceeds may not be sufficient in the future. Therefore, we think that instead of borrowing resources from the budget or making transfers from the budget, it is better to integrate the accounts into it.

Ms. Lissakers also asked about technical assistance. In the monetary field, the MAE mission in December recommended the introduction of a repurchasing agreement to implement open market operations, to begin implementation of the automated book entry system, and to introduce repurchase agreements for interbank transactions. Overall, it had a long list of recommendations. The Bank of Uganda has been acting on some of them. For instance, the automated book entry system is operational, and the Bank of Uganda is looking into a master repurchase agreement. Other measures will become more operational once the final recapitalization is actually done, and this is expected in the next month or so.

FAD currently has a mission in Uganda working on pension reform. Some of the questions being addressed are whether all the people who are receiving pensions are entitled to them, and whether all of those who are entitled are actually receiving them; what should be done with the pension formula, now that monetization has taken place; and whether there should be indexation of benefits.

Regarding the questions on privatization, let me give you some background. Last summer, when the World Bank and the Fund were discussing with the authorities the medium-term strategy for the policy framework paper, all agreed that it would be desirable to have a very ambitious privatization program. In fact, the target was to virtually finish it in the first two years of the ESAF program, and to complete it altogether by the end of the final ESAF arrangement. There is no doubt that the commitment is there. In fact, the authorities themselves had internal targets which were even more ambitious than the benchmarks of the ESAF program. Recently, however, a World Bank mission went to Kampala to investigate whether to extend funding for the privatization unit. That mission found that the unit was having some difficulties and that if it spent more time preparing for the privatization of fewer enterprises, those privatizations were likely to be more successful. There are definite pros and cons for changing to that strategy. The disadvantage is that the privatization program now has a momentum which should not be perceived as being hindered. Moreover, as enterprises are aware that they are going to be privatized, asset-stripping ensues, which means that it would be desirable to move quickly, as the government does not have the capacity to monitor or prevent what is being done. We have agreed with the Bank that when we talk about the new policy framework paper for the subsequent three-year strategy, we will discuss with the authorities the best way to overcome these technical and legal difficulties, the lack of time and preparation, and we will see whether the privatization program numbers have to be amended and to what extent. However, we have not changed any of the benchmarks for now.

Apart from technical and legal difficulties, the parliament has also been asking a lot of questions, and some of the responsible people working on the privatization program have spent hours in parliament answering questions. Staff resources are stretched quite thin, and there is a case for increasing them. Recently, the World Bank mission had a discussion with parliament. Mr. Adams can inform you further about the privatization program, and the discussion to educate parliament and assuage their fears as to all these assets being given away. While I favor an ambitious program, this will require adequate resources.

On export processing zones and tax holidays, Directors will recall that this debate was mentioned in the last Board discussion. It continues in the sense that the ministry of finance is very much against export processing zones and tax areas, but there are others in Uganda who think that this is the way to industrialization and fast growth. The tax holidays have been removed from the incentive structure and they have been replaced. There is no question of going back to a generalized tax holiday regime. The only question is whether, if there are export processing zones, they should include tax holidays. The Government had commissioned a study from the World Bank in that regard, which has just recently been presented to the Government. In response, officials are planning to visit other countries who have export processing zones to see how they are working. We have strongly recommended that even if export processing zones are introduced, tax holidays should not be introduced for obvious reasons. Mr. Adams, who supervised this study for the government, may have more to add on this point as well.

On social expenditures, I agree with Mr. Fujii's assessment, with small caveats. It is correct that the composition of social expenditures has to change, and there is progress in that regard. Moreover, In the context of the HIPC Initiative, the Government has decided and announced that greater resources will go to the social sectors. There is certainly some room for expenditure expansion. However, it should await a further increase in the revenue ratios, so that a higher expenditure level can be achieved at the same time that the fiscal deficit is reduced.

Mr. Konan asked whether we are not too optimistic about making up shortfalls on the revenues. It is true that the weather has been a problem, and that rains have affected not only Uganda, but also much of Eastern Europe. However, the shortfall that we had estimated is not all that different. Therefore, unless the weather worsens later on in the fiscal year, there is only Sh 3 billion that the authorities still have to make up. This has been built up because of this new system of meter seals which we didn't have before, and also the yield from the taxation of benefits, which is having a remarkable yield that we had underestimated. I would agree that there is danger in the recent oil price increases, and the program includes a decline in the oil price in the beginning. However, it is the more recent one that could be problematic. That information wasn't available when we were in the field; what we discussed with the authorities was the question of lags, and if the lags turn out to be right, then we are probably close enough to target. If somehow the lags are not right and the effect is considerable in the next two months or so, then there is a risk that the revenue target may not be met, in which case the authorities will try to cut expenditures further. Of course, there is a limit to how much one could continue to cut expenditures.

The staff representative from the Policy Development and Review Department made the following additional remarks:

> Mrs. van Geest correctly described the way in which interest rates are used. The overall position is that we use commercial interest reference rates published by the OECD, known as CIRRs, for all NPV calculations, discounting for claims of all creditors and for all countries under the initiative. That is a generally agreed procedure, and it was in the original documents as of a year and a half ago. We choose the CIRRs because they are an independent, published, and easily available rate available to all our participants, and other multilateral creditors in particular. The CIRR is based on the medium-term yields of the currencies involved—or the currency, in the SDR case—and does involve a margin of 100 basis points on those yields.
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> As to why we are using 4.5 percent instead of 6 percent, the difference reflects the margin on the CIRR. Moreover, the 4.5 percent is simply a conservative projection of future interest rates. Obviously, the rate of return earned on the account will reflect future interest rates, and indeed could be above 4.5, and possibly above 6 percent depending on the actual course of those rates.
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> The issue of seeking to maximize returns on this account was discussed with the Treasurer's Department some time back, in consultation with the authorities involved. I fully agree with what Mr. Shields has said, that the objective should be to maximize returns on this account, subject to normal prudential investment type of constraints as to the places where the money can be put. My understanding is that the Treasurer's Department will be producing a paper on this wider issue of the investment of Fund resources in the near future, but if you wish for a more precise timetable, I'm sure that the representative of the Treasurer's Department can provide that.

The staff representative from the World Bank made the following remarks in response to questions from Executive Directors:

> The World Bank has traditionally been a big investor in the energy sector in Uganda. Indeed, the first project was made before Uganda was independent. With regard to privatization, we face two different pressures. One is that the sectoral ministry, not in an untypical fashion, has not always been as constructive and supportive of the magnitude of the change that both the Bank and the President feel is necessary. Over the past two months a decision has been made with Government to move the major responsibility for policies in this area to the privatization unit within the ministry of finance. We hope that this will provide a more constructive environment to not only meet the conditions which have been set forth, but, indeed, to accelerate them, and in some cases put in place a bolder reform in the energy sector. Second, in parallel with our work, the Government is engaged and talking to

the private sector about investment. In that context, the IFC is involved on the Bank side and there is a possibility that IDA guarantees will be extended. We hope that, in parallel with structural reform, this will allow for a more significant private sector investment in this sector.

In the telecommunications sector, a second national license has been issued. This is critical because it has removed some of the fears of people within the telecommunications sector who did not want to change, and it has really put the government entity in a position where in order to maximize the benefits from a favorable environment, it has to move more quickly. Therefore, the incentives are right.

There is no disagreement between the Bank and the Fund on privatization. We work very closely together on this issue, and have given the government very consistent signals that slowing down is not an option. We want to see the government move as quickly as possible. While there may be a need at the margin to make some change in the numbers, we do not want to change the basic thrust of the privatization program.

The Bank and the Fund have also presented consistent messages on the tax holidays. The Foreign Investment Advisory Services (FIAS) report presented an objective discussion of experience with such holidays in different countries, and both the report and, more importantly, its cover note, emphasized to the Government the general direction that we thought governments with good economic policies were pursuing, which is the direction of accelerated appreciation. That certainly remains, both on the Bank and the Fund side, the consistent recommendation to the Government. We hope that, in working with the ministry of finance on this, we will be able to ensure that those elements in the Government which are more interested in disbursing benefits than in dealing with industrial reform and industrial growth are contained through this interaction.

The FIAS report also covered the issue of export pricing zones. We are arguing very strongly that we do not see this as a key element of future industrial policies, and we are concerned that the Government not forego the revenue benefits in a way that does not facilitate industrial growth.

Mr. Shields observed that, as there was a certain predictability in disbursements from the escrow account, there should be a potential for higher returns than would normally be obtained on Fund resources. That needed to be taken fully into account.

The staff representative from the Policy Development and Review Department confirmed that there was full predictability of the disbursements in the escrow account, in the sense that there was agreement among the authorities concerned on a drawdown schedule.

That factor was being taken into account in trying to maximize the returns that could be obtained. However, he would point out that for most of the currencies in the SDR, the yield curve was fairly flat, and the present was not the best time to try to do what Mr. Shields had described.

Mrs. van Geest stated that her chair had raised the issue of the investment policy with the Treasurer's Department because there were various reasons why there should be a fair review. She would not necessarily predict that such a review would lead to the possibility of a higher return, but it would be useful to look into the issue. Such a review was relevant for Uganda, but also for the financing of the HIPC-ESAF trust as a whole.

Mr. Jadhav made the following statement:

> Our chair would like to thank the staff of both the Fund and the Bank for providing a very useful set of papers which, along with the helpful statement from Mrs. Guti, present an excellent account of current and prospective developments in the Ugandan economy. We would like to join others in commending the Ugandan authorities for their impressive track record in achieving macroeconomic stabilization with strong growth and one of the lowest non-food inflation records in sub-Saharan Africa, as well as in furthering structural reforms even in the face of weather-related setbacks. The commitment of the Ugandan authorities to the program is evident from the fact that, in 1997/98, despite adverse weather conditions, a number of performance targets were met by large margins, and significant progress was achieved in respect of structural reforms.
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> While appreciating the policy resolve of the Ugandan authorities, our chair would like to make a few observations. The setbacks to the program's growth and inflation targets in 1997/98 emanating from adverse weather conditions are a painful reminder of the extreme vulnerability of the Ugandan economy to exogenous shocks. This underscores the impressive need for intensifying the reform process, especially with a view to reducing Uganda's heavy dependence on coffee and promoting the diversification of its production and exports base expeditiously. Accordingly, high priority should be accorded to establishing a stable and adequate power supply and improving fiscal infrastructure.
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> In this regard, we feel encouraged that the HIPC completion point document has projected that non-coffee exports would constitute more than two-thirds of total merchandize exports by the year 2016–17, compared with only one-third in the year 1995–96. This would make it imperative for the authorities to concentrate on diversifying their export-based industries.
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> It is heartening to note that the fiscal program which is the cornerstone of the Ugandan adjustment endeavor has remained on track despite serious

disruptions to revenue collection resulting from weather-related factors. With the return of more seasonal weather, as pointed out in the latest statement by the staff representative on Uganda, the revenue shortfall in January and February of 1997 could be largely made up by the improved collection in the remainder of the fiscal year, and yet there is no room for complacency. The bold initiatives by the URA to improve efficiency in tax administration must be sustained and indeed strengthened further. We entirely agree with the staff's recommendation to the Ugandan authorities to resist emerging pressures to undo the beneficial effects of the new income tax act. In our view, any policy reversal or even slackness at this critical juncture would decidedly be counterproductive. On the expenditure side, it is reported that only a small proportion of social expenditure reaches the target. This requires further analysis, and authorities must ensure that there is no leakage of scarce resources that are allocated to the social sector.

While in the short run, the monetary policy would have to focus on maintaining a delicate balance between containing non-food inflation and supporting economic activity affected by adverse weather conditions, over the medium term, concerted efforts would have to be made to improve the potency of monetary management by developing a range of monetary instruments including open market operations. In this regard, the ongoing financial sector reforms need to be pursued vigorously.

Finally, the updated DSA analysis shows that after an initial increase, the net present value of the debt to export ratio would decline to 196 percent by the year 2001–02, following the delivery of assistance under the HIPC Initiative and will remain well within the agreed target range of 191 to 212 percent. The relevant assumptions underlying the DSA as detailed in box 2 indicate that non-coffee exports are projected to rebound through the year 1998/99 and the year 2001, and then to grow on an average by 9 percent per annum in real terms. The basis for this assumption is not clear. In fact, even the thrust areas for such unprecedented export growth do not seem to have been adequately spelled out in the papers. The staff may like to elaborate on this aspect.

These observations are not meant to belittle the exemplary commitment to reform demonstrated by the Ugandan authorities. We support the proposed decisions and wish the authorities continued success in their policy endeavors.

Mr. Kaufmann made the following statement:

At the outset, let me thank the staff for the informative papers on Uganda and Mrs. Guti for her helpful statement. These papers paint a very complete picture of Uganda's economic situation. The main conclusion one can draw is simple: the track record of this country remains highly impressive. Given the authorities' strong commitment to policy reforms, I am pleased to see that a country like Uganda is the first one to profit from the HIPC Initiative.

As mentioned in the staff report, Uganda has remained broadly on track despite adverse external factors. I am particularly glad to note that the fiscal figures have remained close to the targets. The dividend of earlier structural reforms in the fiscal sector is one important factor behind this positive outcome. Moreover, I welcome the authorities' continued efforts to improve tax administration and their strategy to root out corruption. Concerning the deviation from the performance criterion below-the-line, I recognize that it cannot be attributed to policy failure and, therefore, I agree to a waiver. Consequently, I can give my support to the proposed decision.

Taking into account Uganda's performance under the SAC III, I also agree that Uganda fulfills the conditions for reaching the completion point and I am able to approve the decision set out in the completion point document. In this respect, I note the significant revisions in Uganda's balance of payments projections and the calculations of the NPV-to-exports ratio since the decision point. This should remind us of the uncertain reliability of such forecasts—something we might keep in mind when we discuss other HIPC candidates.

The fact that a first country will now receive assistance under the initiative is certainly an important event. However, it is not a happy ending. It is not the happy ending for Uganda, yet, because there are huge challenges in the years ahead. Uganda is still very poor, still has very weak social and demographic indicators as well as weak and fragile fiscal and current account positions. Many years of ongoing policy reforms will be needed for reaching social and macroeconomic objectives such as the eradication of poverty or the broadening of the export base. I am confident that Uganda will tackle these challenges with the same determination as it implemented reforms in the last ten years.

Ms. Mercusa made the following statement:

Notwithstanding the adverse external conditions of recent months, the Ugandan authorities managed to maintain both monetary and fiscal policy under control, deserving full credit for their difficult decisions. We found the staff paper convincing in considering unavoidable the deviation of the government net position vis-à-vis the banking system from program target, and we can go along with the proposal to grant a waiver for the non observance of the performance criteria. However, as some of the flaw is the consequence of previous policy mistakes, as the use of promissory notes and the accumulation of arrears, we expect to see no further delay or postponement of due payments.

On fiscal policy, I will briefly note that although targets were achieved, the composition of expenditure was not the one planned, resulting in overruns of non-wage expenditures of as much as 0.3 percent of GDP and, as an offsetting measure, accumulation of arrears to teachers' wages. If targets have some meaning other than accounting tools, they should be respected in their full scope. As the upgrade and enlargement of the education system is a priority of the program, and of the whole HIPC Initiative, we think it is important that the budget for schooling is carefully planned and teachers granted the resources and incentives needed to deliver a successful program. We would like to know whether current expenditure plans for the next months allow for enough resources to fully meet wage expenditures in the education sector.

In light of the useful explanation presented in the Selected Issues of the staff document, we reiterate our previous comments on the design of the VAT implementation policy, noting that uncertain results stem from an uncertain design of the tax itself. The unresolved extent of a tax base and its several modifications and auditing do not seem fitting for the simplicity and the certainty of the new revenue law. Although collection of trade taxes remained substantial, notwithstanding the reduction—albeit small and not ambitious—of tariffs, it is tax revenues that are meant to constitute the main part of fiscal receipts. We encourage the authorities to adhere to the plan of increasing revenue by 1 percent per year.

I will add few words on the HIPC Initiative. Uganda is presented today with a tremendous opportunity to clear its external account from a large debt burden, and we expect that it does so, exiting permanently from a long history of debt restructuring. We also expect that a large amount of resources be dedicated to the social sector, namely the health and education sectors. We were surprised to see no details of this on the staff paper, but we are confident that the Ugandan authorities will make good use of this exceptional treatment. The remaining two years of the ESAF program should also be used as an opportunity to forcefully implement the announced reforms, especially now when the authorities have a better control of their resources. We are granting exceptional financing to put the country on the path of sustainable growth, but after all what will count in confidence building and investment attraction is not the granting of this relief but the adherence of the authorities to home-grown sustainable economic policy and the implementation of structural reforms.

Mr. Chelsky made the following statement:

I would like to join Ms. Lissakers and others in highlighting the symbolic importance of the decision we are reaching today in terms of the overall strategy and the appropriate role for multilaterals in the debt strategy for the most indebted low-income countries. In doing so, I would like to thank the staff who have been involved in the formulation of the Initiative, as well the staff who have worked on Uganda in particular. I have noted that today is the sixth discussion we have had on Uganda in the last 18 months, and I've been impressed with the degree to which the staff have been able to take on board the comments that Executive Directors have made and integrated them into the discussions on the program.

I would also like to commend the Ugandan authorities for their efforts not only over the last ten years, but particularly over the last year and a half. I do not recall ever seeing before a statement in a Board report that said that progress on civil service reform had been more comprehensive than planned.

I would like to support the staff in continuing to reiterate their position on tax holidays and the introduction of export processing zones, and I would like to join Mr. Fernandez in his comments about the responsibility that now rests on the shoulders of the Ugandan authorities to show that, in fact, the exceptional treatment that has been extended is well-warranted. I am confident that they will make the best use of the resources made available.

Lastly, I would just like to draw attention to paragraph 24 in the document on governance. Like Mr. Shields, I very much appreciate the comments staff make there, and am encouraged by the efforts in the strengthening of the office of the inspector general, which is one way of ensuring that the resources we have freed up for debt service will find their way into productive use in the years to come.

Mr. Donecker made the following statement:

I would like to congratulate Uganda on having reached this stage of our HIPC Initiative. It is a historic moment, indeed.

Since I broadly concur with the staff's analysis and policy recommendations, and the thrust of our policy discussions today, I just want to record our support for the proposed decision on the ESAF midterm review.

Second, from the completion points document, we conclude that the conditions for reaching Uganda's completion point under the HIPC have been broadly fulfilled. I can, therefore, also support the proposed decision contained in the HIPC completion point document. I hope that some of the other bilateral non-Paris Club creditors of Uganda will take the positive examples of the multilaterals and the Paris Club to also try and grant Uganda debt relief.

We wish the Ugandan authorities much success in their firm implementation of their ESAF-supported economic program. As Mr. Cippá has noted, there are still huge challenges ahead for Uganda. This debt relief provides an unique opportunity to achieve more rapid economic progress and, in this context, to address poverty alleviation issues as well.

Mr. Lehmussaari made the following statement:

Let me start by stating that I support the staff's proposed decisions to complete the midterm ESAF review for Uganda, and to deem that Uganda has reached the completion point under the HIPC Initiative.

It is truly encouraging that the debt sustainability analysis now shows that Uganda's debt situation, under the HIPC Initiative, would become sustainable and that Uganda is to exit from the debt-rescheduling process. I'm also tempted to add that I think it is important to look at the completion point under the HIPC Initiative not as a finish line, but more as a starting point. Although this decision certainly is a milestone, the need to persist with sound economic policies is more critical than ever to assure that the HIPC Initiative will be a success, for both Uganda and the international community.

On the Article IV consultation report and the ESAF review, staff covers the various areas of economic policy and the measures that the Ugandan authorities have to implement as part of the ESAF program. I can easily agree with the staff's analysis and policy recommendations, but I would like to make a few comments, as food for thought, on the banking sector issue, and, as a matter of emphasis, stress the governance issue.

In the background paper, the staff mentions several obstacles to efficient banking activity in Uganda. Among other things, lack of competition between banks and the non-existence of a formal interbank market are impediments for the development of an efficient banking sector. The result is a large spread between borrowing and lending rates, which is of particular concern when private saving and investment needs to be promoted. Hence, it is important to focus on improvements in the financial sector. Some observations are worth mentioning in this context.

First, referring to the selected issues paper written by the staff, page 9, the requirement that banks may not be licensed unless they offer new financial products seems unnecessary restrictive, and, in fact, may hinder some potentially efficient banks from entering the market. Second, I wonder whether the Bank of Uganda should take a more active and central role in developing the interbank market. One measure could be to establish a committee chaired by the Bank of Uganda, which should have as its mandate to address the various obstacles to an efficient interbank market. Among other things, and as the experience from many countries has shown, the committee could work out trading and behavioral rules for the interbank market, and thereby improve the functioning of that market. Often the markets participant may find it difficult to take such an initiative, sometimes simply because of a reluctance to expose their interests. Third, the Bank of Uganda is probably well positioned to deal with payment system problems, since interbank transactions commonly are settled through the Central Bank. In addition, the Bank of Uganda may also consider to operate as a market-maker in reserves, to improve redistribution of the liquidity in the banking sector, as a way to help the market at an early stage.

Finally, I briefly turn to the governance issues, which I think still need to be followed up closely. In this respect, the Ugandan authorities should be applauded for the recent strengthening of the Office of the Inspector General of Government. Continued forceful efforts in this area will bring increased credibility in the government and improved confidence in business, which is important to reinforce the relationship with the international community.

Mr. Zakharchenkov made the following statement:

Let me start by joining other speakers in congratulating the Ugandan authorities upon achieving the completion point under the HIPC Initiative.

Last year was a difficult one for Uganda's economy due to the adverse weather conditions that negatively affected GDP growth and the country's exports. Despite that, almost all quantitative and structural performance criteria for end-December 1997 were met. Performance was also satisfactory with respect to the structural benchmarks, and in some cases it exceeded expectations. According to the staff's appraisal, most of the program's external targets for 1998 remain achievable given the assumption of an expected return of normal weather conditions.

There is little to add as the staff paper provides a comprehensive analysis of the country's performance as well as sensible policy recommendations. I will make only a few comments on several aspects where further improvement might be of some merit.

On the fiscal front, despite the revenue shortfall in January-February it is expected that the government's revenues and expenditures for the year as a whole will be in line with the program target. We noted several measures implemented by the authorities aimed at strengthening revenue collection and broadening the tax base. It is commendable that the authorities undertook some steps to prevent the sale of smuggled motor spirits and diesel, because excise taxes on petroleum products account for a quarter of all revenues. However, much has to be done in this area. As is rightly noted by the staff, the main risk to the revenue target for the year as a whole stems from public pressure to reopen the discussion on the new Income Tax Act, with a view to rolling back taxation and extending tax holidays to investors. We welcome the authorities' commitment to resisting such pressures.

In the external sector, the recent developments once again pointed out that Uganda's economy remains highly vulnerable to weather conditions stemming from a high dependence on one export commodity. Strengthening of the external sector and sustaining economic growth require the continued strong implementation of economic reforms to develop a more diversified export base. In this connection we share the staff's view that establishing a stable and adequate power supply and improving the physical infrastructure would be two important steps to remove impediments to growth in exports.

In the structural area, we welcome the authorities's continuing commitment to program targets as well as recently implemented reforms in the financial sector and in the field of privatization.

Finally, there remain some data deficiencies, including those related to private transfers. As is also noted by the staff, there has been a "reduction in attention to improving the statistical base, as adequate funding has suffered in the competition for scarce budgetary resources" (p. 18). We urge the authorities to improve the quality of statistical data.

With these comments we support the proposed decision and wish the authorities success in their efforts.

Mr. Rouai commended the authorities for their progress, and wished them well in Their future endeavors.

Mr. Goffinet made the following statement:

Despite the effects of bad weather on GDP growth and fiscal revenues, Uganda's adherence to the policies and measures of the program has brought impressive progress on the macroeconomic and structural fronts. This reflects the efforts of the Ugandan authorities to devise and follow a positive strategy for sustaining fundamental reforms. Fiscal and reserve targets are still achievable, and credible progress has been made with structural reforms. I have no problem granting a waiver for missed performance criterion with respect to banking claims on the government.

The health and education targets of the authorities' anti-poverty plan are commendable, but it will take enormous additional efforts to bring Uganda's social indicators to the targeted levels. Per capita social spending has increased significantly during the period of the ESAF arrangement period, and I urge the authorities to continue implementing this plan which aims at creating a climate conducive to economic success and a better living standard. I am accordingly encouraged to note that the authorities intend to earmark for social sector spending the resources freed by the debt relief under the HIPC Initiative.

In light of Uganda's progress with the reform process, and its economic performance, which remain subject to external and fiscal vulnerabilities, I agree that Uganda has satisfied the conditions for its completion point under the Initiative, and that its debt-to-exports ratio should be set at 196 percent. No agreement has however been reached so far with all non-Paris Club bilateral creditors to restructure Uganda's debt. Could the staff bring the Board up to date concerning the outcome of these discussions?

Finally, I wish the Ugandan authorities all the success they deserve in their endeavors.

Mr. Alosaimi made the following statement:

I join others in welcoming this discussion of the first completion point document of a HIPC eligible member. Uganda, which has a good track record in policy implementation, continued to perform well during the past year. As Mrs. Guti notes in her statement, all quantitative performance criteria and structural benchmarks for end-December 1997 were observed with the exception of the ceiling on net claims on the government by the banking system which was exceeded due to technical reasons. Moreover, economic performance remained strong despite adverse weather conditions.

In light of this performance and given that the updated NPV of debt to export ratio falls within the agreed range, I support the proposed decision.

In this regard I have two comments:

First, while the fiscal program remains broadly on track, the recent shortfalls in receipts and overruns on some recurrent expenditures raise concerns. In this regard, I am encouraged by Mrs. Guti's assurances that steps have been taken to address these issues and ensure that fiscal targets will be met.

Second, being the first to graduate under the HIPC Initiative, the world will be following developments in Uganda closely. Continued progress in improving economic performance is not only critical for the country but is also an early indication of the success of the HIPC Initiative.

With these remarks, I wish the authorities success.

Mr. Merino made the following statement:

This Chair commends the Ugandan authorities for their continued strong implementation of adjustment policies and structural reforms, which have sustained Uganda's rapid growth with moderate inflation. The program's quantitative and structural performance criteria for end-December were met by large margins, with the exception of the ceiling on net bank claims on the government, owing primarily to an unexpected reduction in check float, while structural benchmarks performance was satisfactory and in some cases exceeded expectations. Real GDP growth was 5 percent, notwithstanding unfavorable weather conditions, and the authorities were able to contain inflation to moderate levels despite food price shocks related to the drought.

As I broadly agree with the staff appraisal and the remarks of previous speakers, I would like to confine my comment to a few salient points.

The Ugandan authorities should be commended for keeping the fiscal program broadly in line with expectations and urged to continue their efforts to keep fiscal consolidation on a firm footing. The progress made in strengthening tax administration, particularly in the customs area, through the strengthening of civilian-based flexible antismuggling teams under the direct control of the Uganda Revenue Authority. VAT compliance below expectations, due to administrative capacity constraints, showed the need for more integrated approach to tax and customs administration, including the establishment of a large-taxpayer unit. In this regard, I welcome the new Income Tax Act which, inter alia, further tightens exemptions policy. Emerging pressures to roll back taxation of in-kind benefits and to extend tax holidays to investors who had not received tax concessions should be resisted.

On the expenditure side, the extent of unsatisfied social needs precludes significant expenditure reduction. The expenditure program is in fact very tight and will require a substantial compression in the second half of the year of nonwage outlays preferably through adequate budgetary and expenditure control systems. As to Uganda's fiscal stance, I sympathize with the authorities' suggestion to assess it excluding from the overall deficit grants and externally funded development expenditures, in addition to traditional measurers of fiscal balance, as long as present expenditures reflect future savings, as in the case of major social security reforms.

In the monetary sector, the authorities are to be commended for their commitment to price stability. Reforms in the financial sector should be accelerated to reduce the high intermediation costs, tackle the systemic problem of nonperforming loans, and enhance the efficiency of monetary policy. In this regard, I welcome the sale of forty-nine percent of the Uganda Commercial Bank with the option to buy another two percent within three years and the strengthening of bank supervision that reduced the ratio of the remaining nonperforming assets to total assets to 27 percent at end-September 1997 from 40 percent in the previous year. In this regard, I fully share staff's view that the merits of requiring uniform reserve requirements for all deposits in all banks should be considered given the current ratios of 8 percent for time and saving deposits, 9 percent for demand deposits, and 20 percent for foreign exchange deposits.

Considerable progress continues to be made in other important structural areas. In this regard, however, it is important not only to ensure transparency in the ambitious privatization program, to increase the public and investors' confidence in the process while minimizing the justification for political interference, but also to place greater emphasis on capacity building, which has constrained the speed of implementation of reforms as well as the efficacy of the regulatory framework. I particularly welcome developments in the area of governance, as reflected in the strengthening of the Office of the Inspector General of Government and the more open attitude within official and private circles to the discussion of governance issues. Equally relevant is the design and implementation of a comprehensive pension system reform to favorably impact not only on the fiscal consolidation effort but also to deepen the domestic capital market. This element of reform should therefore be accelerated and warrants adequate technical assistance support.

Uganda's external position remains fragile. The external sector remains highly dependent on the evolution of international coffee prices; thus, continuing with trade facilitation measures aimed at fostering export diversification including regional integration, moving toward a low uniform duty, establishing a stable and adequate power supply, and improving physical infrastructure remain of the essence.

Turning now to the debt sustainability analysis, the main conclusion is that, with assistance under the HIPC Initiative, Uganda's debt situation would become sustainable and Uganda would exit from the debt-rescheduling process; nonetheless, general balance of payments support is assumed to be phased out only by 2006/07. In this regard, I welcome the new NPV of debt-to-exports ratio of 196 percent, below the original target of 202 percent. Although this new ratio is a signal of improved export performance, and other favorable external factors, Uganda's overall economic conditions remain fragile. It is therefore essential that the commendable efforts by the Fund and Bank management and staff lead to a clear signal of completion that in turn serves to broaden the participation of other donors and multilateral creditors to ensure a successful exit after debt reduction. We look forward to consideration of completion points in other eligible cases before the Annual Meetings.

With these remarks, this Chair supports the proposed decisions and wishes the Ugandan authorities continued success in their reform efforts.

The staff representative from the African Department made the following additional comments:

On bank licenses, there is a temporary moratorium on new banks, so that they can better regulate and develop the current system. The idea is not to prevent the development of new banks in the longer term.

On current expenditures, there was, in fact, a well-defined plan to pay teachers wages. It is part of the education sector adjustment credit and part of our program that these arrears be systematically cleared by May 1999.

In terms of the export-growth assumption, the coffee volumes which have been badly affected by the weather are expected to go back to the 1996/97 level in 1999. For the other exports, we have based the projections on the planned and actual private sector developments in the key sectors.

In terms of the non-Paris Club bilateral creditors, progress has been made recently, particularly with regard to Tanzania, where an agreement for $160 million was reached. In the debt reconciliation process, things have also been clarified. However, it is true that there are a number of non-Paris Club bilaterals where agreement has not been reached. The authorities have renewed efforts, and invited further discussions and negotiations. In some cases, however, progress has not been easy because some of the developing countries feel that they are debtors, too, and cannot give concessional financing. From the point of view of the authorities, they have stuck to the principle that they will seek comparable terms with the Paris Club.

Mrs. Guti made the following concluding statement:

> The staff have answered all the questions raised, and I do not have much to add to what has already been said.
>
> I would like to thank the staff for their efforts in Uganda, and Board members for their support. This is an historic moment or Uganda, for the Fund, and indeed for the international community. My authorities are grateful for all the work that has helped them to reach the completion point. They are aware that this is not the end of the road. They are facing many challenges, which they are very committed to face. I am sure that, with continued support from the international community, they will be able to continue with their path of reform and to address the many problems that still face the country.
>
> On a more general note, the issue raised by Mrs. van Geest is of interest. We will be looking forward to the paper being prepared by the Treasurer's Department.

I will communicate all the comments that have been made here to my authorities.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal and commended the Ugandan authorities for their continued commitment to macroeconomic and structural reforms. They recognized that heavy rains had made it difficult to achieve some of the program targets for 1997/98, particularly regarding economic growth and inflation. Nonetheless, the authorities' determination to control inflation appeared to be bearing fruit, and the prospects for the remainder of the year were encouraging.

Directors welcomed the Ugandan authorities' commitment to achieve the programmed budget deficit in 1997/98, despite the emergence of new challenges. In this regard, they commended the authorities for the measures taken to strengthen tax and customs administration and to improve the functioning of the Uganda Revenue Authority. They encouraged the authorities to intensify their efforts to enhance tax administration, including through better control of smuggling and improvement of the value-added tax administration, and to avoid an erosion of the beneficial effects of the new Income Tax Act. These efforts should help contain the shortfall in revenues stemming from the adverse weather conditions and the decline in oil prices. Directors welcomed the efforts to control nonpriority expenditures, which should make it possible to meet the program target while safeguarding critical allocations for social expenditures, especially on education and health. They urged the authorities to maintain the momentum and credibility of the Universal Primary Education program. They also emphasized the need for improved expenditure control and better accountability at the district level. They welcomed the greater attention to governance issues, and called for further improvements in this area, including at the district level.

Directors welcomed the envisaged further tightening of broad money during the remainder of the fiscal year. They viewed the recent sale of the Uganda Commercial Bank as an important milestone in the country's financial sector reform efforts. Directors expressed the hope that under new management, the restructuring of the UCB would be speedily completed. They also welcomed the improvement in bank supervision and the health of the banking system, and urged strengthened efforts to ensure that all banks were meeting the required capital adequacy ratios. They supported efforts to strengthen the supervisory capacity of the Bank of Uganda, and to develop its monetary instruments.

Directors welcomed the progress on structural reforms, including in the areas of trade liberalization, the civil service, the financial sector, privatization, and efforts to enable diversification of the economy. They encouraged the authorities to move quickly to complete the sale of the Uganda Telecommunications Corporation. While recognizing technical and other difficulties related to the privatization program, Directors argued for best efforts to conclude the sale of as many public enterprises as possible, and to avoid losing the momentum of the privatization program. They also encouraged speeding up the restructuring of those public enterprises that would remain in the public sector. Directors stressed the importance of overcoming obstacles to growth through improvements in power and road facilities, legal and judicial frameworks, technical and administrative capacity, and the statistical base.

Directors agreed that the conditions for reaching Uganda's completion point under the HIPC Initiative had been fulfilled, and they supported the proposed schedule for drawing down the Fund's assistance to Uganda under the Initiative. They were pleased to welcome Uganda as the first country to reach the completion point under the HIPC Initiative, but stressed that Uganda should remain fully committed to the adjustment program. They welcomed the authorities' announced intention to use the resources freed up under the Initiative to support the social sectors and address poverty. Directors stressed that the authorities should pursue their external debt management strategy in order to help safeguard the debt sustainability that would be achieved through the ongoing implementation of the structural reform agenda, in concert with the delivery of assistance by all of Uganda's creditors under the Initiative. They indicated their expectation that the authorities would not relax their commitment to the reform effort after the delivery of the HIPC assistance.

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

The Executive Board took the following decisions:

**Uganda—Enhanced Structural Adjustment Facility—Review Under First Annual Arrangement**

1. Uganda has consulted with the Fund in accordance with paragraph 2(d) of the first annual arrangement for Uganda under the Enhanced Structural Adjustment Facility (EBS/97/191, Sup. 1), and paragraph 40 of the memorandum annexed to the letter dated October 22, 1997 from the Minister of Finance of Uganda.

2. The letter dated March 19, 1998, with its annexed memorandum of economic and financial policies, from the Minister of Finance shall be attached to the first annual arrangement, and the letter dated October 22, 1997, with its annexed memorandum of economic and financial policies, shall be read as

supplemented by the letter dated March 19, 1998 and the memorandum attached thereto.

3. Accordingly, the benchmarks specified in paragraph 3(a) of the first annual arrangement shall also comprise those specified in Table 1 attached to the memorandum annexed to the letter dated March 19, 1998.

4. The Fund determines that the midterm review contemplated in paragraph 2(d) of the first annual arrangement has been completed and that Uganda may request disbursement of the second loan specified in paragraph 1(c)(ii) of that arrangement, notwithstanding the nonobservance of the performance criterion for December 31, 1997 specified in paragraph 2(a)(ii) of the arrangement. (EBS/98/58, 3/24/98)

Decision No.11704-(98/42), adopted
April 8, 1998

**Uganda—Initiative for Heavily Indebted Poor Countries—Completion Point**

1. The Fund, as Trustee (the Trustee) of the Trust for Special ESAF Operations for the Heavily Indebted Poor Countries and Interim ESAF Subsidy Operations (ESAF/HIPC Trust) established by Decision No. 11436-(97/10) ESAF, adopted February 4, 1997, determines that:

(i) the conditions specified in paragraph (ii) of Decision No. 11491-(97/44), adopted April 23, 1997, for Uganda to reach the completion point have been met;

(ii) the external debt sustainability target for the present value of the debt-to-exports ratio for Uganda is within the range specified in paragraph (iii) of Decision No. 11491-(97/44); and

(iii) satisfactory assurances have been received regarding the exceptional assistance to be provided under the Initiative by Uganda's other creditors.

2. Accordingly, the Trustee confirms that, in accordance with Section III, paragraph 3(d) of the ESAF/HIPC Instrument, the SDR equivalent of $68.9 million shall be made available by the Trustee to Uganda in the form of a grant that shall be paid on April 15, 1998 to an account for the benefit of Uganda established and administered by the Trustee in accordance with Section III,

paragraph 5, of the ESAF/HIPC Trust Instrument; the proceeds of the grant shall be used by the Trustee to meet Uganda's debt-service payments on its existing debt to the Fund as they fall due, in accordance with the schedule specified in the table attached to EBS/98/55, 3/20/98.

Decision No.11705-(98/42), adopted
April 8, 1998

## 4. IMPLEMENTATION OF INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—DRAFT REPORT OF EXECUTIVE BOARD TO INTERIM COMMITTEE

The Executive Directors considered a draft report of the Executive Board to the Interim Committee, prepared jointly by the staffs of the Fund and the World Bank, on the implementation of the Initiative for Heavily Indebted Poor Countries (EBS/98/69, 4/6/98).

The Director of the Policy Development and Review Department commented that, in light of recent Board discussions, the reference to Guinea-Bissau on page 3 of the staff report should be amended to read: "...at the completion point was toward the lower end of the range of 200 to 230 percent." Also, there had been some questions about the timing of transfer of resources from the Reserve Account to the ESAF-HIPC Trust. In this regard, he suggested that the first paragraph of the subheading "Financing of Bank-Fund participation in the HIPC Initiative" should be amended, inserting as the third to last sentence the phrase "The transfer to the ESAF-HIPC Trust will be made promptly after the end of the financial year in 1998."

Mr. Wijnholds noted that the next sentence, "Finally, a number of bilateral contributions to the ESAF-HIPC Trust have been received," was buried unobtrusively in the paragraph. Given the importance of bilateral contributions, he suggested that the sentence be given greater prominence, and perhaps placed at the beginning of the paragraph.

Mr. Esdar and Mr. Shaalan supported the existing language of the draft report, with the modifications suggested by Mr. Wijnholds and the Director of the Policy Development and Review Department.

Mrs. Guti agreed that the language could remain unamended, as long as it was clear that the issues she had raised were still open for consideration, and as long as they would be covered sufficiently in advance of the review.

Mr. Guzmán-Calafell agreed that the report should remain unaltered, except for the amendments that had been suggested so far.

Mr. Fujii supported Mr. Wijnholds's sentiments, and suggested that the wording of the paragraph on page 4 be altered to mention specifically the six countries that had contributed to the ESAF-HIPC Trust. Also, the summing up of the preliminary HIPC Initiative meeting for

Mali had mentioned that a few Directors had recommended that Mali be considered as a borderline case. He suggested that the views of those Directors be included in the current report to the Interim Committee.

The Chairman, noting the complications that might arise if every minority opinion were included, urged Mr. Fujii to reconsider his request, now that his wish had been placed on the record. He also agreed that the language of the paragraph on page 4 would be amended to note the bilateral contributions of members, who would be listed in alphabetical order.

Mr. Fujii agreed with the Chairman's suggestion.

Ms. Lissakers suggested that it might be useful for the report to mention explicitly that the case of Guinea-Bissau, like Mozambique, would involve a financing gap requiring creditors to go beyond the usual stock of debt reduction. Also, she suggested that the report mention the interim relief that the World Bank had been providing through International Development Association grants.

The Chairman agreed that those points would be incorporated into the report, along with the other suggestions agreed by Directors. The report would then be submitted to the Interim Committee.

## 5. EVALUATION OF ENHANCED STRUCTURAL ADJUSTMENT FACILITY (ESAF) AND STATUS OF FUNDING FOR ESAF AND HEAVILY INDEBTED POOR COUNTRIES INITIATIVES—DRAFT REPORT OF MANAGING DIRECTOR TO INTERIM COMMITTEE

The Executive Directors considered the draft report of the Managing Director to the Interim Committee on the ESAF evaluation and the status of funding for the ESAF and Heavily Indebted Poor Countries (HIPC) Initiatives (EBS/98/70, 4/6/98).

The Chairman invited Directors to comment on the draft report. The report was important, as it indicated to Ministers and Governors the types of changes to the ESAF that the Fund would introduce in the near future.

The Deputy Treasurer recommended that the last sentence of paragraph 17 be amended to reflect the Director of the Policy Development and Review Department's suggested change to the draft HIPC report, concerning the timing of the transfer to the HIPC Trust. He also suggested that the third line of that paragraph be amended to reflect recent budget estimates, which had an updated figure of SDR 40.7 million.

Mr. Wijnholds suggested that it might be useful if the report mentioned that the internal and external evaluation reports had been published, underlining the Fund's commitment to transparency. Also, he noted with approval that paragraph 12 mentioned explicitly the possibility of precautionary arrangements under the ESAF. On paragraph 14, the sentence explicitly mentioning the need for more staff resources was somewhat redundant, given that a previous sentence had already dealt with the resource implications of improving the ESAF.

The Chairman agreed that the sentence could be dropped, but asked Directors to make Ministers mindful of the fact that there were limits on what the Fund and the Bank could do. In a recent discussion with the President of the World Bank, he had stressed that improving the ESAF would help strengthen cooperation between the two institutions, but he had also warned that the new process would be labor intensive. The president had replied that he fully supported the proposed improvements, and would make every effort to secure the needed resources.

Ms. Lissakers pointed out that unsuccessful programs were also labor intensive. One of the key findings of the recent evaluation was that greater ownership and stronger initial monitoring would result in fewer interruptions to ESAF-supported programs, which implied a reduced need for remedial action, reevaluation, and repeated renegotiation.

The Chairman remarked that many of the shortfalls and deficiencies in the current ESAF arrangements could be attributed in large part to a lack of resources. And it had to be stressed to Ministers that addressing those shortfalls would require further resources.

Mr. Shaalan and Mr. Rouai said that they supported the Chairman's sentiments.

Mr. Wijnholds remarked that his suggestion had been intended to preclude a detailed discussion of budget issues.

The Chairman thanked Mr. Wijnholds and agreed that the sentence on staff requirements could be dropped. However, there had to be no misunderstanding by Ministers that the intended improvements could be achieved with the current level of resources.

Mr. Esdar remarked that the Board had been divided on whether the new procedures would include precautionary ESAF or Stand-By arrangements. He therefore recommended that the draft report keep the phrase "precautionary arrangement."

The Director of the Policy Development and Review Department commented that the language of the report had been drafted with that difference of opinion in mind. However, the Board would soon consider a staff report outlining the operational implications of the two approaches.

Mr. Sivaraman considered that the language of paragraph 9 might be improved. The first sentence, in which it was noted that many governments had felt a loss of control over the policy content and pace of their reform programs, did not seem to connect with the second sentence, in which it was pointed out that governments had a low level of commitment to pursuing policy objectives.

The Chairman agreed with Mr. Sivaraman's concerns and suggested that an intermediate sentence might be inserted, so as to integrate the two concepts.

Mrs. Guti pointed out that paragraph 10 referred to the front-loading of structural reforms with long lead times. However, she considered that the emphasis should instead focus on the actual economic benefits of front-loading particular reforms, rather than on their lead time per se. The paragraph might be reworded, therefore, to stress the prioritization and front-loading of those reforms which would contribute to an improved supply response by the economy.

On financing the ESAF-HIPC Initiative, there was some concern as to whether the cost estimates remained adequate, particularly the report's assumptions on the availability of funds from Second Special Contingency Account refunds, Mrs. Guti continued. Also, there was a question as to whether the self-sustained ESAF, the interim ESAF, and special ESAF operations would have to compete for funds, or perhaps require adjustments elsewhere.

The Chairman responded that he had insisted on having paragraph 20 explicitly refer to the financing issue. The required amount had been set at SDR 1.5 billion, and would be the focus of Fund efforts leading up to the 1998 Annual Meetings.

Mrs. Guti commented that, given the constraints on bilateral funding, the Fund might have to consider the use of General Resource Account funds.

The Chairman remarked that Fund policy on that issue had been set down in the summing up of the September 1996 meeting.

Mr. Shields suggested that, while it might be a large exercise to completely update all cost estimates, it might nevertheless be useful to provide updated figures on those agreements that had been made so far—to allow comparison with their initial estimates. The updates might be included in paragraph 15, or in a footnote. Similarly, the figures in paragraph 18 might need updating.

Mr. Chelsky remarked that the report should clarify that the transfer of SDR 250 million was an interim measure, and was not an additional source of funding. Also, he suggested that the second sentence of paragraph 2 be changed from "Although they did not endorse all of the views expressed by external evaluators,..." to "Although they endorsed many of the views of external evaluators,..."

The Chairman agreed with Mr. Chelsky's suggestion.

Ms. Lissakers commented that the internal ESAF evaluation appeared to have strongly supported nominal anchors for the disinflation process, and she suggested that the report might refer to that position. Further, in paragraph 18, the report had stated that "On the basis of preliminary cost estimates for the five [four] additional countries, including Ethiopia, which are expected to reach their decision points this year..." It was doubtful whether Ethiopia would actually reach its decision point within that period, and similar reservations might be expressed about Mauritania.

The Chairman noted that it was agreed that the sentence be altered to "...additional countries, including Ethiopia, which could reach their decision points this year."

Mr. Guzmán-Calafell noted the reference in paragraph 4, which stated that "many ESAF users continue to perform below their potential, per capita growth only recently having caught up with the average in other developing countries." That appeared to disagree with the statement in the summing up of the Board's discussion, which had stated that many ESAF users remained below the average in other developing countries. He asked whether the report reflected more up-to-date information.

At the end of paragraph 6, there was a reference to areas where ESAF-supported programs should pay particular attention, Mr. Guzmán-Calafell continued. However, in the summing up, it was stated that responsibility for helping policy formulation in most of those areas should be left to the World Bank. That was an important point and should be kept in the text of the report.

The Chairman agreed that the point was important, and noted that paragraph 7 mentioned the need to draw on the expertise and data of the World Bank.

The Director of the Policy Development and Review Department remarked that paragraph 7 was somewhat concentrated on the issue of social indicators, so that maybe a more general reference to the World Bank might be included in paragraph 6.

Mr. Guzmán-Calafell suggested that paragraph 10 be amended to state: "a key consideration in program design is to ensure that structural reforms with long gestational lags..."

The Chairman agreed to the suggestion.

Responding to a question from Mr. Sivaraman, the Deputy Treasurer agreed that the figures for assistance at completion point, in both the HIPC document and the ESAF report, would be quoted in SDR terms.

Also, in the forthcoming review of the HIPC Initiative, there would be a full updating of the costs of the Initiative, the Director continued. So far, the total cost of the Initiative had been slightly below the original estimates.

The Chairman remarked that, following the successes of the past few years, the Fund was currently facing a window of opportunity and an expectation among poor countries for improved performance. The evaluations of the ESAF had stressed that not enough preparatory work—in terms of data collection, institution building, consensus formation, safety net reform, and so on—had preceded ESAF-supported programs. Therefore, the Fund and the World Bank would build on their success in handling the HIPC Initiative, and deliver a new, more efficient ESAF.

On the need for improved nominal monetary anchors, which were necessary for the achievement of single-digit inflation, the Chairman continued, experience had shown that low inflation had been associated with: increased growth, open trade, regional integration, quality budget expenditure, efficient public sector reform, privatization, and greater focus on social development. The Fund could make a real difference in helping countries reach those goals.

It was agreed that changes suggested by Directors would be incorporated into the report, and then sent to the Interim Committee, the Chairman noted.

## 6. DRAFT CODE OF CONDUCT—FISCAL TRANSPARENCY

The Executive Directors considered a staff paper containing a draft code of conduct on fiscal transparency that took into account comments and suggestions made at Executive Board Seminar 98/3 (4/1/98) (SM/98/66, Rev. 1, 4/7/98).

The Acting Chairman noted that Directors generally thanked the staff for their redrafted report. They had done an exemplary job of incorporating the various, sometimes conflicting, suggestions and concerns of Directors.

Mr. Daïri made the following statement:

> I support this initiative to promote fiscal transparency in member countries, including a declaration by the Interim Committee on this issue. However, I reiterate my strong reservations regarding the proposed title. Instead, I favor a declaration of principles of fiscal transparency that could serve as benchmark through which members' performance can be assessed by the public, with due consideration to their political and social circumstances and resource constraints. Any reference to what countries "should do" or to what "ought to be implemented," as mentioned on page 1, should be deleted. The supporting manual would therefore be regarded as background information on how such principles are applied in different country situations and not as guidelines on how to implement the Code. I also reiterate my proposal that the universal character of this declaration of principles should be highlighted further by referring to issues that are most relevant to advanced economies, including the need to provide information on unfunded entitlement liabilities, long-term health care financing, and generational accounting.
>
> While I broadly agree with the principles spelled out in the paper, I have a few comments on the suggested draft:

Under 1.1.1, in defining the general government, reference to the central government should be replaced by reference to the central government's budget. Otherwise, there will be no need to make explicit reference to extra budgetary accounts. These accounts are by definition outside the budget, but not necessarily outside central government control.

Under 2.1.2, it is clear that the outturn of the preceding fiscal year will not be available at the time of budget presentation. It is better to refer to the likely outturn.

Under 3.1.3, any reference to the consistency of the budget with a quantitative macroeconomic framework should be deleted. Consistency should be appraised by the general public and other interested parties on the basis of the announced policies. However, it is important that a quantitative macroeconomic framework, including the underlying assumptions, be presented with the budget.

Under 3.1.5, reference to uncertain costs of specific expenditure should be deleted. The budget should only include expenditures that can be identified and quantified, any other expenditures that may become necessary during the fiscal year should be addressed in a transparent manner in the context of a revised budget.

More generally, the paper should make explicit reference to recourse to revised budgets or supplementary budgets to deal with significant departures from the original budget in a transparent manner.

Under 3.2.1, the reference to IMF Government Finance Statistics for budget classification should be deleted. Budget presentation needs to be tailored to the country's particular circumstances while allowing for international comparisons. It is better to refer to the main classification principles, as spelled out in the paper, than to complex standards of an IMF publication.

Ms. Cilento, speaking on behalf of Mr. Taylor, made the following statement:

I would like to congratulate staff on an excellent revision to the Draft Code of Conduct on Fiscal Transparency.

As I may be unable to attend this afternoon's meeting, I am circulating my remaining comments in advance.

On the Code itself,

I can accept either 'Code' or 'Principles' in the title;

Paragraphs 1.1.2 and 1.2.3 are marginal cases for inclusion in a document on fiscal transparency, but given their more general usefulness, we agree to their inclusion;

Under 3.1.5, the words "where possible" should be added to the sentence after the word "quantified."

The Preamble would be even better, I submit, with the modifications proposed in the attachment (italics indicate additions/changes).

I attach particular importance to the explanatory references to the Manual (fourth paragraph); and to the use of the Code and the Manual in the Fund's work (sixth paragraph).

The Director of the Fiscal Affairs Department commented that the current draft reflected the staff's best efforts at incorporating Directors' suggestions. However, three issues remained to be resolved. First, there was a question as to whether the document's title should refer to a "code" or simply a list of "principles;" second, there appeared to be disagreement on whether the transparency process should include a normative dimension; and third, there were somewhat minor questions on the precise role of the Fund.

Mr. Hansen made the following statement:

First of all, as I did not have the opportunity to welcome the Code last week, I would like to do it now, and, like Mr. Taylor, I think the staff has done a commendable job in revising the original draft.

Turning right away to the specifics of the draft Code, there is one point I want to raise. I'd like to reiterate the position of this chair that in its work on fiscal transparency and dissemination of good practices, the Fund should complement and not duplicate the work of other international organizations. In this regard, the first sentence of the second paragraph of the preamble of the Code, which explains why the Interim Committee is encouraging members to implement the Code and says "the IMF is well placed to take the lead in promoting greater fiscal transparency," goes one step too far. My view is that the previous wording from the draft discussed in the Board seminar last week fits more neutrally in the context of the cooperation of the Fund and other institutions in the field of fiscal transparency, but I also can accept the wording suggested by Mr. Taylor in his Grey. I also share the point raised by Mrs. Van Geest during the Board seminar last week that a cooperative ownership of the Code among international institutions would surely benefit the good cause of promoting fiscal transparency. Furthermore, similar institutional cooperation spirit should also be maintained in extending technical assistance to the countries in need.

Now, on a few points raised by my colleagues in their preliminary statements. I support Mr. Taylor's suggestions for the Preamble of the Code. On the points raised by Mr. Daïri, I think that the whole purpose of the Code is to change things to the better in the area of fiscal transparency. Therefore, references that countries should do something to implement the principles contained in the Code are entirely appropriate. Similarly, the forthcoming Manual will be more than just a fact-sheet, and will implicitly guide actual implementation of those principles by presenting a choice of best practices followed by various countries. Finally, the need to identify the risks relating to uncertain costs of specific expenditures would emphasize more clearly the awareness of the budget-planning authorities of the underlying risks. If, unfortunately, the worst case of the uncertainty materializes and high costs are incurred, there would be less shock to the public if the public was aware of those risks from the beginning.

Mr. Shaalan made the following statement:

First, I support Mr. Daïri's proposal for the change in the document's title.

Second, if I understood the Director of the Fiscal Affairs Department correctly, it has not yet been decided whether the Fund will monitor the implementation of the guidelines. In that case, I do not understand the first full sentence on page 2, where it says: "The Code will facilitate surveillance of economic policies by country authorities, financial markets, and international organizations." I had assumed that the Fund would be one of the mentioned international organizations.

The Acting Chairman replied that the issue was related to whether the Fund would use the Article IV process to promote transparency.

Mr. Daïri considered that, if the goal was to raise awareness and monitoring by financial markets, it was best not to confuse the issue by including surveillance by the Fund. He therefore supported Mr. Shaalan's proposal that the reference to Fund surveillance be dropped.

Mr. Shields made the following statement:

The redraft has been handled well and incorporates many of the points that were raised last time. I am satisfied with the code as it has now stands, and I agree with Mr. Daïri that it should be universally applicable.

On the implications of the title, I prefer to remain with the original suggestion of the Interim Committee, which refers to a code of conduct rather than a list of principles. Mr. Daïri's preliminary statement indicates why that is important—a code suggests a list of more practical guidelines, whereas a set of principles suggest more lofty, less reachable ambitions. Still, a code does not necessarily imply a legal imperative. It is just a practical expression. The recommendations of Mr. Daïri and others would seem to water down the document, perhaps to the point where it would fail to achieve anything of significance.

The elements of the Code are not contentious around this Board, in terms of the suggested improvements to the presentation of countries' policies. But if we keep it as a declaration of principles, it is somewhat vague and uncommitted. I believe we should go further, but that should not imply that the Code is legally enforceable. I recognize that the issue is legitimate concern, and I agree that there would be a problem if such an implication existed. But I do not think the problem arises.

It is important to determine how the Fund can encourage implementation without in any way forcing countries to act against their will. And it is important for the code to explicitly note that it is just one step in the process, and that there will be a helpful manual which will suggest further ways forward.

It is also crucial that we refer to the Fund's use of the Code and the manual in the context of surveillance. That would demonstrate how the Fund could take the process forward, and how we can add value. Also, we need to make clear that we stand ready to provide technical assistance if necessary. All those elements are nicely dealt with in Mr. Taylor's redraft of the preamble, and I would be pleased to take Mr. Taylor's recommendations as they stand.

Mr. Grilli, Mr. Shaalan, Mr. Toribio and Mr. Sivaraman remarked that they understood the word "code" to have legal connotations.

Mr. Sivaraman also questioned whether the inclusion of paragraph 1.1.3 was appropriate, as the allocation of responsibilities between different levels and branches of government was usually outlined in each country's constitution. Further, he wondered whether the reference to ethical standards of behavior for public servants belonged in a document on fiscal transparency.

Mr. Szczuka remarked that he had no preference for the term "code" over "principles," but he accepted the judgment of Mr. Shields and the staff that the word "code" did not imply any legal authority for the document. There was a clear understanding between Directors that the Code would not be legally enforceable, but rather something that would be helpful to members. On the role of the Fund, it should have some involvement in the assessment of each country's progress. Although there would be no scope for sanctions, Fund oversight would help foster fiscal transparency as an effective norm of international behavior.

Mr. Toribio remarked that the current draft captured the appropriate normative dimension of the code, and the proper role of the Fund. The Fund was seeking to encourage, not compel, members to implement the code of conduct on fiscal transparency. On the issue of "code" versus "principles," he was willing to be persuaded by the majority.

The wording of the draft text was acceptable, Mr. Toribio continued, with a single reservation concerning paragraph 3.2.1. That paragraph-requiring government transactions to be on a gross basis, distinguishing revenue, expenditure, and financing, appeared to be in direct contrast with existing Fund practices. The Fund had previously allowed crisis countries, when reporting the budgetary impact of bank restructuring, to consider only the annual interest on associated debt. The Code's paragraph was entirely appropriate, but it emphasized the need for the Fund to reconsider that particular practice.

Mr. Shields stressed that the word "code" could be used in many different contexts, and that the current context did not imply any legal authority for the document. On the point raised by Mr. Sivaraman, on whether the suggested ethical code for civil servants belonged in a document on fiscal transparency, the overall goal of the document was to ensure that the public was sufficiently informed about the government's fiscal activities. The public also needed to know on what basis they would be dealing with the government—their rights, responsibilities, and avenues of appeal—and that would include details on the proper relationship between the public and the civil service.

Mr. Sivaraman stated that he was not objecting to ethical standards for public servants. Rather, he was simply questioning whether they should be part of the guidelines on fiscal transparency. Such an ethical code would be wide-ranging, and might have to encompass officials and departments that had little to do with fiscal affairs.

Mr. Toribio remarked that the document was not concerned with the details of a particular country's ethical code. It simply suggested that such a code be clear and well-publicized. It was reasonable to include such a suggestion in any treatment of transparency.

Mr. Sivaraman replied that he would not object to that suggestion being included in the document, but it seemed strange to focus on that particular issue, when there were so many other items that might also be clearly laid down and well-publicized.

Mr. Daïri said that he supported Mr. Sivaraman's comments.

Mr. Esdar remarked that the word "ethical" was perhaps too normative. It might be preferable to simply refer to a "code of conduct."

Mr. Wijnholds, noting that the issue of the document's title seemed to be taking up much of the Board's time, recalled the language of the Interim Committee communiqué. Ministers had appeared to be satisfied with the use of the word "code," and the Board should be reluctant to retreat from language that had already been agreed by the Committee. He was satisfied with either term, "code" or "principles," but efforts to water down the title further might render the document meaningless.

Mr. Fernandez said that he shared the views of Mr. Wijnholds. On the reference to the Fund's surveillance, the wording of page 2 was acceptable. It would be helpful, however, for the manual to attempt to prioritize different objectives.

Mr. Sobel stated that he also shared Mr. Wijnholds's views.

Mr. Askari-Rankouhi said that he was similarly ambivalent as to whether the title should include the term "code" or "principles." He supported the proposed changes suggested by Mr. Taylor.

Mr. Daïri stated that he did not think using the word "principle" instead of "code" would water down the document, as the Fund was essentially asking countries to adhere to a list of general principles. A code of conduct, by implication, dealt with actual implementation, and so should be negotiated within the framework of a wider international discussion, as had been the case with principles of bank soundness. Rather than negotiating such a code internationally, it was instead preferable to agree on a broad set of principles, and then to wait for a more detailed manual, which would then help each member adopt its own code of conduct.

Mr. Hansen asked the staff to comment on the extent to which they had envisioned sharing the increased technical assistance burden with other institutions, such as the OECD and the World Bank. Also, paragraph 3.2.3 stated that standard figures on the government's financial position should be supplemented by a variety of other fiscal indicators. Some of those indicators, such as the primary structural deficit, were subject to different interpretations, and had been the subject of debate between different institutions. Staff comments would be welcome on how those differences might be reconciled.

Mr. Sobel endorsed the report's references to surveillance, as well as the reference to ethical standards for public servants—rent-seeking behavior by officials had often had a significant fiscal impact. Although the proposed text was acceptable, Mr. Taylor's suggested amendments appeared to reflect the views of the majority, and offered a basis for moving forward. However, in the second sentence of the second paragraph of Mr. Taylor's text, the concept of implementation appeared to have been lost. Also, concerning the last paragraph of the text, he wondered whether the words "will provide technical assistance" were appropriate, given the current financial constraints on the Fund.

Mr. Grilli, commenting on the first paragraph of the staff's preamble, considered that "popular support" was perhaps too strong a phrase to be applied to something as typically unpopular as fiscal policy. He suggested instead the phrase "...strengthen the credibility and public understanding of macroeconomic policies and choices..." Also, the word "central" in the following sentence was perhaps too forceful. Many things were important in a globalized environment, but it was difficult to say whether one particular issue was "central." The preamble might instead state that transparency was of "considerable importance." Those were minor suggestions, however, and he was willing to accept the preamble as it stood.

Mr. Mozhin commented that, owing to the use of the word "code" in the title, he had been questioned on the status of the document, and whether cabinet or parliamentary approval was required before his authorities would be able to agree. The word "principles" would address such concerns, while not watering down the document in any way.

Mr. Taylor's statement was mostly acceptable, Mr. Mozhin continued, but the staff's draft text had already been satisfactory. Mr. Taylor's inclusion of the phrase "the Fund will make use of both the Code and the manual to assess fiscal transparency of its members as part of its Article IV consultations" was worrisome. Although the sentence captured the ultimate purpose of the current initiative, it was premature to refer to such a use of the manual before the Board had had an opportunity to review the document itself. It would be difficult to ask his authorities to make an assessment, when little about the manual was known.

The Director of the Fiscal Affairs Department remarked that he could not be responsible for the different interpretations of the word "code" in different languages. The intent, however, was to present a general document, which would be in line with the 1996 declaration of the Interim Committee, but which would have no precise legal significance.

Mr. Al-Tuwaijri agreed with Mr. Mozhin's sentiments on the preferred use of "principles." He also agreed with Mr. Toribio that the staff's text appropriately reflected the normative element of the initiative, and the proposed role of the Fund.

Mr. Prader remarked that none of the countries in his constituency had a problem with the word "code." Also, it was important that there be monitoring of progress by the Fund, otherwise the current document might simply become another forgotten declaration. The aim instead was to incorporate the stated objectives into the operational work of the Fund.

Mr. Morais considered that the word "code" was not necessary for the Fund to promote transparency. The issue of fiscal management was an extension of a broader discussion on governance, which itself had already been the basis of limited conditionality. In addition, fiscal management was an uncertain field, in which it was difficult to distinguish between political, social, and economic factors. As such, it was not a field conducive to accurate and objective judgment, and there should be no misunderstanding that an external "code" would be enforced.

On the staff preamble, it might be helpful for further clarification on the circumstances in which the Fund would provide technical assistance, Mr. Morais continued. He also asked for staff comments on whether paragraph 1.1.2 would prohibit the use of fiscal incentives.

Mr. Daïri remarked that proceeding too quickly would prompt a withdrawal of enthusiasm by members. It was preferable, therefore, to agree on a general set of principles, and only then—within a framework of cooperative discussions on implementation and monitoring—consider how they should be put into practice.

Mr. Costa said that he shared Mr. Daïri's sentiments on the use of the term "principles," but he was willing to go along with the majority opinion of the Board. Mr. Taylor's draft of the preamble was acceptable, but should include a reference to the tangible benefits of fiscal transparency, such as reduced borrowing costs.

Mr. Grilli and Mr. Mozhin remarked that there seemed to be some confusion as to which draft was now being tabled, the draft provided by the staff or Mr. Taylor's proposed version. They suggested that Directors comment on the staff draft.

Mr. Esdar commented that perhaps a compromise title might be found in the wording of the Interim Committee, which had referred to a "code of good practices."

The Director of the Fiscal Affairs Department, commenting on Mr. Hansen's surprise at the statement that the Fund was well-placed to promote transparency, remarked that the Fund's membership covered the entire globe, unlike the OECD, and the Fiscal Affairs Department possessed the largest concentration of fiscal economists in the world, surpassing the World Bank. Further, the Fund was regularly involved in a variety of detailed fiscal issues—technical assistance missions were dispatched to over 100 countries each year. As for the likely work load, adoption of the Code would result in a large number of requests for technical assistance, and realistically, the vast majority of that work would fall to the Fund, rather than other institutions.

On the usefulness of certain specified fiscal indicators, such as the primary structural deficit, much of the debate over those measures had been settled in recent years, the Director continued. And the report was not suggesting that more traditional indicators should be replaced; rather, it was simply arguing that, in many cases, a range of different indicators would provide a more accurate picture of a country's fiscal situation.

On the issue of monitoring, the Director pointed out that the reference on page 2 of the draft code referred to oversight by countries, financial markets, international institutions, and local decision makers themselves—one of the greatest benefits of the initiative was that information available to local policy makers would be enhanced. Oversight by the Fund was a different issue. The Board was yet to decide whether the Fund would monitor members' progress through the Article IV process, or through other means. That discussion should probably be left until after the Board had seen the manual.

On paragraph 1.1.3, which asked for a clearly defined allocation of responsibilities among different levels and branches of government, it had been the experience of staff that such responsibilities were not always clearly understood, particularly in transition economies, the Director commented. On paragraph 1.2.3, which referred to ethical standards, it was now widely appreciated that corruption, non-transparency, and poor governance often contributed significantly to the problem of unintended consequences. Codes of behavior for individuals would help reduce that problem, and so would likely improve the efficacy of fiscal policy.

Responding to a suggestion by the Acting Chairman, that the Board consider the draft paragraph by paragraph, Mr. Grilli remarked that there had been many proposals by Directors that would be acceptable. However, there were others, such as Mr. Taylor's suggestion that members would be judged by Article IV missions on the basis of a hitherto unseen manual, that would have to be first submitted to his authorities.

The Acting Chairman noted that it was agreed that the first paragraph of the draft be amended to reflect the previous suggestions of Mr. Taylor and Mr. Grilli.

After some discussion, the Acting Chairman remarked that Directors agreed that the first sentence of the second paragraph be amended to read: "Because of its fiscal management expertise, and universal membership, the IMF is well placed to take the lead in promoting fiscal transparency." It was also agreed that the suggested changes from the third paragraph of Mr. Taylor's text should be included, but otherwise, paragraph 2 of the staff's draft would remain.

On the third paragraph of the staff's draft, after further consideration of drafting alternatives, the Acting Chairman remarked that it was agreed that the first sentence would be amended to read: "Guidelines to the implementation of the Code are to be provided in a supporting manual, which is currently being developed." The second sentence would drop the reference to the manual, and the language on technical assistance would be altered to read "...that the Fund must be prepared to provide technical assistance, in cooperation with other international organizations, to those countries that request it in connection with improving fiscal transparency."

In summarizing a discussion on whether to include a specific reference to the monitoring of members' progress in the context of Article IV consultations, the Acting Chairman noted that some Directors stressed that monitoring should be seen to apply to all members, not just program countries. Other Directors expressed concern that their authorities had not had a chance to review the proposed language. It was agreed that, as "surveillance" in the context of the Fund was widely known to encompass Article IV consultations, the staff's language could safely remain unaltered.

After some brief discussion, the Acting Chairman remarked that Directors agreed that paragraph 1.1.1 be amended to read "The government sector should correspond to the general government, which comprises the central government and lower levels of government, including their extrabudgetary operations. "Paragraph 1.1.4 would also be amended to refer to "state-controlled financial and non-financial enterprises."

The staff representative from the Fiscal Affairs Department, responding to a question from Mr. Jones, confirmed that paragraph 1.1.2, which called for non-discriminatory rules and procedures, would not limit authorities' ability to pursue active fiscal policy. The intent was to ensure that such policy was applied in a fair and non-discriminatory manner.

Following a brief discussion on various drafting suggestions, the Acting Chairman noted that it was agreed to alter the language of paragraph 1.1.2 to read: "Government involvement in the rest of the economy (e.g., through regulation, equity ownership) should be conducted in an open and public manner on the basis of clear rules and procedures, which should be applied in a non-discriminatory manner."

After some further brief discussion, the Acting Chairman remarked that Directors generally agreed that paragraph 1.1.3 be kept, although some Directors noted that it was somewhat superfluous.

Summarizing a discussion on ethical standards for civil servants, the Acting Chairman stated that it was agreed that paragraph 1.2.3 be replaced by "Codes of Conduct for public servants, to be decided by their respective national authorities, should be clear and well-publicized."

Responding to a concern expressed by Mr. Szczuka, the Acting Chairman noted that it was agreed that the second sentence of paragraph 2.1.1 be amended to read: "In addition, for lower levels of government, sufficient information should be provided on their revenue and expenditure to allow a consolidated financial position for the general government to be presented."

On a suggestion from Mr. Daïri, that the Code mention explicitly issues more relevant to developed countries, such as the long-term prospects of health and pension schemes, the Acting Chairman remarked that Directors noted that such issues were covered by paragraphs 2.1.3 and 2.1.4, which referred to contingent liabilities and the composition of government debt. The issue was also covered by paragraph 3.1.1, which dealt with assessments of sustainable fiscal policy. Detailed examples might be included in the manual.

Mr. Sobel pointed out that the first sentence of paragraph 3.2.1, which required the classification of budget data to be compatible with the Fund's Government Financial Statistics, had concerned some of his authorities' fiscal experts. He suggested that it be replaced with "The classification of budget data should be comprehensive and in a format from which IMF Government Financial Statistics can be derived."

Mr. Daïri suggested that the sentence delete any reference to a particular international standard.

After some consideration of various alternatives, the Acting Chairman noted that Directors agreed that the sentence be removed, and that a new sentence be inserted at the end of paragraph 3.2.1 as follows: "Budget data should be presented in a way that allows international comparisons." Details on that presentation, and compatibility with Government Financial Statistics, would be taken up in the manual.

Mr. Szczuka, commenting on paragraph 3.1.1, asked why the staff had removed all references to a medium- or long-term framework.

Mr. Askari-Rankouhi and Mr. Esdar replied that the issue had been discussed at the previous meeting on transparency, where it had been stressed that consistent and realistic medium- and long-term projections were not feasible.

The Acting Chairman remarked that Directors agreed to retain the language of the staff text.

In response to a suggestion from Ms. Honeyfield, the Acting Chairman said that it was agreed that the words "where possible" be inserted into paragraph 3.1.5 after the word "quantified."

Mr. Daïri suggested that the reference in paragraph 3.1.5, to the uncertain costs of specific expenditure commitments be removed. Only expenditures that could be identified and quantified should be included in the budget. Other uncertain expenditures could be addressed in a revised budget, if and when they arose.

Ms. Honeyfield agreed that circumstances often required supplementary budget estimates, which were a transparent means of admitting that initial assumptions needed to be changed.

The Director of the Fiscal Affairs Department remarked that, in many cases, a revised budget had been the best indicator that the original budget had not satisfied the principle of transparency. Directors should therefore consider carefully whether to allow scope for such a practice within the Code.

Responding to a question from Mrs. Van Geest, on why supplementary estimates could not be combined with sensitivity analysis in the original budget, Mr. Daïri remarked that official expressions of uncertainty in some areas, such as the health of the financial sector, might prove harmful.

After some further brief discussion, the Acting Chairman remarked that it was agreed that the staff text would remain, with Ms. Honeyfield's initial amendment.

In response to a suggestion from Mr. Daïri, the Acting Chairman noted that it was agreed that the second sentence of paragraph 3.4.1 would be amended to read: "In the absence of detailed information on lower governments, available indicators of their financial position (e.g., bank borrowing or bond issues) should be provided."

In response a comment by Mr. Szczuka, the Acting Chairman remarked that it was agreed that the wording of paragraph 3.3.1 would be changed to: "A comprehensive, integrated accounting system should be established, which should provide a reliable basis for assessing arrears."

Following some further discussion, the Acting Chairman noted that it was also agreed that paragraph 3.3.2 would be amended to read: "Procedures for procurement and employment should be standardized and accessible to all interested parties."

After some brief discussion, the Acting Chairman said that it was agreed that heading 4.1 would be changed to "The integrity of fiscal information should be subject to independent and public scrutiny." Also, Paragraph 4.1.2 would be changed to read: "Macroeconomic forecasts (including underlying assumptions) should be available for scrutiny by independent experts. "In addition, paragraph 4.1.3 would be changed to: "The integrity of fiscal statistics should be enhanced by providing the national statistics office with institutional independence."

In concluding the meeting, the Acting Chairman stated that Directors agreed that the title of the document would reflect the language of the recent Interim Communiqué, and refer to a "Code of Good Practices."

APPROVAL: May 15, 2001

SHAILENDRA J. ANJARIA
Secretary

**DRAFT CODE OF CONDUCT—FISCAL TRANSPARENCY**

Proposed Modifications from Mr. Taylor:

The Interim Committee stressed the importance of good governance when it adopted the **Partnership for Sustainable Global Growth** in September 1996, and again at its September 1997 meeting in Hong Kong SAR. Fiscal transparency would *make* a major contribution to the cause of good governance. It would lead to better-informed public debate about the design and results of fiscal policy, make governments more accountable for the implementation of fiscal policy, and thereby strengthen credibility as well as mobilize popular support for sound macroeconomic policies. In a globalized environment, fiscal transparency is of central importance to achieving macroeconomic stability and high-quality growth. However, it is only one aspect of good fiscal management, and attention has to be paid also to increasing the efficiency of government activity and establishing sound public finances.

Because of its fiscal management expertise, the IMF is well placed to *identify the key ingredients of fiscal transparency and to promote these among its membership. As a first step,* the Interim Committee *endorses* the following Code of Conduct on Fiscal Transparency and encourages IMF member countries *to work towards achieving the practices and principles set out in the Code.*

*The Code is based around the following key objectives*: roles and responsibilities in government *should be* clear; information on government activities *should be* provided to the public; budget preparation, execution, and reporting *should be* undertaken in an open manner; and fiscal information *should be* subjected to independent assurances of integrity. The Code sets out what governments should do to meet these objectives in terms of principles and practices. These principles and practices are distilled from the IMF's knowledge of fiscal management practices in member countries.

Guidelines to the implementation of the Code are to be provided in a supporting *practical* Manual, *which is currently being developed. The Manual will set out a range of good practices in fiscal transparency, drawing on experiences in member countries, and will develop in more detail the principles and practices set out in the Code.*

*The Code has been framed in general terms, and designed to transcend differences in fiscal management systems and cultural, constitutional, and legal environments.* The Code will facilitate surveillance of economic policies by country authorities, financial markets, and international institutions.

*For its part, the Fund will make use of both the Code and the Manual to assess the degree of fiscal transparency of its members as part of its Article IV consultations.* While there is scope in all countries for improvement with respect to some aspects of fiscal transparency covered in the Code, diversity and differences across countries inevitably imply that many countries may not be able to move quickly to implement all aspects of the Code. *Where members seek technical assistance to bring fiscal management practices into line with the Code, the IMF will provide such assistance where appropriate, in collaboration with other relevant institutions.*

Modifications to the Code *will* be considered periodically, in light of the experience with its implementation.