March 6, 2003
Approval: 3/13/03

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 02/125

9:00 a.m., December 19, 2002

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

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

Executive Directors	Alternate Executive Directors
	A.S. Alazzaz
	A.A. Al-Nassar, Temporary
D. Ondo Mañe	K. Kpetigo, Temporary
I.E. Bennett	N. O'Murchú
	C.J. Faircloth, Temporary
	D. Lewis-Bynoe, Temporary
M.J. Callaghan	W.-D. Cho, Temporary
F. Zurbrügg	W. Szczuka
	O. Steudler, Temporary
K. Bischofberger	H. Fabig, Temporary
P.C. Padoan	H. Vittas
	A. Lanza, Temporary
	D. Lombardi, Temporary
S.M. Indrawati	I. Alowi
	H.E. Phang, Temporary
Y.V. Reddy	R.A. Jayatissa
	K. Kanagasabapathy, Temporary
W. Kiekens	J. Sipko, Temporary
	B. Andersen
	A. Alber, Temporary
N. Jacklin	M. Lundsager
	P.A. Dohlman, Temporary
P. Duquesne	S. Boitreaud
	S. Boucher, Temporary
	A. Monajemi, Temporary
	S. Rouai, Temporary
A.V. Mozhin	A. Lushin
	Y. Lissovolik, Temporary
	M. Beauregard
	R. Calderon-Colin, Temporary
	M.A. Brooke
	B. Kelmanson, Temporary
M. Portugal	R. Steiner
	A. Maciá, Temporary
I. Usman	P.J. Ngumbullu
	J. Mafararikwa, Temporary
A.S. Shaalan	N.H. Farhan, Temporary
	Wang X.
	Wei X., Temporary
J. de Beaufort Wijnholds	N. Yeritsyan, Temporary
K. Yagi	H. Toyama
	T. Komatsuzaki, Temporary
	D. Ayala, Temporary
	R. Maino, Temporary

B. Esdar, Acting Secretary
A.S Linde, Acting Secretary
J. Morco, Assistant; M. Pedroni, Assistant; M. Schulte, Assistant

Also Present
IBRD: M. Barton-Dock, N. Benjamin, J. Sackey, African Regional Office; B. Mierau-Klein, Credit Risk Office. African Department: A. Bio-Tchané, Director; A. Basu, Deputy Director; V. Arora, G. Bagattini, J. Clement, A. D'Hoore, O. Dore, L. Erasmus, N. Kirmani, M Nowak, L. Ricci, D. Ross, L. Schmitz, I. Thiam, M. Vocke. Asia and Pacific Department: R. Elson, A. Richter. European I Department: R. Moalla-Fettin. External Relations Department: S. Bhatia, T. Dawson, B. Murray, P. Reynolds. Fiscal Affairs Department: C. Allard. International Capital Markets Department: G. Häusler, Director; H. Tran, Deputy Director; A. Bertuch-Samuels, P. Breuer, D. Grigorian, C. Medeiros, E. Psalida, J. Roaf, K. Srinivasan, M. Vera Martin. Legal Department: F.P. Gianviti, General Counsel; S. Hagan, T. Laryea, C. Ogada. Monetary and Exchange Affairs Department: E. Frydl. Policy Development and Review Department: M. Allen, Deputy Director; A. Aranitis, T. Dorsey, L. Ebrill, M. Fisher, M. Gilman, A. Kapteyn, R. Kincaid, A. MacArthur, M. Mecagni, L. Moers, C. Rosenberg, B. Setser. Research Department: J. Zettelmeyer. Secretary's Department: P. Cirillo, P. Gotur, L. Hubloue, P. Ramlogan. Treasurer's Department: L. Jaramillo, Z. Zhan. Western Hemisphere Department: O. Mandeng, R. Teja. Office of the Managing Director: J.T. Boorman, A. Mazarei, R. Moghadam, R. Nord. Office of Budget and Planning: T. Wolde-Semait. Advisors to Executive Directors: S. Antic, S.A. Bakhache, A. Baukol, B. Bossone, C. Duriyaprapan, D. Farelius, S.S. Farid, P.R. Fenton, P. Gitton, N. Guetat, F. Haupt, S. Kropas, F. Manno, A.D. Marinescu, M.F. Melhem, T. Miyoshi, P.A. Nijsse, L. Palei, R. Villavicencio. Assistants to Executive Directors: S. Alcaide, M. Di Maio, N. Epstein, R. Gauba, M. Jamaluddin, H.-H. Jang, Jin Z., C. Josz, J.T. Kanu, R. Karki, J.K. Kwakye, B.T. Mamba, T.P. Nguema-Affane, M.L. Nikitin, E. Pinto Moreira, J.W. Ralyea III, A. Rambarran, K. Sazanov, T. Segara, B. Siegenthaler, T. Skurzewski, A. Stuart, S. Vtyurina, A.Y.T. Wong, Yu J.

1. SWAZILAND—2002 ARTICLE IV CONSULTATION

Documents: Staff Report for the 2002 Article IV Consultation (SM/02/351, 11/14/02); and Selected Issues and Statistical Appendix (SM/02/353, 11/15/02)

Staff: Arora, AFR; Ebrill, PDR

Length: 1 hour, 5 minutes

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

> This statement reports on information that has been made available since the staff report (SM/02/351, November 14, 2002) was issued. It does not change the thrust of the staff appraisal.
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> Inflation has continued to increase. CPI inflation rose steadily to 12.9 percent (12-month rate) in October, from 11.8 percent in July, largely reflecting rising inflation in South Africa (14.5 percent in October) and higher food prices.
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> On December 2, 2002, Parliament approved supplementary expenditures worth E282 million (2¼ percent of GDP) for the current fiscal year (April 2002–March 2003). Three-fifths of the supplementary expenditure represents current spending (nearly half of it on grants and subsidies, education, and housing and urban development) and the remainder spending on capital projects (principally a major road project). The Ministry of Finance anticipates that the impact on the central government deficit will be contained by improved fiscal management and tax collection, reductions in nonessential spending, and, as in the past, underspending on investment projects. It expects the deficit in 2002/03 to be 4–4½ percent of GDP, compared with 3.9 percent reported in the staff report. It is hard to make an assessment of the impact of the supplementary expenditures on fiscal prospects, since details were not released on developments in the other elements of the expenditure plan and in revenues, but the effort to bring the budget deficit down to a sustainable level in the medium term will likely be more difficult. This reinforces the need for fiscal discipline in order to restore macroeconomic stability.
>
> A final decision has not yet been taken regarding the government's proposed acquisition of a new airplane for King Mswati III. After parliament voted against the original proposal in October, the government revisited the issue at a parliamentary caucus on November 18. The caucus suspended the acquisition, but asked for more detailed information on the transaction in order to make a final decision. A select committee was appointed and charged with providing the necessary information.

Governance issues have come to the forefront recently, particularly in the areas of the law and the independence of the judiciary. The majority of the judges in the High Court resigned on December 1 after the government refused to accept a ruling on the grounds that it undermined the King's ability to rule by decree. The planned airplane acquisition and the circumstances surrounding the judges' resignation have triggered protests by the business community and labor unions, who have called for a general strike and mass protests during December 19–20, 2002.

Mr. Usman submitted the following statement:

Key Points

Swaziland is facing a serious humanitarian crisis affecting the entire Southern African region with a food shortage affecting a growing number of the population aggravated by poverty, HIV/AIDS, high unemployment, and income inequality.

Economic growth continues to fall, exacerbated by deteriorating fiscal and external sector outlook.

There is a need to restrain government expenditure and reorient it toward the worsening humanitarian crisis and social sectors, while attempting to achieve macroeconomic stability and sustained economic growth.

Introduction

My Swaziland authorities would like to convey their appreciation to the staff for their constructive views, recommendations and advice during the last Article IV consultation staff mission. They are broadly in agreement with the report, which is candid and gives a fair and balanced view of the recent economic developments in the country highlighting also the numerous challenges.

Recent performance indicate a slump in economic growth, which stood at 1.75 percent in 2001 compared to 2.0 percent the year before. Inflation pressure continued to mount and reached an annualized 12.9 percent by October 2002. Economic growth has been falling over the years, largely as a result of a continued low inflows of foreign direct investments and increased competition from neighboring states. The country also suffered from the closure and downsizing of some of its major manufacturing entities, such as the fridge manufacturing firm, which employed a sizeable number of the work force in the manufacturing sector. A 10 percent decline in agricultural performance as a result of the poor weather conditions resulting in successive poor harvests also contributed to the poor performance. The same trend continued in 2002 as a result of the weak performance of the agricultural sector due largely to the continued drought conditions.

Unemployment remained at unacceptably high levels, estimated at 31 percent of the labor force in 2001, despite the significant number of jobs that have been created mainly in the textile sector since 2001, amounting to 6 percent of total employment. The authorities are however, committed to help ameliorate the situation through the attraction of more textile manufacturing concerns that seek to take advantage of the United States' Africa Growth and Opportunities Act (AGOA).

The international reserve position fell marginally, to two months of imports, as the external sector recorded fewer inflows of foreign direct investments into the country. The country's competitiveness was also undermined by the steady surge in the country's inflation rate. The depreciation of the local currency vis-à-vis its major trading partners in the latter half of 2001 to mid-2002, subsequently improved the country's export competitive edge. Exports to most industrial countries surged as a result of this development, accounting for 55 percent of total exports in 2001 from 40 percent in 1999.

Humanitarian Situation

The HIV/AIDS pandemic has continued to ravage the economy, with indications of an increase in infection rates which stand amongst the highest in the world. To address this concern my authorities established the National Emergency Response Committee on HIV/AIDS (NERCHA) in December 2001. NERCHA seeks to coordinate the fight against AIDS and effectively utilize the limited public resources to fight the pandemic.

Although the full economic impact of the HIV/AIDS pandemic is yet to be assessed, the spate of factory closures and departure of foreign investors largely due to the high incidence of the disease, underscores the seriousness of the humanitarian situation, which is compounded by the food shortage as a result of the prolonged drought. The authorities have allocated extra budgetary resources towards the food crisis and donor assistance has also been sought to deal with the issue. The HIV/AIDS crisis is affecting one out of every three people in the working age group of the population. The pandemic is not only threatening the country's most productive human resource base but stands to undermine longer-term economic growth prospects of the country. Taking into consideration that nearly one third of the population is unemployed and two-thirds of the population is living under US$1 per day, the country needs adequate foreign assistance to deal with the crisis.

My authorities are concerned by the classification which denies the country access to concessional multilateral financing under the PRGF and IDA. The classification fails to address the income inequality that currently exists in the country. They therefore urge the IMF and World Bank to re-examine the rationality of the eligibility criterion with a view to granting the country waiver to enable it to access concessional resources to effectively address the pandemic.

In this connection my authorities intend, in collaboration with the UNDP, to organize a donor conference in due course and they hope that they could count on the goodwill, understanding and support of the international community in this endeavor.

Fiscal Policy

My authorities are committed to improved fiscal discipline. They would develop a medium-term fiscal strategy in conjunction with an EU-sponsored fiscal restructuring project initiated in 2002 that aims at achieving macroeconomic stability and promoting economic growth. They are cognizant of the challenges posed by the HIV/AIDS threat and the need to reorient spending to increase social sector expenditures without worsening the medium-term budgetary position. Spending in health and education is to be increased, while transfers to parastatals would be restrained and the size of the wage bill contained.

My authorities are currently embarking on a comprehensive tax reform exercise under the Fiscal Restructuring Project, targeting diversification and broadening the revenue base. They are also committed to a further broadening of the tax base to compensate for the declines in the Southern African Customs Union (SACU) receipts, which currently account for approximately 50 percent of government revenues. SACU receipts are expected to decline as a result of the countries' WTO commitments and the South Africa-European Union Free Trade Area and the SADC trade arrangements. All remaining income tax exemptions will be abolished and the tax base will be broadened by amending the Sales Tax Act and incorporating previously uncovered commercial activities on the Swazi Nation Land. Tax collection will be improved and tax administration further strengthened. Tax officials will also receive training.

Monetary Policy

Swaziland belongs to a monetary union with Lesotho, Namibia and South Africa, where the currencies of these economies are pegged on a one-to-one basis with the South African rand. The rand circulates widely in Swaziland along with the local currency, the lilangeni. This has meant that it cannot exercise an independent monetary policy. Authorities agree with the recommendation of staff to maintain the peg and they believe that the gains outweigh the costs. This also serves to increase trade and foster further and deeper economic integration with its neighbor and biggest trading partner, South Africa. Monetary and exchange rate policies are therefore closely tied to those of South Africa and this informs the authorities commitment to continued increase in financial integration with members of the CMA.

Structural Reforms

Civil service reforms will continue and will help reduce the size and improve efficiency of the public service. The UNDP, working jointly with the authorities, is currently developing a comprehensive strategy to privatize and restructure public enterprises including the Central Transportation Authority (CTA). On the developments surrounding the Swaziland Public Service Pension Fund, the authorities accept recommendations of staff and would rectify the anomalies and initiate measures to increase its efficiency by increasing contributions and retirement age.

Reform of the Swaziland Development and Savings Bank is on-going, with the appointment of a new management team, recapitalization of the bank and provisioning for nonperforming loans. The Bank is now operating under new enhanced risk management procedures. My authorities support the need to delineate the commercial and development aspects of the bank to increase transparency and accountability of its financial operations while fulfilling its responsibility of improving the living standards of the people and contributing to the country's poverty reduction efforts.

Swaziland's trade policy is largely influenced by the Southern African Customs Union (SACU) which has been recently renegotiated. The new SACU will be a democratic institution which will also have Secretariat which will be responsible the day-to-day running of the affairs of the institution. Recognizing the small size, and relative openness of the Swazi economy and its susceptibility to external shocks the authorities will work closely with other regional economic integration groupings to promote an export sector-led economic growth.

My authorities remain committed to improve agricultural production on Swazi Nation Land through improved agricultural irrigation of land as shown by the recent implementation of the Lower Usuthu Smallholder Irrigation Project (LUSIP). The Land Policy Act is expected to further empower the smallholder rural farming communities to access credit to improve investment and productivity.

They agree with the staff recommendation to improve economic data to strengthen policy formulation and have already joined the GDDS project and would welcome technical assistance in this regard.

Other Reforms

A constitutional review process is currently underway with the formation of a Constitutional Review Commission (CRC). The commission is expected to complete its work soon and present its report and recommendations to the authorities and this is expected to bring into the country a new political dispensation once the commission's recommendations are considered and adopted.

Conclusion

My authorities remain committed to pursuing prudent macroeconomic policy and creating an environment conducive to attracting foreign direct investment. They however remain concerned with the slow response of the multilateral institutions and the international community to help them to address the humanitarian crisis facing the country in particular the HIV/AIDS pandemic and the food shortage crisis aggravating the already pervading poverty situation.

Mr. Ondo Mañe submitted the following statement:

At the outset, we would like to thank staff for the well written set of papers on recent developments in Swaziland and Mr. Usman for his helpful statement. Indeed, Swaziland faces a difficult economic situation that was aggravated by the humanitarian crisis affecting the entire Southern African region. Economic growth continued to decline, inflation picked up, the fiscal and external situation worsened. These difficulties culminated with severe food shortages stemming from a sharp decline in agriculture output, spreading HIV/AIDS, high unemployment, and income inequality. The most urgent challenges facing the authorities are to address steadfastly the humanitarian crisis, regain macroeconomic stability and restore the conditions for longer-term and broad-based economic growth. In this regard, it is important that the authorities implement sound fiscal and monetary policies, and accelerate structural reforms in the context of regional integration.

Fiscal Policy

On the fiscal front, it is important to note that following several years of weak fiscal performance, the authorities have adhered to greater fiscal discipline with the view of reestablishing fiscal consolidation and macroeconomic stability. This move will pave the way for improvement in growth prospects, and ensure the sustainability of the public debt position. As a result, social priorities will be better handled. Tax base-broadening measures are necessary to fill the remaining gap created by the decline in SACU-related trade taxes over the medium term. Additional measures are needed to strengthen tax administration, and accelerate the collection of tax arrears. In the same vein, effective control over transfers to public enterprises is welcome. We caution the authorities that, while reorienting spending toward critical sectors, particularly education and health, they should also pay attention to capital investment that is necessary for the maintenance of the physical infrastructures and economic growth.

Monetary Sector

We encourage the authorities to maintain the peg system since it has helped impose a financial discipline in a secured environment with close links to South Africa. The Swaziland authorities are to be commended for maintaining a sound banking system. Most of the banks are in compliance with the Basel Core Principles on capital adequacy, and the amount of nonperforming loans is relatively small.

Structural Reforms

On the structural front, we note that the authorities are aware that the restructuring of the public enterprises and their privatization should be accelerated. We hope that the draft privatization policy under preparation will be finalized and submitted to the parliament soon, so as to avoid unnecessary delays in its implementation. We also agree with the staff that the government should start implementing the decision to restructure the Central Transport Authority. On the Public Service Pension Fund (PSPF), we encourage the authorities to give full consideration to staff recommendations, so as to put the Pension Fund on a sustainable path.

The Humanitarian Crisis

Due to the continued difficulties facing the country, it is crucial that the humanitarian crisis with its two components, the food shortages and the HIV pandemic disease, be addressed steadfastly. The authorities will also need to pursue their efforts to reverse the trend so that Swaziland becomes a net exporter of food as in the past. In the meantime, we call on the international community to provide all needed aid and financial support to the population of Swaziland and the region. On HIV/AIDS, we share Mr. Usman's concern that the pandemic is threatening not only the productive base of the country, but also its longer-term economic growth prospects. We welcome the establishment of the National Emergency Response Committee (NERCHA) and we encourage the authorities to improve the quality of HIV/AIDS-related expenditure. We support the government' initiative to organize a donor conference to gather further international support on this matter.

With these remarks, we wish every success to the authorities in their efforts.

The staff representative from the African Department (Mr. Arora) noted that the labor strike, discussed in the staff's preliminary statement, had started on that day, but it appeared that most civil servants had reported to work, suggesting that the extent of participation was somewhat less than expected.

Mr. Usman reported that the authorities had consented to the publication of the staff report and the Public Information Notice. On the labor issue and the proposed national strike, the authorities had said that discussions were taking place through conciliation, mediation, and arbitration councils, involving labor federations. The matter had been referred to a labor advisory board and was in the process of arbitration. It was hoped that the strike would be abated, but probably because the issue had still been under arbitration, some people had reported to work while others had not.

Mr. Calderon-Colin made the following statement:

> We thank the staff for a brief but complete and informative paper. The analysis takes into consideration multiple factors that are necessary to assess correctly the economic situation in Swaziland. We also thank Mr. Usman for his statement, which has enlightened us more on the current state of economic affairs. Economic performance in Swaziland has continued to deteriorate, as observed by the deceleration in economic growth, the increase in inflation, a slight but continuing increase in the budget deficit, and the persistent fall in national savings. However, these indicators fail to reflect the gravity of the situation in Swaziland. We concur with the staff that the main economic challenges are to address the humanitarian crisis, to regain macroeconomic stability, and to raise the economy to a sustainable, longer-term growth rate, while ensuring that the benefits are spread widely.
>
> According to the staff's projections, if the current setting of policies is maintained, the real GDP growth rate could remain at around 1 ½ percent, and fiscal and external sustainability would deteriorate sharply, while inflation would remain somewhat higher than in South Africa. This status quo would also imply no improvement in the humanitarian crisis, with an annual 0.4 percent shrinking of the population by 2010, and a fall in life expectancy from the current level of 46 years to a projected level of 27 years.
>
> The authorities should be commended for recognizing that greater fiscal discipline is needed to regain macroeconomic stability, address social priorities, improve growth prospects, and maintain a sustainable public debt position. We remain concerned with the magnitude of the impact of HIV/AIDS in Swaziland and welcome the authorities' decision to form the National Emergency Response Committee. However, we are worried that only one-fourth of the budget allocated to HIV/AIDS was actually spent during 2001/02, due to coordination problems among agencies involved. In addition, as the staff indicated, the budgeted spending on the HIV/AIDS problem continues to be low, at just 0.2 percent of GDP.
>
> We welcome the authorities' intention to address medium-term pressures, with a reduction in the deficit and efforts to move toward a fiscal framework in conjunction with a European Union-sponsored fiscal restructuring project. The authorities should also be praised for the progress in implementing measures to broaden the tax base. However, we concur with the

staff that the authorities should attempt to achieve a primary surplus over the medium term.

We agree with the staff that, although overall expenditure should be restrained, expenditure needs to be reoriented toward critical social sectors, such as education and health, as the link between social spending in this area and income distribution is particularly strong, and public investment in human capital can be an efficient way to reduce income inequality over the long run. We thank Mr. Usman for updating us on the current economic situation in Swaziland and providing his insights.

We welcome the agreement between the authorities and the staff regarding the exchange rate regime and the loss of independence of monetary policy, and agree that trade will be fostered further and economic integration with South Africa deepened under this framework. However, we invite the authorities to carry out policies to attract foreign direct investment—Mr. Usman pointed out that low FDI was one deficiency in the current framework—as well as to correct inefficiencies among public enterprises, and to continue efforts to boost agricultural productivity and reduce unemployment.

We welcome the authorities' decision to participate in the GDDS, but support the staff's request for more comprehensive and timely economic statistics. We are somewhat surprised by the last update provided by the staff, and believe that the new figure for the deficit would indeed make it more difficult for Swaziland to achieve its objectives in the medium and long term. We hope that the governance problems will be solved soon so that the authorities may address the country's most urgent issues.

We wish the authorities success in their future endeavors.

Mr. Ayala made the following statement:

At the outset, we would like to thank staff for the useful economic and social analysis included on Swaziland's consultation reports and Mr. Usman for his informative statement. Swaziland's macroeconomic performance over the past years has been continuously deteriorating due to a combination of adverse shocks, both domestic and external, as well as from significant policy shortcomings. GDP growth continues to slow down, inflation is accelerating, and the external current account and fiscal deficits are widening. The social conditions have significantly worsened as a result of a drought that has seriously affected basic crops, and the HIV/AIDS pandemic that also presents a serious threat to economic prospects. Since we agree with the staff appraisal, we will confine our comments to a few broad areas for emphasis:

We are deeply concerned about the adverse consequences of HIV/AIDS. The outlook presented in Box 2 clearly shows the effects on demographic and social patterns, and of course the terrible human costs and the depressing effect on productivity. The decline in investment associated to concerns on the effects of this disease is also worrisome. We welcome the efforts and measures the authorities have recently taken in order to fight the HIV/AIDS pandemic. However, this is clearly not enough, as the authorities themselves agree, and in order to have an adequate response to the crisis, additional foreign assistance is needed. In that regard, we concur with staff that the government should redirect its policy priorities by focusing on the country's humanitarian situation, and on its macroeconomic stability to generate the adequate environment to attract international donors. The latter, is also necessary to alleviate the food shortage that, due to the drought, has deteriorated in the last months.

The deterioration of the fiscal balance reflecting a decline in tax receipts and the increase in wages for public servants is also troubling. The authorities' commitment to improve fiscal discipline and to attain macroeconomic stability and debt sustainability while increasing competitiveness should be reinforced. In this regard, we encourage them to persevere with the measures initiated in 2001/02 directed at broadening the tax base and also to consider the additional staff suggestions to strengthen the tax administration. We are pleased that the authorities recognize the importance to redirect spending towards education and health and encourage them to make efforts in that direction.

Fiscal discipline and the speed-up of structural reforms are key issues to maintain the exchange rate system based on the peg of the lilangeni to the South African rand. We recommend the authorities to carry out the implementation of public enterprise restructuring and privatization. These reforms are critical to increase the efficiency of the public sector, and to reduce resource misallocations while making the public sector finances more transparent. Regarding the Swaziland Public Service Pensions Fund, we encourage the authorities to consider the actuarial revisions recommended in order to improve its financial position, otherwise the system will eventually become another source of liabilities for the government. Regarding the proposed amendments to the pending Retirement Fund Act to recall investments held abroad by domestic pension funds, we concur with staff that it could be a risky decision. It is a priority to allow the Pension Funds to become more diversified including external assets and rental investment's alternatives in their asset's portfolio. In this regard, we welcome Mr. Usman's statement that the authorities accept recommendations of staff in order to increase the efficiency of the pension fund.

Regarding the financial sector, we are concerned with the situation of the Swaziland Development and Savings Bank and we concur with staff in the quick restructuring or privatization of the institution, so that the budgetary support to this bank could be tracked to social or more needed areas.

We also urge, like staff, the early enactment into law of the Land Policy Act that would provide services to farmers, improve conditions to increase productivity in the agricultural sector, and to reduce disparities in income distribution.

Finally, we welcome the authorities' decision to participate in the GDDS Project for Anglophone African Countries and encourage them to take advantage of Fund Technical assistance to create a good country's data system that would facilitate the design and monitoring of economic policies. With these remarks, we wish the authorities all the success in their future endeavors.

Mr. Faircloth made the following statement:

I would like to begin by thanking the staff for a candid report. As I agree with its main points, I can keep my intervention relatively short and focused on a few issues.

First, we welcome the assessment from the staff, which is endorsed in Mr. Usman's statement, that controlling government expenditures is a key priority. In the near term, expenditures should be restrained, and refocused toward dealing with the worsening humanitarian crisis and strengthening social sectors. The focus should be on macroeconomic stability and sustained economic growth in the medium and long term. With an HIV/AIDS infection rate estimated to be among the highest in the world, at over 33 percent of the working age population, and a food crisis that could affect 280,000 residents by the end of this year, there is an urgent need for the authorities to address these immediate crises to ensure a healthy work force in the future. The scale of the problem appears to be much larger than current resources can cope with, and we welcome the authorities' efforts to focus on macroeconomic stability and sustained growth. Attracting foreign inflows and investment is a main priority here.

Second, the staff's emphasis on issues of governance in the report is welcome and appropriate. The main concerns relate to the rule of law and the judiciary, and the use of scarce financial resources during these difficult times. Clearly, the focus of spending must be on alleviating social problems and enhancing development prospects. I would emphasize that this is not a time for capital spending on highly discretionary and unproductive items. Until governance issues are addressed in Swaziland, prospects for donor aid, foreign inflows, and investment will remain remote.

We welcome the information in Mr. Usman's statement regarding the constitutional review process and the formation of the constitutional review committee. We also look forward to the recommendations of the committee, and hope to see a role in the new constitution for the rule of law, an independent judiciary, and other governance issues. If Mr. Usman or the staff have any additional information on policies that are either planned or in place to address governance issues, I would be interested to hear them.

Third, with respect to the severe income inequality in the country, we understand that the authorities are working toward a Poverty Reduction Strategy and possible PRSP. We encourage the authorities to continue this work, with a view to developing a set of priority areas, as determined by participants in the process. This will be critical for reducing poverty and inequality.

My last point is that we welcome the authorities' recent announcement to decide to publish the staff report. This is a welcome step toward enhancing transparency. With these remarks, we wish the authorities every success in the future.

Mr. Kelmanson said that he supported Mr. Faircloth's statement.

Mr. Monajemi made the following statement:

We thank the staff for their set of comprehensive reports, and Mr. Usman for his helpful statement. In recent years, exogenous factors compounded by domestic policy weaknesses have served to depress Swaziland's growth and per capita income. In 2001, real GDP declined further because of a fall in export demand, associated with the economic slowdown in South Africa, inflation picked up, international reserves declined, and fiscal balance further deteriorated. With the devastating effects of HIV/AIDS compounded by the recent drought, Swaziland faces tremendous challenges, not only to address the humanitarian crisis, but also to regain macroeconomic stability and maintain a satisfactory level of growth and employment. The authorities are striving to organize food imports and strengthen the anti-HIV/AIDS efforts, but they would need substantial foreign assistance.

The authorities have recognized that greater fiscal discipline is needed to regain macroeconomic stability and improve growth prospects. In this regard, their efforts to move toward a medium term fiscal framework in conjunction with an EU sponsored fiscal restructuring project are welcome. We commend the authorities' intention to reduce the fiscal deficit to 1-2 percent of GDP over the medium term. On the revenue side, progress in implementing measures to broaden the tax base is highly appropriate. However, further efforts to strengthen tax administration and improve tax collection are needed. On the expenditure side, we concur with staff and the authorities that there is a need for reorientation of spending towards education and health.

Swaziland has a sound banking system. Bank capitalization, risk management, and provisioning are appropriate and nonperforming loans are low. However, the future of Swaziland Development and Savings Bank remains uncertain. The authorities are encouraged to act promptly to restructure or privatize this bank.

We join the staff in calling for early action to finalize the draft privatization policy, which is being prepared with support of the UNDP. Staff may wish to indicate the reason why the decision to restructure the Central Transport Authority, approved by the cabinet in 1999, has not yet been implemented. With regard to the Swaziland Public Service Pension Fund (PSPF), the authorities are well advised to take into account the Actuary's previous recommendations. The Cabinet's approval of the Land Policy Act is a positive step and its early enactment into law is recommended.

The pegged exchange rate to the rand has been beneficial to Swaziland, in view of its close economic ties with South Africa. However, to ensure credibility of the peg, fiscal consolidation and continued structural reforms will be required. In addition, within the limitations of the common monetary area, monetary policy should aim at building adequate level of international reserves.

The economic database needs to be improved. In this regard, we welcome the authorities' interest in addressing remaining shortcomings by participating in the GDDS Project for Anglophone African countries.

The socioeconomic situation in Swaziland is quite depressing. HIV/AIDS has continued to spread and now includes about one third of the working age population, a quarter of the population need emergency food assistance, and unemployment rate is very high. According to the reports, two third of the population live on less than US$1 per day, and the Gini coefficient, which may be under estimated, is 0.61 (highest among the lower middle income countries). We therefore share the concerns expressed by Mr. Usman and agree that concessional assistance should be provided to Swaziland from the international community. The authorities are encouraged to design and implement an economic program that could attract donor support.

Mr. Dohlman made the following statement:

The current situation in Swaziland is precarious, with fiscal and external balances continuing to deteriorate and governance growing weaker. The most immediate issue is the food crisis, and we urge the authorities to work closely with the international community to address it.

Governance

To reestablish lasting stability and growth, a fundamental strengthening of governance and the rule of law, combined with sound economic policies, is necessary. The struggles between the judicial and executive branches have been particularly damaging, and, if not reversed, could have lasting negative implications for investment and economic performance.

Fiscal

We agree with the staff's call for greater fiscal discipline to reduce deficits and inflation. The recent civil service wage increase was a step backwards in this regard, as is the recent supplementary expenditure decision. The proposed US$45 million jet purchase also seems extravagant. We are therefore gratified by Mr. Usman's statement that the authorities are committed to improving fiscal discipline, including a broadening of the revenue base, and a reorientation of expenditures towards health and education.

Monetary/Foreign Exchange/Structural

The current fiscal stance and rising inflation, combined with the lilangeni's peg to the South African rand (which has appreciated significantly against the dollar), has led to a significant drop in external competitiveness. Structural reforms that could boost productivity—such as a stronger legal framework, land tenure system reform and pension reform—have lagged. Absent a shift to better policies and political stability, the exchange rate appears unsustainable over the medium-term.

AML/TF

We commend Swaziland for its active membership in the Eastern and Southern Africa Anti-Money Laundering Group. Swaziland has promoted a forward-looking AML work program for the region and volunteered to undergo the mutual evaluation process, anticipated in 2003.

Transparency

We welcome Swaziland's decision to participate in GDDS. Finally, we welcome the authorities' decision to consent to publication of the staff report.

Mr. Alowi made the following statement:

I thank staff for the informative reports and Mr. Usman for his useful statement.

As highlighted in the staff report, Swaziland's macroeconomic condition weakened further. Economic growth continued to fall, inflation picked up, fiscal and external position deteriorated further, and unemployment remained very high. The difficult economic condition was aggravated by a serious humanitarian crisis. I agree with the staff's appraisal that the key policy challenges for Swaziland are to address the humanitarian crisis, regain macroeconomic stability and raise the economy's sustainable longer-term growth rate. Fiscal consolidation and further structural reform are critical to address these challenges.

On the humanitarian crisis, I share Mr. Usman's concern that the pandemic is threatening not only the country's most productive human resource base but also its longer-term economic growth prospects. Therefore, it needs to be addressed steadfastly and adequate foreign assistance are required to deal with the crisis. In this connection, favorable consideration should be given to the authority's request to the IMF and World Bank to take into account the income inequality that currently exist in the country so as to enable the country access to concessional resources to address the problem.

On the fiscal front, I am pleased to hear that the authorities are committed to fiscal discipline. In the case of Swaziland, the best option to achieve fiscal consolidation is through strengthening revenue performance and reforming public services, as investment in health, education and infrastructure are still required to raise the economy's capacity and productivity as well as to improve the investment climate of the country. I commend the authorities for their efforts in introducing various measures to increase the revenue including embarking a comprehensive tax reform and strengthening tax administration.

My last comment is on the exchange rate. I agree with the staff and the authorities that the pegged exchange rate system continued to serve Swaziland well, given the financial discipline that it entailed and in view of its high degree of openness and very close integration with South Africa. Nevertheless, the peg must be sustainable and credible. In this regard, sound macroeconomic policy, sound fiscal and external position and continued structural reform are essential.

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

Mr. Sipko made the following statement:

Swaziland is a country in dire need of humanitarian assistance to help the many victims of the HIV/AIDS pandemic. Swaziland's economic situation is complex and highly vulnerable. Almost all economic fundamentals have deteriorated in recent years. Growth has fallen from a high of 8 percent during the 1980s to 1.8 percent in 2001. And despite Swaziland's membership in a monetary union with South Africa, inflation has picked up, its fiscal deficit is growing, and its foreign exchange reserves are shrinking. In addition to dealing with the health crisis, Swaziland needs to begin improving its longer term economic prospects. We are glad to learn that the staff and the authorities have reached agreement on the next steps. Now it is up to the authorities to follow the staff's advice as they implement the needed corrective economic measures.

To halt Swaziland's economic slide and improve basic living conditions, the authorities must create the conditions necessary for sustainable growth. This will include establishing a sound macroeconomic framework, improving governance, and speeding up structural reforms including privatization and land reform. Reforming land ownership is the most critical of these. Almost 60 percent of Swaziland's territory is owned by the monarch. The rest is broken up into small parcels unsuitable for use as collateral. The productivity of agriculture is very low, and there are problems with irrigation. Foreign firms and foreign investment are fleeing the country owing to concerns about the rule of law. We welcome the authorities' plan to prepare a draft constitution, which can serve as the necessary basis for establishing the rule of law.

The present situation calls for the authorities to respond expeditiously to the humanitarian crisis. Swaziland is one of the hardest hit countries in Africa, and Box 2 shows that the situation will soon become even worse. In just three years, from 1997 to 2000, life expectancy fell from 58 years to 46 years, and the outlook for the future is still worse. By 2010, life expectancy could fall further to 27 years. This trend brings with it another problem, that of an increased dependency ratio as the population of orphans increases by 25 percent. As these trends continue, many more question without answers will arise.

Budgetary spending for HIV/AIDS continues to increase but never seems to catch up with the financial need. To prevent the disease from continuing to claim new victims, the authorities have adopted immediate measures to increase humanitarian efforts, notably in the social sector. Swaziland's ineligibility to receive IDA resources limits the options for solving this problem. The staff paper mentions the possibility of a donor conference. But the authorities must fulfill certain basic conditions before such a conference can take place. A major obstacle is their unwillingness to continue reorienting the budget and improving governance. Does the staff see any hope for a donor conference? We urge the authorities to revise the budget rules, increase social spending, improve the governance, and review the judicial system, all of which are crucial requirements for a donor conference.

We would like to learn from the staff what kind of IMF program the authorities plan to ask for, and what are their other options including bilateral agreements. The proposed contract to buy the king a US$45 million airplane is not a good idea. At present it would be more beneficial to spend the money on urgent social needs. So although this operation has been postponed for the time being, we would like to learn from the staff about the status of discussions in the select committee.

> Finally, Mr. Chairman, as I noted at the beginning of my statement, the present situation is very complex. The authorities must work to satisfy all the conditions necessary for holding a donor conference. In this regard, we wish the authorities every success in their endeavors.

The staff representative from the African Department (Mr. Arora) made the following statement in response to questions and comments from Executive Directors:

> On prospective governance policies and the future of the constitution, we have little to add to Mr. Usman's statement. The draft of the new constitution, which was intended to codify the system of law and to spell out the rules of the different branches of government, was completed in October, but the draft has not yet been made public. It is expected to be made public in early 2003, and that is the main event on the horizon as far as governance issues are concerned.
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> On the potential for a donor conference, the authorities had intended to hold one in October 2002, and they had drafted a policy package to present to donors last July. But, in view of the prevailing negative donor sentiment at the time, and the impression that they needed to do more preparatory work on the policy package, it was decided to postpone the conference. At the time of the discussions, it was not yet clear when exactly the donor conference would be rescheduled. The authorities indicated that it might happen sometime in early 2003, but no precise time was indicated, and we do not have any further information.
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> On whether the authorities intend to request a program from the Fund, the authorities did not indicate any intention to do so. In view of the drought and the food shortage, the staff did discuss the emergency assistance facility, but the authorities were not interested in it, mainly because of the lack of concessionality.

Mr. Kelmanson asked whether emergency assistance could only be concessional in post-conflict situations.

The staff representative from the African Department (Mr. Arora) confirmed that only post-conflict emergency assistance would be on concessional terms.

On the status of the select committee to consider the viability of the airplane purchase, on November 19, 2002 the committee had been given a period of 15 days to report back to Parliament, the staff representative informed. Subsequently, it had been reported that Parliament had granted the committee an indefinite extension, although Parliament had expected the committee to submit its findings before the opening of the next parliamentary session in February 2003.

Mr. Calderon-Colin asked the staff to address in greater detail the point raised by Mr. Dohlman on the sustainability of the exchange rate.

The staff representative from the African Department (Mr. Arora) said that the staff's view, with which Mr. Dohlman seemed to have concurred, was that the sustainability of the peg depended on the strengthening of public finances and on continued policy actions that ensured confidence regarding capital flows, as well as a monetary policy stance that secured an adequate level of reserves. There was a need for an urgent correction of the fiscal stance in order to sustain the peg in the medium term.

Mr. Usman made the following concluding statement:

I have nothing to add except on the issue of the select committee. As the staff representative indicated, Parliament is in recess. The committee has been given an extension, but it is expected to report immediately when Parliament resumes, which will be in early 2004.

On the issue of the constitution, I have nothing to add to what the staff representative said. It is expected to be made public early in 2004, probably around the time when Parliament resumes after the recess.

On the issue of the concessionality of resources, I would like to re-emphasize the need for both the Fund and the Bank to review the classification of Swaziland as a middle income country. This is a country with nearly one-third of the working population either infected or suffering from HIV/AIDS. One-third of the working population is out of work, leading to a high rate of unemployment. Nearly two-thirds of the population lives on less than one dollar per day. The classification really is meaningless, because of the high rate of poverty in the country. To say that such a country is middle income, and therefore it cannot access concessional resources, is unduly harsh. Given the HIV/AIDS crisis and the shortage of food due to a drought, even a temporary concession or waiver should be given to enable the authorities to access resources. As the staff representative indicated, the authorities have not requested an official program with the Fund because of the lack of concessionality. It would be an additional burden for the country if it has to access resources at commercial rates.

I want to emphasize this question of a waiver of the middle income classification, at least temporarily, to enable the authorities to access resources to address this crisis at this point in time. I would like to thank the staff for its comprehensive report and comprehensive responses to the issues raised. I would also like to thank Directors for their views, which we intend to transmit to the authorities.

The Acting Chair made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. Directors expressed concern about the serious economic situation in Swaziland, with the food shortage and continued spread of HIV/AIDS exacerbating the already severe impact of persistent high unemployment, income inequality, and poverty. They saw the main economic policy challenges as addressing the humanitarian crisis, regaining macroeconomic stability, and raising the economy's sustainable longer-term growth rate, while ensuring that the benefits were spread widely. Meeting these challenges would require a return to fiscal discipline, while reorienting spending toward critical social sectors and humanitarian priorities; implementation of structural reforms to increase economic efficiency, including through restructuring public enterprises and further strengthening the financial sector; and an urgent and well-coordinated response to the HIV/AIDS pandemic; as well as strengthening of governance.

Directors considered the most immediate issue would be to find an adequate response to the humanitarian crisis. They welcomed the authorities' efforts to alleviate the food shortage, including through budgetary allocations and the work of the task force on disaster relief. Equally, Directors welcomed the authorities' renewed commitment to fight HIV/AIDS, notably through the establishment of the National Emergency Response Committee on HIV/AIDS (NERCHA). Directors stressed that an effective response to the growing humanitarian crisis would urgently require greater foreign inflows and concessional assistance. In this regard, a reorientation of policies, with a clear, determined focus on the humanitarian situation, would be beneficial both through its direct impact and confidence-building effects among the donor community. Directors noted that, over time, it would be critical for the authorities to address the underlying factors behind the successive run of poor harvests and the continued spread of HIV/AIDS.

Against the background of a fragile medium-term outlook, Directors considered that the central longer-term challenge was to address the factors that were holding down Swaziland's growth prospects and preventing improvements in the standard of living. They felt that greater fiscal discipline was needed to restore macroeconomic stability, address social priorities, prepare the budget to withstand prospective medium-term pressures, and regain longer-term growth prospects. Directors also recommended the early adoption of a medium-term framework for the formulation of fiscal policy as a means of strengthening budgetary planning.

Directors welcomed the measures initiated in 2001/02 to broaden the tax base, which would help compensate for an envisaged decline in Southern African Customs Union (SACU) receipts, and they urged further measures in this direction. Directors also saw a need to strengthen tax administration, particularly audit and enforcement, and to enforce prompt collection of sizable outstanding tax arrears.

On the expenditure side, Directors emphasized the need to reorient spending toward critical social sectors, such as health and education, while restraining overall expenditure. In particular, they considered it important to contain the public wage bill and transfers to public enterprises. Directors expressed concern about the substantial additional expenditures announced by the authorities in early December, which they felt were likely to further weaken the fiscal situation. Directors strongly urged reconsideration of the government's proposed acquisition of a new airplane for the King. This expenditure could crowd out social needs and deter donor support while depleting foreign exchange reserves. They suggested that the authorities' concerns about an appropriate form of transport for the King be met through less costly alternatives that did not require significant additional budgetary and foreign-exchange resources. Directors supported the authorities' intention to devolve the majority of the Millennium Projects to the private sector, and urged them to ensure the economic viability of the few projects in which government participation might be warranted. More generally, they stressed the need to address governance concerns and encouraged further strengthening of the rule of law, including through the current constitutional review process, with a view to improving the environment for private investment.

Directors noted that membership in the Common Monetary Area, which involved pegging the exchange rate of the lilangeni to the South African rand, continued to serve Swaziland well, given the monetary discipline that it entailed and the close economic integration between Swaziland and South Africa. They emphasized that a strengthening of public finances, a prudent monetary policy stance that secured an adequate level of international reserves, and continued structural reforms would be important for ensuring the credibility of the peg.

Directors noted that Swaziland has a well-developed banking system. Banks' capitalization, risk management, and provisioning appeared to be sound and their nonperforming loans were relatively low. However, Directors observed that the future commercial viability of the Swaziland Development and Savings Bank remained a source of concern. They recommended that continued budgetary support to the bank be dependent upon the prevention of a build-up in bad loans, and urged early action to restructure or privatize the institution.

Directors commended the authorities for the passage of anti-money-laundering legislation in August 2002, and encouraged them to move ahead with plans to implement the legislation and develop institutional capacity to combat both money laundering and the financing of terrorism.

Directors cautioned that the Swaziland Public Service Pensions Fund could pose a significant future liability to the government if its financial difficulties were not adequately addressed, and they encouraged the authorities to initiate measures to put the fund on a sustainable path.

Directors felt that reform of the land tenure system would be helpful in raising agricultural productivity and alleviating poverty. They welcomed the cabinet's approval of the Land Policy Act, which would institute long-term leases for agricultural and peri-urban land, and recommended its early enactment into law.

Directors considered that the effectiveness of policymaking in Swaziland would be greatly enhanced by improvements in the economic data. They encouraged the authorities to address the shortcomings in the economic statistics, particularly with respect to the national income, balance of payments, and government accounts. They also encouraged the authorities to improve the timeliness of data reporting to the Fund. In this context, they welcomed the authorities' decision to participate in the General Data Dissemination System (GDDS) Project for Anglophone African Countries, and considered that the initial GDDS assessment should form a sound basis for future technical assistance.

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

2. SENEGAL—POVERTY REDUCTION STRATEGY PAPER AND JOINT STAFF ASSESSMENT

Documents: Poverty Reduction Strategy Paper (EBD/02/145, 10/22/02; Sup. 1, 12/13/02, and Cor. 1, 12/16/02); Poverty Reduction Strategy Paper—Joint Staff Assessment (EBD/02/158, 12/3/02)

Staff: Schmitz, AFR; Allen, PDR

Length: 1 hour, 30 minutes

Mr. Ondo Mañe submitted the following statement:

Background and Formulation of the PRSP

In June 2000, the interim Poverty Reduction Strategy Paper (I-PRSP) prepared by the government of Senegal was presented to the Boards of the International Development Agency and the International Monetary Fund. Directors made proposals and recommendations to improve the document. The PRSP takes advantage of these proposals and lessons learned from the design of the I-PRSP as well as experiences accumulated by my Senegalese authorities in the design of economic policies and strategies that aim at fighting poverty.

The PRSP document is concise and focused. It is based on broad participatory consultations that have involved all stakeholders and the participatory process is well described in the document. The document profiles the nature of poverty and addresses the phenomenon in its multidimensional aspect. The assessment of poverty highlights regional differences (rural versus urban areas) and gender gap (male versus female and girls versus boys). It also lays emphasis on key determinants of poverty in Senegal, including economic environment, education and health. The PRSP identifies the major risks to the strategy and provides tentative policy responses and actions on the part of government, civil society, private sector, as well as development partners so as to minimize their impact. In particular, it examines the impact of exogenous shocks on growth and low-income households and call upon the donor community to help mitigate the consequences of such shocks.

As indicated by the Joint Staff Assessment, the PRSP provides an adequate framework for guiding the implementation of a credible poverty reduction strategy. The document will be the basis of the authorities' policy actions and measures to maintain macroeconomic stability and push ahead structural reforms with the view to fight widespread poverty. My authorities are fully aware that the PRSP process is a dynamic process that requires in-depth measures, coherent actions and long-term vision. They are cognizant that key challenges related to the implementation of the strategy lie ahead, and they are determined to take necessary actions to implement the strategy and reach the objectives set forth in the PRSP. The authorities are hopeful that they can count on the international community's timely support in their fight against poverty.

The Participatory Process

Senegal's PRSP is the result of a broad participatory process. The approach adopted by the government has involved diverse groups both at the local and national levels, including the public sector, the private sector, civil society, and development partners. More than 250 participants attended various seminars to discuss the content and substance of the PRSP.

The preparation of the PRSP followed a gradual approach and took place in various phases. Each phase built upon achievements realized at the earlier stage of the process. The process has drawn attention of various participating groups, including NGOs, trade unions, religious associations, the media, research and educational institutions, independent experts, and the private sector on their key role in the design of poverty reduction strategy and made them aware of the objectives and procedures of the PRSP. The participatory process built upon the experience of the 1997 Poverty Reduction Plan and led to the setting up of a list of priorities as defined by the Senegalese people.

Poverty Diagnosis

Based on a broad range of quantitative and qualitative data indicators, the PRSP provides a good analysis of the characteristics, causes, and various aspects of manifestations of poverty in Senegal. The authorities have used surveys of high quality to distinguish the relative importance of constraints of access to public services, define vulnerable groups, and identify policy actions to provide assistance to them. They have also candidly highlighted the shortcomings of development policy and their impact on economic growth and poverty. The policy response lays emphasis on the key role that a private sector-led growth can play in helping the poor.

My Senegalese authorities are also fully aware of the need to enhance equity and reduce disparities. In this connection, the PRSP emphasizes the need to improve equity and efficiency of public expenditures. However, my authorities are cognizant that such improvement is a first step that needs to be completed through in-depth actions and reforms. They concur with the staff's statement that improvements in the monitoring and the evaluation of anti-poverty programs will be needed to maximize the PRSP strategy's possibilities for success. In this regard, they are hopeful that they can rely on technical assistance from the Bretton Woods institutions.

Priority Objectives and Strategy for Reducing Poverty

Objectives

The long-term goal of my Senegalese authorities is to achieve a substantial reduction of poverty. In this regard, the PRSP draws from the objectives set forth in the New Partnership for Africa's Development (NEPAD), an initiative that the Senegalese president has pioneered. It is also in line with the broad poverty reduction objectives defined in the Millennium Development Goals. The poverty reduction strategy in Senegal incorporates four goals: the creation of wealth, promotion and capacity-building of the basic social services, raising of the living conditions of the vulnerable groups and a participatory approach to monitoring and evaluation based on decentralization of steering and execution.

The following specific targets are set forth in the document: double per capita income by 2015; generalize access to the essential social services; and eradicate all forms of exclusion in the nation and ensure gender equality, especially in primary and secondary education, by 2015.

In the short term, the objective is to reduce the percentage of poor persons by at least 15 percent over the period 2003–2005, increase access rates to health and education while providing the quality of the services and the level of equality between girls and boys. Strong growth will be required to achieve the short-run goals. In this connection, the aim will be to ensure average growth of 7–8 percent.

The Poverty Reduction Strategy

My authorities are committed to create conditions for wealth and boost growth. In this regard, they will support policy for small and medium enterprises development and an employment policy which focuses on: labor management measures that will help to increase capacities and the possibilities of access to employment for the poor; improvement of the management and employability of labor; greater efficiency and transparency of the employment market; and promotion of independent employment in rural and urban areas. These measures will be accompanied by promotion of high labor-intensive activities. Their strategy will favor complementarity between public and private investment. They will enhance the business environment to attract foreign direct investment and better target and improve the quality of investments. As agriculture is still the most important sector of economic activity and the fight against poverty, policy actions and reforms will be taken to strengthen this sector's contribution. Strengthening human capital through education and training and health improvement programs will be crucial in the combat against poverty. In this regard, in 1998, my authorities have launched the Ten-Year Education and Training Program which sets the government's policies with regard to education up to 2010.

Macroeconomic Framework

Cognizant that macroeconomic instability hurts the poor, my authorities have reaffirmed their strong commitment to the adherence of sound macroeconomic policies as a key arm to combat widespread poverty. Since the devaluation of the CFA franc, growth has averaged 5 percent in Senegal. However, this performance has not been translated into poverty reduction. Indeed, growth has been led by the tertiary sector, where fewer jobs have been created. Most of the poverty is in the rural area, where 80 percent of the population lives, with two-thirds depending on the groundnut sector. To address this issue, the authorities are developing their strategy with a view to improving the efficiency of the agricultural sector as well as to diversify it. Concrete actions will favor improvement of water and irrigation.

To enhance growth prospects, alternative scenarios identified in the PRSP will serve as a basis for policy actions. The authorities will target better public and private investments. In this context, large infrastructure projects promoted by the President are expected to improve national and regional growth. The projects will be financed mostly through private partnerships.

Implementation, Evaluation and Monitoring

Implementing the PRSP will be the major task of my Senegalese authorities in the coming years. Macroeconomic and sectoral policies, structural reforms and resources allocations will be geared towards achieving the objectives set forth in the PRSP. The PRSP will serve as a strategic anchor, which will determine policy actions to improve human development and living standards in Senegal. My authorities' objectives are in harmony with those of the Millennium Development Goals, as evidenced by outcome indicators defined in the medium- and long-term goals in the PRSP. However, my authorities are aware that an effective monitoring system requires intermediate outcome indicators to measure progress toward poverty reduction in the short term. In this regard, in the process of implementing the PRSP, my Senegalese authorities intend to develop such indicators so as to allow the assessment of short-term progress in the fight against poverty. They will draw lessons and experiences from other countries within the region. They are hopeful that they can count on assistance from the donor community in this respect.

Conclusion

Senegal's PRSP identifies clearly the constraints to growth and the poverty issues. It defines the economic and social strategies and describes the measures that the authorities intend to implement. However, it is to be noted that the high level of participation of all stakeholders at the local, regional and national levels have raised expectations in the outcomes of the PRSP. Therefore, to avoid the risk of "PRSP fatigue" and to ensure the credibility of the process, my Senegalese authorities are hopeful that they will continue to benefit fully from technical and financial assistance from the international community in support of their ongoing efforts.

Mr. Usman submitted the following statement:

At the outset, we thank staff for their detailed report and Mr. Ondo Mañe for his very helpful statement. Despite the fact that stabilization policies have helped improve the macroeconomic framework, Senegal's economic performance remains below expectations. However, the country was able to achieve a 5 percent average growth during 2001 as a result of the reduction of the public finance deficits as well as the current account balance of payments, with inflation being kept under control. This growth, however, is considered not sufficient to significantly reduce poverty due to the fact that productivity in agriculture remains low and that there is insufficient competitiveness of the supply sectors, coupled with their vulnerability to outside shocks. Overall we are in agreement with the report, and would however, like to comment on the following areas for emphasis.

Fiscal Policy

We note that tax revenue is mainly derived from consumption taxes and not income taxes which are based on the individuals ability to pay. As direct taxes bring in relatively little revenue, despite a high marginal tax rate, we urge the authorities to expand the tax base so as to provide the much needed finances that would spur the required growth and subsequently reduce poverty.

On public expenditure, much improvement is needed for the achievement of the 20/20 initiative which has already been endorsed for the country. Also, the debt burden is considered a major obstacle to the efficient allocation of public resources in favor of the social sectors that mostly affect the poor. This limits the authorities' redistribution capability and hinders the much needed development of the social infrastructure. We encourage the authorities to pursue prudent management of public expenditures.

Monetary Policy

The authorities should continue to pursue a prudent monetary policy in conformity with the community objectives of stability, growth, and the consolidation of WAEMU's external position. A continuance of this approach should be based on more flexible and attractive oversight mechanisms, continued government disengagement from the banking system in favor of the private sector and the availability of adequate funding for the private sector. In order to maintain price stability, we urge the authorities in addition to the above, to implement prudent budgetary policies.

Poverty Related Issues

Access to Basic Social Services

We note that the authorities have adopted capacity building and access to basic social services as paramount in its drive to raising the stock of human, social and natural capital, sustainable growth, the favoring of community participation through local development and administrative decentralization policy.

On education, which is key in reducing poverty, we note that significant progress has been made in strengthening the educational system. We however, urge the authorities to increase the student satisfaction levels through the provision of assistance in obtaining books and supplies; and also take measures to increase the rates of elementary school enrollment by coming up with relevant policies to combat the growing number of child labor.

On health, we note the high rate of insufficient health and social infrastructures, provision of services as well as the distribution of available health personnel in urban areas, with little motivation to work in rural areas. We urge the authorities to increase access to health services and at the same time improve the quality of these services, whilst increasing health indicators to match the WHO recommendations. The authorities should also try to eliminate the various constraints that are responsible for the deterioration of the state of health of the population.

On access to drinking water, we welcome the authorities determination to provide clean water supply to all those areas of the country with low rainfall. We urge the authorities to reduce the exposure by the rural poor people to water borne diseases and infant mortality through the granting of access to water in these areas. In the urban areas, the authorities should implement measures to reduce, if not eliminate, the existing gap in the payment for water supply whereby the poor using public standpipes pay more than those not using public standpipes.

PRSP Process

The economic performance thus far has not contributed to substantially improving the population's living standards or reduction of poverty. We therefore, encourage the authorities to pursue measures towards instituting and implementing a sustained economic and social program aimed at raising socioeconomic growth and at the same time placing the country on a sustainable human development path. A lack of resources by the population in turn favors a continual deterioration of their living conditions, aggravates inequalities and, ultimately leads to extreme poverty. The authorities' commitment to create conditions for wealth and the boosting of growth, as well as their intention to support policy for small and medium enterprises is therefore welcome.

Private Sector Issues

As rightly stated by Mr. Ondo Mañe, we welcome the authorities' policy response which has placed more emphasis on the key role of the private sector in enhancing growth and helping the poor. We therefore encourage the authorities to pursue the introduction of conditions conducive to attracting investors to the country and to boost local investment. This would involve the establishment of mechanisms for identifying market outlets, improve the legal and institutional environment as well as the expansion of the privatization process of local enterprises on the international market. The authorities should further create improved access to credit for enterprises through revision of the existing business law so as to better accommodate the need to develop financial markets, reform the tax regime applicable to financial operations, encourage the establishment of specialized banks and the development of trading outlets for marketable securities issued by enterprises.

Other Issues

On decentralization, the authorities should try to pursue and deepen decentralization by supporting institutional development so as to promote local administration, and making provision under local taxation systems to enable the local authorities to garner sufficient funds for the financing of local public investments.

With regard to assistance to vulnerable groups, we encourage the authorities to reinforce and consolidate social investment projects and programs; set up impact monitoring mechanisms for projects at grassroots communities and strengthen the capacities of community organizations to identify, prioritize and implement their projects.

The authorities should ensure re-organization of the labor market, establish systems to manage jobs, professions and skills; create a national agency that would be responsible for ensuring transparency and efficiency in the labor market; provide support and promotion of micro-enterprises in peri-urban and rural areas as well as ensure the assessment of experiences with highly labor-intensive undertakings.

The pursuit of the above would help promote independent employment in rural and urban areas, promote highly labor-intensive activities, increase the efficiency and transparency of the job market and ensure better human resources management.

Monitoring and Evaluation

We concur with the recommendation that in order to ensure the program reaches its target population, the authorities should set up networks of interlocutors and representatives of target population, which would include agents of regionalized and decentralized government departments, local elected officials, community organization leaders such as village development associations, women's groups, young people's organizations and professional associations, that include civil society. Aware of the fact that a system of monitoring and evaluation is essential to gauge progress made towards the desired goals and results, we encourage the authorities to pursue the establishment of the National Statistics Institute which will be charged with the enhancement of the basic reliable data and the establishment of a program to boost the capacities of populations and organizations of civil society in terms of project and program management.

With the above remarks, we wish the authorities every success in their future endeavors.

The staff representative from the African Department (Ms. Schmitz) informed the Board that a Fund mission had visited Senegal in November 2002 to start negotiations on a new three-year program based on the authorities' PRSP and conduct Article IV consultation discussions. Major progress had been made in formulating a macroeconomic framework and reform policies for the next three years. The authorities planned to complete in the coming weeks technical work required for reform policy decisions in some areas, with assistance from the World Bank and other development partners. The finance minister had invited Fund staff to return in January to continue discussions on a program for which the authorities wished to request a PRGF arrangement.

Extending his remarks, Mr. Ondo Mañe said that his authorities had consented to the publication of the Joint Staff Assessment of Senegal's Poverty Reduction Strategy Paper.

Mr. Zurbrügg made the following statement:

> To have a stand-alone PRSP discussion is somewhat unusual, and it reminds us that an agreement on a new Fund-supported program is still pending. Such a program would help provide a sound macroeconomic framework, which—after all—is the primary pillar of Senegal's Poverty Reduction Strategy. However, I welcome this early adoption of a full PRSP and agree with staff that it provides an adequate framework for the Poverty Reduction Strategy. This early adoption gives us an opportunity to monitor implementation for some time before an eventual reaching of the HIPC Initiative completion point. This is welcome, because implementation is certainly the key issue in the case of Senegal, given past experience.
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> As pointed out by staff, a strength of the PRSP is the very useful poverty diagnosis with its detailed poverty profile. This analysis should be updated with the new household survey data and also be actually used to analyze the impact of specific measures on the well-being of the poor. It should also be used to better target social transfers, particularly since the PRSP points out that in the past, social transfers have not in general greatly benefited the poor, an in fact often benefited the rich more (para 38).
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> Given that in our view endogenous policy hazards rather than external shocks are the main risks affecting implementation, it is all the more unfortunate that the government's plans to implement the poverty reduction strategy are not spelled out in sufficient detail. Like staff, I also missed a discussion of the government's policy regarding the long overdue privatization of SONACOS. I also support staff's call for integrated sector strategies that link institutional reforms to investment programs, and for a more comprehensive costing approach.
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> Institutional reforms—particularly a strengthening of the judicial system and governance—are absolutely crucial for containing the endogenous risks to implementation. Decisive reforms in this area are also needed to encourage private investment, which is supposed to improve global factor productivity. And it is also telling that the household survey reveals that 95 percent of all households think that living conditions could be improved significantly if the government could overcome "the country's rampant corruption" (para 167). We thus believe that Senegal's next Fund-supported program should contain structural conditionality in this area.

Such a Fund-supported program will also have to be based on a credible macroeconomic framework, and we thus very much agree with staff that the high growth scenario is far too optimistic. In fact, even the intermediate case scenario looks daring. For instance, the Economist Intelligence Unit forecast real GDP to grow by only 5.1 percent in 2003 and 5.6 percent in 2004, compared to the 5.8 percent and 6.5 percent envisaged in the intermediate case scenario. To base economic policy on realistic macroeconomic assumptions is not only important for credibility, it also seems to me that it would be a better strategy to play safe and intend to surprise on the positive rather than on the negative side. I would thus welcome to have a realistic analysis of the feasibility of the macroeconomic scenarios in the PRSP implementation progress report.

For the sake of monitoring implementation progress, I strongly support staff's call for decisive implementation of budget systems reforms. Accordingly, I would like to reiterate our call for structural conditionality in the next Fund-supported program in the area of expenditure control and budget execution. I also support staff in calling for indicators against which short-term progress can be assessed, and that these targets be included in the authorities' implementation progress report.

Finally, I would like to point out a number of risks that should be avoided in the implementation of the PRSP. First, like staff, I urge the authorities to take the necessary steps to assure that fiscal decentralization does not pose a risk to expenditure execution and monitoring. Second, I agree with staff that the authorities will have to be very careful in giving tax concessions for private investments, in order not to erode the revenue base. Third, the civil service reform mentions the need to provide civil servants with suitable incentives, but this should not translate into excessive wage increases for the public sector. Fourth, the PRSP states in paragraph 169 that "the core of the modernization of the State should be the introduction of an information system integrating the latest technologies,"—just to be sure—this should not mean that large amounts are spent on high-tech equipment. I can assure you that a large part of the Swiss administration works reasonably well without having the latest technologies at its disposal.

With this, I look forward to the implementation progress reports.

Mr. Dohlman made the following statement:

We concur with the Joint Staff Assessment (JSA) determination that this PRSP provides an adequate framework for guiding the implementation of a credible poverty reduction strategy, with commendable overall objectives (para. 58).

The document presents a comprehensive list of indicators (Annex II matrix), but we are concerned about the lack of prioritization. Moreover, many indicators appear more ambitious than what can be accomplished in the time frame that they cover, particularly those for 2005. It will also be essential to improve the monitoring and evaluation of anti-poverty programs. We agree with the JSA that it is important to develop indicators for the period before 2005 to evaluate early progress. We also concur with Mr. Zurbrügg's comments on the refinement and use of the household survey.

With respect to the macroeconomic assumptions, we concur with the JSA view that Senegal's PRSP is overly optimistic about growth, particularly with the downturn in agriculture. We also concur with the JSA suggestion that the authorities provide an in-depth analysis of the feasibility of their macroeconomic scenarios in the PRSP implementation progress report. Realistic scenarios, with policy contingency plans, will be important as the authorities work on implementation plans. On a related point, we wonder if staff could comment on the consistency between the PRSP and next year's budget.

The authorities rightly recognize the urgent need to increase investment (paras. 124–129) and include a number of proposals conducive to higher private sector investment and enhanced export capacity. However, we do not have a clear sense of how and under what timetable these plans will be implemented. It is important that the state not take on functions that are most effectively handled by markets and the private sector. In our view, it will be particularly important to encourage the growth of small and micro businesses in the informal sector. The Senegal authorities recognize the importance of SMEs and plan support for this sector (paras. 130–131). These efforts should focus on sustainability and commercial principles. In the same vein, the authorities should also re-commit to timely completion of the delayed privatization efforts.

We agree that improved public expenditure management should be a priority. We call on the Fund and the Bank to support Senegal in this area. Regarding fiscal decentralization, we concur with the comments made by Mr. Zurbrügg (that decentralization can contribute to better delivery, but only if it is properly sequenced and paced, with appropriate measures in place to manage the handover of decentralized functions).

We appreciate the thorough analysis and inclusion of specific indicators of key social sector issues, notably health, education and drinking water. It would be helpful to know more about how these goals are linked to specific programs, and implementation will support poverty reduction and increased equity.

The staff referred to ongoing negotiations with the authorities regarding a possible new PRGF-supported program. We hope that Senegal will continue to lay the groundwork for a successful program. These should include steps to put SENELEC on a path toward sustainable financial management, progress with SONACOS fiscal management and privatization, and further progress on pension reform. We also agree with the comments made by Mr. Zurbrügg on corruption.

Also, given the current relatively healthy balance of payments position, and the history of Senegal's relationship with the Fund (IEO prolonged use report), our view is that the authorities should consider a program with low access and that would put Senegal in a strong position to exit from dependence on Fund resources.

Mr. Alazzaz made the following statement:

I commend Senegal's diligent completion of the Poverty Reduction Strategy Paper. As Box 1 of the staff report makes clear, the paper represents a comprehensive effort that drew on an extensive dialogue among the broad-based participants. The joint staff assessment also expresses satisfaction on its adequacy as framework for a credible poverty reduction strategy. While I appreciate that much work remains to be done, this is to be expected in view of both the country's capacity limitations and the continual need to adjust the authorities' poverty reduction strategy in a changing world.

I therefore fully support the proposed decision that the PRSP provided by the authorities is a sound basis for concessional assistance from the Fund.

Mr. Fabig made the following statement:

The Senegalese authorities have to be commended for the completion of their Poverty Reduction Strategy Paper. We broadly agree with the staff's assessment of its main strengths and weaknesses. In particular, the extensive public participation deserves praise. Also, the thorough diagnosis of causes for the widespread poverty forms a very good basis for poverty reduction efforts. Further, the paper covers the wide range of topics that need to be addressed in order to achieve sustained success in fighting poverty.

Against this background, I would like to make four points.

First, the paper itself acknowledges that improvements in governance and in the absorption capacity of the Senegalese economy are key to the fight against poverty. We very much agree here and we encourage the Senegalese authorities to implement vigorous reforms in these fields. More transparency and more effectiveness in the judicial system as well as the fight against corruption are crucial in this regard. I fully support Mr. Zurbrügg's comments on this topic.

Second, we agree with the staff that the high growth scenario is too optimistic. Whatever scenario is realistic, it should be clear that without substantial private investment, sustained growth cannot be achieved. Thus, the framework for private investment needs further improvement along the lines I have just indicated.

Third, it seems as if there is quite some room for improvement concerning the interplay between the Poverty Reduction Strategy as stated in the PRSP and the various sectoral strategies of the World Bank. It is of utmost importance that the implementation of the PRSP takes these strategies into account.

Fourth, while the PRSP is very precise in the analysis of the status quo, it has a certain weakness in the development of indicators that will allow to operationalize and to monitor the various poverty reduction goals. This shortfall is particularly problematic insofar as the coordination of development aid requires a certain set of indicators in order to track progress and further needs.

Notwithstanding these somewhat critical remarks, the Senegalese PRSP is a remarkable achievement. If it is successfully implemented, the abbreviation PRSP could just as well stand for “Proud Resolute Senegalese People.”

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

Mr. Lombardi made the following statement:

At the outset, we would like to express our appreciation to the staffs of the Fund and the Bank for their joint assessment. We very much welcome this PRSP since it provides the authorities with an adequate framework for implementing their poverty reducing strategies in the context of sound macroeconomic policies. We broadly concur with the staffs’ assessment and therefore will confine our remarks to the following points.

We favorably note the extensive participatory process within the civil society that has preceded the strategies laid out in the PRSP. In practice, this should ensure a more effective prioritization of the PRSP goals. We also note that the PRSP lists major risks affecting the implementation of the strategies, including the possibility of the economy being subject to exogenous shocks.

The challenge now lies in the operational sphere. In this regard, authorities should not lose momentum and should focus on the implementation of the envisaged strategies with the help of a set of indicators to assess short-term progress. A very good PRSP is in itself of little help if its implementation is not monitored effectively, and short-term outcomes do not feed back into a thorough assessment of the overall framework.

Still on the operational sphere, it would be important that scenarios and strategies—as envisaged in the PRSP—be consistent with other government documents, such as the budget. Quite often, a feature in the implementation of PRSPs is that their medium-term strategies do not always underpin other government's economic documents. In this regard, we have some concern that the forecasts underpinning the more optimistic scenario diverge from the historical performance of the Senegalese economy by a non-negligible margin. This in turn may increase the difficulties in integrating the PRSP with other government documents.

One more aspect we would like to emphasize is that PRSPs should be internally consistent. In this regard, we concur with Staff that the high-growth scenario only allows for a modest increase in the GDP deflator, which most likely overestimates the absorption capacity of the Senegalese economy.

It is also important that outcomes and their related policies be clearly spelt out in the PRSP. This would also help authorities to monitor the implementation of the strategies envisaged in the paper.

Instrumental to the achievement of the PRSP outcomes is a thorough reform of public expenditure management. In this regard, the PRSP might have been more clear regarding what type of reforms are needed. Also, a shortcoming of the PRSP is that no room is allowed for the financial sector in fostering development and poverty-reducing strategies. Along these lines, the financial sector development may play a relevant role in developing rural areas and thereby reducing poverty. Staff comments would be welcomed in this regard.

In conclusion, we appreciate the efforts by the Senegalese authorities for coordinating the production of this valuable paper. We wish the authorities all the success in the implementation of these much-needed poverty reducing strategies.

Ms. Lewis-Bynoe made the following statement:

Given that I agree with the thrust of the Joint Staff Assessment, I will keep my intervention relatively short and focused on a few issues.

We endorse the PRSP, given its extensive participatory process and its focus on issues such as the need to improve the equity and efficiency of public spending, as well as the quality of social services. The assessment by the staff that it provides an adequate framework for the country's objective to fight poverty is justified, and the Canadian International Development Agency (CIDA) has already taken steps to build its new country program framework around the objectives and targets set out in the PRSP. Nevertheless, the PRSP also has some weaknesses that need to be addressed if the process is to move forward toward implementation. In particular, I would like to focus my comments on three main areas.

First, we agree with the staff that the projected growth rates for the macroeconomic framework, especially in the optimistic scenario, but even in the middle case scenario, are very ambitious, given historical growth rates. We would urge the authorities to base the macroeconomic framework on cautious assumptions and ensure as much as possible that the growth scenarios are consistent with what is planned as part of any future PRGF arrangement or World Bank Country Assistance Strategy.

Second, with respect to achieving economic growth of sufficient quality and quantity for poverty reduction, actions to improve economic governance and to undertake structural reforms will be important. However, sequencing is also important. There is only so much that can be done at once, and it is important to undertake reforms that will give the right signals to the private sector.

Third, we welcome the information in Mr. Ondo Mañe's statement, which confirms the staff assessment that implementing the PRSP will be crucial. The acknowledgment by the Senegalese authorities that an effective monitoring system requires immediate outcome indicators to measure progress in poverty reduction is welcome and appropriate. I concur with a plan to draw lessons and experiences from other countries within the region, as this is very much in keeping with the theme that has been advanced at the Board of developing and applying best practices. Relating to the issue of implementation and monitoring, improving expenditure management and tracking will be essential components of successful implementation.

Lastly, we commend the authorities for the decision to publish the PRSP, and we encourage them to also publish the Joint Staff Assessment.

With these remarks, we wish the authorities every success in the future.

Mr. Macíá made the following statement:

We are pleased with the participation of all stakeholders in the PRSP process; the consensus on the strategies; and the surveys on household consumption, welfare, and perceptions of poverty, which have been crucial to the formulation of the program. The surveys have provided the basis for the priority actions under the PRSP, which are consistent with the objectives pursued toward achieving the Millennium Development Goals. Though the overall objective may be ambitious, the establishment of annual indicators of progress in key social areas under the PRSP program is a welcome commitment.

We note that the average annual GDP growth has been below the rate of growth of the population. Furthermore, growth has concentrated on low-employment sectors. The primary sector is weak. Agriculture has been exposed to external shocks, and capital contribution to growth is well below the average for the sub-Saharan African region. In addition, Senegal faces a high debt burden and has poor infrastructure. It is essential that Senegal pursues new sources of revenue in order to attain fiscal sustainability, and reforms must target economic efficiency. It is within this view that we support the priority objectives for poverty reduction adopted by African leaders under the NEPAD and in the Tenth Social and Economic Planning SDP for 2000–2007.

There are immediate challenges regarding the management of the overall program, particularly in relation to the monitoring, tracking, and accountability in the use of resources for combating poverty. This becomes crucial as the authorities intensify fiscal decentralization. Concerns remain with respect to the lack of institutional capacity and governance, which are accentuated by the growing availability of poverty-related resources. In this vein, we envision the need for strong technical assistance to tackle program budgeting, public expenditure management, and the establishment of a reliable tracking system. In this we support Mr. Zurbrügg's observations at the beginning of this session. Institutional capacity-building is also a clear candidate for technical assistance, not only for program management, but also to improve the efficiency in the delivery of public services.

The PRSP identifies rural areas as the most affected by poverty. We note progress in the poverty threshold compared to the situation in 1994, although the questionnaire CWIQ of 2001 portrays a worsening situation. We would like the staff's opinion concerning the real trend of poverty in Senegal, given these two different outcomes

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We would also like to point out inequalities in the distribution of public expenditures for education and social transfers. We would like to emphasize the importance of strengthening the primary sector's micro-projects and agricultural technical extension services and of addressing environmental degradation and malnutrition. We encourage investment programs toward improving production and export infrastructure, tackling unemployment, and upgrading social infrastructure.

To conclude, we concur with the staff that the PRSP provides an adequate approach to tackle poverty and economic issues, wealth creation, and human capital formation. We therefore support the request for concessional assistance and debt relief under the HIPC Initiative and wish the authorities well in their endeavors.

Mr. Ayala made the following statement:

We thank the staff for preparing a comprehensive assessment of the Poverty Reduction Strategy Paper (PRSP) of Senegal and Mr. Ondo Mañe for his informative statement.

We broadly concur with the staff's appraisal and agree that this PRSP focuses on the critical issues that will help reduce poverty in Senegal over the next years. We welcome the quality of the participatory process implemented since it ensures a successful program, considering the consensus achieved among many and diverse groups in the strategy to be followed. We also welcome the fact that the PRSP has been developed on a broad range of indicators of poverty making it easier to identify the causes of poverty and clearly recognize the uneven distribution of growth and income between rural and urban areas. The latter is important in order to design a good compilation of priority actions and strategies to be implemented with the aim of effective outcomes, particularly taking into account that 70 percent of the poor are found in the rural areas. In the same vein, the emphasis placed by the authorities on sound macroeconomic policies as the cornerstone of the poverty reduction strategy is commendable. In this regard, it should be noted that the Senegalese economy has grown over 5 percent per year on average between 1995 and 2001 with a continuous reduction of the fiscal deficits, and at the same time the inflation has been kept under control.

Notwithstanding a relatively successful economic performance, progress in reducing poverty has not been very significant, thus a more concentrated effort is called for. We concur with the staff's assessment that to maximize the PRSP-strategy's chances of success, the allocation of public spending should be closely monitored. In that sense, the quality and transparency of public expenditure management will contribute to a good execution of investment projects. In this regard, we consider crucial the development of a regulatory framework and to expedite the implementation of institutional reforms that creates confidence and reinvigorates domestic and external investments. Nevertheless, we remain concerned about the protracted process of privatization of SONACO, whose recurrent imbalances impact negatively in the public finances, and, that here should be a clear commitment of the authorities to rapidly complete the privatization program.

Regarding growth scenarios, the targeted growth in the intermediate macroeconomic scenario is higher than Senegal's historical growth average since 1994, pointing to the favorable impact on growth of the strategy being implemented. We believe that this intermediate scenario represents nonetheless a challenge and it will be more achievable and realistic than the high case scenario. We concur with the staff, that it is appropriate to establish short term objectives that can be closely monitored. It should be important to evaluate the progress at the beginning of the process in order to take corrective measures without delay to reach the final targets for poverty reduction, and we encourage the authorities to follow the staff's suggestion to include these targets in the implementation progress report.

The improvement of social services, in particular education and health, is an essential element for a successful poverty reduction strategy. In order to assure better public services, as the staff observes, we encourage the authorities to build a detailed plan through a fiscal decentralization strategy. It is very important that the investment projects go together with the institutional reforms, especially in the education sector where some inequities among primary and high level education sectors are observed.

Although the challenges ahead are enormous, including risks outside the control of government, we encourage the authorities to persevere in their efforts to achieve the goals of the PRSP and to consider staff suggestions to further enhance its implementation and effectiveness.

Ms. Boucher made the following statement:

We join other directors in welcoming today's discussion on Senegal's PRSP. I noted that Mr. Zurbrügg qualified it as an "early" discussion and I am not sure it really applies here, since it is my understanding that the authorities submitted the PRSP to the Fund and the World Bank as early as April 2002. Let me also commend Bank and Fund staff for their concise and comprehensive assessment. We found the JSA well articulated and believe it provides very useful guidance to the authorities to help them consolidate the PRSP process and facilitate its implementation and monitoring. I can also confirm at the outset that we endorse the PRSP as a credible strategy that provides a sound basis for Fund and IDA concessional assistance and debt relief under the HIPC Initiative.

At this stage, I will try to be brief and focus my comments on a few points for emphasis :

We agree with the main strengths of the PRSP as underlined by the staff, including the extensive participatory process, the quality of the poverty diagnosis, which, as noted by Mr. Zurbrügg, will nonetheless need to be finalized further to the completion of the household survey, the authorities willingness to define clear objectives and to determine an adequate course of actions in key areas, promote equity and improve efficiency of social services.

However, it should also be recognized that this is an ongoing process and, as in other country cases, the PRSP will certainly need to be strengthened going forward. We would therefore join other directors in encouraging the authorities to address the shortcomings which are spelled out in the JSA and also to take on board the recommendations made by the group of donors further to the SPA mission in October of this year. In particular, we feel it important for the authorities to clarify the link between the PRSP and the budget, to undertake a more comprehensive costing approach and to concentrate their efforts on strengthening public expenditure management and implementation capacity, addressing governance issue and enhancing transparency, all points which have already been raised by many previous speakers.

In order to operationalize the PRSP, more work is also needed on the definition of integrated sector strategies, including clarifying the rural development strategy. As pointed out by Mr. Ondo Mane in his comprehensive and helpful statement, 80 percent of the population live in rural areas with 2/3 of this population depending on the groundnut sector. It is therefore crucial to elaborate a comprehensive strategy, which would assess the poverty and social impact of the proposed actions as well as the vulnerabilities of the sector to exogenous factors. We noted, in the PRSP, the reference to increased efficiency, diversification, water and irrigation and strengthening the role of farmer organization, all of which being critical areas. We believe this strategy should also be associated with the objective of sustainable management of natural resources, addressing in particular the issue of soil degradation.

Refining the set of indicators would also facilitate monitoring the process and would allow for a better assessment of the actual impact in terms of poverty alleviation of sectoral policies and investment projects. We took note of staff's word of caution regarding the Presidential infrastructure projects. It is, indeed, important to ensure that such projects will have an effective impact in fostering growth and contributing to poverty alleviation. Also, while we appreciate the authorities' intention to finance such projects through private partnerships, we would note that such partnerships are often associated with some kind of public support, either direct financial contribution or government guarantee.

Finally, on the issue of the growth scenario, we are confronted with the dilemma, which is common to many PRGF-supported countries, of promoting the ownership of the PRSP process, on the one hand, while, on the other hand, ensuring that Bank and Fund support to the PRSP is provided within a framework which promotes sustainable growth and poverty alleviation without posing a threat to macroeconomic stability. We believe the various macroeconomic scenarios presented in the PRSP enable establishing a constructive interaction between the authorities, civil society and the donor community. We agree with staff that this should be complemented by an in-depth analysis of the feasibility of these macroeconomic scenarios.

The PRSP process will require the technical and financial support of the donor community in order to meet its objectives. France, of course, stands ready to do its part.

We also look forward to the rapid conclusion of the negotiation of a new PRGF-supported program and thank Ms. Schmitz for the update on the status of the discussion on the program and on the progress in finalizing technical work, under the guidance of the World Bank, that will assist the authorities in their decision process. The program design, including in terms of access, should be commensurate with the financing needs, which will be identified during the upcoming mission, in order to adequately support the PRSP process. We do hope that Senegal, which is a retroactive case and reached its decision point in June 2000, will soon be in a position to finally reach its completion point. With these comments, we wish the authorities every success in their endeavors.

Ms. Phang made the following statement:

At the outset, I commend the Senegalese authorities on their completion of the Poverty Reduction Strategy Paper (PRSP), which is a really massive exercise involving broad participation of both public and private sectors as well as the country's development partners. It is obvious from the JSA that staff have considered very carefully the authorities' development plan and I concur with the broad thrust of their appraisal. Hence, I will focus my comments on a few areas for emphasis as well as to highlight issues of concern

Beginning first with the quantitative criteria, I would like to commend both staff and the authorities for using, as far as possible, the outcomes-based approach in specifying the performance criteria for assessing whether the program is on track. Since the objective of PRGF-supported programs is the eradication of poverty, it is not so relevant whether a certain amount of financing was disbursed or whether reserves exceeded three months of imports and so on. Instead, what is relevant is whether poverty was alleviated over a specified time period through the provision of, say, training to a certain percentage of the population, or access to health facilities and so on.

Moving to the contents of the PRSP, I concur with staff that of the three scenarios based on three different assumptions of full absorption, 50 percent absorption and no absorption of additional resources, the optimistic scenario is not likely to be achievable as it assumes, among others, GDP growth and savings rate that are significantly higher than the norm during the period since the CFA franc depreciation in 1994. I concur with staff that the medium or baseline scenario has a good chance of being achievable assuming there are no major shocks to the system. However, I notice that the table of indicators in Annex V of the JSA provides quantitative targets for health, education and other social services for only one scenario, namely, the optimistic scenario. Since these variables constitute the core aspects of poverty reduction, I would strongly encourage the authorities to target the achievement of these poverty-related criteria regardless of whether they are able to achieve the optimistic scenario. In other words, the authorities should prioritize the various outcomes, and the core outcomes should be given priority in the event of resource constraints should growth be lower than what was expected in the optimistic scenario.

On the strategy itself, the authorities have assumed that growth will be driven by the agriculture sector, so that its contribution to GDP will double between 2001 and 2005. There is no doubt that the agriculture sector is important and should not be neglected. However, in the absence of dramatic change such as extensive irrigation, it would be almost impossible to double the contribution of such a rain fed/vulnerable sector. Furthermore, although the PRSP has correctly targeted the promotion of labor-intensive economic activities in order to generate more employment opportunities, nevertheless, experience of many other developing countries has clearly demonstrated that there is limited scope for the agriculture sector to generate sustainable growth since productivity is low in small scale farming. In fact, the industry and tertiary sectors appear to have more scope for generating growth, not only in terms of having higher interlinkages with other sectors in the economy but also in terms of higher global demand and lower vulnerability to weather conditions and a declining trend in the terms of trade. Staff's comments would be welcome.

At the same time, although studies have shown a high negative correlation between the growth in per capita income and the poverty level, yet the PRSP does not include measures to contain population growth. Perhaps staff could comment on whether China's success in this respect could be usefully emulated by Senegal.

There is no doubt that effective systems for monitoring and evaluation are critical to enable both donors and the authorities to evaluate progress in achieving the program's objectives. In this respect, I concur with staff that the authorities should put in more effort to specify the details of the institutional mechanism for monitoring and evaluation. In fact, from a longer term perspective, I would suggest that it is not enough to merely include annual indicators of progress in the allocation of resources. This form of tracking would merely serve a custodial purpose but would not give a strong incentive for the different sub national or local authorities to optimize the achievement of the objectives. I would propose that the Fund or Bank provide technical assistance to help the authorities design an incentive structure which would encourage different levels of government to internalize the objectives and enhance their performance in achieving the deliverables. This, in turn, would also provide an incentive for the different levels of government to put in place credible audit functions to provide improved information on the program's outcomes. I would appreciate staff's views on the proposal.

I now move on to two of the staff's proposals that I have difficulty in agreeing with, and I would appreciate clarification from staff. With reference to paragraph 28 of the JSA, I agree with staff that the authorities should provide staff with information on the big infrastructure projects as they might have potential fiscal implications. However, I cannot accept the staff's assertion that the projects "might not be in line with the poverty focus of the government's medium term investment plans". Even staff themselves have reported that Senegal lacks good infrastructure which is needed for growth but I would agree with staff if in fact they were referring to the importance of appropriate matching of the maturity profiles of financing with the fact that infrastructure projects are long term investments.

With reference to paragraph 30 in the JSA, the staff comments that "the PRSP does not reconcile the equity objective with the fact that a large part of the education budget is spent on higher education, including scholarships for the relatively few university students." I would agree with staff that there is inequity if they were referring to the point made in paragraph 38 of the PRSP report where 20 percent of the poorest households who account for 28 percent of all children aged from 7 to 12 years receive 17 percent of public expenditure, whereas the richest households who account for a smaller proportion of the population also receive the same percentage of benefits. However, from the point of view of the proportion of education expenditure that is expended on primary education, 42–44 percent would appear to be adequate as it is equally important to provide adequate training for secondary and tertiary education as part of the strategy to provide adequate higher skills.

With these comments, I wish the authorities continued success in their efforts to eradicate poverty and to generate sustainable growth, and, since the PRSP provides a good framework for poverty reduction and a sound basis for Fund concessional financial assistance, I support the proposed decision.

The staff representative from the African Department (Ms. Schmitz) made the following statement:

I will start by responding to some concerns that were raised about corruption and governance in Senegal. There are several initiatives underway to deal with this. First, the government has prepared a comprehensive plan for streamlining the regulatory framework for the private sector, and this is being reviewed currently by the cabinet. The goal is to have a more transparent system that leaves less room for discretion. Second, at the recent first meeting of Senegal's Investor Council, which is chaired by the president, it was decided to institute a committee to monitor good governance. This committee consists mostly of private sector representatives. Third, the World Bank is working closely with the authorities on a ten-year plan for judicial reform, which will also be taken account in the budget. Fourth, there are several initiatives underway dealing with public expenditure reform. During the recent mission, staff had extensive discussions on this issue, and agreed on a comprehensive plan of reforming expenditure execution in such a way that the entire expenditure process could be tracked electronically from the initial stage to the execution stage, i.e., from the time warrants are issued to the actual payment of an expenditure. In parallel, the World Bank is working with the authorities on a comprehensive review of expenditure practices in Senegal, and their work focuses on external and internal controls of expenditure execution, procurement procedures, and transparency of the expenditure process in general. The analysis is expected to be ready in the first half of 2003, and a comprehensive plan would be agreed with the authorities based on this.

There was a question regarding the relationship of Senegal's budget for 2003 with the PRSP's priorities. The budget, which is currently being discussed by Parliament, is in line with the priorities of the PRSP. It emphasizes expenditures for health, education, access to safe water, and rural roads; those were chosen by the cabinet as key areas for the initial phase of PRSP implementation.

In terms of the financial and macroeconomic aggregates, the draft budget is tending toward the middle case scenario of the PRSP, and the authorities recognize that the pace of overall growth hinges both on the government's capacity to implement projects and carry out reforms, as well as on the response of the private sector to those policies. They believe that, in determining the macroeconomic framework for the budget, they have applied cautious assumptions about growth and implementation capacity.

In the fiscal area, there was a question about an incentive system in the civil service. The authorities would like to conduct a study in the next six months, which will address two issues that affect the wage bill: the hiring strategy for the medium term that takes account of the need to improve public sector services and a pay strategy that addresses incentives and remuneration in key posts. This work has not begun yet; hence, this year's budget starts with very conservative assumptions about the wage bill. The ultimate goal is to develop a strategy for the medium term that is coherent with the PRSP.

The staff representative from the World Bank (Ms. Benjamin) made the following statement:

I have three points on the household survey and the poverty statistics. First, when the last comprehensive household survey was conducted in 1994 and 1995, the Senegalese authorities measured two variables. One was a very fundamental variable on housing plumbing characteristics, and the other was on total expenditures. The authorities then estimated a relationship between the two variables. In 2001/02, the authorities have figures for the fundamental housing plumbing characteristics, and, using the old relationship, they estimated the expenditure levels.

> Second, further refinement and analysis of the results from both rounds of household surveys need to be done. Some corrections may need to be made. If the refined results confirm the original estimate, then the fact that poverty has not come down very much over the last several years will indicate a fair amount of inequality in the distribution of income.
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> We appreciate the authorities' effort to target resources at primary education. The World Bank has a sectoral program on education with the government, specifically focused on targeting resources at primary education. About 26 percent of the total education budget is being spent on university education, and a big portion of that amount is in the form of scholarships, as opposed to direct instructional expenditures; those are fairly high numbers.

Ms. Phang remarked that the Senegalese government could not focus only on primary education. In many countries, 42–44 percent of the education budget was spent on primary education, while the rest was allocated for secondary and tertiary education. The 26 percent of Senegal's education budget that was allotted for tertiary education had not been much, in particular when spent on scholarships abroad because the country lacked the facilities for university education.

The staff representative from the World Bank (Ms. Benjamin) replied that Senegal had extensive university facilities, and in fact attracted many students in the region.

The staff representative from the African Department (Ms. Schmitz), replying to a comment that the Senegalese authorities should study the growth and population strategy of the People's Republic of China, said that it would be useful to look at the aspects that affected agriculture and industry, and that the authorities might benefit from a dialogue with experts in that area. A large part of the agricultural lands in Senegal relied on rain, owing to the lack of irrigation systems. Hence, the opportunity to rapidly expand productivity and employment in those areas was not high. The authorities had been studying how much to invest in physical infrastructure in agriculture to increase the chances for diversifying into other products. They had had some success with the production of flowers, fruits, and vegetables that could be exported, but more progress was needed. Another aspect also being studied was how to generate activity in the secondary sectors, which would spread more to the rural areas. An industrial center, which was not in an urban area but would be linked to an urban area, was being tested to see whether a targeted approach could work.

On the question of incentives for better expenditure tracking, the authorities were considering some criteria for the expenditure tracking program, the staff representative stated. The authorities were taking the matter very seriously, and major progress was expected in that area.

Ms. Phang said that she was not questioning the seriousness of the authorities in tracking expenditures. She was interested in finding out whether the Fund, for example, would be keen on providing technical assistance to help the authorities devise an incentive structure that would encourage careful tracking of expenditures.

The Acting Chair (Mr. Aninat) replied that technical assistance needs of member countries were discussed among departments within the Fund, as well as with the recipient country itself, following an analysis of the type of assistance that was needed. Technical assistance that was provided in collaboration with the other multilateral institutions were naturally discussed and agreed with those institutions.

Mr. Ondo Mañe made the following concluding statement:

> Let me start by thanking Directors for their support for Senegal and for their constructive remarks and recommendations, which I will faithfully convey to my authorities. I would also like to thank the staff for the excellent advice and support to my authorities. As Directors have noted, Senegal has produced a PRSP of high quality. The document is concise and focused and built upon the interim PRSP. It takes advantage of proposals and recommendations of Directors and builds on lessons and experience accumulated by my Senegalese authorities in the design of economic policy and strategy. As the staff has provided Directors with clear and comprehensive answers to the questions that they have raised, I do not have much to add at this stage.
>
> One of the important contributions of the PRSP process is the enhancement of program ownership at the country level. My authorities have paid great attention to the involvement of all stakeholders in a participatory process. In that regard, the Senegalese participatory process has been unique, involving all stakeholders at the national, regional, and local levels.
>
> As the Joint Staff Assessment has indicated, Senegal's PRSP provides an adequate framework for guiding the implementation of a credible poverty reduction strategy. I would like to emphasize that the PRSP will be a strategic anchor for the authorities' policy actions and measures to maintain macroeconomic stability, push structural reform, and fight poverty.
>
> I would also like to emphasize that the high-quality household survey and the broad range of quantitative and qualitative debt indicators used in the poverty assessment have provided a good analysis of the poverty profile, its manifestations, and its causes. This analysis and the support and advice of international institutions have helped to design a strong strategy to fight poverty. The strategy would emphasize job creation in a sound macroeconomic framework through the support of policies that create opportunities for jobs, facilitate private sector development, and improve domestic conditions to attract foreign direct investment. The strategy would also focus on pro-poor growth. In this regard, the analysis of the sources of growth would be critical. My authorities are hopeful that they can benefit from both Fund and Bank technical assistance to produce a robust analysis, as well as policy recommendations for pro-poor growth in Senegal.

My authorities are also aware that high growth rates are necessary to reduce poverty significantly. In this regard, they view the large infrastructure project promoted by the president as an important source of growth. This project will be financed mostly by private partnerships.

The implementation of the PRSP is crucial in fighting poverty. My authorities would like to reaffirm that its implementation will be done in the same manner as its preparation, that is, with the participation of all stakeholders.

Finally, as I mentioned in my statement, the PRSP has great expectations in its outcomes. The key challenge faced by my authorities is to meet those expectations. They would like to assure Directors that they stand ready to take any additional action to meet the challenge. My authorities are hopeful that the international community can provide predictable and timely technical and financial assistance to support their efforts.

The Acting Chair made the following summing up:

Executive Directors welcomed Senegal's Poverty Reduction Strategy Paper (PRSP), and deemed it a sound basis for the country's fight against poverty and for Fund concessional assistance. At the same time, they noted that further work will be needed to make the strategy fully operational and ensure its effectiveness.

Directors commended the authorities for the detailed poverty profile contained in the PRSP, and for the range and depth of public participation in the preparation of the document. They noted that the PRSP is organized around themes of wealth creation, human development, macroeconomic stability, and implementation strategy, and considered that the priority actions and measures proposed in the PRSP adequately address the main issues facing the various sectors. They welcomed the emphasis given to improving public expenditure management. Directors concurred that monitoring of implementation over the medium to long run should focus on indicators of economic growth and on poverty reduction outcomes related to education, health, nutrition, access to drinking water, gender issues, and rural/urban income disparities. However, they believed that it will be difficult to evaluate progress in the early phases of implementation because of the lack of outcome indicators for the period up to 2005.

Directors observed that the government's plans to implement the poverty reduction strategy are not always spelled out in sufficient detail, citing, as an example, the fiscal decentralization strategy through which the government wants to assure better public services. The social sector strategies should also be defined in greater detail, ensuring also their consistency with the overall investment program. It was noted that increased effectiveness of poverty-reducing spending would require comprehensive public expenditure reform geared to improving the quality of expenditures and expenditure management and the transparency of budget execution. Similarly, Directors stressed that further analysis will be needed to track the impact of specific structural measures on the well-being of the poor.

Directors welcomed the PRSP's emphasis on sound macroeconomic policies. They emphasized that the poverty reduction strategy needs to be embedded into a credible and realistic macroeconomic framework to enhance the confidence of investors. In this context, they stressed the importance of expanding the tax base, limiting the debt burden, and prudently managing public expenditure. They cautioned against basing the poverty reduction strategy on the PRSP's "high-spending case" macroeconomic scenario, given that the necessary immediate acceleration in private investment appears to be overly large and that the assumed implementation rate for public sector investment would imply a substantial increase in the public sector's absorptive capacity.

Directors stressed the key role of the private sector in stimulating economic growth and reducing poverty. They encouraged the authorities to improve governance and tackle corruption and create the legal and institutional framework conducive to attracting foreign investors and boosting local investment. They also urged the authorities to remove impediments to the expansion of credit to the private sector and continue their work on privatization. Directors noted that the large infrastructure projects promoted by the president should be consistent with the macroeconomic framework of the PRSP.

Directors hoped that implementation of the PRSP would facilitate eventual agreement on a PRGF-supported economic program. They noted the risks associated with the PRSP, stressing, in particular, the need for prioritization of goals, policy contingency plans, institution-building, and a better link between social goals and poverty programs in a realistic macroeconomic framework.

Directors emphasized that all outstanding issues should be addressed in the first annual progress report on the implementation of the poverty reduction strategy.

The Executive Board took the following decision:

The Fund determines that the Poverty Reduction Strategy Paper for Senegal set forth in EBD/02/145, 10/22/02, provides a sound basis for Fund concessional financial assistance. (EBD/02/145, Sup. 1, 12/13/02)

Decision No. 12912-(02/125), adopted
December 19, 2002

3. DESIGN OF THE SOVEREIGN DEBT RESTRUCTURING MECHANISM—FURTHER CONSIDERATIONS

Documents: The Design of the Sovereign Debt Restructuring Mechanism—Further Considerations (EBS/02/201, 11/27/02)

Staff: Hagan, LEG; Fisher, PDR

Length: 2 hours, 30 minutes

The Acting Chair (Ms. Krueger) recalled that the current meeting responded to a request from the IMFC to develop a concrete proposal for an SDRM that could be discussed at the IMFC Spring 2003 meeting. The staff paper provided a comprehensive discussion of the main questions and inevitably raised a large number of complex and sometimes unfamiliar issues. In developing the proposals, the staff had benefited from extensive discussion with private market participants, bankruptcy practitioners and other workout specialists, academics, and members of the official community. Two informal seminars had been held which had provided an off-the-record opportunity for Directors to raise issues and have a preliminary discussion. The current meeting provided a first opportunity for Directors to give guidance to staff and management concerning the development of the proposal.

With regard to the next steps in preparation for the Spring Meetings, the Acting Chair suggested that the summing up of the current discussion along with the staff paper should be published on the Fund's website as soon as feasible and in line with the Fund's policies in that regard. Both the summing up and the staff paper would provide valuable background information for the workshop and the conference that were planned to take place in January. The workshop would provide an opportunity for Directors, staff, and management to benefit from having the details of the proposals scrutinized critically by recognized experts, including those who had worked closely with both sovereigns and creditors. It was a key tool to help ensure that the proposal would be balanced and to avoid pitfalls that might lie below the surface. The conference would also provide an opportunity for the proposal to be discussed with a broader range of interested parties, including those drawn from capital markets, academia, the private sector, and civil society. In the interest of helping those who would be invited as speakers to the workshop and/or the conference to prepare their presentations, and in view of the proximity of the holiday season, it would be useful to send copies of the staff paper to the invited speakers right after the conclusion of the current Board session on a strictly personal and confidential basis, making clear that the views of Directors as reflected in the summing up would be circulated as soon as possible.

With the benefit of the guidance provided by the current meeting and the workshop, the staff would prepare a revised paper laying the basis for a report to the IMFC, the Acting Chair said. That report could also include an initial draft of the text of an amendment to the Fund's Articles of Agreement. That paper should be discussed in late February or early March. Meanwhile, the outreach efforts would continue and intensify as the proposals moved forward and attempts were made to build a consensus on the need for and the design of an SDRM.

Mr. Wijnholds submitted the following statement:

I continue to believe that a sovereign debt restructuring mechanism can be a useful addition to the international architecture.

We should be careful in slimming down the proposal to please specific interest groups; effectiveness of the mechanism should be the main criterion for deciding on changes.

I would still prefer not bringing Paris Club debt under the SDRM (not even as a separate class).

The decision to activate the SDRM should rest solely with the debtor. Formal Fund involvement is neither desirable nor necessary.

I am somewhat skeptical about replacing the general stay on litigation by the proposals in the staff paper and would appreciate a more detailed discussion of the pros and cons of such a move.

I would only go along with publication if staff edits the paper in such a way that it adequately reflects the views of the Board—that it becomes clear that there are various options still open on a number of issues—such as the role of the Fund under the scheme, the (non) inclusion of Paris Club debt, and the stay on litigation.

I thank the staff for the detailed and thorough paper and for their concrete proposals. The paper, together with today's discussion, will be an important step towards preparing the text of an amendment to the Articles of Agreement, as was requested by the IMFC. First and foremost, I would like to reiterate that I continue to believe that a sovereign debt restructuring mechanism can be a useful addition to the international architecture. I completely share the stated rationale and objectives, i.e., to create a mechanism that can facilitate an orderly restructuring process and can improve transparency and predictability for all parties concerned.

While the devil is often in the detail, I do not think Board guidance is absolutely necessary on all the specific technical aspects of the proposal. I will therefore limit my comments to some of the more important aspects of the proposals. I would also have liked to discuss the political and economic aspects of an SDRM, but I understand these will be dealt with separately, in the highly anticipated 'companion paper'.

The paper for today's discussion shows that the SDRM proposal has come a long way since the ground-breaking initial proposal by the FDMD. The comprehensive outreach to the private sector, together with a more detailed discussion of the specifics, has led to some substantial changes to the original concept. In particular, the role of the IMF has been significantly reduced, as I understand in order to address concerns from private sector participants. For the same reason, the 'stay on litigation', one of the main planks of the original proposal, has been dropped. I will come back to some of the specific issues later, but in general I believe we should be careful in further slimming down the proposal to please specific interest groups. We would then risk ending up with a mechanism that offends nobody, but might not be very effective either. As it is unlikely that we will be able to please everybody (see for instance the recent –very critical- letter that was co-signed by the IIF and various other creditor representatives), we should perhaps use the effectiveness of the mechanism as the main criterion for deciding on further changes. Instead of pleasing critics by making further changes, it might be better to reiterate the point that the proposed mechanism is not a zero-sum game, but could actually be beneficial to both debtors and creditors. It could also be necessary to explain once more that the SDRM is not a substitute for collective action clauses, but rather a necessary complement.

Coverage of the Mechanism

I concur with the proposal to limit the SDRM to external sovereign debt to private creditors, although it may create equal treatment concerns. Staff points to mechanisms outside the SDRM, such as insolvency procedures for domestic debt, as well as the transparency requirements of the SDRM, to argue that equal treatment within and beyond the SDRM should be guaranteed. But these elements may not be enough to guarantee that the interests of creditors are served equally. I would be interested to learn whether staff has considered arrangements for more formal coordination between the SDRM and restructuring arrangements that fall outside the—relatively narrow—scope of the mechanism (perhaps based on a comparability of treatment clauses).

As to the Paris Club creditors, I would still prefer not bringing this group under the SDRM (not even as a separate class). This was also the position of the majority of the Board at our last discussion. As I explained in detail on that occasion, there is no need to bring official debt under the mechanism, as Paris Club restructurings have a long history of being efficient and fair. It should also be noted that official debt is provided under different terms and for different reasons than private debt, therefore it would not be appropriate to provide private creditors with a de-facto veto over the use of public funds by Club members (through 'reverse comparability'). For these reasons, I would prefer leaving official bilateral debt outside the SDRM for the time being. Its inclusion should be dependent on the success of the SDRM. If the SDRM is successful, it might be expected that the Paris Club and the SDRM would converge and eventually merge.

The exact coverage of the SDRM raises some additional questions. Under the proposals the sovereign would have the option—but would not be required—to include the liabilities of the central bank under the SDRM. It is important to further explore the possible implications of such possible inclusion for the immunity status of a central bank's assets (the staff paper mentions the need for an independent central bank to give its consent, but a more thorough discussion of the political-economic aspects seems warranted).

Given the economic importance of trade credit, it may be desirable to exclude such claims from the restructuring process altogether. I am therefore hesitant about staff's proposal to give the sovereign the option to include trade credit when necessary, especially because this would raise uncertainty for creditors. At the same time, I realize that it is important to close loopholes (e.g., normal credit dressed up as trade credit). Could staff provide more analysis on this issue? Will it be discussed in the companion paper? Finally, the question whether it is necessary for end-investors to register is left open. Although it is indeed a tough call, requesting end-investors to register may be a remedy that is worse than the disease, but obviously more analysis is needed.

Activation

I understand that allowing the debtor to independently activate the SDRM could raise concerns about unjustified use of the mechanism by debtors who are unwilling—but strictly speaking not unable—to service their debt. Nevertheless, I do not think an independent confirmation of the activation by the debtor is practical or desirable. I cannot envisage any other body but the Fund that could perform a thorough analysis of a country's sustainability. As I do not see the need for a more formal role for the Fund in this regard, I believe the decision to activate the SDRM should rest solely with the debtor. If the debtor is unable to convince its creditors of the need for a restructuring (and thus activation of the SDRM), it can—voluntarily- ask the Fund to prepare a sustainability analysis and—voluntarily- decide to publish this analysis. If the creditors remain unconvinced, they can easily (with a small minority) terminate the activation of the SDRM, after which their original claims will be upheld. In such a situation, the unjustified activation might have won the debtor a very short period of protection against litigation, but will have cost it its long-term credibility. I therefore do not think we should be too afraid of debtors unjustifiably activating the SDRM. However, if creditors remain wary of this risk in the case of a particular debtor, perhaps they should reconsider their lending to the country in question, just as—absent an SDRM—they should when they fear a debtor country could unilaterally decide to suspend its payments.

Stay on Creditor Enforcement

Somewhat to my surprise, staff seems to have abandoned the idea of a stay on litigation. Until recently, I thought such a stay was deemed a crucial feature of the SDRM, as it was felt that creditor litigation could seriously inhibit orderly progress in restructuring negotiations. Furthermore, the risk of early litigation could increase if, because of majority decision under the SDRM, the only opportunity to use legal enforcement as a source of leverage is before—rather than after—the reaching of an agreement. This is also one of the reasons why collective action clauses contain provisions that effectively enable a majority of bondholders to block legal action by a minority before an agreement is reached. Staff presents a possible solution for dealing with the potential problem of litigation, through the ‘hotchpot rule’ and empowering the Sovereign Debt Dispute Resolution Forum (SDDRF) with the authority to overrule specific national legal decisions. I fear these alternative proposals—which I understand have replaced the general stay—raise a number of concerns of their own. Specifically, the combination of ‘hotchpot’ and the ‘specific injunctive relief’ comes across as a patchwork of specific rules. I fear that it might turn out to be rather untransparent and unpredictable. This holds especially for the ‘specific injunctive relief’, which would imply that individual legal decisions may or may not be overturned ex-post by the SDDRF. Granting the SDDRF such powers also seems to be at odds with the objective of limiting the powers of the SDDRF to administrative matters and dispute resolution, as specified in the staff paper. I do understand the general stay was one of the main stumbling blocks for private sector creditors, but I doubt whether they would find the new proposals more acceptable. For these reasons, I remain somewhat skeptical about replacing the general stay on litigation by the proposals in the staff paper and would appreciate a more detailed discussion of the pros and cons of such a move.

Classification of Claims

On giving the sovereign the ability—and discretion—to create optional asset classes, so as to allow it to discriminate between different types of creditors, I am not totally convinced of the need. I think we should balance the benefits of being able to devise a tailor-made solution against the reduced predictability caused by the ad-hoc grouping of creditors into different classes. Furthermore, the creation of too many classes may reduce the effectiveness of the SDRM in terms of solving creditor coordination problems, as each class has a de-facto veto over the entire restructuring. A separate class might be desirable for official debt, but if it is excluded from the SDRM—as would be my preference—I believe we should reconsider whether we really need the ability to create classes.

Consistency with Legal Systems

Unfortunately, I cannot yet say whether the SDRM would require changes in one or more of my constituency countries. The legal experts in some of the countries I have been in touch with have thus far reserved judgment, saying they need more specific information on the text of the amendment before they can give a final answer. Hence, I have to reserve final judgment and would like LEG to draft a concrete questionnaire or checklist that we can send to all our constituency countries. That way, we can be certain of concrete and uniform answers across the membership.

Name

Now that we are nearing the stage of texts for amending the Articles of Agreement, I once again want to raise the matter of the name of the beast. As I

> stated on an earlier occasion, the abbreviation SDRM is likely to create considerable confusion with the SDR, our very own unit of account and reserve asset. Let me remind those who may think that I am nitpicking that we still have the fourth amendment of our Articles of Agreement, which deals with a special one-time allocation of SDRs, pending. To now introduce a fifth amendment dealing with something called the SDRM, is bound to require a lot of explaining. Why not do ourselves a favor and choose a somewhat different acronym?
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> Publication of the Paper
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> Finally, the cover page mentions the intention to publish this paper after the Executive Board completes its discussion. Does this imply after this Board meeting? If so, I would only go along with publication if staff edits the paper in such a way that it becomes clear that there are various options still open on a number of issues—such as the role of the Fund under the scheme, the (non) inclusion of Paris Club debt and the stay on litigation. We are in constant dialogue with the private sector on the design of the mechanism. Over the past year, we have seen various versions of the scheme, starting with the FDMD's original proposal up to the most recent version, which is still work in progress. All the different versions can be confusing and I think it is important that when we publish a new paper on the SDRM, it adequately reflects the views of the Board.

Extending his remarks, Mr. Wijnholds stressed that he continued to support strongly the current approach to solving the collective action problem. There was indeed a collective action problem that needed to be addressed, although there were some denying that this was an issue in the context of sovereign debt restructuring. As he had pointed out in his statement, the scheme for the SDRM had been watered down at each successive meeting on the subject. And while it was very good that the Fund had engaged the private sector—an approach which he had always supported—it appeared that there was now a tremendous effort to please the private sector under almost any circumstances. Accommodating the criticism of the private sector to move the project forward could, however, go too far and undermine the SDRM's basic rationale. Keeping in close contact with the private sector in that context was welcome, but it appeared that such contacts had done little to further the private sector's acceptance of the SDRM, as was evidenced in a recent statement by a number of private sector bodies that read: "While we note that the IMF is still revising the SDRM proposal, no changes in its specifics will alter our serious concerns about the SDRM's interim problems." If that were to be the attitude in the private sector, the question arose as to whether the liaison efforts on the part of the Fund had really been worthwhile, particularly since the original proposal had already been a very good one.

It was appropriate to reduce the role of the Fund, as had been done under the current proposal, Mr. Wijnholds considered. However, it was debatable how the changes regarding the stay on litigation should go. In view of the staff's assertion that the main change to the concept had already occurred in February, thus suggesting that there had not been significant alterations since then, one could consider moving back to the position of February without much difficulty. It should also be noted that, regarding the Paris Club, the ideas under the current proposal differed considerably from those held by the majority of the Board before. That was a cause for concern.

With regard to criticism from the debtors' side, Mr. Wijnholds considered that Mr. Oyarzábal and Mr. Beauregard had jumped too quickly to the conclusion that there was insufficient support for the scheme and that the Board was wasting its time. Mr. Portugal had more accurately assessed the situation by admitting that his was a minority view. There were thus many reasons to continue the discussion without rushing to embrace everything put forward by the critics. While some creditors and debtors were rather vocal in their opposition, there was strong support among the membership for moving ahead, and while compromises would be needed, one should not bend over backward to adapt the proposal to some of those criticisms. Rather, the concern should be the effectiveness of the scheme, and weakening the scheme to a point where it could not achieve its intended objectives had to be avoided.

Mr. Portugal submitted the following statement:

> I appreciate the staff's and management's efforts to clarify doubts in two informal sessions and the recognition expressed by management that there is not yet a closed proposal. The willingness to convene outreach meetings with interested parties is also welcome. I would appreciate receiving a list of participants in the various consultations and stress the need to listen fully to the borrowers. I thank the staff for their efforts, but unfortunately the paper still leaves some fundamental questions unanswered. While my basic position relating to the SDRM remains unchanged, I realize that mine is a minority view within the Board and, therefore, I would offer comments and suggestions concerning the various issues for discussion raised in the paper.
>
> The Rationale for the SDRM and Guiding Principles for its Design
>
> I continue to believe that the rationale for the SDRM has yet to be demonstrated by the staff. The staff paper attributes part of the delays in initiating sovereign restructurings to the uncertainties associated with the lack of procedures, to collective action problems among creditors, including the emergence of holdout creditors, and to difficulties in achieving inter-creditor equity that may inhibit creditors' acceptance of the restructuring terms. However, one does not know how large and important a part such problems play in delaying the process. Holdout creditors, major collective action problems, and creditor litigation do not seem to have been major impediments in recent sovereign bond restructurings in Russia, Ukraine, Pakistan, and Ecuador, nor in the current Argentinean default. Unfortunately, despite my repeated requests for the staff to provide empirical evidence of the magnitude and nature of the problems they argue to be the rationale of the SDRM, this has not yet been done.

I therefore still hold the alternative view that the delays in initiating a restructuring ought to be attributed mainly to the uncertainties surrounding the determination of whether debt is sustainable or not, and to the very high economic costs of a restructuring. The uncertainties surrounding the determination of debt sustainability, which the SDRM proposal does nothing to dispel, derive from the great difficulties in making judgments about the future path of variables such as the interest rate, inflation, GDP growth, the real exchange rate, and investors' confidence. The question of very high economic dislocation costs and reputation costs associated with restructurings is not addressed by the SDRM either. Therefore, my conclusion is that the benefits of a possible SDRM are likely to be much smaller than what the staff envisages, and may not be worth its potential costs in terms of risks of reducing the volume of capital flows to developing countries and increasing their borrowing costs.

In general, I am in agreement with the guiding principles listed in paragraph 14, with a few exceptions and one addition. The addition should be that the framework is designed in a manner that does not contribute to reduce international capital flows to developing countries or to increase their borrowing costs, and in a manner that reduces current restructuring costs to the debtor, without imposing additional requirements on them. This should be explicitly acknowledged by staff as a guiding principle. I disagree, in particular, with the implication contained in the second bullet of page 7 that creditors need more information relating to the debt and treatment of creditors that are not subject to the mechanism. With the significant improvement in transparency by member governments and the Fund, creditors already have sufficient information. I also disagree with the idea included in the third bullet of page 8 stating that a dispute resolution forum should be part of the new mechanism.

Scope of Claims to be Covered

The staff has proposed an all-encompassing approach to define the scope of claims to be covered, despite the agreement already reached by the Executive Board that sovereign domestic debt and private external debt should be excluded from this mechanism. The staff envisages the possibility of the inclusion of debt issued by non-sovereign public entities, such as sub-national governments and public enterprises, as well as of private external debt such as trade credit and inter-bank credit. The Board has never discussed the inclusion of these types of debt, and there was the understanding that the scheme would be limited to sovereign debt, as the very title of the mechanism indicates. Instead of clearly limiting the scope of debt to be included, namely the external debt issued by the sovereign, the staff suggests an unacceptable approach by which everything is included, unless it is specifically excluded. The approach should be the opposite: to define in a targeted way the types of claims that are specifically included, with the understanding that what is not included is excluded.

There are significant costs and risks in including sub-national government debts as eligible claims. Given that the debtor can activate the SDRM, such an inclusion could give rise to a sub-national government asking for activation and triggering a default against the will of the sovereign. Moreover, the extensive efforts that have been made by many countries to control sub-national finances would be undermined by such a proposal that could lead to sub-national debt being de facto taken over by the sovereign. The staff's proviso that these debts would not be included if they are subject to the domestic insolvency system does not help since, in a number of countries, while the debts of sub-national governments and public entities are subject to the domestic legal and judicial system, they may not be subject to the insolvency system.

The proposed definition of eligible claims should be stated in terms of a right to a payment by a sovereign in foreign currency related to a bond, note, loan, or financial derivative contract that is governed by foreign law and subject exclusively to foreign jurisdiction. It is with respect to these financial instruments that collective action problems may arise, and which were behind the alleged rationale of the proposal. In particular, the deferred payments and credit for the acquisition of goods and services, payments due under leases, and trade credit should be excluded from the mechanism. Privileged claims should also be explicitly excluded, as proposed and for the reasons mentioned by the staff. Guarantees given by the sovereign to eligible claims should only be included if the underlying obligation that is being guaranteed is in default. Claims of international financial organizations should also be excluded from the SDRM. Official bilateral credit should be excluded too if the alternative would be to make this type of credit a mandatory class.

The criterion proposed by the staff of "a contract relating to commercial activities of the sovereign" is confusing and unsatisfactory. Would contracts to finance activities that are non-commercial, i.e., activities that are exclusive to sovereigns, be excluded? What if a bond contract is issued to finance military expenditures, or other types of expenditures that are exclusive of a sovereign?

The exclusion of domestic public debt should be built into the main definition of the mechanism, and not excluded afterwards. The criteria that the claim has to be subject to the exclusive jurisdiction of the sovereign is too demanding, since it may not be possible to completely and absolutely exclude these claims from the jurisdiction of foreign courts. The criterion instead of being that of the exclusive domestic jurisdiction should be being subject mainly or originally to the jurisdiction of domestic courts. It is not acceptable either that a claim governed by domestic law and subject to the jurisdiction of the sovereign is considered an eligible claim if it is recognized and enforced by a foreign court.

Activation and its Consequences

One of the main agreed features of the SDRM was that activation would be the exclusive right of a sovereign debtor. Unfortunately, the practice of voluntary initiatives in the Fund is that they start as voluntary, and then become encouraged, then presumed, and finally mandatory. It seems that this drifting process towards mandatory activation has already started with the idea proposed by the staff that a third party other than the sovereign makes a determination that the sovereign's representation that its debt is unsustainable is justified. I strongly disagree with such approach. Given that the activation does not trigger a stay or any other change of contractual rights and that creditors may vote to terminate activation, it seems that such independent verification is unnecessary and undesirable.

I do not agree with the staff's proposal that, as a requirement of activation, a Non-Impaired Claims List, which includes information on all claims that are excluded from the SDRM, should be provided by the sovereign. Only claims that are eligible for the SDRM procedure but that the debtor has chosen not to include should be part of the Non-Impaired Claims List. This is an important feature of the understanding that domestic debt and non-sovereign external debt are excluded from the mechanism.

The period of around 30 days proposed in the paper for verification seems unrealistically short and the verification process, according to which claims would be considered verified if not challenged, seems unsatisfactory. The provision that a sovereign would only be able to challenge the value, but not the existence of a claim, may be troublesome and could become a source of false and fictitious claims by creditors. The paper seems concerned with the possibility of creation of fictitious claims by the debtor in order to influence the voting process but pays little attention to the possibility of fictitious claims on the part of the creditors.

While it is appropriate that claims of creditors under the control of the debtor do not participate in the voting process, to exclude from voting creditors that may be merely influenced by the debtor is exaggerated and unrealistic. Such criterion could lead, for instance, to the exclusion of any national of the debtor. Also if a challenge is presented against a particular creditor, the burden of proof should be to those who present the challenge, and not to the burden of the challenged creditor to produce the appropriate evidence. The staff's proposal seems to invert the usual burden of the proof that should lie with the accuser and not the accused. Some countries have large state-owned banks that operate freely in the market. The fact that they have a large position in a given instrument may have nothing to do with undue influence from the sovereign. Particularly if such institutions have minority shareholders, their interests should not be penalized by disenfranchisement.

Similarly, the idea that the end-investor, instead of the lender of record, is registered is unrealistic and would represent a significant complication for current market practices that envisage lenders of record to hold sovereign issues in a global form. The paper contemplates that the registration process will accommodate secondary market trading but does not explain how this can be accomplished. Secondary debt trading in the 1980s produced a reconciliation nightmare that for some countries took up to a year or more to resolve. How could the registry be kept current enough for accurate voting records at the beneficial-owner level? Voting should be at the holder-of-record level.

I agree fully with the staff that the history of sovereign litigation indicates that the ability of creditors to disrupt a restructuring through legal action is limited due to the sovereign's immunity and to the constraints and complications of legal systems that create significant obstacles and costs to litigation. In fact, this is why I believe the SDRM is unnecessary in the first place. Therefore, I also agree with the staff that a stay on litigation is unnecessary and that contractual provisions allowing for debt acceleration and cross-default should not be automatically suspended.

Creditor committees have played a positive role in past restructurings providing for a single counterpart to the debtor, helping to solve inter-creditor issues and performing advisory functions. However, it does not seem either practical or appropriate that they have a role in challenging the registration of so-called non-independent creditors. Also, I believe that rather than asking the debtor to defray all costs of operation of creditor committees, such costs should be split half and half between the debtor and the creditors. A division of costs between the debtor and the creditors would reduce the danger of abusive fees and eliminate the need to assign the function of reviewing fees to the SDDRF.

I agree with the staff proposal of a voting threshold of 75 percent, the same already used in bonds issued under the English law, to approve the proposed new restructuring terms. However, the 40 percent threshold for creditors to terminate the SDRM process seems too high, well above the blocking minority, which would be 26 percent. I do not understand the rationale for a 10 percent threshold for creditors to request a vote on termination of SDRM, as envisaged in the paper. This could give a determined minority an option to call for votes and disrupt the process.

One of the positive, though perhaps not totally realistic, features of the proposal is the idea of providing privileged status to new financing that should be excluded from the restructuring. Under the Baker Plan, so-called new money was by covenant not subject to restructuring, but was restructured. Under the Brady Plan, Brady bonds were by covenant not subject to restructuring but have been restructured. An intercreditor subordination agreement is unlikely to overcome the problem because, in order to be effective, it will require prior agreement by all creditors of a sovereign. The requirement that such priority financing be approved by a vote of other creditors is cumbersome and may be unnecessary and ineffective. Due to inevitable delays in the voting process, this requirement may substantially diminish the value of new financing.

Given that privileged creditors should be excluded from the SDRM, there is no need for mandatory classes. Mandatory classes would have a blocking power to the restructuring and would create a potential for holdout creditors that does not exist nowadays. I agree, however, that the debtor may create optional classes to be able to offer different restructuring terms to groups of creditors with different economic interests, provided that this possibility is not abused through the creation of artificial and arbitrary classes to discriminate amongst equally positioned creditors. However, the possible role of the SDDRF review of creditor classification raises the possibility of uncertainty and delay. I would also like to ask the staff why official bilateral creditors could not form an optional class.

Sanctions

The staff not only proposes to increase the obligations of debtors to provide information, but also adopts an unjustified double standard with respect to the treatment of information. While the staff presents no suggestion to deal with the provision of false or incorrect information by creditors, under the argument that they can be liable to civil and criminal prosecution, it proposes a harsh treatment for the provision of materially incorrect information by the debtors, namely to consider it a breach of obligations under the Articles of Agreement. I would strongly oppose this or other types of sanctions.

The Sovereign Debt Dispute Resolution Forum

I remain unconvinced that the creation of a SDDRF is an essential element of the SDRM. It may be very difficult to create such a mechanism linked to the Fund given the substantial conflicts of interest that exist, since the Fund is a creditor, the main policy advisor, and a possible future lender of the debtor. The argument for a new dispute resolution process is based on the premise that aggregation of diverse claims for voting and restructuring purposes will produce disputes about the validity and value of claims. Yet the potential for such disputes already exists. If there are not many such disputes, it is because of the quality of the existing market practices and the predictability of current dispute resolution procedures, which the proposed SDDRF could undermine. The idea that the SDDRF would have the exclusive jurisdiction over disputes arising between the debtor and the creditor and amongst the creditors to the exclusion of domestic courts is far-fetched, and may create serious problems of compatibility with national legislation. The administrative functions to be performed by the SDDRF such as notifying creditors, registering claims and administering voting have not proven to be difficult in earlier restructurings, and could be done by private entities.

If, however, the idea of an SDDRF were to proceed, I believe that important changes would have to be made to the staff's proposal. The selection panel in charge of choosing the members of the SDDRF should be appointed by the Managing Director after approval by the Executive Board by a 70 percent majority, and a similar majority should be adopted for the Board of Governors to approve the entire list of members of the SDDRF. While I agree that competence and impartiality are very important criteria for the selection process, I believe that national diversity ranks equally high in importance with these criteria. Also, it is not clear that the professionals who deal with private company insolvency have any advantage over individuals experienced in sovereign finance or international economics. The determination of the various issues involved may require the judgment of persons with a broader perspective.

The impaneling of members to participate in a given case should be chosen by both parties, with the debtor and the creditors choosing one member each, and by the President of the SDDRF who would choose the other two members. The proposed approach of having only the President of the SDDRF to name each panel may generate questions about the power concentrated in a single individual particularly since the President himself is not chosen in a process that provides accountability. While this is an issue that deserves further thought, it seems that all four members should hear the entire case. A single supervisory judge would not seem appropriate to make these types of complex decisions.

The members of the secretariat of the SDDRF should be appointed by its President without the requirement of consulting the Managing Director. The SDDRF should enjoy budgetary independence from the Managing Director, similar to the one existing for the IEO.

While I agree that the SDDRF should not have initiative of its own or consider issues that were not raised by the parties, and should not have any subpoena powers, the dispute resolution powers of the SDDRF should be more limited than proposed by the staff. In particular, I believe that it should not have the power to disqualify creditors on the grounds that they are influenced by the sovereign or the power to issue injunctive relief orders to an outside court. Similarly, the SDDRF should not have the power to establish general principles from case law to be followed in future rulings, nor to terminate the SDRM.

While we agree that the SDDRF would have no choice other than applying the local law governing the contract, this possibility creates significant room for conflict with, and the implicit overruling of, longstanding rules in major commercial jurisdictions with consequent negative effects on markets. This needs to be considered carefully, perhaps by a procedure for referring matters to local courts for advisory opinions. The lex fori mentioned in the paper is totally undefined and I reserve our opinion on the issue.

The entire section concerning the relationship of national laws and legal effect and the finality of SDDRF decisions seems hastily prepared. It is an enormous subject that requires extensive further work, particularly on the local recognition and enforceability issue.

I am disappointed that the staff suggests the creation of such powerful international body with judicial powers that could supersede national courts and dedicates only three lines to explore how to make it accountable, presenting just a suggestion of publication of an annual report.

Amendment of the Articles of Agreement

I continue to believe that it is inappropriate to use the faculty to amend the Articles of Agreement for creating the SDRM since it relates to objectives that fall outside the Fund's purposes, and were never envisaged by members when they originally subscribed to the Articles of Agreement. The staff mentions, without offering any supporting argumentation, that the SDRM is closely related to the role assigned in the Articles of Agreement for the resolution of members' external financial obligations. I would like to ask the staff for a detailed analysis that clearly shows such relation, pointing to the provisions in the Articles of Agreement that the staff thinks are related to the SDRM.

Amending the Articles of Agreement for this purpose seems simply to be an expeditious way of trying to bind members that would be in the minority opposing the amendment, which certainly is not an example of good governance. If an SDRM and SDDRF are to be established, that should be done by a completely new international agreement rather than by amending the Articles of Agreement.

The staff's description of the approval process of the amendment indicates that both the Executive Board and the Board of Governors would need to approve it by a majority of votes cast, whereas the amendment would only become effective if it is approved by three-fifths of members having at least 85 percent of the voting power. While such description is correct, it raises important concerns. The worse thing that could happen would be to have an amendment that is approved by the Executive Board and the Board of Governors by simple majority and then never enters in force. If that were to happen, the borrowing countries would face all the noise and costs associated with the amendment, which would stay forever like a sword hanging over the heads of creditors, but would not produce any of the supposed benefits. It is very important, therefore, that on this type of issue, the amendment is approved by the Board not only by a simple majority, but by an 85 percent majority, reflecting a broad consensus. I would like to know if management shares this view and would be prepared to adapt the proposal as necessary so that it gets such substantial majority support rather than relying on simple majority.

Mr. Callaghan and Mr. di Maio submitted the following statement:

Key Points

The aim should be to narrow the key design issues so that by the 2003 Spring Meetings we are in a position to determine whether there is sufficient support for the SDRM.

The contractual approach needs to be advanced at the same time as the SDRM. Support for the SDRM should not be gained by attacking the contractual approach.

The SDRM must be kept in perspective. It is not a 'magic bullet' for resolving unsustainable debt.

While flexibility will be needed, we should try to limit the powers delegated to the SDDRF to judgments on matters of fact and resolution of disputes.

Central bank claims should be included where necessary. Public entities and sub-nationals should only be included if not covered under domestic insolvency laws. Uncalled guarantees, privileged or secured claims, and domestic debt should be excluded.

Private sectors concerns over the Paris Club run deeper than can be addressed by simply including official claims within the SDRM. A fundamental shift in Paris Club arrangements may have negative consequences for the amount of official financing.

Independent confirmation, other than by the Fund, on debt unsustainability is not feasible.

A general stay on enforcement would unnecessarily disrupt creditor rights. We are open to the idea of having a power to halt specific enforcement action.

A 75 percent voting threshold for restructuring is appropriate. There may be value in a 'step down' approach, particularly if 'sleeping' claims are included in the calculation.

There should be an arrangement to approve priority financing.

There are benefits in establishing different classes of claims, but these should be pre-specified as far as possible and guidelines/safeguards established for the debtors' ability to establish additional classes.

The SDDRF should not have the power to terminate the SDRM. The proposals for selecting, appointing and organizing the SDDRF seem sensible.

Advancing the SDRM and the Contractual Approach

The staff paper covers many of the issues that need to be resolved in designing the SDRM. We thank staff and management for their assistance and patience, including the two informal sessions on the issue. These were very helpful.

It is a complex exercise. We could easily become bogged down on points of detail. However, the aim should be to narrow the key issues such that, by the 2003 Spring Meetings, the IMFC is in a position to determine whether there is sufficient support for the establishment of the SDRM. Even if support is forthcoming, this will inevitably be a protracted exercise. The Articles of Agreement have been amended only three times in more than 50 years. The average time for adoption once the amendments were approved by the membership was 22 months. Furthermore, it may be difficult to get acceptable amendments passed by the legislature of some of the largest members.

Given that an SDRM may not receive sufficient support for it to be established, or that the process may prove to be protracted, it is important that the Fund continue to pursue alternative approaches to crisis resolution, such as the contractual approach. While we acknowledge that there are rather limited avenues for the Fund to directly foster contractual solutions, we should contribute by taking stock of the different avenues of work and identify the remaining obstacles to their more widespread adoption. Importantly, work on the SDRM should not be seen as precluding or frustrating advancement of the contractual approach, which is the claim of a number of private sector bodies. It is important that the Fund not attempt to build support for the SDRM by attacking the contractual approach. This will prove counterproductive in the longer run.

Given the importance of the wide range of design issues dealt with in the paper, we have tried to highlight areas where we think additional clarification is warranted, as well as providing our views on the issues for discussion

Purpose and Principles

The establishment of a set of general principles for the SDRM will not only help guide its design, but will also provide the basis for communicating its purpose and scope. With this in mind, there may be value in the principles explicitly emphasizing that the design seeks to ensure that the key decisions under the framework will remain in the hands of the majority of creditors and the sovereign, or as Ms. Krueger has stated, the SDRM will rebalance leverage in a restructuring situation from a small minority of creditors to a large majority.

At the same time, it is important that the SDRM be kept in perspective. It is intended to facilitate the restructuring in the 'extreme' cases when a sovereign's debts are judged as being unsustainable, but even in these circumstances it remains in our interests to emphasize that the SDRM will not be a ‘magic bullet’. It will not address all the issues that require resolution when a sovereign’s debt needs to be restructured. In the midst of financial turmoil, the ability to reduce the costs of debt restructuring by increasing incentives to reach agreement quickly will be limited to the ability of the country itself to resolve domestic issues regarding the speed and costs of adjustment. In other words the problem of collective action of creditors is only one issue, albeit an important one, that must be resolved in a situation where debt needs to be restructured. We should be wary of creating expectations that the SDRM will not be able to deliver on.

In designing the SDRM, we are moving into uncharted waters. As questions arise as to the design of each subsequent layer of detail, it is increasingly difficult for us to judge the effect these decisions will have on the incentives for creditors and debtors. There will clearly be merit in considering avenues to provide for changes to the design of the SDRM that would not require an additional amendment of the Articles of Agreement, but rely instead upon a supermajority of the Executive Board or Board of Governors.

The powers and role of the Sovereign Debt Dispute Resolution Forum (SDDRF) will be a key aspect to gaining wide acceptance of the SDRM among creditors and debtors. The proposal in the paper highlights an expanded role for the exercise of discretion by the SDDRF in several dimensions. Striking the appropriate balance between rules and discretion for this forum could be facilitated through an additional principle guiding decisions on the design of the SDDRF. The principle would seek to limit the exercise of discretion by the SDDRF to judgment on matters of fact and resolution of disputes and would be similar to the first consideration in the design of the SDDRF outlined on page 57. It will be important to ensure that the rule-making power of the SDDRF is constrained and that the development of the SDRM is not ‘delegated’ to the SDDRF.

Scope of Claims

We support the general approach taken to defining the scope of claims which could be included in a restructuring agreement, while leaving the ultimate decision as to the specific claims to be included to negotiations between creditors and debtors. Ultimately, the scope of the debt being covered must be wide enough to address the country’s sustainability problem.

Central Bank claims should be included if the circumstances require it.

Claims on the public entities and sub-national governments should be included only where these entities are not covered under domestic insolvency regimes.

Domestic laws on central bank or sub-national government financial independence should be respected—consent should be sought to include these claims where this is allowed for under domestic law.

Although a wider definition than the extension of credit to, or guarantee by a sovereign, is required, we think some clarification of the definition 'payment under contracts relating to commercial activities of a sovereign' would be beneficial. Do commercial activities in this sense have a well defined meaning in law? Simply defining an activity "commercial" if it could be conducted by a private party may include payments that are listed as excluded from this definition, including wages, salaries and pensions. In certain circumstances, is it possible that these claims may be considered contractual under domestic law?

We agree it would be preferable to leave uncalled guarantees outside the scope of the SDRM, while deeming that guarantees be included where these guarantees could have been called due to a specific event within the timeframe of the restructuring. The transparency provisions applying to claims will probably also need to apply to outstanding guarantees. Could guarantees that had been issued subsequent to activation of the SDRM and then called be included in the restructured claims?

The treatment of other contingent claims seems a little more problematic. The market value of contingent contracts with the government will reflect not only the underlying value of the claims but also the credit risk of the counter-party (in this case the sovereign). Thus using the market value of these claims would be at odds with the treatment of other obligations (i.e., bonds) which would be included at face value. Reference to the value of similar claims among private sector participants may be one way to address this problem, but there seems no easy solution.

It would be difficult to reconcile the inclusion of privileged or secured claims in the SDRM, with the need to interfere as little as possible with contractual rights and obligations. However, the protection of such privilege is likely to increase the incentives on sovereign and creditors to use security enhancements. In some cases, a country without an ongoing relationship with the Bank or Fund may be in a position where it has secured most of its foreign earnings, such that excluding privileged claims from the SDRM would prevent a restructuring from ensuring sustainability.

Excluding trade credit ex-ante does not seem to be feasible.

We continue to support the exclusion of domestic debt from the SDRM mechanism.

We propose that international organizations whose claims will be excluded by the mechanism be listed. Any amendment could provide for additional organizations to be recognized by a majority of the Executive Board/Board of Governors.

Official Bilateral Creditors

In past discussions we have advocated that the SDRM focus on addressing collective action problems that prevent a timely agreement on a debt restructuring. This implies the exclusion of official bilateral claims. This position is analogous to the principle that the SDRM should not replace existing statutory frameworks for resolving collective action problems. The Paris Club is an existing mechanism, albeit not a statutory one, for ensuring collective action.

Private creditor groups appear to have strong views on this issue. However, private creditors' concerns seem to run deeper than can be addressed by simply including official bilateral debt within the SDRM. The private sector may be working under the assumption that inclusion of bilateral debt would lead to a change in the procedures of official bilateral debt relief to more closely mirror practice in the private sector, allow more effective monitoring of comparable treatment, and settle the issue of whether bilateral credit is de facto senior to private credit.

However, such a fundamental shift of bilateral debt relief may have negative consequences for the amount of financing bilateral creditors can provide, and as such, may not be in the interest of the private sector. In addition, it is not clear that key bilateral creditors are willing to engage in such a fundamental change in the methods for delivering debt relief. Even the inclusion of bilateral debt within the SDRM may not resolve the issues that concern private creditors. As such, it is unclear whether agreement to include bilateral claims would result in less opposition to the SDRM proposal from private creditor groups.

Addressing some of these concerns, while maintaining official bilateral credits outside the SDRM, requires integrating the two processes as closely as possible. We suggest that staff be asked, in consultation with the Paris Club, to propose a framework/procedure that would address the some of the concerns of private creditors with respect to Paris Club creditors, building on recent improvements in the transparency of Paris Club operations.

Definitions of official credit will need to ensure that claims which are effectively private owed to the private sector are not considered official claims.

Activation and Consequences

There are two concerns that need to be addressed in considering whether an independent arbiter is needed to activate the mechanism: (i) that a sovereign whose debt is sustainable activates the mechanism; and (ii) that a sovereign whose debt is unsustainable refuses to activate the SDRM.

In terms of the idea of providing an 'independent' confirmation that a 'representation of unsustainability is not entirely justified', there is probably only one international institution with the recognized capability of making such an assessment—namely, the Fund. Furthermore, the Fund will most likely play a determining role in activation of the mechanism through its lending decisions. For this reason, assuming an entity could be identified to provide independent assessments, it would significantly complicate the situation if it was seen to be 'second guessing' the appropriateness of the Fund's lending decisions. While there may be a case to make the Fund's role in the decision to activate the mechanism explicit, we recognize that there is a concern in the private sector about its independence and there are sensitivities about the Fund being seen to be playing an excessively interventionist role in the operation of the SDRM. It also needs to be recognized that creditors will have tools at their disposal, including termination and final approval of a restructuring, to address a case where a sovereign activates the mechanism when its debts are sustainable.

A sovereign considering the relative costs and benefits of an opportunistic default will have to take into account that the costs of activating the SDRM may not be offset by a lower debt burden should it fail to convince a sufficient majority of creditors that the debt burden is unsustainable. Past experience has also demonstrated that sovereigns with an ongoing financing requirement are generally willing to take extreme measures to avoid a restructuring. The SDRM by itself is unlikely to substantially reduce the costs of dislocation from a debt restructuring process.

Where a sovereign whose debt is unsustainable refuses to activate the SDRM, the Fund and bilateral creditors will play a crucial role through lending decisions.

Information, Registration, and Verification

We consider that the risk of sovereign debtors seeking to engineer the voting process is rather slim, and could be handled by the debtor certifying that they are not aware of any debtors that would subvert the related party rules. We do not consider it necessary to mandate that the end-investor register in order to control abuse of the SDRM. This would likely unnecessarily delay the process.

Stay on Enforcement

We agree that a general stay on enforcement, whether automatic or activated by a supermajority of creditors, would be unnecessarily disruptive of creditor rights given the limited risk of successful litigation and claims recovery in advance of a restructuring agreement. The use of the hotchpot rule should reduce the incentives for early disruptive litigation.

We are not opposed to the prospect of introducing a power to halt specific enforcement actions. Although the proposed criteria under which the litigation would be halted seem difficult to judge. For example, even though there may be a risk a creditor is able to extract sufficient value to subvert the hotchpot rule, it is unclear whether this would seriously undermine the restructuring process unless the amount was sufficiently large. A conclusion regarding whether a creditor would be able to extract sufficient value would also depend on an assessment of value to be recovered in the restructuring and the value that could be extracted through litigation.

In fact the question could be posed as to whether there is any real difference between a generalized stay on enforcement subject to creditor approval, and the twin approach proposed by the staff. This is particularly true if creditor approval for injunctive relief can be gained quickly, the voting thresholds are the same, and the criteria under which injunctive relief can be sought are sufficiently broad.

Creditor Participation

We agree that creditor committees could play an important role within the SDRM framework. Consideration regarding whether a creditor committee is recognized or not should be closely aligned to the Fund's lending into areas policy, which would suggest including considerations of the complexity of the case and the ability of creditors to form a committee quickly. The SDDRF could be required to take into consideration past Board decisions regarding the Fund's lending into arrears policy.

Voting Thresholds

A threshold of 75 percent to effect a restructuring seems appropriate, given its wide acceptance in the past in both the sovereign and non sovereign context. We think this threshold strikes an appropriate balance between ensuring that disruptive creditors are unlikely to halt a restructuring and protecting the interests of minority creditors against those who hold the majority of the debt.

In calculating the threshold there may be merit adopting a 'step down' approach, particularly if 'sleeping' claims are included in the calculation of the voting threshold. This approach would seek to prevent a situation where a very low participation in a vote leads to a stalemate. This may be a more likely outcome if it was decided the end-investor is required to register and the creditor base is very fragmented and diverse. One compromise might be a mix of the two proposals presented in paragraph 167. In the first round, approval of the restructuring plan would require 75 percent of the total registered claims. However, if the first round of voting does not receive greater than 75 percent participation, then the threshold for a approval would be lowered to 50 percent.

Priority Financing

One of the key aspects of the original SDRM proposal was to catalyze private financing to maintain ongoing trade credit. It therefore makes sense to look at an arrangement whereby creditors approve priority financing, perhaps up to a limited amount. An appropriate threshold to approve priority financing would need to be decided. We have no prior views as to the most appropriate threshold, but given the dilution of creditor rights created by new priority financing it may be appropriate to have a 75 percent threshold.

We agree with the proposals regarding the restructuring agreement.

Claims Classification

There are benefits in having different classes of creditors within the SDRM subject to different terms. This may also result in a more equitable agreement and therefore a speedier process. Without provision for separate classes, the sovereign would be faced with a simple binary choice of whether to include the claim in the restructuring or not. They may assign too many creditors to the non-SDRM Restructuring List (perhaps on the basis that it is particularly important to restore relations with short-term creditors), hampering agreement with those creditors who claims are to be restructured. Allowing separate classes would allow for a more graduated approach, and is less likely to result in creditor demands to reduce the list of non-restructured claims.

As far as possible it would be desirable for claimant classes to be pre-specified. We are concerned that allowing the debtor to determine creditor classes may introduce additional uncertainty and disputes over classifications. To address these matters there should be safeguards and some form of prescription over the discretion given to creditors to create optional classes of creditors.

Sanctions

We agree that: (i) the Fund's existing policies should generally provide sufficient sanction for the provision of false information to the SDDRF, and (ii) that this could be reinforced by considering the provision of false and misleading information to the SDDRF a breach of obligations under the Articles of Agreement. The Fund should maintain sole jurisdiction over decisions on breaches of the Articles of Agreement.

Termination

We do not think that providing the SDDRF with the power to terminate the operation of the mechanism is warranted. As noted above, the role of the SDDRF should be circumscribed to the greatest extent possible. The ability of a majority of the creditors and the debtor to terminate the mechanism should be sufficient. This view is reinforced by the fact that triggering the mechanism will not result in a general stay on litigation or general interference in contractual rights.

On the question of termination by creditors, we are in favor of a two-step process. In advance of a restructuring proposal by the sovereign, termination of the mechanism should require the same general threshold that is required to approve a restructuring proposal, i.e., 75 percent of registered claims. However, if the initial restructuring proposal is rejected, the threshold could be reduced to a percentage of claims sufficient to block a restructuring, perhaps 30 percent. This is a slightly different way of providing the cooling off period Mr. Hagan referred to in previous discussions.

SDDRF

We agree with the staff's proposal regarding designation of the selection panel. The rules of selection should direct the convened public or private organizations to make their recommendation on the basis of independence, partiality, competence and diversity. The proposals for selecting, appointing, and organizing the SDDRF also seem sensible.

However, we consider it premature to be endorsing proposals regarding rules of procedure, powers of the SDDRF, application of governing law, relationship with national laws' legal effect and the finality of SDDRF decisions. These issues may need wider airing in the Fund's outreach. We would be interested in the opinions of the public and private insolvency bodies on the issue discussed in the papers.

Legal Basis of the SDRM Proposal and Consistency with Domestic Law

We will pass the advice we have received from capitals regarding the legal basis for the proposal and consistency with domestic law to staff bilaterally.

Mr. Padoan and Mr. Bossone submitted the following statement:

We very much welcome this major effort from the Staff, which represents an important step toward meeting the IMFC's request for receiving a concrete proposal by the 2003 Spring Meetings. We would like to praise management and staff for progressing on this task so steadfastly and with such high-quality output. We agree with many of the principles and recommendations put forward by the proposal, yet we have some concerns with the underlying framework.

The paper focuses on a number of key technical issues and is largely inspired by the understandable need to draft a proposal that can garner enough consensus, especially from the market side, so as to make it acceptable and workable. We are afraid, though, that both the technical focus and the staff concern with consensus building are causing the exercise to alter the overall perspective on the problem to a significant degree, and we believe it is necessary to assess the implications of this change in perspective.

A Soft SDRM

In presenting a "soft" SDRM, the staff proposal changes the nature of the statutory approach. More power would go to creditors, according to the new approach, and the incentive would be lost of the automatic and universal stay on litigation and standstill on payment obligations following activation. While this is, perhaps, the result of a process aimed to win the favor of private creditors for the proposal, we need to wonder whether this is a strategically desirable shift in the logic of the mechanism. More precisely, we need to understand whether a soft-SDRM is consistent with the principles we have had in mind ever since we supported the effort to establish a sovereign debt restructuring mechanism.

We have had in mind an SDRM as an integral part of the PSI strategy for crisis resolution under the Prague framework, in a world where official financing is credibly limited, burden-sharing is a necessary principle, and creditors and debtors take more responsibility for their lending and borrowing decisions. Such a world would be a place where all parties would be called on to rely much more than they do today on strong ex-ante incentives and market discipline mechanisms to prevent crises. In such a world, the SDRM was supposed to be a costly option—short of outright default—available for use by the sovereign debtor in extreme situations where all attempts at resolving the crisis cooperatively had failed.

As such an option, the SDRM was envisaged to include a temporary stay and a standstill as essential components to address creditors' collective action problems, promote orderly and relatively quick debt rescheduling, and suspend normal market operations in order to grant to all the parties involved enough time to work out solutions whereby debt restructuring, macroeconomic and structural adjustment, and new financing would be combined in an appropriate mix (hard-SDRM).

In such a context, the high cost of the hard-SDRM (both to creditors and the debtor), fundamentally resulting from its power to suspend contractual relations, would discourage its use but would give market participants a strong incentive to search for cooperative solutions early in the process and prior to activating the mechanism. It was in the SDRM's capacity as a catalyst of (pre-SDRM) cooperative solutions that we saw the complementary relationship between the statutory and contractual approaches to sovereign debt restructuring, and that we supported the task to develop the contractual approach in parallel to the SDRM.

We doubt that the soft-SDRM now proposed by the staff would have the same strong incentive power as a hard-SDRM. Activating the former would leave the debtor pretty much in the same conditions as before activation, would force creditors to organize in cooperative groups but, unlike the hard-SDRM, would not change anything substantial without creditor approval. The staff proposal replaces the stay and standstill components of the hard-SDRM with a weaker option (i.e., the "hotchpot" rule) and reintroduces some of their lost incentive effect by including a right of injunction, which opens the way to selective stays.

At this stage we would like the feasibility of alternative options to be further explored. For instance, an alternative to the proposed approach could be to reinstate the automatic-and-universal-stay-with-standstill option following activation, with the provision that, as part of the negotiation process, creditors and the debtor would agree on selected claims to be excluded from the stay with the related payment obligations being re-enforced. This alternative would recuperate the effect of the full-fledged statutory approach, and yet allow the flexibility needed to treat claims differentially as deemed necessary by the parties. We would welcome Staff comments on this alternative approach.

The Fund's Role

The staff proposal, as noted, focuses on the technicalities of the mechanism while leaving aside the role of the Fund. We expect this issue to be covered in the forthcoming companion paper that should place the SDRM in a broader crisis resolution framework. Yet, we think that there are aspects of the Fund's role that should be considered in the context of the mechanism itself. It would be crucial to know, for instance, if the Fund would advise the sovereign on debt sustainability, and what the implications would be of the Fund and the sovereign arriving at different conclusions on debt sustainability: would the disagreement be made public? With what consequences? Would it preempt the possibility of a Fund program during the SDRM?

Similarly, it would be important to know what the Fund's role would be throughout the debt negotiation: would the Fund sit at the table as a "consultant" ? Would it share information with the negotiators?

Finally, it would important to investigate what role the Fund could play in terminating the SDRM, in particular with regard to the conditions of debt sustainability as resulting from the terms of the restructuring agreement.

We ask that these aspects be considered thoroughly in the upcoming paper. Their consideration would also shed light on whether the Fund should play any (formal or informal) role in providing an independent confirmation of the member's representation of unsustainability as a condition for activation.

Coverage of the Mechanism

We have reservations on the need to include official bilateral debt claims (especially those under Paris Club treatment) under the SDRM, for two main reasons. First, official creditors and private creditors have different objective functions when dealing with debt restructuring operations. While private creditors aim to maximize their recovery ratio on unpaid debts, the official creditors pursue other objectives as well, including strengthening the financial stability of the debtor country and providing it with economic development assistance. As a result, the terms of official debt rescheduling may turn out to be more generous than under private-sector criteria, and generate externalities for the private creditors themselves by enhancing the sovereign's repayment capacity overall. Including official bilateral debt claims under the SDRM for comparability purposes might (paradoxically) diminish the externality effect.

The second reason for not including official bilateral debt claims under the SDRM is that this would interfere with, and risk to hamper, the official creditor procedures that have proven so highly effective and efficient over time. In particular, the inclusion of Paris Club debt under the SDRM could raise serious foreign policy issues in that the decision to grant Paris Club terms would no longer be a decision of each individual sovereign creditor, as it is now, but would become dependent on majority decisions.

Consistency with Legal Systems

While we reserve the right to inform the Board at a later stage as to the changes in domestic law required by the proposed SDRM design in the countries of this Constituency, our Italian authorities have indicated that the procedures to amend the law would be relatively smooth and speedy, and that the attitude of the deciding bodies is friendly to international treaties

Publication of the Paper

As regards the publication of the paper, we agree with the position expressed by Mr. Wijnholds his preliminary statement. In particular, we think it should be made clear in the paper that there are still issues, such as the desirability of a stay on litigation, over which no consensus has yet emerged.

Extending his remarks, Mr. Padoan reiterated his support for Mr. Wijnholds's position on the publication of the staff paper. If the paper was made public, it should be clear to all those participating in the debate that many options remained open even after the conclusion of the current session. A second issue that needed to be emphasized was the fact that the proposal had been shifted toward what one could call a "soft SDRM". While one could debate the reasons for that change, it was more important to ensure that there was clarity about the general framework within which the SDRM should operate. Clarity about that was necessary to facilitate reaching a consensus in future discussions. Regarding the companion paper on which the staff was currently working, it would be useful if that paper provided some judgment of the usefulness of the SDRM by simulating its operation in a context of a general debt resolution mechanism that also included other aspects such as access policy and questions relating to debt sustainability. If that context was not taken into account, then any judgment of the SDRM, whether favorable or not, would be incomplete and fail to comprise all the implications.

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

We thank the staff for an interesting preliminary design of a possible sovereign debt restructuring mechanism (SDRM). Unfortunately, while the proposed design paper appears to have benefited considerably from consultation with market participants, it does not seem to have benefited to the same extent from consultations with sovereign debtors, whose concerns appear to have been brushed aside in the current proposal. By bending backwards to accommodate private creditors' resistance to the idea of an SDRM, the paper seems to have lost sight of the rationale behind the establishment of an SDRM in the first place. In our view, the SDRM proposed in the staff paper provides little in terms of "appropriate incentives to a sovereign and its creditors to reach rapid agreement on a restructuring that preserves asset values and facilitates a return to medium term viability", which was the overriding rationale for embarking on this SDRM journey. We would be surprised if member countries would be willing to initiate the arduous task of amending the Fund's Articles of Agreement to establish such a watered-down version of the original concept of an SDRM.

As noted many times in this Board, the SDRM is meant to deal with the extreme cases, where a sovereign's debt is judged to be unsustainable, that is, the country is judged to be incapable of servicing its debt without undertaking adjustments that would cause extreme dislocation to its economy. However, in view of the great costs and uncertainties associated with a debt restructuring, sovereign debtors are also extremely hesitant to recognize the need for a debt adjustment and, therefore, go to extraordinary lengths to avoid it for as long as possible. Delay, of course, generally magnifies the costs both to the debtor and the creditors, and possibly to the global financial system. A central purpose of the SDRM was, therefore, to provide a sovereign whose debt is deemed unsustainable, with the incentive to address its debt problem at an early stage, preferably before it defaults and a crisis erupts. This would be achieved by instituting a greater level of predictability to the restructuring process than is currently the case. To the debtor, a key element of that predictability was the institution of a temporary stay on debtor litigation during restructuring negotiations, based on certain rules established in advance. For the creditors, the key incentive would lie in the guaranteed transparency of the restructuring process, which would facilitate the achievement of inter-creditor equity. The common incentive to both debtors and creditors would be the mechanism's capability to bind all creditors to a restructuring agreement accepted by a qualified majority of creditors. The absence of a stay upsets the balance between the interests of debtors and creditors to the advantage of the creditors.

We will focus our remarks primarily on two of the broader design issues put forward in staff's proposal. First, we shall elaborate more fully on the incentives to the debtor to use the proposed mechanism, and second, we shall address the role of the Fund in the proposal. We also have some comments on the SDDRF.

What are the incentives for the debtor to activate the mechanism early on, hopefully before default actually takes place?

To our mind, the most important advantage would have been the institution of some form of temporary general stay on enforcement of creditor rights. However, staff argues against this possibility, in deference to the views of "market participants" who find even the subjection of the activation of a stay to an affirmative vote of a qualified majority of creditors to be unnecessarily intrusive.

Thus, after cautioning that default without an imposition of a stay may well result in a highly disorderly period by fueling a race to the courthouse among unsecured creditors, staff nonetheless come to the conclusion that this risk is small. The argument is that, given the possibility that creditors may organize quickly and agree to a restructuring before a litigant is able to enforce its claims, it is unlikely that creditors would be ready to incur the expense of litigation. However, the paper does not address the flip side of this argument, which is that if enough creditors decide to litigate, they could well prolong the restructuring negotiations until they have enforced their claims. Adding to the uncertainty, is the fact that the mechanism could even be terminated by a qualified majority of creditors at the termination of the verification period. The alternative approaches of a "hotch pot" rule or a targeted stop on enforcement of specific claims with the approval of creditors, while they may discourage litigation, they also have serious limitations and, of course, are significantly less predictable in their effect than a generalized stay.

Another imbalance in staff's proposal, that would act as a serious disincentive to the debtor to make use of the SDRM, relates to the debtor's obligation to full transparency with regard to all its debt at the time of registration. This is an onerous and very demanding requirement. It also would seem to place the debtor at a disadvantage vis-à-vis the creditors, when viewed in combination with the power accorded to the creditors to terminate the activation after having benefited from this very wide disclosure requirement. The creditors would be in a position to walk away from the mechanism if they felt that, given the information they had acquired, they could exert more leverage on the debtor by negotiating outside the SDRM mechanism.

We cannot support the widened coverage of "eligible" debt proposed in the paper, and we fully support all of Mr. Portugal's comments on this aspect of the staff proposal. We need to limit the coverage to what was agreed to previously, which would exclude domestic debt as well as the foreign debt of entities other than the central government. Accordingly, the provision of information by the debtor upon activation should be limited to the sovereign's foreign debt owed to private creditors. Furthermore, we cannot accept the threat of sanctions to be imposed by the Fund in case of incomplete information from the debtor. We all know the difficulties involved in the reconciliation of debt figures in any restructuring, despite the good faith of all concerned. In fact, we know of no case where initial debtor figures were in accord with those of creditors. The Paris Club reschedulings will attest to that. In any case, with the above reservations we firmly believe that differences should be sorted out without any threat of sanctions.

There is another important disincentive to the sovereign debtors, especially those who want to activate the mechanism at an early stage while they are still in a position to service their debt during the restructuring process, which the SDRM is rightly supposed to encourage. As the staff note in paragraph 143, in response to the establishment of the SDRM, the expectation is that market practice would change so that all sovereign debt contracts would be expected to include provisions enabling the creditor to declare an event of default when the debtor activates the SDRM, even if the member remained in compliance with all covenants under the contract. By triggering such an event of default creditors would have the right to accelerate their claims and the full amount of the debt would be payable. Paragraph 147 offers a solution, namely, to design the SDRM in a manner that would prevent a declaration of default after the activation of the SDRM, except in the event of a payment default. Yet, after noting the value of such a provision, staff concludes that it would be an unnecessary interference with contractual enforcement. Staff's reasoning, is that the key purpose of such a measure would be to prevent a default on unsecured debt from triggering an event of default on secured debt, and since according to staff proposal, secured debt will be kept outside the SDRM, then the measure is unnecessary. This, of course, assumes that the secured creditor is certain that there is no risk that its claim would be restructured under the SDRM without its consent. However, such an assumption will not always be valid since the value of the collateral could erode and at least part of the claim would, in fact, be subject to the restructuring. Furthermore, what about the possibility of triggering a default and acceleration of claims of unsecured debt, even though the debtor continues to make payments? Clearly, that would constitute another disincentive for debtors to activate the SDRM. In our view, it would make sense to include a provision that would prevent the activation of the SDRM from providing such a trigger.

What is left as an incentive to the sovereign debtor to utilize the SDRM is the ability to bind all creditors to a restructuring agreement that has been accepted by a qualified majority of creditors. While this is an important incentive, it is not clear that it would be sufficient to lead debtors to an early activation of the mechanism. Furthermore, it is not clear that the problem of "hold out" creditors would be significantly overcome in the proposed design. The aggregation of creditors into separate classes—each of which would have a veto—may end up holding up the process rather than expediting it. This could end up delaying the conclusion of an agreement and increasing the uncertainty surrounding the process.

The Role of the Fund in the Proposal

If we accept the premise that the Fund should not play a direct role in the SDRM, for the reasons put forth by the private sector creditor community, then it is difficult to reconcile that with the prominent role being given to the Fund in setting up the mechanism (by amending its Articles of Agreement) and by the proposal that the Fund impose sanctions on a member that is deemed to have unjustifiably activated the mechanism (by forcing it to bear the costs of the operation of the SDDRF) or to have provided incorrect information regarding its debt (by making it constitute a breach of the member's obligations under the Articles of Agreement). As a matter of principle we find such sanctions unacceptable. First, the Executive Board should not be in the business of imposing sanctions on its members based on judgments made by another organ, namely the SDDRF, which would be the case with regard to the provision of information. The fact that, technically speaking, the SDDRF would be an organ of the Fund, does not change this basic principle. As for the imposition of sanctions by the Fund if a member is deemed to have unjustifiably activated the mechanism, this proposal is baffling. If the Fund is to express a view on the unsustainability of a member's debt, it should do so at the time of activation, not after the mechanism is put into operation. If the Fund is not to be accorded a formal role in the confirmation of sustainability, which is the view of the creditors, then it should also not be accorded the power to challenge the member's declaration of unsustainability at a later stage and to impose sanctions for what it would consider as "inappropriate use of the mechanism" by the member. We cannot have it both ways.

The SDDRF

With regard to the designation of a selection panel, we would suggest that the procedures outlined in paragraphs 238–239 (for the identification of potential candidates by the Selection Panel) should also apply in the identification of potential selection panel members. The appointment of the panel should be made by the Executive Board, with a sufficiently high majority like 70 percent. The vote of the Board of Governors on the SDDRF judges should also be subject to a similar majority.

Conclusion

In conclusion, we feel that the staff's present proposal differs considerably from the original proposal presented by the FDMD, which we had supported. It would grant too much leverage to the creditors and is therefore unlikely to receive the support of the sovereign debtor community. We cannot go along with the proposal in its present form. A more even handed approach is called for, which would not be biased to the interest of one party at the expense of the other. The interest of the creditors clearly takes central stage in this proposal.

Finally, on publication, in addition to the reservations put forward by Mr. Wijnholds, we are of the view that publication of a proposal should await further consultations with the debtor countries and should reflect their views.

Mr. Mozhin and Mr. Palei submitted the following statement:

It is still difficult to see whether the benefits from the SDRM justify the associated costs of its creation and operation;

While progress is evident with respect to key features of the SDRM, many crucial issues remain unresolved, including the debt sustainability analysis, the burden sharing, and potential conflicts with national legislations;

Our preference remains for the Fund to continue to play its traditional central role in crises resolution, while avoiding association with direct interference into negotiations between a debtor and its creditors; the Board of Directors and the Governors of the IMF should not directly participate in the SDRM;

We welcome the evolution of the SDRM design towards greater reliance on the decisions made by a debtor and its creditors and call for a further shift of decision-making authority in their favor;

Further empowerment of a debtor and its creditors under the SDRM would put more emphasis on prevention and create stronger incentives for the private sector to come up with better mechanisms of creditors' organization and representation;

The SDDRF—a central element of the proposed mechanism—should only have powers that are absolutely vital for the correction of shortcomings in the current practice of the sovereign debt restructuring.

The new paper on the SDRM is a significant step towards eventual elimination of the uncertainty surrounding the proposed framework. We recognize the extraordinary effort made by the staff to advance this project and hope to see soon the reaction of the outside observers as well as private sector participants to this new version of the SDRM. Given the complexity of the paper, at this stage we can offer only a few preliminary comments on the document.

We welcome the evolution of the SDRM design. In particular, the new paper recognizes more clearly the limited nature of the SDRM's benefits, which mainly stem from the imposition of legal constraints on the activities of holdout creditors. It is more realistic in evaluating the risks of aggressive litigation at the initial stages of a sovereign debt crisis. The proposed modalities of the SDRM show greater reliance on the decisions made by a debtor and its creditors. At the same time, the staff are frank in admitting that many issues remain unresolved. There are many unanswered questions associated with the debt sustainability analysis, the catalytic role of the Fund, access limits on the use of the Fund resources, etc. The burden sharing modalities, including the appropriate links between the SDRM and the restructuring of the Paris Club claims, still have to be explored further. The interplay between the proposed framework and the national legislations appears to be a major challenge. Overall, despite the significant progress achieved by the staff in working out the details of the SDRM, it is still difficult to see whether the benefits from the SDRM justify the associated costs of its creation and operation and, more generally, whether the SDRM is a feasible approach to the sovereign debt restructuring. We encourage the staff to update their costs-benefits analysis, even if mainly in qualitative terms, at every iteration of the discussion.

We welcome the formulation of the SDRM principles. Indeed, with a benefit of a hindsight, it seems to us that their earlier formulation could have facilitated more constructive discussions with the private sector participants and, maybe, could have helped to avoid some of the hostility towards the SDRM. Having said that, we largely share the spirit of the principles and hope that they will make the broader discussions on the SDRM more expeditious and constructive.

The proposed adjustments to the SDRM already reflect intensive consultations with various experts in the sovereign debt restructuring. As we have stated on previous occasions, our preference is for the Fund to continue to play its traditional central role in crises resolution, while avoiding association with direct interference into negotiations between a debtor and its creditors. We would encourage the staff to go an extra mile to ensure that even a perception of such an interference is minimized.

With respect to some of the more specific features of the SDRM we have only a few comments at this stage. The choice between the treatment of the Paris Club claims inside or outside the SDRM is difficult to make without specifying the possible modalities of adjusting the existing Paris Club procedures to the key task of the SDRM. Also possible means of coordination between these two groups of creditors should be explored further. This said, we would like to mention that were the Paris Club claims to be treated inside the SDRM, private creditors would de facto have a veto power over the Paris Club decisions. This, and also a significantly different nature of claims, may complicate the process of coordination between private and official creditors if undertaken within the SDRM.

In our view, an independent confirmation of the unsustainability of debt as a precondition for the activation of the SDRM is not necessary. If the creditors consider the decision by a debtor to activate the mechanism to be poorly justified, they can easily terminate its activation.

Some Directors believe that the staff have already gone too far in adapting the framework to the concerns raised by the private sector participants. In our opinion, this is not necessarily the case. We are troubled by the continuing lack of support for the SDRM among various private creditors' organizations. While the opponents of the SDRM are vocal and articulate in their criticism of the proposed mechanism, we are not aware of any supporters of the SDRM in the private sector. The staff may want to explain their understanding of the situation. Moreover, some of the large and systemically important emerging market countries remain opposed to the introduction of the SDRM. Our conclusion is that, at the very least, there is still room for significant improvements of the SDRM through further shifting of the power in decision-making from the SDDRF to a debtor and its creditors. Even if this could make the mechanism somewhat more complicated, it would definitely improve the quality of decision-making. While we share the staff's sentiment about the attractiveness of the speedy debt workout process and understand their hope that the SDDRF would make the sovereign debt restructuring more expeditious, the quality of the decisions should not be sacrificed.

As the staff have correctly pointed out in their paper, one of the central issues of the SDRM is the appropriate representation of the creditors. For any sovereign debtor it is important to have an efficient mechanism of communications with its creditors. The "know your creditor" rule should be an integral part of any public debt management system. The staff report shows that an adequate representation of all creditors becomes indispensable under the SDRM and is a key to improvement in the quality and speed of any sovereign debt restructuring. However, although this challenge of creditors' representation is identified in the report, the staff, in our opinion, do not offer sufficient incentives for a debtor and its creditors to pay needed attention to ex-ante registration and verification of claims. It is true that currently there is an obvious gap in this area and that the markets have not yet come up with the necessary infrastructure that would allow formation of legitimate creditors' committee(s) well before the urgent need arises, but the situation in this area is already improving and the SDRM, if adopted, could play a useful role in this process.

For this to happen, in the future work on the SDRM there should be an explicit task of stripping the SDDRF—a central element of the proposed mechanism—of all the powers that are not absolutely vital for the correction of shortcomings in the current practice of sovereign debt restructuring. The answer to each of the problems should not be assigning of additional powers to the SDDRF, but an opportunity for a debtor and its creditors to come to an agreement and for the SDDRF to only certify it. All the proposed modalities of the SDRM should be re-examined in a similar fashion with the purpose of further shifting the power of decision-making in favor of a debtor and its creditors. If such an empowerment does take place, it could create strong incentives for the sovereign debt issuers and their creditors to come up with appropriate solutions to make the SDRM a more attractive restructuring mechanism.

Consistent with the above approach would be to allow the private sector to perform through an independent entity all the administrative functions currently assigned to the SDDRF. Most of this work should ideally take place well in advance of any negotiations and should not even be necessarily considered a part of the SDRM. The SDRM should encourage such activities. The previous staff report did envisage such a possibility, however, it has disappeared in the current version. The option of private provision of registration and other related services should remain under the SDRM, and we would appreciate it if the staff could elaborate on the recent discussions within the private sector on possible alternatives in this area.

Another controversial power currently assigned to the SDDRF is the ability to disqualify certain creditors from voting. On the one hand, such a rule can be relatively easily circumvented, as the staff themselves have pointed out in the paper. On the other hand, the decisions of this nature would always be difficult to persuasively justify. Hence, they could undermine the authority of the panel and the effectiveness of the SDRM. A sufficiently high majority required to approve the restructuring should be a satisfactory safeguard of the integrity of the voting process. Similarly, we have reservations about valuation of collateral for the secured claims being a prerogative of the SDDRF panel. More thought should be put into the design of this procedure with an eye on involving a debtor and the creditors' representatives in the process.

If the creditors are well-organized with their claims properly registered and verified and the creditors' committee(s) are established in advance, the SDRM should offer them more decision-making powers. For example, properly represented creditors together with a debtor could be more involved in the impaneling of the members of the SDDRF. The choice of the panelists who would have significant discretionary powers in dispute resolution, should not be a prerogative of the SDDRF's President, even if the latter were selected through a rigorous process. Preferably this key decision would be made by a debtor and its creditors and approved by the SDDRF or could be made in close consultations with them.

It is also important to make sure that the Board of Directors and the Governors of the IMF are not dragged into negotiations on the sovereign debt restructuring. In this respect, we feel uneasy about the proposal to allow the Governors to expand the list of the SDDRF members after the selection panel had already accomplished its task. Similarly, we would prefer to sever the direct link between the SDDRF and the Board in case of misreporting. The Board, in our view, should not be directly involved in the enforcement of the mechanism.

We agree with the staff that details of the design of the SDRM are extremely important and, in order to simplify the analysis for the readers of the report, we would propose that in future versions a table is attached to the report listing all the important decisions/functions included in the SDRM and specifying the roles of all the parties involved.

We support Mr. Wijnholds's proposal for the staff to prepare for Fund member authorities a standard questionnaire aimed at revealing potential conflicts between the national legislation and the proposed SDRM.

Mr. Bennett submitted the following statement:

Key Points:

We welcome the evolution of the thinking on the SDRM; these proposals represent significant progress towards a concrete, implementable SDRM.

We differ somewhat with the staff on the circumstance in which the SDRM would be activated. We think that waiting for certainty that a country's debt is unsustainable would work against the goal of encouraging timely restructurings. We would prefer the criteria to be that "a country's debt is probably unsustainable given the set of feasible adjustment policies". This would be more compatible with the Board's position on Debt Sustainability Analysis and the policy on exceptional access to Fund resources.

We continue to think there is a role for a temporary stay in situations where a country is clearly solvent but illiquid.

We think including bilateral official debt as a separate class under the SDRM will lead to the same results as leaving it outside the mechanism, provided there is full transparency and the principle of fair treatment is firmly embedded in the SDRM. That is also our view on the treatment of privately held debt subject to the debtor's domestic jurisdiction.

We do not think there is a need for independent third party verification, but we strongly urge that all IMF analysis (debt sustainability analysis, etc.) be available to all interested parties.

We favor a voting threshold of 75 percent for creditor termination of the activation of the mechanism.

We strongly welcome the innovative idea of mimicking the hotchpot rule and support empowering the SDDRF to enjoin specific actions.

In several members of our constituency, legislation would be required to implement any amendments to the Fund's Articles of Agreement.

The staff are to be commended for the open-minded and balanced approach that they have taken to the development of the SDRM. We particularly welcome their intensified outreach efforts and their willingness to consider all points of view. As a result, the conception of the SDRM has evolved considerably since the initial proposal, notably with respect to limiting the role of the Fund in the mechanism, protecting creditors' interests and curtailing opportunities for abuse of the mechanism. We are encouraged by the design proposals in this most recent paper, and look forward to further refinements as a result of today's discussion and the January "outreach" conference.

I shall organize my remarks as suggested in the Issues for Discussion. But before turning to this, I would like to repeat a point that I, and several other Executive Directors, have made in the past: it is essential to place the SDRM within the broader context of the overall efforts to reform the international crisis prevention and resolution framework. The overriding goal of these efforts is to achieve efficient international capital markets in which lenders bear the consequences of their investment decisions, characterized by undistorted assessments of risk and return, and payments problems are resolved in a timely and transparent manner. And the effectiveness of each element of the framework depends on the design and application of the other elements.

The Rationale for the SDRM

While we are in general agreement with the rationale for a SDRM set forth in the staff paper, we do differ with staff on one important aspect of the rationale. We see the staff formulation of applying the SDRM only in "situations where there is no feasible set of sustainable macroeconomic policies that would allow the member to resolve the current crisis and regain medium-term viability without a significant reduction in the net present value of the sovereign's debt" as too rigid and narrow. I appreciate that the Fund wants to reassure private creditors that the SDRM will not be used frivolously or abused. But I would prefer to cast the decision in terms of probabilities. The key question being whether there is a high probability that the debt is sustainable. Casting the issue in terms of probabilities would be more consistent with the position that the Board has taken in other areas such as Debt Sustainability Analysis and the conditions for exceptional access. Recall that in the latter case, it was the view of the Board that a high probability that the program would succeed should be a necessary condition for exceptional access. And several Executive Directors made the point that if there were not a high probability of success, the adjustment policies and PSI contribution should be revisited.

In other words, a significant probability that the debt is not sustainable under the most stringent adjustment policies that are feasible should be sufficient to activate the SDRM; there is no need to require absolute certainty that the debt is unsustainable. After all, the goal is to encourage timely restructurings. As the staff paper notes, delays magnify the already significant costs of restructuring on sovereign debtors and damages the interests of most creditors as well. There will always be a need for judgments in these situations. Judgments on the activation of the SDRM and access decisions should both be informed by a high quality debt sustainability analysis.

We also continue to think that there is a useful role for stays (for a limited period, say 90 days) in cases where the SDRM does not apply i.e., when a country is clearly solvent, but illiquid. Indeed, in practice the distinction between illiquidity and insolvency is controversial and difficult to make, particularly in the heat of a financial crisis.

Principles Guiding the Design of the Mechanism

I suggest redrafting the first principle to incorporate the notation of probability. A possible formulation would be "used to restructure debt that is judged to probably be unsustainable."

I agree with the remaining suggested principles as drafted.

Scope of Claims to Be Covered

With respect to the claims of official bilateral creditors, we are not convinced there is a dominant argument for either option—in or out. Provided there is transparency and equality of treatment, the outcome should be the same under either option. Accordingly, if such claims are to be subject to the SDRM, they should be a separate class and there should be full transparency in the restructuring process. Analogous reasoning would apply to privately held debt subject to the debtor country's jurisdiction.

Independent Confirmation

We support making any debt sustainability analysis done by the Fund available to both the country and its creditors. But it should be left to the debtor country to decide whether to activate the SDRM and to the majority of creditors to terminate the procedure should they decide that activation is not justified. There should be no scope for a third party to make these decisions.

Again, the strong transparency and information requirements of the current version of the SDRM, are key to achieving an appropriate outcome. As well, as noted above, the Fund's other policies, such as access policy and lending into arrears policy, will likely have a determining influence on activation and termination decisions.

Protecting Creditor Rights and Termination

The strong transparency and information requirements also help to protect creditors' rights, as does the fact that this version of the SDRM drops the automatic suspension of creditors' right to litigate. Given the private sector's well-founded criticism that rogue creditors have not been a serious problem in the vast majority of all restructurings, and that the blanket suspension of enforcement rights was a disproportional solution to the problem, we welcome this change.

We also welcome the proposed feature that creditors have the opportunity to terminate the SDRM in circumstances where they view the activation to be unjustified. In essence, this allows creditors to act as the "gatekeepers" of the process, thereby helping address earlier criticism that the mechanism tilted the bargaining power too much in favor of the debtor (as the debtor alone triggers the mechanism, decides the timing of the activation and determines the scope of the debt). We support a voting threshold of 75 percent.

SDDRF

We welcome the addition of the innovative "hotchpot" rule to minimize the incentives for litigation. This rule, however, will not dampen litigation where there is a real prospect of creditors receiving more in litigation than would be available in a restructuring plan, which could occur if there are particular circumstances that provide for an abundance of eligible assets. Thus, we support granting the SDDRF the power to stay a specific enforcement action if such an order was requested by the debtor and approved by creditors subject to the SDRM. As to how creditor approval should be obtained, we would be interested in hearing the staff's view on the potential role that creditor committees could play.

Required Changes in Domestic Laws

Amending the Articles of Agreement would necessitate an Act of Parliament in several countries in this constituency.

Mr. Brooke and Ms. Stuart submitted the following statement:

Staff has done an excellent job moving us a substantial way towards a workable and acceptable SDRM proposal that would be a useful instrument.

We continue to see the SDRM as an important complement to other work on crisis resolution including: collective action clauses, access policy, lending into arrears, and ideas on best practice for debtor/ creditor negotiations. Collectively, these policies should create stronger incentives for governments to act early and address unsustainable debt positions.

To be effective, we believe the SDRM needs to be sufficiently comprehensive to address a range of collective action and inter-creditor equity problems. Therefore, we would prefer not to rule out the possible inclusion of domestic debt at this stage. And, we firmly believe that official bilateral debt should be included in the SDRM as a separate class, not least because it would provide a powerful signal of the official sector's endorsement of the SDRM.

Increased transparency by all parties will be an integral feature of the SDRM and should strengthen support for it by helping to overcome inter-creditor equity concerns. With fuller information provision, and the creditors' right to terminate the mechanism, we see no need for an independent confirmation of debt [un]sustainability.

The biggest change in this paper is the move to a more targeted stay, based on the hotchpot rule and injunctive powers. This addresses market concerns and would be less disruptive of contracts. There are merits to this approach, but given the concerns of some Directors, we would welcome further reassurance of the ability of these measures to deliver a significant disincentive to litigation and the 'pros and cons' relative to a more general stay activated by a majority of creditors.

We are broadly happy with the proposals for the role of the SDDRF but would welcome any further workable ideas to reduce the IMF's role in its establishment—for example through reducing its influence over the selection panel.

Further discussion of this paper with market participants will be essential to help refine the approach and to develop a concrete proposal for the SDRM in time for the Spring Meetings. We support staff's intention to publish the paper.

This is a very clear and thorough paper which takes us a long way forward in designing an SDRM that responds effectively to the concerns of Directors, private sector creditors and Emerging Market debt issuers, but which delivers a useful instrument to aggregate claims, bind minority creditors and promote early collective action. We thank staff for their extraordinary effort in accomplishing such a large task in a short space of time and keeping the Board well informed of developments. The paper includes a large number of detailed proposals; on some of these our authorities have yet to reach a firm view. It is likely to be necessary for staff to revise some of the proposals in the light of today's discussion, further outreach efforts and the January workshop. Following the workshop, we would find it helpful to have a staff summary of the range of private sector and emerging market reactions to this paper. We also look forward to the companion paper that will set the SDRM in the broader perspective (and which we hope will include an assessment of the likely role of the Fund at each stage of the SDRM).

Given the potential for debt to be rescheduled both within and outside the SDRM, and the scope for a sequencing of debt reschedulings for different debt classes within the SDRM, improvements in transparency are essential to ensure that the SDRM operates as smoothly as possible. Full information will be required to ensure credibility of the SDRM and to deliver an appropriate degree of inter-creditor equity. We believe that greater transparency is needed on the part of all parties—the debtor, private creditors, the IMF and official bilateral creditors.

The Scope of Claims

The coverage of the SDRM needs to be comprehensive enough to solve a range of collective action problems and to deliver a debt restructuring that is sufficient to restore debt sustainability. As such, we continue to believe that, in some circumstances, the debtor might wish to include domestic claims in the SDRM rather than conduct a parallel restructuring alongside the SDRM. Therefore, we would prefer for the SDRM not to rule out the possibility for the debtor to choose to include some domestic claims. In a similar vein, we agree with staff that the SDRM should be sufficiently flexible to be able to encompass the restructuring of trade credit.

We agree with staff that the SDRM should not disrupt the contractual arrangements related to privileged claims. Secured creditors pay a premium to hold instruments with lower credit risk and we recognize the need to respect the seniority of these claims and thereby avoid any disruptive effects that this could have on capital markets. We also accept that the inclusion of secured credit would greatly complicate the practical application of the SDRM and so we support its exclusion. However, we think it will be important to monitor any shift in the demand for secured credit once the SDRM is up and running and react to any adverse developments, as necessary.

We are firmly of the view that official bilateral debt should be included in the mechanism as a separate class. This will help to better promote full transparency and inter-creditor equity, as well as faster parallel restructurings of debt. Importantly, it will also send a strong signal to the private sector of the official sector's support for the SDRM. We do not see the difficulties that this could pose as being insurmountable. Given the flexibility and adaptability that the Paris Club has shown in the past, we are confident that solutions could be found that would enable inclusion of official bilateral debt in the mechanism without undue disruption to Paris Club procedures.

Activation, Provision of Information, Registration, and Verification

We agree that activation of the mechanism should be at the behest of the debtor. However, we also believe that creditors should have the power to terminate the SDRM once they are in a position to cast their vote (when their claims have been verified) and that this should be subject to a suitable threshold. We suggest that the threshold (possibly a simple majority) should be considered further and would welcome the additional views forthcoming from the January workshop. The combination of this creditor termination capacity, and a requirement for the debtor to provide fuller information about its debt sustainability, should be sufficient to limit the prospect of inappropriate activation of the mechanism. As such, we do not think that any independent confirmation of the debtor's fiscal unsustainability is necessary.

We note the problem of creditor identification and agree that staff should seek private sector views on the need for end-investor registration.

The requirements for information provision set out in the paper represent the minimum to enable the smooth functioning of the SDRM and to promote an effective restructuring agreement. We agree that there must be a procedure that ensures that the debtor furnishes creditors with full and timely information which would cover a complete list of claims and detailed restructuring terms. But we would go further than suggested by the paper. We would like staff to give consideration to the merits of the debtor, supported by the IMF, providing creditors with an up-to-date debt sustainability analysis on activation of the mechanism, and that—throughout the process—the IMF should furnish creditors with information on possible program design and financing gap calculations. Transparency about these projections, the probabilities of success of different policy options, and the risks attached to forecasts, would help to promote better dialogue between creditors and debtors over the best way forward. We believe that this would then help to facilitate speedier and smoother debt restructuring based on a shared understanding by all parties of the full extent of the problems.

Consequences of Activation: Stay on Enforcement

The biggest change to the design of the SDRM in this paper is the scope of the stay on enforcement. A general stay would be aimed at protecting the debtor against litigation and protecting the entire creditor group against payments by the debtor to a 'selected set' of creditors. These aims are met in this paper using a more targeted approach that relies upon the use of the hotchpot rule, possibly supplemented by specific injunction powers. We recognize that this change reflects the staff's efforts to address the major concerns of the private sector and emerging markets that the mechanism should limit unnecessary interference with contracts. We also note that legal experts think that an automatic stay is unnecessary and that these provisions deliver a lighter, more precise approach, that is more proportionate to the scale of the problem. The hotchpot rule could reduce the expected payout from rogue litigation and the specific injunctive powers add force to the mechanism. Together they provide some protection for the debtor and the creditors in the mechanism as well as providing a useful incentive for speedy formation of a creditor committee. However, given concerns over whether the targeted approach provides a sufficiently forceful disincentive to the threat of litigation and a powerful enough incentive for collective action, we would welcome further consideration of this issue—drawing on the views expressed by the Board and at the forthcoming January workshop. In particular, it would be helpful to consider whether the targeted approach is in practice substantively different from a creditor-approved more generalized stay (given that it is targeted over the whole range of the debt included in the mechanism).

Creditor Participation: Organization, Voting, and Decisions

One of the principal goals of the SDRM is to encourage early negotiations between debtors and creditors. As staff note, in the first best case the negotiations over debt restructuring should be largely complete before the debtor activates the SDRM. More generally, we think it would be useful to facilitate early and fruitful debtor/creditor negotiations and that this could be considered further as part of a wider code of conduct that could be endorsed by the IMF.

In the specific context of the SDRM, a representative creditor committee has a useful role. We support the idea that the SDDRF should resolve questions of whether a committee is sufficiently representative and feel that the SDDRF could benefit by being provided with broad guidelines to assist this (such as a certain minimum proportion of each instrument being represented).

Sovereign Debt Dispute Resolution Forum

We agree with the broad principles proposed for the SDDRF, but we feel that the extent of the IMF's involvement in the establishment of the forum may still be perceived by some to be a little on the heavy side and could be further reduced. Consequently, we strongly welcome the transparency rules for appointments to the SDDRF and that professional competence and impartiality are the overriding criteria for nominees. But we are a little uneasy with the specific proposal that the Board of Governors should have the ability to select or exclude nominees for the SDDRF (could an independent body do that job?). If other Directors agree, we think it might be helpful for staff to consider other ideas to further reduce the IMF's involvement.

Legal Basis

The United Kingdom would need domestic legislation to make the amendment to the Articles of Agreement effective.

Further Work

Further work would be helpful in a number of areas:

First, this paper says little about the likely simultaneity or sequencing of restructuring of different classes of debt in the SDRM or the use of cross vetoes. It could be helpful for staff to flesh out further their views on how restructurings might be sequenced or occur in parallel.

Second, whether or not the IMF provides confirmation that a country is justified in activating the SDRM, the IMF will play an important role in assessing a country's sustainability and in providing assistance possibly both prior to and after a restructuring. We think transparency on the actions of all parties will be important to make the SDRM work. Therefore, we urge the IMF to consider further the information set that it is prepared to share with creditors at all stages of the SDRM process. We believe that this should include information on debt sustainability and on assumptions underlying possible program design.

Third, further outreach will be essential. We would be particularly interested in receiving a detailed critique from a range of points of view—private sector, legal experts and emerging markets—on their reactions to this paper as it stands. In that regard, it is important that this paper be published.

Mr. Andersen and Mr. Farelius submitted the following statement:

The paper before us is a significant step forward in fleshing out the details for an SDRM and to respond to the request of the IMFC to come up with a concrete proposal for the Spring Meetings. We would like to thank staff and management for their impressive efforts on this important issue, including the comprehensive and high-quality paper in front of us and the helpful informal sessions organized recently. As this chair has argued on many previous occasions, we believe that there is a need to ensure a more orderly and predictable debt restructuring and crises resolution process. The SDRM would be an important addition to the architecture of the international financial system.

We also firmly believe that we should not lose momentum in our work on other related issues; progress is needed also on the contractual approach as well as operational improvement and further implementation of the framework for PSI agreed on in Prague more than two years ago. For an SDRM to be efficient, progress toward a strict application of access limits and a clarification of conditions and strengthened procedures for exceptional access would be necessary. Further work on developing and applying the Fund's debt sustainability analysis is also vital in this process and, like Mr. Wijnholds, we would have liked also to discuss the political and economic aspects of the SDRM. However, we understand that these issues will be raised in a companion paper, which we also recommend addresses the need for further refinement and elaboration of the issues related to standstills and lending into arrears. We look forward to discussing such a companion paper in the near future.

Before turning to the specific questions in the report, we have some additional general observations. The current proposal contains some changes relative to the earlier proposal. We understand that the way the roles of the Fund and the SDDRF have come out—as well as the exclusion of the previously proposed general stay on litigation—reflects efforts to try to accommodate the concerns raised by external parties, notably the private sector. While we fully understand the need to come up with a proposal that in the end is feasible for actual implementation, we would be hesitant to be too accommodative towards calls for diluting the statutory approach. It is necessary to keep in mind that it is important to maintain a balance between all parties concerned, including the official sector and the debtors. Therefore, we believe that it is necessary to retain on the table the original ideas of the SDRM proposal, most notably the proposed stay on creditor litigation. We also share Mr. Padoan's and Mr. Bossone's doubts whether the proposed "soft" SDRM would have the same strong incentive power as the earlier, "harder" version, and we look forward to staff's response on their related question.

Rationale and Principles for the SDRM

We agree with staff that, solving collective action problems, more specifically, the aggregation problem that arises in the debt restructuring across diverse instruments and creditors, is the main rationale for the SDRM. The SDRM could improve the possibilities for creditors and debtors to reach a more rapid and collaborative agreement, prevent dislocations of resources, and generally bring about more clarity in the debt restructuring process. Moreover, the proposed SDRM could also be considered as a means to limit moral hazard problems that can arise when the international community is expected to bail out private creditors or provide large scale support to sovereigns. A major challenge in the design of the SDRM is also to avoid creating new incentives for moral hazard on the debtor's side.

The SDRM should be designed in such a way that it infringes as little as possible on creditors' and debtors' rights as specified in national legislation. Given the multiple role of the Fund as a creditor and advisor we find it appropriate to keep a limited and clear function for the Fund within the debt restructuring mechanism. It is important to make the rules of the SDRM clear and transparent.

Scope of Claims to be Covered

Staff suggests that the scope of debt to be included in the mechanism is limited to sovereign debt to the private sector. While we concur with this suggestion, there might be questions as to whether such a narrow scope would effectively ensure equal treatment of creditors, in spite of the proposed transparency requirements and the existence of already well-functioning restructuring mechanisms outside the SDRM. Moreover, a narrow coverage of the SDRM might make it difficult to bring about acceptance of the mechanism among private market participants. Like Mr. Wijnholds, we would appreciate comments from staff on these concerns.

The major theoretical advantage of the SDRM is the possibility of uniformity of application across all instruments. However, as this chair stated in our meeting in September, we should avoid reinventing the wheel; there is already a mechanism in place for the treatment of official bilateral debt restructuring and given that the Paris Club has a long history of being efficient and fair there is no need at this stage to include official bilateral debt in the mechanism. It would, however, be important to ensure close cooperation and synchronization with the SDRM, including burden sharing. To assess the possible desirability of including official bilateral debt as a separate class in the SDRM, further analysis is needed, especially compatibility with the work of the Paris Club.

Activation of the Mechanism

On the issue of an independent assessment, the Fund would probably always have a role to play in the assessment of debt unsustainability. However, the role of the Fund in this process would need to be defined more clearly. On the one hand, it might be difficult for the Fund to provide an independent confirmation as there might be doubts about its impartiality in sensitive cases due, e.g., to its possible prior involvement in the country in question. On the other hand, there are "checks and balances" to the process since creditors always would have the possibility to terminate the activation of the SDRM. Moreover, the fact that activation of the SDRM most likely would be extremely costly for the sovereign in terms of loss of market access etc, the chances of it being activated on “false grounds” seem small. However, on balance, we agree that in order to ensure impartiality and credibility of the SDRM mechanism, it would seem necessary that an independent confirmation of the member’s representation of debt unsustainability is provided, especially if a general stay is a feature of the SDRM. One possibility would be to have an independent body such as the panel of judges in the SDDRF, perhaps supplemented by ad hoc experts with macroeconomic background, perform this function. We look forward to further considerations of the role of the Fund in this process, perhaps in the forthcoming companion paper.

Exclusion of a Stay on Litigation

A stay on creditor litigation has been an important feature of earlier versions of the SDRM proposal. The abolishment of the stay from the mechanism in the current proposal solves some difficult operational problems, as noted in the staff paper. However, we are concerned that the exclusion of a general stay will make the SDRM weaker. Although a “Hotchpot” rule aided by an injunctive relief under the authority of the SDDRF could make disruptive litigation less attractive, it does not fully replace the functions or the role of a stay.

In corporate bankruptcy procedures, a stay is an important element inter alia to create a “breathing space” and we are concerned that the SDRM may need such an instrument for similar purposes. Abolishment of the stay will not fully prevent litigation or a “run to the exit”. Therefore, along the lines of Mr. Wijnholds’s reasoning, we remain to be convinced of the need to abolish the stay on enforcement. We would ask the staff to retain this as a possible feature of the mechanism in the upcoming discussion with external parties.

Other Technical and Operational Issues

End-investors should be required to register their claims into the SDRM as a matter of accountability and transparency.

We support the proposal that creditors should have the opportunity to terminate the mechanism after the completion of the verification procedure if the view is that the activation was unjustified, even if an independent confirmation of debt unsustainability exists. However, a qualified majority (75 percent minimum) should be required to terminate the mechanism.

At this juncture, it appears necessary to provide the SDDRF the power to issue an order that would enjoin specific enforcement actions.

Consistency with Domestic Legal Systems

All countries in the Nordic-Baltic constituency are required by law to formally ratify amendments to the Articles of Agreement of the International Monetary Fund. However, it remains difficult to give an answer to what extent domestic legislation would have to be amended until there is a concrete proposal to amend the Articles of Agreement on the table.

According to staff, SDRM and SDDRF can be established by an amendment to the Articles of Agreement. We would like staff to clarify whether Article I on the purposes of the Fund also needs to be amended.

Publication of the Document

As regards publication of the paper, we share the views expressed by Mr. Wijnholds, and Messrs. Padoan and Bossone. We are dealing with an issue rightly labeled as "work in progress", and as such it would seem warranted to have emphasized more clearly in the paper that there are still some key issues where various options are under consideration.

Extending his remarks Mr. Andersen said that he concurred with the thrust of the additional remarks made both by Mr. Wijnholds and Mr. Padoan. Following up on the remark made by Mr. Padoan about the companion paper, he wondered what would be the staff's plans for the involvement of the Board in considering that paper. His chair looked forward to that companion paper and would be pleased to address it.

Mr. Alazzaz submitted the following statement:

Key Points:

This chair remains of the view that an appropriately designed and implemented SDRM could help reduce costs of restructuring for both sovereign debtors and their creditors.

Care is needed not to unduly water down the proposed SDRM to satisfy all concerned groups.

This chair continues to see merit in excluding domestic and official bilateral debt from the SDRM.

Activation should be the exclusive right of the sovereign. There is no need for an independent confirmation of the sovereign's representation of debt unsustainability.

I am not fully convinced by the arguments in the paper for replacing the stay on litigation by the new staff proposals.

The costs and complications of registering end-investors appear to outweigh the benefits.

The proposed voting threshold for creditors to terminate the SDRM appears to be on the high side.

The SDDRF powers should be limited to dispute resolution and administration of claims.

I thank the staff for a comprehensive and well written paper that includes a number of concrete recommendations. The substantial change in some of the staff's proposals and recommendations underscores not only the complexities of the issue, but also the varying views and inputs of different groups. Here, I will make two general comments before I turn to the specific issue raised in the paper.

First, this chair remains of the view that an appropriately designed and implemented SDRM could help reduce costs of restructuring for both sovereign debtors and their creditors. However, in the effort to try and get the support of all the concerned parties, the Fund needs to be careful not to water down the SDRM to the point where it is not of much benefit.

Second, there appears to be substantial concern regarding the possible abuse of the SDRM by debtors. While the abuse of any system cannot be ruled out completely, the evidence so far is that countries will do their utmost to avoid debt restructuring and the associated economic, social, and political costs. Therefore, my concern is not that the SDRM will be abused, but rather that it would not be used at an early enough stage to achieve the maximum benefits.

Scope of Claims to be Covered

I agree that public debt governed by domestic law should be excluded from the SDRM in view of the flexibility the authorities have in restructuring this debt and the complications that could result from including it under the SDRM. Here, Mr. Portugal raises an important question on whether it is possible to completely and absolutely exclude domestic public debt from the jurisdiction of foreign courts and accordingly whether "the criteria that the claim has to be subject to the exclusive jurisdiction of the sovereign is too demanding." Staff comments would be appreciated.

This chair remains of the view that official bilateral claims should be excluded from the SDRM. While such an exclusion may raise equity issues, inclusion will create a host of new complex issues as well as lengthen and complicate the restructuring process. Claims of international organizations should also be excluded.

I agree on excluding claims of secured creditors from the SDRM for the reasons detailed in the staff paper.

On the issue of the central governments' option to include claims on the central bank, public entities, and subnational governments under the SDRM, I would appreciate some further elaboration on the additional complications and delays that this may entail.

Activation and its Consequences

Activation of the SDRM should be the exclusive right of the sovereign debtor. I do not believe it is not necessary or warranted to have an independent confirmation of the sovereign's representation of debt unsustainability. As I noted earlier, my concern is not that sovereign debtors will abuse the system by activating the SDRM when debt is sustainable, but rather that they will wait too long to activate when debt is clearly unsustainable. Moreover, if creditors feel that the activation is unjustified, they have the right to terminate it.

On the issue of stay on creditor enforcement, I share the views expressed in Mr. Wijnholds's statement. The staff has made persuasive arguments in the past on why a stay is needed to reduce the threat of litigation and facilitate an orderly restructuring. While their new proposals of "hotchpot" and "specific injunction relief" are meant to discourage litigation without the recourse to a stay, I am not convinced that they are as transparent or efficient. I am also not comfortable with giving the Sovereign Debt Dispute Resolution Forum (SDDRF) the power to enjoin specific enforcement actions. I thought that there was broad agreement in the September meeting to limit the powers of the SDDRF to dispute resolution and administration of claims. Moreover, it is not clear that the new staff's proposals will satisfy the private sector.

I am not convinced that the benefits of registering end-investors outweigh the costs and complexities. If the aim of registering end-investors is to help creditors verify claims and identify related parties, the staff paper indicates that this could be circumvented as the sovereign could establish a special purpose vehicle as the end-investor.

Creditors should have the right to terminate the mechanism after the completion of the verification procedures, if they felt that the activation is unjustified. While any voting threshold for termination could be viewed as arbitrary, 40 percent appears to be high. A threshold of somewhere between 26 percent and 30 percent would be more justifiable given that the blocking minority is just over 25 percent.

I share Mr. Portugal's concerns regarding the exclusion of creditors that may be influenced by the debtor from voting. It would be very difficult to make a judgment on what constitutes influence or undue influence. I also agree that the Fund should not impose sanctions on a debtor for the provision of materially incorrect debt information to creditors. Resolution of disputes between creditors and debtors is the responsibility of the SDDRF and the Fund should not be involved, especially as it has no leverage on private sector creditors. In this regard, I would like the staff to elaborate more on how detailed is the information that debtors are supposed to provide.

SDDRF

The SDDRF is clearly an essential part of the SDRM. Therefore, one should take great care in ensuring that there is broad consensus on its organization and staffing. In that context, the suggestions made in Mr. Portugal's statement merit further consideration.

Publication of the Paper

On publication, I share the views expressed by Mr. Wijnholds and Mr. Padoan.

Mr. Wei submitted the following statement:

We appreciate the opportunity to further discuss the design of the Sovereign Debt Restructuring Mechanism and thank the staff for their efforts in thoroughly examining almost all aspects of the SDRM in the paper. This paper marks important progress in the design of the SDRM since the IMFC requested the Fund to further study this issue at the last annual meetings.

Despite the strenuous work done by the staff and the progress that has been made so far, there remain many areas that need further clarification. Some parts of the proposed mechanism continue to be controversial and need more cautious considerations. In these areas, perhaps no simple conclusion can be immediately drawn at this time.

One of the aspects in designing the SDRM is to minimize the collective action problems that may hamper an orderly restructuring of sovereign debts and cause unnecessary delay to the restructuring process. The contractual approach which is preferred by many market participants and sovereign authorities may also play an effective role in minimizing the collective action problems. Compared with the SDRM, the contractual approach could be more flexible. Nevertheless, the attempt to encourage greater use of CACs has so far born little fruit. Moreover, the contractual approach is less comprehensive and faces certain limitations in terms of its applicability and coverage. In this sense, the SDRM may have more advantages over its counterpart. Before we can develop a mature approach that is proved to be effective and realistic, we had better have both in place rather than just one.

With respect to the design of the SDRM, we feel that the view of the private sector is given too much weight in this paper. While we agree that the acceptance of the SDRM by the private sector is of great importance to the success of our efforts to develop a statutory approach towards sovereign debt restructuring, we should not compromise our goal; the interests of both debtor and creditors should be taken care of in a fair manner.

Activation

We agree that the decision of activation can only be made by the debtor. Undoubtedly, no one is more knowledgeable than the debtor with respect to its debt sustainability. However, we also understand the concern that debtors, especially taking into account that it is often quite difficult to judge debt sustainability with confidence, may possibly incorrectly use the SDRM. Though, in our opinion, the possibility is quite slim, it is hard for the creditors to accept the SDRM if such concern is not addressed at all. The design where creditors can vote to end the SDRM could be an effective solution. Given this design; creditors can close the SDRM by casting a vote if they believe that the debt remains sustainable. The staff's proposal to have an independent judgment could be problematic. First, which institution will take on the duty of judging debt sustainability? Of course, technically the Fund is the most capable institution for doing this job. However, as indicated by the staff, the Fund may not be in the best position to do so for the reasons given in the paper. We also caution against having the Fund play an interventionist role by making debt sustainability judgments associated with the activation of the SDRM. Definitely, we should not grant creditors veto power with respect to the activation since that will give them excessive leverage and could make the restructuring process more difficult. Therefore, while an independent judgment might be helpful, we may not find a party more qualified than the sovereign itself to do this job. Second, is the independent judgment binding? In our opinion, creditors should use the result of judgment only as a reference and the final decision should be left to the creditors and the debtor during their negotiation. As mentioned above, if creditors believe that the debtor is using the SDRM in an incorrect way, they can terminate it by a qualified majority vote.

Coverage of the SDRM

While we appreciate the detailed discussion on the coverage of the SDRM in the staff paper, it might not be appropriate to be so ambitious as to include so many categories of debt in the SDRM. We suggest that at least at the initial stage, the SDRM should only cover sovereign debt to private sectors.

To put it in more detail, we appreciate the staff's proposal with respect to the treatment of domestic debt that reflects many Directors' views in previous discussions. Indeed, domestic debts governed by domestic law should be restructured outside the SDRM since the member already has the legal tool to overcome the collective action problems.

With respect to the bilateral official credits, we hold that they should not be restructured under the SDRM either. Most bilateral official credits are not made on commercial terms and the features and purposes of such credits are also different from commercial lending. Sometimes, official bilateral credit is provided when the debtor has no access to international commercial credits. Hence, it may not be appropriate to restructure bilateral official credits under the SDRM for the purpose of inter-creditor equity, even if official creditors form a separate class. Moreover, we also share the concern that to include official bilateral credit in the SDRM may negatively affect official financing for developing countries. Therefore, we favor the second approach proposed by the staff that excludes official bilateral creditors from formal inclusion under the SDRM but establishes a procedure that would ensure sufficient coordination between the two restructuring frameworks. In this context, more research is needed regarding the procedures that ensure inter-credit equity and sufficient coordination between official and private creditors, taking into account the non-commercial feature of official bilateral credits.

Stay

We still recall that stay was an important part of the proposed SDRM in previous papers prepared by the staff. Now it seems that the staff has changed their mind after discussion with the private sector. While the "hotchpot" approach could to some extent reduce the incentive for litigation, its effectiveness is limited, in particular when the creditor is able to recover more through litigation than what it can receive under the restructuring agreement. To grant SDDRF the power to issue an order that requires a court outside the territory of the sovereign to enjoin specific enforcement actions might be helpful to dampen harmful litigation. It may, however, be unrealistic under certain circumstances. In particular, we fear that the absence of stay in the mechanism could provide the wrong incentives and induce litigations as described by the staff as "rush to the court house", which is definitely not what we would like to see.

In general, we believe that a stay provides a valuable option for creditors to block the behavior of uncooperative and aggressive litigants. Since enabling the sovereign to impose a stay may possibly impair the already fragile contractual relationships, conditioning the activation of the stay on an affirmative vote of a qualified majority may be preferable.

SDDRF

Generally, we can go along with the rules governing the establishment and operation of the SDDRF. What is most important for the credibility of the SDDRF is its independence and transparency. The approach proposed by the staff with respect to the establishment of the SDDRF and the selection of its members appears reasonable and can possibly meet the requirements of a prompt and predictable restructuring process. For the selection panel and member of the SDDRF itself, we favor an approach where the Board of Directors and the Board of Governors play an active role in appointing independent and qualified persons to the selection panel as well as the judges of the SDDRF. To ensure fairness of the selection process, the number of members in the selection panel can be increased to 15–24 and each constituency can be allowed to nominate one candidate for the selection panel. Meanwhile, the members of the SDDRF should reflect country diversity, in addition to competence, independence, and impartiality.

With regard to the power to enjoin specific enforcement action by a court outside the territory of the sovereign, we are still not convinced by the staff that the SDDRF should be empowered in this way. To grant the SDDRF this power might cause certain problems of untransparency and unpredictability. We suggest that the staff make more efforts in finding a solution on this issue.

We are also unclear of the rationale of the staff proposal to empower the SDDRF to terminate an SDRM. In our opinion, either the debtor or a qualified majority of creditors should decide it. We wish to hear the staff's clarification.

Verification

We refer to Para. 115 to 117 that discusses the possible dispute over voting rights by related parties. It appears odd to us that the duty of producing evidence rests on the challenged creditors rather than the creditors who launch the challenge. We feel it more appropriate for the creditors who challenge the vote and claim of certain creditors to provide evidence.

Mr. Yagi and Mr. Miyoshi submitted the following statement:

The staff paper is of high quality, and we greatly appreciate the efforts by management and staff in coming up with a comprehensive design for the Sovereign Debt Restructuring Mechanism (SDRM) in a relatively short period of time. We believe the paper has laid a foundation on which the Fund will be able to develop a concrete proposal for the SDRM, which the IMFC requested by the time of its spring meeting for consideration by the membership. That said, more work still needs to be done to achieve this mandate, by management and staff on one hand and member countries on the other. Although only one more meeting on the SDRM is scheduled before the spring meetings, this chair feels that more extensive discussion by the Executive Board is clearly needed to address this wide-ranging and complicated issue, in addition to outreach to the private sector, which is also essential. In this regard, we appreciate the two informal sessions that were held before this formal Board meeting and hope that arrangements will be made in the coming months to provide the Board with opportunities for further discussion.

Since we support the thrust of the staff paper as the basis for further discussion by the Executive Board, we will limit our comments basically to responses to the issues for discussion and to the points on which this chair's views differ from those of staff. We also have to add that, because of the complexity and breadth of the issue and the limited time for consideration of all of these difficult issues, our comments are still to be finalized.

Scope of Claims Covered by the SDRM

Claims on the central bank. Staff recommends that governments should have the option to include the debt of the central bank (that does not have a government guarantee) into the claims subject to the SDRM when they activate the mechanism. In our view, however, inclusion of central bank debt should be mandatory because exclusion could result in circumvention. If central bank debt were outside of the SDRM, debt issuance by a sovereign could be made largely by its central bank, and we might be forced to amend the Articles of Agreement again to subject central bank debt mandatorily to the SDRM, thereby preventing such circumvention. We would like to know whether including central bank debt within the scope of claims covered by the SDRM could adversely affect a central bank's independence in conducting its core role of monetary policy. The staff's comments would be appreciated.

Privileged Claims. We think that the treatment of privileged claims needs more analysis. Although staff's explanation on the merit of excluding such claims from the scope of the SDRM is understandable, we are still not sure about the impact of the exclusion, for example, how it would affect the borrowing behavior of the debtor sovereign, and to what extent negative pledge clauses in other loan and bond contracts could mitigate the incentives for borrowers to rely on privileged financing, which the exclusion would create. We also have to consider the treatment of some contractual privileges such as escape clause account, and how statutory privileges differ among member countries. On the other hand, we also recognize that including such claims would inevitably complicate the structure and operations of the SDRM, as the staff paper points out. In this sense, we think the economic aspects of the SDRM should also be discussed before making a decision on this issue. In this connection, we hope that this issue will be dealt with in the "companion paper" that is to be issued soon.

Domestic Debt. Although the argument could be made that domestic debt should be restructured under the SDRM (albeit as a separate class) in order to ensure intercreditor equity, we agree with staff that claims governed by a sovereign's domestic law and subject to the exclusive jurisdiction of its courts should not be covered by the SDRM. In addition to the reasons presented by staff, we are concerned about the possibility that, if domestic debt is included as a separate class, negotiations under the SDRM could be protracted since domestic creditors would have an effective veto over an agreement between the sovereign and its external creditors. Moreover, we do not believe that the proposed framework for debt restructuring under the SDRM could allay the concern that domestic creditors could be somehow influenced by the sovereign in negotiations and decision-making.

International Organizations. Credit is extended by international organizations at a lower cost and with longer maturity than can be obtained from international capital markets in circumstances where private financial institutions will not lend. Given that such financial assistance is vital for a debtor's macroeconomic and financial stability, and that such assistance is predicated upon the assurance that the claims will not be restructured, the idea of excluding from the SDRM claims held by international organizations is understandable. The problem is in deciding which organizations to include under the heading of "international organizations." Although the Fund, the World Bank, and other MDBs should clearly be included under this heading, some international organizations, once included under this heading, might not play the role described above as expected. Staff presents two options in the paper, one being a list of existing organizations and the other being the definition of criteria, but we feel this might involve politically sensitive issues.

Official Bilateral Creditors. Although most Directors indicated a preference at the September meeting for not including claims of official bilateral creditors, the paper leaves this issue open again, perhaps owing to the reaction from the private sector. However, as we pointed out in September, the characteristics of those claims are substantially different from the characteristics of the claims held by private sector creditors: official claims are provided from resources that come from the taxpayers of creditor countries; they include claims that arise from trade credit and bilateral aid, the credit terms of which do not fully cover sovereign risk premium while those of private creditors do; and, in most cases, such assistance is crucial for the economic recovery and development of the debtor country, and thus prompt rescheduling and restructuring of these claims is needed, leading to normal financial relations with all categories of creditors. In this regard, the Paris Club has been able to compile restructuring proposals expeditiously and efficiently, based on established rules but with sufficient flexibility.

This chair is concerned that negotiations on the rescheduling of claims held by official bilateral creditors could be protracted if they were included within the scope of the SDRM, where other creditors have an effective veto over the rescheduling plan. Therefore, we believe that official bilateral claims should be left outside of the SDRM. It should also be noted that decisions are made in the Paris Club by unanimous rule. It is important that the framework of the SDRM take into consideration the sovereignty of creditor countries if official bilateral claims are to be included in the SDRM.

We would like to know the staff's view on how far private creditors would go on insisting on including official bilateral claims in the SDRM. We recognize that the exclusion of these claims could give private creditors an excuse to refuse to participate in a serious dialogue, thereby possibly forestalling progress towards the establishment of the mechanism. The staff's comments would be welcome on the merit of not expressing a firm position on this issue in the dialogue with private sector representatives.

Activation

Although the staff paper refers to concerns that allowing the debtor to activate the SDRM unilaterally could cause unjustified activation and abuse of the mechanism, it appears reluctant to recommend that the Fund (or any other organization) should assume the role of confirming independently that a sovereign's debt is unsustainable and activation of the SDRM is justified. The staff argues that market participants are sceptical about the Fund's judgment on sustainability because it may be affected by political considerations; however, it is not clear to us whether in this context the "Fund's judgment" means the judgment of management and staff, or the judgment approved by the Executive Board. The staff's comments would be appreciated.

In any case, the staff mentions in the latter paragraphs of the present paper that the Fund would be able to affect the restructuring process by virtue of its financial powers, especially its lending into arrears policy (paragraph 220), and that the SDDRF would have no authority to challenge decisions of the Board related to the Fund's financial assistance (paragraph 259). We think that the Fund's involvement in the judgment on unsustainability of the member's debt may be consistent with these principles. Above all, the Fund should get involved in the development of economic adjustment programs of the debtor, as well as elements of private sector involvement. In this respect, although staff mentions the concern of the private sector only with regard to the Fund's involvement in the activation of the SDRM, we wonder whether the private sector representatives expressed their concern about other areas of the Fund's influence, for example during negotiations in connection with its lending into arrears policy, and in connection with restructuring agreements because of its decisions on financial assistance. If the private sector has concerns about the Fund's involvement in these areas, too, then removing the Fund from the activation process would not seem to have any meaning.

We understand that the private sector and emerging markets representatives have concerns that establishment of the SDRM would make it more difficult for the governments of debtor countries to resist domestic political pressure to activate the mechanism even if the debt is still sustainable. Such concerns would be alleviated by making activation of the SDRM conditional on the Fund's confirmation of the validity of the debtor's representation of debt unsustainability. Under an automatic activation system, activation made under domestic political pressure could worsen the member's debt situation, making it unsustainable even if it was sustainable initially. Such a situation would be detrimental to both creditors and debtors.

Moreover, creditors would expect that it would be easier for the debtor to resume payments after the restructuring agreement under a Fund arrangement. Therefore, the Fund's involvement is unavoidable in this respect, too. In this connection, we would like to know the staff's view on where the need for a Fund arrangement for a debtor would be defined, for example under the SDRM framework or in the contract of the restructuring agreement.

In conclusion, we are of the view that the Fund should be involved in confirming the validity of the debtor's representation of unsustainability. However, in light of the apparently strong opposition of the private sector to the Fund's involvement, alternatively it may be worth examining whether the SDDRF could play an independent confirmation role with respect to unsustainability of a member's debt after hearing from the debtor and the Fund.

Consequences of Activation

With regard to the provision of information, staff recommends that the text of the amendment would stipulate only in general terms about the media to be used for publication, and that the rules on the actual form of publication should be confined to administrative rules to be adopted by the SDDRF. Given the rapid development of information technology, we think this approach is appropriate. We would like to point out, however, that careful examination is warranted with regard to the media of publication by the SDDRF, because such information (or failure to receive such information) affects the rights of creditors, including voting rights, substantially. Just posting the information on the World Wide Web may not be adequate.

As for the registration and verification of claims, we share the staff's view that verifying all end-investors would be either impossible or not fruitful. Pragmatically, we have to be content with an arrangement in which creditors on record would register their claims and disputes that arise with regard to the true identity of the creditor would be resolved by the SDDRF.

On the treatment of "sleeping claims," the paper suggests that unregistered claims that appeared on the SDRM restructuring list could be treated as null and void at a certain period after the restructuring agreement. Although we understand the value of creating incentives for registration, such treatment, if included in the amended Articles of Agreement, could mean that the SDRM would override the treatment of such claims under domestic law, and seems to go too far.

Stay on Enforcement

We broadly support the idea of combining the "hotchpot" rule with a target stay ("injunctive relief") instead of introducing a generalized stay on creditor enforcement by litigation. As staff points out, a generalized stay is out of place unless it is accompanied by a general cessation of payments, which is not envisaged under debt restructuring with the SDRM as stipulated in the paper. As long as the advantage of prior litigation is neutralized by the "hotchpot" rule, supplemented by a target stay, it is neither necessary nor desirable to introduce a stay on enforcement, which inevitably would substantially interfere with the contractual relationship.

However, we should not yet rule out the possibility of introducing a stay on enforcement. In particular, if privileged claims are to be included in the SDRM, such measures as a stay or temporary suspension of contractual provisions are necessary to prevent acceleration and enforcement by privileged creditors. That said, we reserve judgment on the consistency of a stay on enforcement and "injunctive relief" by the SDDRF with our domestic laws.

Creditor Participation

Although the proposed voting procedure and threshold are different from those found in existing collective action clauses, they are understandable because the denominator is the total outstanding principal of registered claims. Registered creditors are presumed to be conscious of their interests and to have the intention to participate in restructuring. Therefore, a threshold of 75 percent is possibly adequately high. We are concerned about whether the mechanism could really work with such a high threshold. It is particularly so when there are more than one classes of creditors and each class would be required to approve restructuring terms by this qualified majority of 75 percent. We therefore support the lower threshold. There are also possible alternative designs that would allow some flexibility to facilitate the restructuring. For example, one option could be to require the approval of a smaller qualified majority for each class to make a restructuring plan binding on all creditors, if the aggregated affirmative vote exceeds 75 percent of the total outstanding principal of registered claims. We would like to have the staff's view on the need for such flexibility.

Sanctions

The staff paper raises the concern that the role of the Fund would be enhanced if the SDRM were to rely on the Fund to penalize the debtor for providing false information through an Executive Board decision to suspend purchases under an arrangement. We think, however, that such involvement by the Fund is inevitable, in order to prevent harm to creditors' interests and inequity among creditors.

Termination

We share the staff's view that some sanctions are necessary against possible abuse by the debtor of the right to terminate the SDRM process. We suggest that staff consider the possibility of imposing penalty charges (that constitute liability of the member in the GRA) and of having the debtor bear the costs of activating the SDRM, in addition to their proposal for precluding the debtor from reactivating the SDRM within a particular period.

On the issue of the voting threshold for creditors to terminate the SDRM, we are of the view that the application of the general threshold (75 percent of the outstanding principal of registered claims, or lower as we suggested above) is too high in this case, while the SDRM could be easily terminated by the minority of creditors even at an early stage of negotiation if the threshold were set at 40 percent. The threshold figure is actually judgmental and using the simple majority of the outstanding principal of claims in each class could be another option. In any case, further examination is needed to explore an appropriate level of threshold beyond the blocking minority, in parallel with the further consideration of the voting threshold for the approval of restructuring plans.

SDDRF

On the designation of selection panel for identifying potential judges for the SDDRF, we think that the proposed first option, in which the members of the panel will be selected by 7 to 11 member countries chosen by the Board, is also sensible. In any case, it is essential to ensure impartiality in terms of the nationality of panel members. If the second option is employed, there should be a statutory provision that each judge and practitioner on the panel should be of a different nationality.

Other Comments

As our authorities are in the process of examining the consistency of the SDRM with our domestic legal systems, we reserve final judgment on this issue. Staff notes that most important decisions would be made by the qualified majority of creditors and not the SDDRF. However, it must also be noted that what makes the creditors' decisions legally binding is certification by the SDDRF and the amended Articles of Agreement. Thorough consideration of the legal implications of the SDRM is necessary, including the legal effects of injunctive relief by the SDDRF, if this is included in the amendments.

Finally, we would like to reiterate the importance of making the Fund's lending policy more transparent, particularly access policy, in order to make the SDRM truly workable. Taking into account the amount of its own financial assistance as well as its impact on a member's debt outlook, the Fund needs to improve its debt sustainability analysis to facilitate the ordinary restructuring of sovereign debt, whether such analysis is formally recognized under the SDRM or not. In this sense, the SDRM should be seen as an important part of the framework for crisis resolution, in which the Fund should play a crucial role.

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

We would like to thank staff for preparing the document for today's discussion.

At the outset, and before entering into the issues for discussion, this chair would like to state that it is worrisome that a subject like this has advanced without having a minimum political consensus to implement it.

Debtor countries have strongly opposed the idea due to concerns regarding its negative implications on borrowing costs and potential reduction of capital flows to their economies. This discussion has taken place precisely at a moment when uncertainty regarding future developments in the world economy, in particular the developed world, is mounting, heightening risk aversion.

The reaction of the private sector to this proposal has been also negative. Despite what has been said to us in the seminars we held before this meeting, which we appreciate, the private sector continues to show a clear opposition to implementing a statutory framework for a sovereign debt restructuring. Last December 17, several associations, representative of a significant volume of capital that invests in emerging market economies, publicly rejected the idea of an SDRM. It is important to say that our authorities' contacts with the private sector confirm this opposition. We sincerely expect that management will invite all these associations to the outreach that will take place early next year with the Executive Board.

Finally, the proposed SDRM entails a change in the Articles of Agreement. It seems to us that the votes required for accepting such amendment is not reachable. Thus, it is unclear to us the aim of advancing an issue that seems very difficult to reach the needed votes to change the Articles of Agreement.

Rational for an SDRM

Before commenting on the rationale of the SDRM, let us recall the premises under which this discussion has unfolded.

There will always be countries confronting an unsustainable debt situation;

In today's world, emerging markets rely more upon the issue of debt in international capital markets, rather than through direct lending from banking institutions to fund their activities. Therefore, the group of creditors is now more widespread and disperse and thus difficult to identify, making it hard to organize them to initiate a restructuring process. This difficulty enhances the possibility that "holdout creditors" could act legally against the sovereign;

The architecture of the international financial system lacks a legal framework to help restructure sovereign debts in a timely and efficient manner. The absence of such legal framework, and the uncertainty regarding how a restructuring process unfolds, explain why governments prefer to delay the decision to start a restructuring process; and

The delays have proven to be very costly in terms of the depth and length of the economic crisis it causes.

We would like to make the following comments on these premises:

First, we agree that it is realistic, though unfortunate, that there will always be countries that will face a situation of debt unsustainability. However, we do not think that this problem should be dealt with by the Fund through the establishment of a statutory framework to restructure the sovereign's debt, but through more efficient crisis prevention mechanisms. Having said this, we should also say that a situation of debt unsustainability might also arise due to liquidity problems caused by exogenous factors. In our view, the cases where a restructuring has been needed are not the rule. Too much attention has been devoted to the SDRM instead to continue enhancing the institution's crises prevention strategy. We firmly believe that the latter is the root of the problem.

Second, although it is true that the group of creditors has now become more difficult to identify, recent restructuring episodes do not support the idea that it is difficult to organize them to initiate a restructuring process. On the other hand, there are very few instances of "holdout creditors" and, when they have been present, they have not been an impediment to complete the restructuring process. Thus, the existence of a legal framework that would guide debt restructurings does not seem to be a necessary condition to achieve this goal.

Third, the argument that the international financial system will be better off with a legal framework that allows restructuring a sovereign's debts is flawed. In this regard, we would like to quote Mr. Jacques de Larosière, former Managing Director of this institution, "I believe it would (be) most unwise for the international community to build legal systems that are based on the assumption of failure and default" (Institute of International Finance, London; October 17, 2002). This is the signaling problem inherent to the SDRM. On the other hand, the government's reluctance to accept that they are in an unsustainable debt situation and that they have to restructure its debt is, in our view, not associated with the lack of a legal framework like the SDRM, but with the reputation costs such step entails. It is true that the long-term costs of a debt restructuring, in terms of loss of confidence and access to international capital markets, will not disappear if the SDRM comes into effect, as Ms. Krueger has repeatedly pointed out in the past. Our main worry is that the mere existence of such a framework will make defaults a more probable event in the minds of creditors given the strong support that this proposal is having from the Fund and a majority of G7 countries.

Fourth, in our view, the reputation costs associated with the decision to restructure the sovereign's debt are an integral part of the incentive structure of the international financial system. These costs need to be large enough in order to deter governments to rely on restructurings as a first solution to their problems. These costs have served those countries that have taken the decision to restructure its debt—and have been a remainder to others—that it is better to act timely in adjusting economic policies rather than in opting to restructure the sovereign's debt. In other words, these costs have played a crucial role in the international financial architecture as a crises prevention tool by making such decision a costly one.

There is yet another implication of the SDRM on the incentive structure of the international financial architecture, in particular in how the official sector will deal with future crises. Debtor countries believe that if the SDRM were to become a reality, institutions like the IMF would be less prone to help countries with a "liquidity" problem, forcing them to restructure their debt. There is a problem in identifying when a country enters into a liquidity problem vs. a solvency problem. The signaling that this proposal would send to creditors will have a negative impact on the countries' cost of debt and in reducing the flow of capital to emerging market economies.

Further reflections on the impact of the SDRM on emerging market economies.

Are we going to be better off by having a framework to restructure the sovereign debt of a country? Or are those countries with unsustainable debt burdens going to be the only ones to be benefited from this framework? Why is that the group of economies the SDRM is supposedly going to benefit oppose this idea? We will answer these questions by focusing on two important assertions made in the paper under discussion.

Will the existence of a framework for sovereign debt restructuring lower the cost of borrowing to emerging market economies? reduce contagion? At the outset, our answer to both questions is no.

First, how can an SDRM lower the borrowing costs of emerging and developing economies if ex-ante creditors would know that a sovereign could restructure their debt using a framework that has the blessing of the IMF? The answer to this question is in the paper. Why is that the sovereign's debt to the Fund, and other IFIs, not included in the SDRM? Simply because, as stated in the paper: "The ability of these institutions to provide financing at the current cost structure depends critically on the assurances that their claims would not be captured in a sovereign debt restructuring" (end of paragraph 72, our own highlighting). Exactly the same rationale applies to private creditors, and that explains why since we began discussing this issue most emerging market economies have expressed concern about the impact the SDRM would have in the capital flows to their economies and in its cost.

Second, with regard to the paper's argument that the SDRM would reduce contagion we have two comments. We need to differentiate between financial and other types of contagion. If a restructuring process allows an economy to achieve higher rates of economic growth sooner rather than later, then we can accept that the contagion arising from real economic channels, like export and import activities, could be mitigated. However, in our view, it is more important to analyze the impact that the establishment of the SDRM could have on financial contagion. We have to remember that this type of contagion arises from certain market practices—not always backed by a rational economic analysis—that promotes "herd behavior". We believe that a debt restructuring under by the SDRM would set such negative precedent that would increase, not reduce, financial contagion. The reason is that it will give the signal to creditors that, instead of adopting corrective measures on time, the existence of this framework will increase the probability of restructurings.

Debt Sustainability Analysis: Where do we stand?

At the center of the SDRM proposal rests the debt sustainability analysis. This is an issue that since our first discussion on the SDRM we have pointed out as a crucial element of the proposed framework. Yet, we have to recognize that we have not developed an adequate debt sustainability analysis. The one we are using is still a work in progress.

The implementation of the SDRM without having a well-defined and comprehensive debt sustainability analysis is quite dangerous. Certainly, there might be cases that would not need a very sophisticated analysis to affirm that the sovereign is facing an unsustainable debt. In such cases, a restructuring of the sovereign's debt could be done as in the past, without a statutory framework. However, to help achieve a faster solution we think that the development of a Code of Good Practices, as both creditors and debtor countries have suggested in different fora (see below).

However, in other cases, perhaps the majority, it is going to be more difficult to say that the sovereign's debt is unsustainable. The result of the analysis will depend on the assumptions used to model the future behavior of important variables like economic growth, nominal and real interest rates and the exchange rate, among others. These are maybe the easiest ones to forecast. What about forecasting investor confidence? Staff is correct in highlighting that this would be a potentially contentious issue in the activation of the SDRM. This issue is so important that staff suggest that there might be a need of an independent debt sustainability analysis in order to make sure that the activation is well justified. Clearly, the powers that this panel would get are far from what any sovereign debtor would be willing to grant and we strongly oppose this idea.

In addition to the above, the proper definition of claims that ought to be included in the debt restructuring analysis is another source of concern. Depending on which claims are included in the exercise the result could differ substantially.

Code of Good Practices

We think many of staff's proposals could be used to develop a comprehensive set of good practices should a country decides to restructure its sovereign debt. The advantage of this approach would be that the country that takes such decision would have to face the consequences of its own mistakes, setting an example for future generations and other countries. Most important, this decision will not have the consent of the international community and would not set a precedent that financial obligations could be breached.

In such a scenario, each sovereign debt restructuring process would have to be dealt on a case-by-case basis. Many of the rules developed by staff to try to identify creditors and the nature of claims; to provide information, registration and verification upon the decision of the sovereign to restructure its debt; the role of creditors' committees and its voting thresholds, and the rules to exchange information between the sovereign and the committee of creditors, etc., could well be part of said Code of Good Practices.

Comments on the Staff's Preliminary Recommendations

We would like to make the following comments regarding staff's recommendations as to how a specific feature of the SDRM should be design.

One of the main arguments to develop an SDRM was precisely the need of a stay on litigation to prevent "holdout creditors" to act legally against the sovereign that opted to initiate a restructuring process. However, in staff's proposal the stay on litigation was eliminated. From the sovereign's perspective there are trade-offs in this decision. On the one hand, once a restructuring process initiates, it is important to eliminate any legal action by any creditor or group of creditors that would hamper the negotiation process, although as we have said before, this is something that has never occurred. On the other hand, an SDRM that includes stays on litigation would send such a negative signal to creditors that they would penalize the sovereign through an increase in borrowing costs or reduced capital flows to the country. It may give too much power to debtor countries. It seems that staff is well aware of the latter and has therefore preferred eradicate this problem. In our view, the removal of the stay on litigation confirms to us that the premises under which this proposal has unfolded is flawed.

On the scope of debt to be included in the mechanism, we strongly oppose the enlargement proposed by staff to include debt that is not covered by domestic insolvency regimes. Initially, the SDRM was supposed to cover only the sovereign's foreign debt, understanding that this would only include the sovereign's debt issued under a foreign legislation. It seems to us that this proposal for enlargement is unjustifiable.

Staff also proposes that the debtor country will provide the group of creditors information on "all claims other than the eligible that the sovereign debtor intends to restructure outside the SDRM" the so called "Non-SDRM Restructuring List" and also a list on "all other claims, i.e. that the sovereign does not intend to restructure" the so called "Non-Impaired List". We think this proposal goes too far to what a sovereign would be willing to accept and effectively produce, and we do not agree with it.

Staff proposes that creditors that are under the control or under undue influence of the sovereign should not be able to participate in the voting process. Although we agree that those creditors under the control of the sovereign should not be able to vote, we cannot accept the second proposal. How will "undue influence" be defined and by whom? This very subjective issue could be used by the group of creditors to their advantage.

Closely related to the provision of information by the sovereign is the issue of sanctions. Staff recommends that the provision of false information by the sovereign would constitute a breach of the member's obligations under the Articles of Agreement. We strongly oppose this recommendation. The probability that "mistakes" could be made is large and the sole possibility that such a sanction be imposed makes the SDRM an even less desirable mechanism.

On the designation of the selection panel for the SDDRF and the formal appointment of SDDRF members, we have two suggestions. The Executive Board should be in charge of selecting the 7-11 judges that would be in charge of selecting the SDDRF members. This will add transparency to the selection process and it has the advantage of being a process that includes both creditor and debtor countries' which enhances participation. In addition, this panel would have to be approved by the Executive Board by a 70 percent majority. Subsequently, the group of 12–16 candidates that would constitute the pool from which judges would be impaneled when a crisis arises would have to be approved by the Board of Governors also by a 70 percent majority.

Questions Put Forward by the Staff

With regard to those areas where the staff has not yet formed a view as to how the SDRM should de designed, we provide the following comments.

On the official bilateral creditors, it seems to us that given the nature of this debt, it should be restructured outside the SDRM. In particular, the Paris Club has proven to be an efficient restructuring process.

On the independent confirmation of the member's debt unsustainability situation, we think that it would be very difficult to find an impartial entity or person to do this analysis objectively. Therefore, the debtor country should be the only one to judge if its debt is sustainable or not.

On the issue of registration by end-investors, we believe that in order to give the process more authority and eliminate any doubt about possible influence by the debtor country, end-investors should be the ones to be registered.

On the voting threshold that should apply to terminate the mechanism after the completion of the verification procedure, we think that a 40 percent of the outstanding principal registered is sufficient to allow creditors to take such decision.

On the SDDRF, powers to issue an order that would enjoy specific enforcement actions in circumstances where such an order is requested by the debtor and approved by creditors; we think these powers would be necessary for the SDRM to be strong mechanism.

Mr. Reddy submitted the following statement:

We commend the staff for a very comprehensive and analytical paper taking a significant step forward towards the design of Sovereign Debt Restructuring Mechanism (SDRM) and with active participation of FDMD, for organizing two informal seminars on the subject to discuss various issues. We are also encouraged by the fact that apart from private market participants, academia, legal experts and some emerging market authorities have also been consulted actively in the design process. We understand that this work is still an ongoing process and a series of next steps are planned before the proposal is given shape in concrete terms and taken to the IMFC.

At the outset, we would like to mention that while the paper attempts to develop a broad set of principles to guide the design of SDRM, many of the fundamental legal and financial issues are still open and on the basis of a discussion of this paper, it would not be possible to arrive at decisive conclusions at the Board at this stage. It is necessary recognize that there are a number of legal proposals having close relationship with issues of cross-boarder insolvency and debt restructuring. It would be difficult to interpret the precise legal implications for the domestic legal and financial systems, without careful considerations of the actual proposals as they emerge and take shape. Furthermore, a companion paper is expected from the staff on the closely linked aspect of broad range of economic and financial policies. Given the tentative nature of the design and proposals regarding SDRM, we do not support the idea of publishing this document even after modifications as an outcome of Board discussions, but would encourage otherwise wider dissemination of this paper for a wider debate and for identifying crucial issues for forging ahead further with the work.

General Principles

Before commenting on the specific issues raised in the paper for discussion, we would like to reiterate and delineate our basic views on certain ground rules and general principles which should guide the approach to evolving SDRM:

The SDRM should, in both letter and spirit, be voluntary in nature and to that extent it should not give rise to infringement of fundamental principles of sovereignty. The invocation of SDRM by the sovereign should be treated as an extreme response.

In order to gain general acceptability of the SDRM, it is imperative to ensure that the acceptance SDRM is not only purely voluntary, but also should have adequate safeguards to ensure that the SDRM would not infringe any of the functioning of domestic frameworks explicitly or implicitly. Acceptance of SDRM should not subsequently impose upon country any stipulations, which due to economic, social or political reasons are unacceptable to the debtor.

As the name suggests, the scope should be limited to sovereign debt and to that extent, proposals should centre around restructuring of sovereign debt and not clouded with issues relating to non-sovereign bonds and the like instruments.

As has been discussed and agreed in the earlier Board discussions, the Fund's involvement should be minimal, given the Fund's role as the major international financial institution and the possible conflicts of interests in its direct involvement with the SDRM.

The SDRM, being a parallel effort along with other efforts towards improving mechanisms for crisis prevention and resolution, it should not be viewed as a substitute but essentially complementary. Therefore, SDRM should not create any limitations or restrictions on special access financing nor it should be directly related to IMF conditionalities in Fund supported programs. Given the position of declining trend noticed in private capital flows, it should build up and improve confidence levels in financial markets restoring greater capital flows into developing economies.

For the SDRM to become acceptable, it should be free from being perceived particularly supportive of any one side or group, such as debtors, creditors, or financial agencies; it should be viewed as beneficial and fair to all stakeholders. General principles should also take into consideration the need to allow for a system to evolve, and thus provide 'sufficient incentives' to both official sector and private sector to achieve the SDRM objectives.

In view of the above, we still have a strong bias towards the contractual approach, and the statutory approach should be complementary to the extent it is basically supportive of the contractual and market based approach.

Rationale

We welcome the SDRM as a bold and desirable effort to building up better institutional mechanism and practices, in dealing with crises resolution and prevention, and improving stable conditions in the global financial market. The basic objective of the SDRM is to provide a framework that strengthens incentives for a sovereign and its creditors to reach a rapid and collaborative agreement on the restructuring of unsustainable debt in a manner that preserves the economic value of assets and facilitates a return to medium-term viability. We agree with the basic tenets around the rationale for the SDRM. We believe that a set of procedures for orderly debt workouts in countries facing capital account crises with extremely unsustainable debt situations could make the debt restructuring more predictable, minimize loss of asset values and reduce costs to both debtors and creditors.

Scope of Claims and Related Issues

As regards the Scope of Claims, we strongly go with the earlier conclusions reached in the Board that it should target only sovereign debt, i.e., Central Government debt, in principle, which is not subject to domestic insolvency framework. That would mean it would cover only external debt of the sovereign. Within the external debt, on the question whether it should cover only the financial contracts like marketable securities such as bonds and the like instruments, or it should include the bilateral debt, the choice should be left to the sovereign.

We support the view of Mr. Portugal that as a general rule, eligible claims should include only the external sovereign debt of the Government in the form of financial contracts such as bonds and traded securities and should be precisely defined. Of course, Official lending potentially plays a key role in sovereign debt restructuring. Evidently, exclusion of official bilateral creditors from the SDRM is an issue as far as 'inter-creditor equity' is concerned. This concern needs to be given due attention in light of opposition of some private sector players to the statutory SDRM and articulation of possible negative impacts of involuntary private sector 'bail-ins'. However, inclusion of official bilateral creditors could make the SDRM more complex and time consuming. Issues of existing debt restructuring procedures of Paris Club, including the need for an IMF program, would come into play. This could also expand the say of the IMF in the overall SDRM process. Further, there could be delays in decisions being taken by the various bilateral creditor governments once the SDRM process is activated.

One of the main concerns sought to be addressed by the SDRM was the new phenomenon of the existence of a diverse and large (possibly very large) number of creditors. This would not be a factor with reference to official bilateral creditors. It may, therefore, on balance, be better to exclude the official bilateral creditors from the SDRM, but incorporate appropriate arrangements to ensure transparency and 'inter-creditor equity' to all creditors—both within and without the SDRM. Under the circumstances, the choice of inclusion of bilateral creditors should be left to the sovereign.

Secondly, as a consequence of this, the requirement relating to furnishing of information should only relate to such eligible claims included as a part of the SDRM. Failure to institute necessary safety clauses to safeguard the privilege of information and any subsequent conflicts on these grounds will severely undermine the SDRM's credibility. Therefore, the question of non-impaired claims list which include all claims that are excluded from the SDRM does not arise.

Thirdly, it would be very difficult to distinguish between financial contracts relating to only commercial activities of the sovereign because of the fungible nature of borrowed funds.

Fourthly, for purposes of exclusion from voting, it would be impracticable to apply the principle of those creditors under the "control" or "influence" of the sovereign. While in principle, voting should not be manipulated, there could be entities functioning under indirect control or influence of the sovereign, but working at arms' length with independent financial and other powers. The nature of control and influence is very difficult to establish in practice. While manipulation of voting no doubt is undesirable, the question of any dispute arising in that regard could be handled similar to other disputes before the SDDRF.

Fifthly, the idea of registering end investors would not be feasible given the current market practices in respect of investments and trading in securities in the international capital market. It would be sufficient if the registration recognizes the lender of record for the purposes of voting.

Lastly, the question of treating materially incorrect information on the details of claims as a breach of the Articles of Agreement will be highly punitive. It is of course recognized that the information provided should be correct to the best of knowledge, and that any willful suppression of information should be prevented. For this purpose, the SDDRF could evolve a disincentive mechanism in the form of a penalty structure.

Activation

Keeping fundamentally the spirit of voluntary nature of SDRM, we agree that the sovereign debtor could alone initiate the SDRM, if in their opinion their debt is 'unsustainable'. However, the paper raises a question, as to whether the debtor can unilaterally conclude that its debt is unsustainable or is it in order, if a party other than the debtor would conclude that the debtor's debt is really 'unsustainable' and justifies the need to activate the SDRM and whether this can made as a condition for activation, and who should be that third party? In this regard, we strongly feel that apart from the complex issue of what exactly constitutes debt unsustainability in particular for the eligible class of external sovereign debt, the other related issues raise intricate questions. The more difficult question is whether the member's assessment of the unsustainability of its debt is to be accepted directly, or should it be confirmed by a third party. The paper notes that providing unilateral power to member countries could get abused, for instance due to domestic political pressures. On the other hand, it would be equally difficult to identify a suitable third party who could confirm the unsustainability of debt. The IMF, while probably qualified, may not be acceptable to some debtors/creditors. The paper notes that activation of the SDRM does not lead to automatic stay on repayments or interference with contractual obligations. It primarily means initiation of the SDRM process. It is also unlikely that a sovereign debtor would gain much over the long-term from such abuse of activation powers or possible maverick action. Since the reasonableness of the activation would be reviewed at subsequent stages of the SDRM, including by the Creditors' Committee, we favor acceptance of the member's declaration of unsustainability of debt as the activation trigger.

Voting Threshold

The paper proposes a voting threshold of 75 per cent of the total outstanding principal amount of registered claims to rely upon for decisions under the SDRM under a situation where all the parties concerned are convinced about the need to put in place the SDRM. This is justified on the grounds of having a threshold that adequately balances the need to resolve 'collective action' problems and to protect the interests of creditors.

However, if the circumstances are such that the creditors are convinced at a later stage that the activation is unjustified, what should be the voting threshold is an issue that needs to be resolved. If, even a minority group of creditors, say a five to ten per cent of voted creditors can convincingly establish that the activation is unjustified, probably, it is in order to consider termination of the procedure. However, the onus of conclusively proving the fact that the activation is unjustified needs to be squarely on the minority group of creditors. It is also necessary to define clearly the circumstances under which activation can be deemed as unjustified. This is in accordance with the principle of natural justice, as both the sovereign and the

SDDRF are given rights under the proposals to terminate the procedure at any given point of time during the procedure. The creditors, even if they constitute a minority, also deserve such right. So, the design of the SDRM should be flexible to take this fact into account.

Powers to SDDRF for Securing Stay on Specific Enforcement Actions by Creditors.

The paper opines that the most controversial proposal in the design of the SDRM is whether it is necessary to provide for a stay on creditor enforcement by suitably empowering the SDDRF. On this issue, a view has been expressed by market participants that such a generalized stay on enforcement would constitute an erosion in the contractual rights of the creditors. This is an issue wherein, powers are sought to provide the SDDRF with authority to issue an order that would require a court outside the sovereign's territory to prohibit enforcement actions. In our view, as a rule of thumb, the SDDRF should not be given any overriding powers on the domestic legal frameworks, if the SDRM is to be accepted without reservations. Instead, while designing the SDRM, efforts should be made to provide appropriate and sufficient incentives to the creditors not to take resort to courts once the SDRM is conceived for a sovereign.

SDRM Principles and Domestic Laws

While some ground rules for universal application are necessary as part of SDRM, a complete harmonization of domestic laws with SDRM would be practically not feasible and also not desirable. Many countries are streamlining their insolvency procedures with an eye towards adopting best practices available elsewhere, but development of codes for domestic bankruptcy should not degenerate into mandatory compliance by member countries. The diversity of practices and historical and institutional features as also the underdeveloped nature of domestic securities markets in many countries has been brought out in a recent BIS report by the Contract Group on the legal and institutional underpinnings of the international financial system. The scope of claims to be excluded under the SDRM, in principle being those governed by domestic bankruptcy laws, the member countries should have the complete freedom and flexibility in designing domestic bankruptcy codes.

The more important related issue is whether an amendment to the Articles of Agreement is required for the establishment of the SDDRF, under the statutory approach. Basically, this undermines the accepted principle that the Fund's role in the SDRM should be minimal and its direct involvement introduces the element of conflicts of interest. The Fund's role is essentially catalytic, as part of improving mechanisms for crises prevention and resolution. Secondly, the SDDRF should not be construed as having overriding powers over domestic jurisdictions and domestic legal framework and this could be viewed as an infringement on the principle of sovereignty. Thirdly, apart from the practical problems of a cumbersome and protracted process to effect the legislative changes that may be required for compliance at the domestic level, this could further delay and hamper the institution and commencement of the SDRM process, defeating the purpose of evolving this mechanism at a quicker pace as part of crises resolution. Therefore, in our view, as expressed on earlier occasions, the SDDRF should ideally be created totally as an independent structure, through an international treaty, avoiding amendment to the Articles of Agreement.

Conclusion

Genuine progress in reducing the costs of sovereign debt crises will require that all players—the international financial institutions, the major industrial countries, policy-makers in emerging markets, and creditors—address unsustainable situations more quickly. Expeditious acceptance of the SDRM is an important step in that direction. While considering the initiation of the SDRM, an early tightening of financial policies and structural reforms can go a long way in strengthening the Mechanism. While it is necessary to keep in mind that countries undertaking a restructuring of their official debt will continue to depend on international financial and technical support, this fact should not induce them to postpone the inevitable restructuring, which requires the support of all members. In the ultimate analysis, what is needed is a system, which is transparent, easy to understand and simple to operate. This would ensure that the cost of operationalizing the mechanism is low, thereby enhancing acceptability.

In principle, a sovereign debt restructuring mechanism should be in the interest of both debtors and creditors, just as bankruptcy procedures are for firms facing difficulties. Any such process that makes the workout procedure predictable and orderly should, in principle, reduce the cost of borrowing. Creditors' views, apparently, are that the SDRM will make credit more expensive. This has led the affected countries, particularly in Latin America to express doubts on the desirability and efficacy of the SDRM. This issue needs to be addressed before a consensus can be reached.

Mr. Zurbrügg and Mr. Siegenthaler submitted the following statement:

First of all, we would like to thank the staff for a very useful paper. Obviously, many open questions remain to be answered and considerable work needs to be done. But the great value of the paper is that the questions have at last been made explicit and that it presents the first concrete and comprehensive proposal for a Sovereign Debt Restructuring Mechanism (SDRM). We sincerely hope that the Board will be able to present a complete and effective proposal to the IMFC by the time of the Spring Meetings.

Second, in order to reiterate our basic position, let us stress again that we strongly support the two-track approach, including both the promotion of universal use of Collective Action Clauses (CACs) as well as the creation of an SDRM. Our support for the SDRM is not simply a strategic position in order to advance the introduction of CACs. We believe that such a mechanism is essential to solve the problem of creditors' collective action and to deal with the existing stock of debt.

The Role of the Fund

The new SDRM proposal does not foresee a formal role for the Fund anymore. However, the informal role of the Fund remains very important. In particular, its sustainability assessment and lending decisions will be very influential in the process as a whole. Absent a clear and credible access policy, an SDRM risks getting us involved in unwanted games with debtors and their private creditors about lending. It is thus important that we define the role of the Fund in the SDRM framework as clearly as possible. To do this, we will have to look at the interplay between Fund lending and the mechanism and identify the position of lending decisions on the timeline presented in the Appendix of the staff document.

Stay on Litigation and Debt Coverage

The core change in the proposed model is the replacement of a general stay on litigation with a "hotchpot" rule supplemented by a selective stay under control of creditors. We understand that such a concession may be necessary in order to accommodate major private sector concerns. Even though we have argued for an automatic stay in the past, we recognize that in order to be successful we need to reach a certain level of acceptability for all parties involved. If the envisaged changes can reach this objective without reducing the effectiveness of the mechanism, we would be happy to support them. However, we should keep in mind that there is a point beyond which the efforts to "soften" the SDRM by accommodating all possible concerns would become counterproductive and would put in question the rationale for pursuing the whole idea.

In our view, the weakest point of the current SDRM model is the lack of a mechanism to prevent litigation in the time between the activation of the SDRM and the establishment of the creditors' committee (or the organization of the voting procedure). We take the point of staff that this problem might hardly occur in practice given that in the shadow of the SDRM debtors and creditors will have an incentive to organize themselves even before activation. However, in the absence of stronger assurances that this will really be the case, we should try to refine the procedure and to design instruments that could prevent a rush to the courthouse. One option would be to give the Sovereign Debt Dispute Resolution Forum (SDDRF) a larger than envisaged role, at least until creditors are able to speak with one voice through either a vote or a committee. In any case, it is an indispensable part of the SDRM to grant the SDDRF the power of issuing orders which require a court outside the territory of the sovereign to issue a stay on specific enforcement action by a creditor. This would be done at the request of the debtor and upon approval of the non-litigious creditors, whose rights would also be protected by such an order. Approval of creditors can be obtained through a vote or by conferring the necessary authority to a representative creditors' committee.

Regarding the coverage of debt, we should carefully analyze the implications of excluding certain creditor groups. For example, what are the dangers of the emergence of financing facilities disguised as trade credits? How can we assure that national laws are sufficiently strengthened to allow for parallel treatment of liabilities to other creditor classes, especially domestic debt?

In this respect, we view the risk of an increasing reliance on privileged debt as the second major weakness of the proposed SDRM model. The model envisages that privileged claims should be restructured outside the mechanism. This might greatly increase the incentive to issue privileged claims. According to staff, this incentive can be “modulated” through enforcement of negative pledge clause in loans extended by multilateral development banks. We are not sure, however, whether this is really the case and would like to know how far this “modulation” could go and how it would work in practice. As a principle, any undesirable effect of the SDRM on the composition of debt should be avoided.

Concerning the treatment of official bilateral debt, neither option should be excluded at this stage. The objective should be a restructuring process that ensures inter-creditor equity, independent of the fact whether the Paris Club is inside or outside the mechanism. However, we tend to agree that the current Paris Club rules and procedures do not seem to be compatible with the proposed SDRM framework and would have to be significantly revised to allow the inclusion of the bilateral debt. We also agree that there is a need to ensure that the private sector would not be given the power to effectively block the provision of official debt relief. Some of the non-Paris Club members of my constituency also insist that their interests should be protected and that they should be given an adequate role when designing the modalities of the contemplated inclusion of the bilateral debt into the SDRM framework.

Other Issues

Regarding the assessment of whether a debt situation is truly unsustainable, we do not believe that an independent confirmation is necessary. First, it is difficult to imagine an independent agency which is not directly involved in the process but has the same level of expertise as the IMF. Second, even if there were an opportunistic activation of the SDRM, creditors would maintain the possibility of terminating the mechanism once their claims are verified. In any case, the Fund should increase the transparency of its methodology for assessing debt sustainability and continue to work on improving the quality of these assessments.

The rationale for end-investor registration is to control abuse of the mechanism, that is to exclude from voting creditors that are under control or undue influence of the sovereign. However, as the staff paper points out, "the sovereign could always establish a special purpose vehicle as the end-investor". End-investor registration (with explicit approval of creditors) thus seems to be a necessary but not sufficient measure to control abuse. It should therefore be complemented by other measures helping to achieve the objective. We see merit in promoting the "know your creditor" rule even independently of the SDRM because it would help in any debt restructuring and could be useful for other purposes, including our AML/CFT efforts.

The ability to terminate the mechanism is crucial for the SDRM. It is an incentive for the debtor to negotiate in good faith, not only under the SDRM, but also with creditors that are not under the SDRM. The voting threshold should be high enough to prevent a minority of creditors to litigate successfully and then terminate the SDRM. Even though I agree that the voting threshold should not be too high in order to make a termination of the SDRM feasible, I would rather see it at a somewhat higher level than proposed by the staff. This is an issue upon which we should not decide until we have more insight. Whether the SDDRF should be able to terminate the mechanism is an issue we may want to discuss in the future.

In a later discussion we will need to take a closer look at the procedures for the establishment of the SDDRF, in order to assure its independence and competence. I would, for example, like to hear more about the advantages of having the Managing Director, as opposed to the Executive Board, appoint the members of the selection panel.

Concerning the possible changes required in domestic laws, a process of consultation has begun within our constituency. We will report on the results as soon as we have some definite answers.

We see some merit in discussing further the issue of costs of creditors' committee operation. Given that the SDRM is supposed to benefit both sides, it could make sense to share these costs between the debtor and the creditors.

Finally, it is clear that a minimum level of agreement on the way forward will be required from all parties involved. To this end, abandoning the idea of an automatic stay and other changes proposed in the staff paper should significantly soften the opposition of market participants. Nevertheless, "selling" the SDRM to the private sector will require more intense outreach efforts. The market seems to have had problems keeping current on the crucial evolution between the initial proposal of November 2001 and the subsequent stages with a much reduced role of the IMF. We must make every effort to communicate clearly today's proposal, with the key feature of a stay under control of creditors.

Ms. Jacklin submitted the following statement:

The IMF continues to make an invaluable contribution to the important work under way to improve the process of sovereign debt workouts, particularly with regard to fleshing out the details of a proposal for an SDRM. These efforts and the complementary efforts regarding collective action clauses are moving forward in parallel. We remain strongly of the view that good public policy requires carefully investigating all alternatives and pursuing the option or combination of options that will work best, whether it be the decentralized approach via clauses, the centralized approach via the SDRM, or a combination of the two. This detailed analysis itself serves to enhance the understanding, by both public and private sector participants, of the essential features of a successful debt restructuring process. It is important that we all urge the private sector and issuers to work toward the early inclusion of clauses in debt instruments. We look forward to continued progress by the IMF in developing a proposal for an SDRM so that the Board can carefully consider the pros and cons of this proposal. We look forward to the ongoing discussion of these issues.

The ongoing efforts to develop the SDRM have highlighted a range of important conceptual as well as numerous and complex implementation issues that need to be considered carefully. The fact that the SDRM allows for aggregation of claims across different debt instruments is a distinguishing element of the design, but also one that raises extremely complex issues, as the paper makes clear. These complexities warrant extensive consideration. The SDRM would establish a dispute resolution forum, which raises many issues about its remit, the appointment and accountability of its members, as well as perceptions regarding the IMF and supranationalism that also need to be considered carefully. The SDRM would become a part of national law and would affect certain terms in existing bond contracts, an issue of some concern to private sector participants, and one which can raise issues of "due process" under the constitutions or legal systems of certain countries as noted in the staff paper. More broadly, the SDRM approach would require a good deal of time to implement.

We appreciate the staff's efforts to address concerns that have been raised by various parties regarding the original design of the SDRM, and in particular to scale back the role of the IMF. Good policy depends upon respecting the rule of law and the direct relationship between the debtor and its creditors, with very limited and appropriately defined interventions from the official sector. Ongoing consultations with concerned parties may suggest further scope for decentralizing the SDRM and considering further the need for and role of the SDDRF.

Scope of Debt

We agree that there is value in a simple, targeted approach to the scope of debt, particularly in the initial stages. The framing principle of excluding debts covered by existing domestic insolvency procedures seems reasonable. However, we must acknowledge that some domestic insolvency regimes may not be well-developed or the judicial systems which apply may not be robust; therefore, some caution on application of the exclusion principle is needed. In addition, it will be important to fully consider the concerns of some market participants that debt covered under a formal, well defined structure like the SDRM effectively would be subordinated, as the SDRM would make it easier to restructure eligible debt versus excluded debt. The paper properly emphasizes that the sovereign would have to provide full information as to how it intends to treat claims that are not restructured under the SDRM, but it also makes clear the complexities, including those that may arise from differing time horizons for treatment and related sequencing issues.

Any principle that includes certain debts while excluding others also runs the risk of being subject to loopholes and/or perverse incentives. For example, on the exclusion of privileged claims, we have reservations about possible shifts in issuance toward increased collateralization and the potential implications for financing flows. We question whether reliance on negative pledge clauses to limit possible increased collateralization is feasible. Separately, the paper raises interesting questions regarding the treatment of guarantees and other contingent claims. How to handle derivatives contracts that have or have not been terminated raises a host of practical issues, which require further consideration. More broadly, while the paper does an excellent job in highlighting the difficult issues regarding the scope of debt and the relationship between covered/excluded debt in a comprehensive debt restructuring, we remain unclear about how some of these complexities will be resolved in practice. We also have concerns whether adoption of generally applicable rules will be feasible, as the level of debt in each category (e.g., matured versus contingent) can affect the appropriate treatment.

Finally, on the issue of official debt, we agree with staff that particular international financial institutions, such as the IMF and the World Bank, have preferred creditor status; there is no question that these institutions will not be subject to restructuring under the SDRM. However, there are also other regional or multilateral groupings and/or financing arms which have asserted, erroneously in our view, that they too should be treated as having secured preferred creditor status. To ensure that the practice of conferring preferred creditor status is not overly broad, there is a need for a concrete and restricted definition of multilateral financial institutions in this context. On the specific issue of inclusion of official bilateral debt, we are not prepared at this time to take a position on the treatment of Paris Club debt.

Activation

If the SDRM were to be adopted, the debtor should have the ability to activate the SDRM when it has come to the judgment that its debt is unsustainable. We should be very clear, however, that activation is not a decision that should be taken lightly. That said, the incentive structure of the SDRM and the ability of creditors to terminate the mechanism should serve to discourage a debtor from activating the mechanism when its debt is sustainable, even without independent verification of debt sustainability, including from the IMF. Thus, we do not see a need for an independent verification of debt sustainability, including from the IMF. We recognize that the IMF for its own operations will assess the sustainability of a sovereign's debt and this will continue to inform the IMF's lending decision, but we see no benefit and substantial downsides to any kind of direct or formal linkage between these processes and decisions regarding activation of the SDRM.

Stay

We share the staff's concerns about the practical difficulties in implementing a generalized stay on enforcement under any SDRM, and this deserves further analysis.

We find the "hotchpot" approach interesting, noting that it has strong precedents in private sector restructuring. However, the lack of inter-creditor disputes in the sovereign restructuring area to date may indicate that this may not be an important area to pursue. We do have questions regarding the advisability and practicability of the proposal to give the SDDRF powers to enjoin specific enforcement provisions, even if based on majority creditor instruction. We view the high cost of further intrusion on contractual rights by granting the SDDRF an ability to enjoin specific enforcement provisions—and the further complexity this feature raises for compatibility with national law—as exceeding any possible benefit.

Creditors' Participation

Creditor Representation: We do not think the SDRM should stipulate any particular form of organization for creditor representation. Rather, we believe that whether or not creditor committees are formed is best left to market participants.

Voting Threshold: A voting threshold of 75 percent of total outstanding principal appears reasonable, though it will be important to ensure that there is broad consultation on this point. It may be appropriate to apply a lower threshold for early termination; we look forward to the views of key stakeholders in this area.

Classes of Debt: The number and types of classes of debt to be included in the SDRM should be as flexible as possible so as to allow for different restructuring terms. While, again, we believe it is premature to support the inclusion of official bilateral debt at this stage, we would agree that any official bilateral debt that is covered by the SDRM would need to be considered as a separate class of debt in any SDRM framework.

Priority Financing: We appreciate efforts to facilitate priority financing via the SDRM. However, we note that the provision of priority financing raises difficult questions that are not easily resolved, including in reference to the preferred creditor status of IFI financing.

Restructuring Agreement: It is not entirely clear how sequencing issues will be resolved across different classes of debt within the framework. In addition, we are concerned that failure to reach an agreement on one class of debt could stall the entire process.

Sanctions

With respect to the provision of false information, lack of information, or inappropriate use of the framework, we favor leaving the sanctions to the debtor and its creditors in terms of their ability to terminate the SDRM process. At the same time, footnote 26 provides a good example of a possible creditor-designed sanction. We would also be cautious about any kind of formal, rigid linkage to the Fund's Lending into Arrears strategy, given the importance for the Fund to maintain a flexible and independent perspective in assessing the appropriateness of such lending on a case-by-case basis.

SDDRF

Recognizing the substantial efforts to reduce the role of the SDDRF in the redesigned framework, we continue to wonder whether the kind of binding oversight the SDDRF is envisaged to have is necessary for the operation of the mechanism. For instance, administrative functions could be performed by independent auditors, and we tend to think that debtors and creditors can decide whether a creditors' committee is sufficiently representative—not the SDDRF. In addition, it remains unclear whether the SDDRF should have any role in deciding whether there is a stay of enforcement. We are also concerned about how the SDDRF would be financed. This issue will need to be thought through carefully.

On questions of constitution and administration, it remains unclear to us, particularly in light of the expressed concern regarding the role of the Fund in the SDRM, why the Managing Director has a role in the formation of the SDDRF panel or the appointment of panel members to the secretariat.

As proposed, the SDRM would be established through an amendment of the Fund's Articles of Agreement. This will require U.S. Congressional authorization. We would have to consider the issue of consistency of any definitive SDRM proposal with provisions of the U.S. Constitution guaranteeing due process of law, as no federal law or treaty may override our Constitution.

We believe that each IMF member should also consider carefully the issue of compatibility of the SDRM with national law.

Future Amendments

We would like to highlight that under no circumstances would we accept an amendment that would allow the mechanism to be amended with any less than 85 percent of the voting power.

The staff representative from the Policy Development and Review Department (Mr. Fisher), responding to questions raised by Directors regarding the issue of a comprehensive stay on litigation, recalled that the very early staff papers had indeed talked about a comprehensive stay, as had been remarked in some of the statements submitted by Directors, which noted that the staff had modified the proposal. In a corporate context, the comprehensive stay was a familiar concept which tended to be combined with an interruption in debt service payments. Companies would halt almost all debt service payments and only maintain operational expenses. At the same time, the company would operate under the supervision of a court. That produced a symmetric arrangement that protected the company and ensured intercreditor equity.

In the sovereign context, the staff was not advocating an automatic interruption in all payments by the debtor, the staff representative clarified. A comprehensive interruption of payments by a sovereign would likely bring about a banking crisis and capital flight in many cases, which could in turn lead to the introduction of exchange controls, thus bringing the payments system of the entire country to a standstill. That had to be avoided, and the aim was to restructure the sovereign debt without such a disruptive process. Hence, ideally, countries would restructure their debt without any interruption in payments and conclude the restructuring before there was an actual default. However, even in cases where a default occurred, it would be desirable to maintain certain types of payments on certain types of debt, particularly those necessary to keep the banking system operational. While it was possible to interrupt payments to foreign bondholders, interrupting payments to banks for an extended period would inevitably produce difficulties for the entire banking system. In the absence of the symmetry brought about by a comprehensive stay in the corporate context, the staff had wrestled with the question of how to strike an appropriate balance between the following two competing objectives—to ensure that the restructuring was not disrupted by creditor litigation and, at the same time, to limit the intrusion into investors' contractual rights. The concern was that, if one went too far in limiting creditor litigation, the efficient operation of capital markets could be undermined and a mechanism designed to handle only a few rare and extreme cases could end up damaging capital flows to the bulk of the emerging market economies.

The staff representative from the Legal Department (Mr. Hagan) stated that the proposal currently before the Board did indeed differ from that presented in November 2001. However, in the view of the staff, the significant change to the proposal had already been made in February 2002. Then the staff paper had proposed that, in principles, the stay would be based on the decision by a qualified majority and would hence be an instrument to address intercreditor equity issues and could not be used unilaterally by the debtor against the creditors. The paper currently under discussion addressed two additional issues of great importance. The first was the question as to whether a creditor-driven stay should be generally applicable or targeted to prevent only particularly disruptive litigation. Thus one of the main issues for discussion, as Mr. Brooke had pointed out in his statement, was the relative advantage of a general versus a specific stay. The second issue concerned the period after the activation when creditors were still organizing to vote and the question as to what could be done to create a disincentive for litigation. The staff paper discussed a number of options in that regard. One was the hotchpot rule and another one the possibility of using a creditors committee as a proxy for the decision as a stay pending creditor organization.

The Acting Chair (Ms. Krueger) remarked that it was intended to publish the staff report together with the summing up once the summing up had been finalized. It would also be made clear to the public that this was work in progress.

Mr. Wijnholds considered the suggestion to place the staff paper on the Fund's external website as problematic, given that Directors did not all agree with the approach taken in the paper. Thus, it was necessary, at a minimum, to have an explanation that there were several options all of which were still on the table and that the proposal contained in the paper was by no means accepted by many members of the Board. Sending copies of the paper to the speakers at the upcoming conference was a different matter and did not pose a problem.

Mr. Duquesne expressed surprise that the Acting Chair suggested publication of the staff report, given that several Directors had expressed concern in that regard for reasons which he shared. In his view, the staff paper should not be published as it stood.

Mr. Portugal supported publication of the staff paper, as that was the policy applying to policy papers and as it would help the discussion.

Mr. Andersen considered that, regarding publication, the rules applying to the current case were not entirely clear and the Board seemed to be in a gray zone in that regard. The SDRM was work in progress, and in previous cases that had been used as an argument against publication. His chair was, however, very strongly in favor of transparency and it was very important that the participants at the conference in January had the necessary background information. Therefore, it was advisable to be somewhat more pragmatic in that case and to underscore in the introduction some of the points made by several Directors about some of the key issues under consideration and that various options were still on the table.

Ms. Jacklin also supported publication of the staff paper together with the summing up and a clarification that it was a working draft and that there continued to be a variety of positions by Executive Directors on the issue. Given the considerable public interest in the item before the Board and the amount of detailed thought, there was probably some awareness in the marketplace that a Board meeting was being held. In view of that, it was useful to publish the information in the appropriate context, particularly with the Spring Meetings coming up, which would also receive considerable press coverage.

Mr. Bennett supported publication of the staff paper with the appropriate disclaimers and the summing up. While it was work in progress, there were probably precedents for publication of staff papers even in such cases. The informed community outside the Fund recognized anyway that it was work in progress, given the considerable changes since its inception.

Mr. Zurbrügg supported publication of the staff paper, as that would increase the level of knowledge of private market participants, which was currently rather low. It was clear from the staff paper that there was not a unified position at the current stage and that this was obviously work in progress. With regard to the usual practice of not publishing work in progress, one could compare the SDRM to the discussions about PRGF-supported programs where the Board was interested in reactions from the NGO community and bilateral donors. Similarly, the Board was now interested in the reactions from the private sector and the academic community. Hence, the benefits of publishing the paper greatly outweighed the costs.

Mr. Wijnholds clarified that he had not objected to publication as such, but to publishing the paper in its current form. There should be some explanations and some editing to make clear that many issues were still open. In its current form, the paper did not make it clear. If the paper were to be published as it stood, the impression would be created as if it represented the direction of the Board's discussion on the SDRM, which was not exactly the case. Thus, he did not agree with Mr. Zurbrügg's view that the paper showed where the Board stood at the moment. That was not the case. Publishing the paper only with the summing up would not be sufficient as a clarification and an additional clarification would have to be added.

Mr. Brooke strongly supported publication of the staff paper in its current format as had been suggested by Mr. Zurbrügg and others. That would be important for ensuring a well-informed debate outside as well as inside the institution. A well-crafted summing up should be able to reflect the views of the current discussion and also to inform outsiders on areas where the Board had not found a common position concerning the direction that the SDRM proposal should take.

Mr. Portugal considered that the staff paper reflected the position of the staff, not of the Board or the Fund. That should perhaps be clarified in the context of the publication policy. Both the staff paper and the summing up should be published together. The fact that previous papers on the subject had already been published was an additional reason why his chair supported publication of the current staff paper.

Mr. Duquesne considered that Mr. Portugal's suggestion that the paper only reflected the staff's view was not entirely accurate, given that it would also be regarded as the view of management and of the First Deputy Managing Director in particular, given that her name was closely attached to the SDRM proposal. It should not be ignored that this would be the impression created in the public. While the publication of the summing up along with the staff paper could help to clarify matters, particularly if the distinctions were made plain in the summing up, it was nonetheless preferable to include the views of Directors into the document before its publication. Hence, the preferred options were to change the text of the paper considerably in view of the current discussion or not to publish the paper given that it was work in progress.

Mr. Yagi supported publication of the staff paper as it stood. This was advisable in view of the schedule for the upcoming conference.

Mr. Padoan considered that one of the values of the conference was for the Fund to propose to the public or to the experts involved options on which they should express their preferences. For that reason he supported Mr. Duquesne's view on publication. However, if the paper were to be published, that should happen together with the summing up of the current discussion and also with explanatory cover note saying that the Board would like to offer to the public debate options and that the staff paper reflected one view which was not necessarily fully endorsed by the Board. It should be made clear to the outside experts that they were called upon to express their preferences on options that should be clearly stated.

Mr. Beauregard supported publication and agreed with Mr. Padoan's proposal about its modalities.

The Acting Chair (Ms. Krueger) suggested that management would consider a form in which Directors' comments regarding publication of the staff paper and the summing up could be taken into account and the different views accommodated. She would make a proposal to that effect before presenting the summing up to the Board.

The staff representative from the Policy Development and Review Department (Mr. Fisher), responding to questions raised by Mr. Padoan about the role of the Fund in debt negotiations, said that the Fund would continue to operate within the guidance that had been provided by the IMFC and that debt negotiations were hence primarily a matter for the debtor and its creditors. The Fund would operate much in the way as it had done in the 1980s by working closely with the member concerned on developing a medium-term framework and an understanding of the capacity to make debt service payments. Also, at the request of the member, the Fund would assist at the committee level. Similar mechanisms had been used in the context of the deals reached regarding Brady bonds.

On Mr. Wijnholds's and Mr. Andersen's questions about coordination between restructurings under the SDRM and those done in parallel elsewhere and the possibility of using comparability-of-treatment clauses, the staff representative considered that it was, in principle, possible to envisage a contractual approach in which SDRM restructurings came into force conditional on various other events, in particular other creditors agreeing to restructure on specified terms. However, that would be rather cumbersome in practice, and it was more likely that agreement would be reached with a certain degree of inter-creditor equity after a period of negotiations, as was generally the case in corporate workouts.

On the question of trade credit and the suggestion by some Directors to exclude it, the staff representative considered that its exclusion would raise the problem of circumvention. A number of distinguished practitioners had told the staff that in the experience of the 1980s, where trade credit had in many cases been excluded, there had been efforts to describe any loan as a trade credit, whatever its actual underlying purpose. Hence, simply using a documentary test would not be sufficient and an economic test had to be applied to establish the nature of the credit in question. The general principle had been that commercial banks and the Paris Club restructured medium- and long-term debts, leaving short-term trade credit free to run. However, there had been a number of cases where the nature of the underlying problem was such that trade credit had to be included in the restructuring, possibly under somewhat different terms. In view of that, it would be appropriate also under the currently envisaged mechanism to have a sufficient degree of flexibility to allow the inclusion of trade credit, where that was required.

Mr. Portugal considered that circumvention would not be a serious problem. However, the fact that the staff was arguing in that way seemed to suggest that the staff did not place much trust into the mechanism that it advocated. Otherwise, why should someone want to circumvent something that was supposedly of good quality. Similarly, and following up on a question raised by Mr. Daïri in the recent seminar, Mr. Hagan had agreed that creditor and debtor would have right to stipulate in the contract that they would never use the SDRM, given that it was a voluntary scheme. That would also be a form of circumvention. With such a major permissible avenue for circumvention, why should the staff be concerned about circumvention in the small area of trade credit?

The staff representative from the Policy Development and Review Department (Mr. Fisher) responded that the circumvention issue that he had in mind regarding trade credit referred to the likelihood that creditors who perceived that there was some priority given to trade credit would inappropriately attempt to wrap themselves in that cloak, so as to obtain priority treatment for themselves. The issue of the voluntary nature of the SDRM was somewhat different from the issue of circumvention as such. Any member was free to declare whether as a matter of public policy or of contract, it would not use the SDRM. However, the contractual implications of such a declaration were not clear, given that a country in default had broken the most important covenants in the loan agreement, which were the payment terms. After such an event and under such circumstances, it was difficult to determine how much credibility could be put on the adherence to other covenants. Whether that had any significance at all would be for the country's creditors to consider.

On the question of the role of the Fund in activation and in particular regarding the concerns raised by the private sector about the Fund's judgment being influenced by considerations of political economy, the staff representative clarified that the latter formulation in the staff paper referred to the judgment of the Executive Board. The staff had separately referred to the judgment of management and the judgment of staff, recognizing that, on occasion, there was some divergence.

On whether there was a need to have a program in order to activate the mechanism, the staff representative stated that this was not the case. One could expect that most cases would occur in a context of a financial relationship with the member having come to an end because of a lack of sustainability under the catalytic approach. However, that was by no means a formal requirement, and it was conceivable that countries would approach the point of unsustainability in their debt without having a Fund arrangement.

On Mr. Portugal's question as to whether official bilateral creditors could not form an optional creditor class, the staff representative informed that discussions with the Paris Club creditors had indicated that, if they were included, they would only be included as a separate class because of their special status. There were some strong analytical reasons to support that argument. Thus, their decision-taking procedures were entirely different from those of the private sector, their motivation for lending was different, and they were in a somewhat different economic situation. More importantly, they traditionally restructured debt on rather different terms than the private sector. The Paris Club was typically willing to extend maturity by very long periods, with very slow amortizations, and with interest rates that were typically only a small spread over their own cost of funds. That was very different from restructurings that would be marketable to the private sector. If one were to have a single creditor class, the same menu of instruments would have to be offered to everybody within that class. In the interests of reaching an agreement, it made sense to separate out those defined blocks within which very different repayment terms would be offered.

Mr. Portugal wondered why the various differences between private sector and bilateral creditors listed by the staff would not allow bilateral creditors to form an optional class. He was not questioning that bilateral creditors should be in a separate class. The question was rather why they had to be a mandatory class and could not form an optional class. Even if they constituted an optional class would bilateral creditors be in a position to be offered very different terms for debt restructuring?

The staff representative from the Legal Department (Mr. Hagan) responded that a mandatory creditor class would be formed for the purpose of protecting creditor interests. That was warranted when a group of creditors had such fundamentally unique interests, that they needed to be separated from other creditors. If that separation were not made, there was a risk that creditors with a particular set of rights would outvote creditors with a very different set of rights. The classic example for that was the distinction between secured and unsecured debts and their treatment in a restructuring. The only mandatory creditor class would be the Paris Club, given that the interests of Paris Club creditors were fundamentally different for the reasons already cited. An optional creditor class would be formed not for purposes of protecting creditor interests, but rather to facilitate a restructuring by giving the debtor the option of offering different terms to different creditors. That was the basis for making the distinction between mandatory and optional creditor classes.

With regard to the issue of the general stay and concerns expressed by Directors that the staff's consultations had mainly been with creditors, the staff representative clarified that many of the specific issues discussed in the staff paper on the design of the stay had been generated during a two-day workshop with members of the legal and judicial profession that represented both creditors and debtors. The attorney who had been most vocal about modifying the stay and suggesting something much more specific, was a person known for representing sovereign debtors. There had to be a recognition that to the extent to which a stay represented a significant intrusion into contractual rights, there was a concern that it would raise the cost of borrowing. Thus the question arose to what extent the stay could be calibrated to effect what was needed but nothing more. While the question as to where that line was is a matter of debate, it should be noted that this was not just a concern for creditors but also for sovereign debtors.

Responding to issues raised about the scope of claims, and in particular Mr. Portugal's request to clarify what was meant by a commercial activity of a sovereign, the staff representative noted that the staff would like to elaborate on those important issues in the next paper. The intention was to perform a test to determine the extent to which an activity could be engaged upon by a private party. If the result were to be positive, the activity would be deemed to be commercial. It was not intended to mean that borrowing for a non-commercial purpose would be excluded. The thinking followed in some respects the analysis used in domestic legislation, including the U.S. foreign sovereign immunities act. The concern expressed by Mr. Portugal that the existing language did not clarify sufficiently that the only debt to be included in a restructuring was debt governed by a foreign law and subject to the exclusive jurisdiction of a foreign court highlighted the usefulness of having a draft of a text of an amendment. In the view of the staff, the scope should be formulated along those lines and not as an exclusion.

On the concerns expressed by a number of Directors regarding voting thresholds, the staff representative acknowledged that more clarity on that issue was desirable. For purposes of calculating the voting majority, the denominator would not comprise all claims on the restructuring list, but be limited to those claims on the restructuring list that had been registered within the time frame required. Hence, the threshold of 75 percent referred to all registered claims. To the extent to which a creditor was on the restructuring list but failed to register, it would not participate in a vote, but its claims would be restructured, along with those who had registered. That procedure had some similarities with a quorum concept, in which the quorum would be defined by registration before a certain deadline.

Responding to questions about the SDDRF, the staff representative recalled that, as a general principle, the powers of the SDDRF would be limited to the resolution of disputes. The staff paper had introduced two possible exceptions to that rule, which did not appear to be popular with Directors, and the staff would make adjustments in line with the views expressed in that regard. The first exception to that principle had been the possibility that the SDDRF could terminate the mechanism early if there were to be a stalemate. The motivation for introducing that power was related to cost saving, given that having the SDDRF operational without any progress was undesirable. The staff recognized that it might give the impression that the SDDRF was playing a more active role in the process, and did not consider the feature essential for the mechanism, as creditors would have the power to terminate the process early at the end of the verification process. The second exception was the possibility that the SDDRF would be making the judgments on the targeted stay. The staff would review this option.

On the establishment of the SDDRF, the staff representative considered that there seemed to be progress in narrowing down the acceptable options. While several Directors wanted to reintroduce the Executive Board into the process, others preferred to create additional distance between the Board and the mechanism. The assumption had been that to address issues of the politicization and the voting power, the Executive Board's role in the appointment process should be minimized. While it appeared difficult to avoid an appointment by the Managing Director given that the personnel had to be paid and needed a contract as well as the privileges and immunities of the Fund, there seemed to be progress also in that regard.

Mr. Portugal thanked the staff for accepting his point that the definition of the scope of claims, instead of being all-encompassing, should be targeted. With regard to the scope of claims, some questions remained open. While his impression had been that, from the beginning, the mechanism was concerned with sovereign debt only, the staff had suggested to include several types of nonsovereign debt, which could raise problems. One example was the case of subnational government debt.

With regard to the process of amending the Articles of Agreement, Mr. Portugal requested that the staff point out in the Articles of Agreement to those that were closely related to the function that the SDRM would perform, given that this had been the staff's argument for suggesting the use of the faculty of amending the Articles of Agreement. The description of the amendment process given by the staff seemed to suggest that a proposal of amendment could be approved in the Board with a simple majority, instead of a majority of 85 percent. However, such an approach could pose a problem, if there were to be insufficient support among members to ratify the amendment with the required 85 percent. In that case, there would be an amendment that could not enter into force. Under such circumstances none of the benefits of the mechanism would be realized, while the costs in terms of heightened uncertainty and fears of the private sector would increase. Was it management's intention only to proceed if there was an 85 percent majority in the Board?

The staff representative from the Legal Department (Mr. Hagan) responded that to submit a proposed amendment to the Board of Governors a majority of the votes cast in the Executive Board would suffice and the Board of Governors could submit the proposal to the membership with the same majority. However, at that stage, the higher majority—85 percent of the voting power and three-fifths of the members—was required. There was currently an amendment that had been proposed but had not been ratified by the membership. The hope was that in the case of the SDRM the necessary consensus would be reached in the Board.

The Acting Chair (Ms. Krueger) considered that management would want to address that problem only once the discussions had moved forward sufficiently. However, apart from the legal element, there was also a pragmatic element involved in that decision. It would not be appropriate to move forward, if the required majority could not be reached.

The staff representative from the Policy Development and Review Department (Mr. Fisher), responding to Mr. Portugal's question about the treatment of debt of subnational governments and state-owned enterprises, noted that the earlier proposals had indeed not discussed that possibility. The earlier proposal had been somewhat more general in nature, but when entering into the detail it became clear that, in some cases, subnational governments had been able to make international bond placements. When a sovereign needed to restructure its debt in order to move the domestic fiscal accounts to a sustainable position, subnational governments had to be included into the exercise, and if a major collective action problem arose in resolving the situation of the subnational government, that could prevent the sovereign from achieving a sustainable position. It was therefore sensible that, in circumstances where there was no domestic legislative framework for resolving those issues, they could be brought within the framework of the SDRM.

The question of including debt of state-owned enterprises posed a slightly different problem, the staff representative considered. While the number of such cases was limited, there were state-owned enterprises that had been used as a conduit for the sovereign to borrow abroad because of their good credit rating. That was the case of mineral exporters and telecommunications companies, which had on-lent to the government. The borrowing had not been made for commercial purposes but clearly to support the government's budget. While one could exclude them from the restructuring, the experience of the 1980s suggested that creditors were not willing to accept that, as had been shown in the case of Mexico where PEMEX had been included in the restructuring. While it was impossible to predict whether that would also occur in the future, it was important to have a mechanism that could encompass state-owned companies. If there were no insolvency regime governing state-owned companies and if, as a result, a collective action problem arose, it made sense to fold that problem into the SDRM. Given that one of the principles of the SDRM would be that it would not override any existing statutory framework, the need for including state-owned companies under the SDRM would not arise, if a statutory framework were to be already in place. While the staff had noted the concern expressed by Ms. Jacklin that some of the existing statutory frameworks might have shortcomings, those were probably best addressed through domestic legislation rather than through the SDRM.

The staff representative from the Legal Department (Mr. Hagan), responding to Mr. Portugal's question regarding the specific provision in the Articles of Agreement that could be considered the enabling provisions for a proposed amendment regarding the SDRM, remarked that there was not one specific provision that anticipated the establishment of the SDRM. However, the original Articles of Agreement had not had a specific provision that would have anticipated the establishment of the SDR, which had nonetheless been established through an amendment of the IMF's Articles of Agreement. The question was to what extent the establishment of the SDRM was sufficiently related to the Fund's mandate. The staff recognized that this amendment was a fundamental one, because it would affect the rights of individuals and not just obligations between governments. It would thus actually have an impact on members' domestic law. The staff paper had noted that Article VIII, 2(b) represented an analogy, albeit without one expansive interpretation in many jurisdictions. That treatment of exchange controls under the Articles of Agreement was a close analogy to the amendment envisaged for the SDRM, which concerned the sovereign's own indebtedness. In addition, Article I, established as one of the purposes of the Fund to shorten the duration and lessen the degree of disequilibria arising from balance of payments problems. The SDRM would assist in furthering this objective since it would address the situation of countries for whom unsustainable debt had unusually high balance of payments costs.

Mr. Yagi wondered about the extent Fund involvement in the context of the activation of the SDRM. The private sector had apparently had misgivings about the Fund's involvement, and it should be clarified whether those misgivings only concerned the activation of the mechanism or also the Fund's judgment about debt sustainability. If that was the case, it was not clear as to why there was no Fund involvement foreseen in the initial stage, while the Fund would be clearly involved at a later stage.

The Acting Chair (Ms. Krueger) agreed with Mr. Yagi that the Fund would inevitably be involved in one way or another through its role in helping members understand the prospects for the balance of payments and debt sustainability as well as through its financing role. The point that had been raised in the staff paper had simply stated that the staff's contacts with the private sector suggested that they did not consider Fund involvement in triggering the mechanism would protect them against misuse, because of the political considerations. It was somewhat troubling that, according to recent statements from a number of trade associations, they seemed to want to take the Fund entirely out of the mechanism, even when sustainability issues were concerned. That neglected the fact that, as a financial institution, it was inevitably the responsibility of the Board to assess the circumstances in which it was appropriate to lend Fund resources.

Mr. Kiekens made the following statement:

> I am grateful for the staff's good work in presenting concrete proposals for a sovereign debt restructuring mechanism, as requested by the IMFC. An orderly process for dealing with insolvency is an essential institution in a well functioning market economy. Well designed bankruptcy procedures enhance market discipline, protect—to the extent possible—creditors' claims, and ensure fair and predictable treatment of creditors. This requires that insolvency procedures be transparent. In all jurisdictions, the administration of bankruptcy procedures is largely the responsibility of public authorities, particularly the courts or court appointed administrators or liquidators, although creditors themselves may have important collective decision making powers under bankruptcy provisions.
>
> Just as orderly insolvency procedures are a necessary institution of a market economy—and the Fund has many times rightly insisted that countries adopt adequate bankruptcy and foreclosure procedures—an orderly mechanism for restructuring sovereign debts—both external and domestic—is an essential component of a well functioning international financial system.
>
> Until now, creditor rights against sovereigns have often been very limited, as the assets of sovereigns generally enjoy immunity of attachment, unless it is specifically waived. Organizing an orderly debt restructuring mechanism would clearly enhance the protection of creditor interests. I remain perplexed by the perseverance—or should I say short-sightedness—with which representatives of creditor interests continue to oppose any kind of statutory SDRM. To me, their attitude clearly reveals moral hazard, as

creditors seem to believe that in the absence of an SDRM their claims will be better protected since they will be bailed out by the Fund and other public lenders. This is why several Directors insist on hard lending limits for the Fund, to reduce creditors' propensity to reject a restructuring proposal under a soft SDRM.

I would rather prefer to preserve a large discretion for the Fund to decide on exceptional access, and to establish a more far-reaching SDRM than that proposed today. Such a stronger SDRM would make it possible to suspend and reduce—at least temporarily and possibly only on a contingency basis—creditor rights by decision of an independent, impartial international authority. This authority would be bound by the rule of proportionality and comparability. The rule of proportionality would limit the scope of the restructuring to the minimum needed to restore debt sustainability. The rule of comparability would ensure that the burden of the restructuring is fairly distributed among the creditors.

The gradual softening of the SDRM proposals since November last year are efforts to foster consensus or at least to break down the resistance of private creditor groups. Well-intentioned as it may be, I fear that this process will lead to excessively cumbersome procedures involving all creditors, but in which in the end many if not most of them will have to accept decisions made by others, not public, independent, impartial professional judges but creditor groups who may be either excessively reluctant to accept reasonable proposals by a debtor country or who are excessively complacent because they have bought their claims on the secondary market at deep discounts.

I therefore join Mr. Andersen, Wijnholds, Padoan, and others in asking the staff to not to become too accommodating with respect to calls to dilute the statutory approach. A sovereign debtor should be able to asks protection against creditor and obtain a temporary stay of creditor litigation, but only when an independent, impartial international authority has confirmed that the country faces an unsustainable debt.

The staff's latest proposal gives the debtor country substantial discretion, even after defaulting, to decide whether or not to activate an SDRM procedure. The proposal also makes it possible for a majority of creditors to reject or terminate an SDRM procedure. I strongly insist on the public interest character of the SDRM. Countries should not be allowed to renounce, before defaulting, the protections of the SDRM. In other words, borrowing countries should not be allowed to promise their creditor that they will never activate the SDRM. Today, individual creditors can protect their rights by rejecting collective action clauses in bond contracts or syndicated loans. We should avoid that this status quo can be preserved notwithstanding the establishment of an SDRM by creditors stipulating that borrower countries must promise never to activate the SDRM procedure. If such clauses were permitted, they would not only substantially erode the SDRM's provisions but would also significantly increase uncertainty about creditor rights. Indeed, bonded claims that contain a clause excluding SDRM procedures would de facto have seniority over claims that lack such escape clauses.

Similarly, instead of giving a majority of creditors the right to reject an SDRM procedure after a sovereign has defaulted, we need to protect minority creditors with stricter rules guaranteeing pari passu payments among all creditors except for secured and preferred creditors, who must be paid first.

The discretion for debtor countries to decide which debt to include in the SDRM and which to continue paying in full, or not at all, is at odds with the principle of pari passu payments and comparable treatment of creditors.

The latest proposals align the statutory SDRM more and more closely with the contractual approach of collective action clauses. Their most serious shortcoming is the exclusion of the automatic stay on creditor litigation and the absence of an authoritative independent assessment of the sustainability of the debt. Even so, the proposal still has significant merits:

1) The SDRM would apply to existing debt contracts, and would therefore overcome the stock problem under the contractual approach;

2) The statutory approach will facilitate the aggregation of debt across different instruments, at least if clauses excluding the SDRM would not be allowed;

3) The SDRM makes it possible for private creditors to grant new credit to a country in crisis on a preferred repayment basis, and without the need for the debtor country to use assets as collateral;

4) The amendment of the Article of Agreement to establish the SDRM would provide an explicit legal basis for the Fund's preferred creditor status, which is by no means a negligible detail.

When the Fund has an indisputable preferred creditor status, we should reflect on the rationale for asking large interest premiums for credit risk that is largely mitigated by that preferred status. Granted, even as a preferred creditor, the Fund faces significant risk. Only experience will show whether the today's interest premiums are excessive. If after some time it appears that the reserves built up by these interest premiums are excessive, we should consider returning the excess amounts to the borrowing countries who paid them.

The staff, in reply to Mr. Portugal, confirmed that the debt of sub-national governments, public enterprises, and the central bank, may be included in the SDRM when the central government so decides in agreement with the relevant authorities. I would like to stress that in such instances, the restructuring agreements must be parallel and cannot be consolidated under a single overall restructuring, as the staff rightly confirms in paragraph 46 of the paper. In paragraph 38 the staff argues that the activation of the SDRM for the central bank's debt would require the central bank's consent where that bank is independent. I think this is a slip of the pen, since from the legal viewpoint the central bank's consent will be necessary in all cases where it is a distinct legal entity, irrespective of its political independence.

Let me now consider some more technical issues raised by the staff.

I broadly agree with the new proposals on the scope of the claims to be covered by the mechanism. The SDRM should only be used where there is a problem to be solved. It should not replace well-functioning debt restructuring procedures already in use. As sovereign debts governed by domestic law can be restructured by the act of the sovereign, they should not be included under the SDRM.

The claims of most bilateral creditors have successfully been rescheduled under the auspices of the Paris Club. No serious collective action problems have emerged. There is thus no overwhelming need to include official bilateral credits in the SDRM. But doing so would have the advantage of also including the claims of non-Paris Club official creditors. I would like to hear more from the Paris Club members themselves. One work on the relevance of the SDRM for poor countries, including HIPC countries. For most of these countries, debt to the IFIs and official creditors is by far the most important part of their external public debt. Even if those kinds of debt were excluded from the SDRM, this mechanism would not be irrelevant for the HIPC Initiative countries. Experience shows that serious difficulties in implementing the HIPC Initiative may arise as private creditors, particularly vulture funds, aggressively pursue their claims in court in total disregard of the letter and spirit of the initiative. With an SDRM in place, this free rider problem would be largely solved.

As to the nature of the claims, the SDRM should not only include the repayment of money lent, but also deferred payment obligations under contracts for the purchase of goods and services, and amounts due after the cancellation of such contracts.

As I have said, I still believe that an independent confirmation of a country's representation of debt unsustainability is necessary, if the activation of the SDRM involves and automatic stay of creditor litigation. To avoid perceived conflicts of interest, such an assessment should be made by an independent, impartial international authority distinct from the Fund's present organization. However, if there is no automatic stay of creditor litigation, such an independent assessment would not be needed.

Like Mr. Andersen, Mr. Wijnholds, and others, I am concerned by the exclusion of a general stay of creditor litigation. The proposed "hotchpot" rule, and the injunctive relief orders issues by the SDDRF, are only second-best measures that make disruptive litigation less attractive. It seems justified and acceptable to give the SDDRF the power to issue an order that would enjoin specific enforcement actions.

If the restructuring of claims is made dependent on a majority decision of creditors, a qualified majority of creditors should also have the power to halt the SDRM process, if after review and verification they conclude that the activation is unjustified.

One word on sanctions. The staff suggests that the provision of false or inaccurate information by a debtor country in the course of SDRM procedures would be a breach by that country of the country's obligations under the Fund's Articles of Agreement. I am reluctant to go that road. The consequences of providing incorrect information, and of improper behavior during debt restructuring negotiations, should be ruled by the law that governs the restructuring agreement or the debt issued as a result of that agreement. Of course, the Fund can consider such incidents when evaluating a debtor country's good-faith stance in its negotiations with its creditors.

It is too early for a thorough investigation as to whether domestic legislation will need to be amended to give the newly established SDRM full effect. When the work of drafting the new amendment of the Articles of Agreement is more advanced, we could submit this issue to our authorities, preferably by means of a carefully worded questionnaire prepared by the staff.

There has already been a lot of discussion on the publication of this staff paper. When discussions have not been completed, it is our principle not to publish the paper, except when informing the public of the state of the discussion would be useful. (See paragraph 11 of the Board's decision of January 4, 2001, on Publication Policies of the Fund). The Board must therefore assess whether informing the public about the state of these discussions is useful, and if so, make sure that the published documentation fairly and reliably represents the state of the discussions. I therefore think that the paper should clearly indicate that various options are still under active consideration, and should be accompanied by a press information notice about the views that were expressed in the Board today.

Mr. Maino made the following statement:

We welcome Staff's paper revisiting the rationale, principles and design of the operation of the Sovereign Debt Restructuring Mechanism (SDRM). We are grateful for the extensive and candid discussions during the two recent workshops with management and Staff that shed more light on this difficult topic.

General Considerations: Rationale and Guiding Principles

We concur with the idea that the SDRM has come a long way since the pioneering original suggestion offered last year. As such, it has suffered modifications and revisions that open new questions. As Mr. Padoan and Mr. Bossone clearly underlined, the change in nature in this "new soft version of the SDRM" involves loosing the automatic and universal stay on litigation and standstill on payment obligations following activation which would imply a shift in the logic of the mechanism that may soften the creditors' opposition.

We tend to share Mr. Portugal's concerns regarding the effective implications of holdout creditors, major collective action problems and creditor litigation in propelling delays in initiating sovereign restructuring; however, we believe it is a laudable objective to develop mechanisms for the orderly resolution of external crises. There is no doubt that a mechanism like the SDRM has a place in the international financial architecture, as a crisis resolution instrument, to facilitate the restructuring process for sovereign unsustainable debt. We do share this idea, under the general belief that this mechanism can enrich transparency and predictability of the restructuring process.

While adhering to the idea that the SDRM may become a useful element of the international financial architecture, there is a long way ahead, in part, a bumpy ride, considering that now the Staff is submitting a document with ample modifications to the original proposal. Therefore, as Mr. Portugal has underlined in his preliminary statement, we appreciate the recognition, already expressed by management, that there is not yet a closed proposal. The design is still open for modifications and improvements.

Once again, we agree with a restructuring mechanism that helps promote the recovery of international capital flows and reduce borrowing costs. However, we still support the idea of complementarity with the collective action clauses approach. We have advocated complementarity between the statutory and the contractual approaches, as their concurrence could actually be beneficial, thus providing the basis for a rapid return to medium-term sustainability. Further work is needed not only on the resolution of the stock problem but also on the flow issues, in particular those linked to the nature and dynamics of regaining access to voluntary market financing.

Having said this, we value the appropriateness of the incentive structure—including adequate access to Fund resources even before considering SDRM activation- as an element to the formalization of a cooperative PSI framework. Let me turn to some specific topics that require clarification.

Scope of Claims

On the scope of debt to be covered under the SDRM, we note, once again, that striking the right balance between allowing debtors to overcome collective action problems—to attain a sustainable level of debt after restructuring—and intercreditor equity concerns is a complex undertaking. In this regard, the differences among creditors point to the desirability of their proper differentiation. A creditor classification that entails a certain degree of flexibility, taking into account the diversity of instruments and creditor-specific classes of claims, would be most preferable in keeping with the evolution of capital markets. At the same time, the creation of creditor classes could anticipate a potential risk associated with demarcation and cross-veto.

Consistent with market preferences, we see merit in the proposal to exclude the domestic public debt and private external debt from SDRM coverage. The debt restructuring framework should envisage sufficient flexibility, thus allowing the sovereign debtor concerned to determine the categories of public debt to be excluded in light of country-specific circumstances. In this regard, the necessary Fund technical assistance should be available in order to advance towards an efficient debt classification consistent with the need to reduce debt service.

Therefore, we would advocate a narrow approach to define ex-ante the scope of claims to be covered. We share the concerns raised by several chairs on the inconvenience of encompassing sub-national government debts, public enterprises debts, trade credit and inter-bank credit debts, and all the important loopholes associated with them. Needless to say, all claims of international financial organizations should also be excluded from the SDRM, as well as official bilateral debt claims, given that, as Mr. Padoan and Mr. Bossone mentioned, official and private creditors have different objective functions. In this regard, we concur with Mr. Wijnholds that a long history of Paris Club restructurings shows that there is no need to include official debt under this mechanism as the Club demonstrated, time and again, that it was efficient and fair in this respect. In any case, in the event of activation, official bilateral and private creditors should pursue a cooperative coordination.

Activation

Against the previous backdrop, Staff's suggestion as to whether it is necessary to provide an independent confirmation of the member's representation of unsustainability as a condition for activation, signals a departure from what we actually agreed upon here at the Board in previous meetings on this issue. The sovereign debtor, being cognizant of the full costs of exercising the option and having the exclusive authority to activate the SDRM has the sole responsibility and authority to activate the mechanism. The sovereign should be responsible for making the case for the activation and, if needed, it can ask the Fund for technical advice. As creditors may vote to terminate activation, if the group remains unconvinced about the need for a restructuring, it remains unclear why such an independent third party involvement in the analysis of sustainability would be needed.

At the same time, it should be kept in mind that the market dynamics also has a bearing on the decision once the pressure of unsustainability, for whatever reason, has become established. While this option could facilitate transparency and incentive-compatibility, the need for continuing support from the Fund during the restructuring process—in the context of its lending into arrears policy—remains key for an orderly process of economic adjustment and debt restructuring.

We see merit in the Staff proposal's of a voting threshold of 75 percent to approve the new restructuring terms, although we tend to agree with Mr. Portugal on the inconvenience to place a 40 percent threshold—above the blocking majority—for creditors to terminate the SDRM process. Additionally, we tend to believe that a period of 30 days, as proposed in the document, for verification might be too short to consider or even to challenge claims. In spite of our agreement with the staff's rationale for having abandoned the idea of a "stay" on litigation, we remain unconvinced about the new "hotchpot rule" as a solution for dealing with potential problems of litigation, given its lack of predictability. This mechanism reintroduces a lost incentive effect for creditors by including a right of injunction, as Mr. Padoan and Mr. Bossone underscored. We would also appreciate more specific details on the pros and cons of the new proposal under the new authorities provided to the SDDRF.

The SDDRF

Initially, it seems to us that the proposed powers and composition for the Sovereign Debt Dispute Resolution Forum (SDDRF) still raises a number or pending issues to resolve. As Mr. Portugal has underlined, some of the administrative functions that the SDDRF would perform could be undertaken by private entities. At the same time, the idea of conferring exclusive jurisdiction to the SDDRF over disputes among creditors and debtors might imply compatibility problems with national legislation. In this respect, we still wonder whether existing market practices are providing answers for these problems. In addition, we tend to agree with the idea by which the selection panel, responsible for choosing the members of the SDDRF, should be appointed by the Managing Director after approval by the Executive Board by a 70 percent majority.

Lastly, we hope to further discuss some of the specific economic implications and other technical considerations when the "companion paper" is presented at the Executive Board.

Mr. Bischofberger made the following statement:

We thank the staff for the impressive amount of work that has gone into today's paper. The paper constitutes a large step forward in terms of fleshing out the complex details of an SDRM and in terms of preparing a concrete proposal to be presented to the membership.

Before continuing, we would like to echo those Directors who have stressed the need to also carry on our work on related issues, including PSI, exceptional access, and lending into arrears. The staff's work on the companion paper is therefore highly welcome, and I look forward to discussing this paper in the near future.

At the outset, let me emphasize that this chair continues to share management's and staff's convictions on the need for a SDRM. We endorse the proposed guiding principles including in particular the notion that the SDRM is not intended to displace existing statutory frameworks. It may also be useful to step back and recall the broader objective of this exercise which is to foster sustainable economic growth by restoring debt sustainability and access to capital markets. Maybe this could be reflected more clearly when spelling out the rationale of the SDRM.

As to the specific elements of the mechanism, we are in broad agreement with many of staff's proposals, although we have yet to reach a firm view on some of them.

One important such point concerns the fact that the staff now rule out any type of general stay of litigation. Our thinking on this issue is similar to that of a number of other Directors, including Mr. Andersen, Mr. Padoan, Mr. Zurbrügg, Mr. Wijnholds, and Mr. Kiekens.

In my further remarks, I shall begin with the issue some Directors have addressed under the heading of "SDRM light". I shall then, while trying to be brief, comment on a few other issues, including the scope of claims, activation, and priority financing.

We are not fully convinced that litigation will occur only in limited cases. The risk of a "grab race" before the courts in the run up to a restructuring agreement cannot be discarded. This risk may even increase within a SDRM framework in particular with a 75 percent voting majority in place, making restructuring negotiations a potentially lengthy exercise. As to the hotchpot rule, we agree with the staff that there are limitations to its effectiveness. As to the option of specific injunctive relief, this raises new issues that need to be carefully examined, as Mr. Wijnholds has pointed out in his statement. At the same time, any undue erosion of creditor rights must obviously be avoided. One way to address this concern might be to allow a qualified minority of creditors to appeal to the SDDRF for a lift of the stay. To conclude this point, we remain to be convinced that without the general stay, the SDRM will still bring about the necessary restructuring incentives and the degree of predictability that would set it apart from the contractual approach. We therefore encourage the staff to keep the option of a general stay on the table including in upcoming discussions with external parties.

Let me now turn to some of the other issues. As regards the possible inclusion of official bilateral credits in the mechanism, we see advantages and disadvantages to both options. In any event, whichever approach is chosen, care must be taken to preserve the principles governing the Paris Club's work such as the consensus principle. I also take note here of the observation made by Mr. Bennett that both approaches are likely to lead to the same results as long as full transparency of the process is ensured. Still on the scope of debt, we would emphasize that while it may be up to the debtor to propose a subset of eligible claims to be restructured, the choice of claims ultimately needs to be a matter of negotiations between the debtor and its creditors. On central bank claims we agree with Mr. Callaghan that these should be included if circumstances require it.

As to the treatment of privileged claims, we take note of the staff's concerns about the complexity of the issues involved in including such claims in the mechanism. At the same time, we would caution against the risk of circumvention through increased securitization and financial engineering. All in all, the issue of privileged claims is one that might need to be explored further.

Turning to activation, we can accept the unilateral trigger. We do not think abuse by the debtor will be a major concern, as long as a few important safeguards are in place. One such safeguard is creditor-driven termination. The other important safeguard would be to make the Fund's debt sustainability analysis available to interested parties. Through this contribution and through its financial powers, the Fund will clearly play a crucial role in the mechanism. While we do not regard a more formal role as helpful, we agree with those Directors who call for a clearer definition of the Fund's informal role.

On the specific question whether to have end-investors register, we see merit in such an approach, in order to make the verification process as effective as possible. It would be up to the deposit banks in this case to make the necessary provisions to allow for investors to register. Further in this context, we note with some regret that the staff has dropped the idea of establishing a standing organization to register claims.

On the issue of priority financing, we would underscore that such financing plays a crucial role. It helps contain the economic dislocation associated with a debt crisis, and it mitigates incentives on the part of debtors to put off the necessary debt restructuring. With this in mind, it might be questioned if the staff's proposal to exclude only specified credits on the basis of qualified majority decisions would not lead to undue delays in the generation of such valuable financing.

As regards creditor committees, we find it premature at this stage to decide to let the debtor bear the full cost of their operation.

Turning to the SDDRF, the mandate of this body should not be broader than absolutely necessary. That said, however, we agree that the forum should have the power to enjoin specific enforcement actions when such an order is requested by the debtor and approved by creditors.

On the issue of consistency with legal systems, according to our preliminary assessment in Germany, the SDRM may make legislative changes necessary and may raise some constitutional questions. I support the proposal of Mr. Wijnholds to circulate a questionnaire so as to allow a firmer and more uniform judgment across the membership.

Finally, on publication of the staff report, I share the concerns of Messrs. Wijnholds, Andersen, Padoan, and Duquesne that the paper does not sufficiently reflect the spectrum of issues that are still unresolved. This should be reflected in the summing up, but as Mr. Wijnholds and others have argued earlier, this might not be enough to give the public an unbiased view of where we stand in the discussion. Therefore, I am reluctant to agree to the publication of the paper in its current form.

Ms. Indrawati made the following statement:

We welcome another round of discussion on the SDRM, and thank the staff for preparing this paper, especially for their efforts in consulting with market participants and members of the judicial as well as legal profession. We also welcome the initiative to host a conference in mid-January 2003 comprising the representatives of emerging market countries, key policy makers and market participants, among others. Given that the SDRM issue has particular relevance to emerging market countries, it is important to seek views from these countries, especially those who are debtors, and the conference should be an appropriate platform for this proposal.

Since the paper covers a very broad range of technical issues, we will keep our comments confined to some of the main aspects of the proposal and to the area which we seek further clarification. On the scope of claims covered by the mechanism, as highlighted in Mr. Portugal's and Mr. Shaalan's statement, the staff has proposed an all-encompassing approach to defining the scope of claims to be covered. Despite the agreement already reached by the Executive Board, sovereign domestic debt as well as the foreign debt of entities other than the central government should be excluded. We strongly feel that the earlier decision of the Executive Board should be adhered to.

Nevertheless, we concur with Mr. Callaghan that the scope of the debt being covered must be wide enough to fully reflect the real condition of debt sustainability of the country. In addition, the debtor should be allowed to determine which debt needs to be restructured. On the official bilateral creditors, the status of the official bilateral claims in the SDRM remain an issue. As highlighted in the paper, the private sector has strongly expressed their view that the inclusion of the official bilateral creditors within the SDRM would be critical if the SDRM is to establish a framework that provides for greater intercreditor equity. The private sector has also expressed a concern that Paris Club restructuring may not address the sustainability of sovereign debt since it typically deals only with the claim falling due rather than with the stock of debt, and for that reason, often relies on repeated rescheduling. This view differs from the perspective that favors the exclusion of official bilateral claims from the SDRM. We still believe that there remains the risk of private creditors preventing a restructuring of official bilateral debts by the Paris Club even if the Paris Club is prepared to restructure their debts on highly concessional terms in order to assist another sovereign and avoid contagion in the interest of the global financial community. These risks outweigh in our opinion the inter-creditor equity concerns in any event since the Paris Club has already a well coordinated mechanism for restructuring sovereign debt. Countries should attempt to address their debt problem through the Paris Club first before considering the activation of the SDRM.

On the provision of information, the staff indicated that if the SDRM is to achieve its objective, there must be a procedure that enables debtors and creditors to make timely decisions on the basis of all material information. In this regard, the staff suggested that the sovereign debtor would have to provide the SDDRF all known information regarding its indebtedness, and this includes debt to be restructured outside the mechanism, and other debt that the sovereign does not intend to restructure. We concur with the view of Mr. Portugal and Mr. Shaalan that this procedure is very demanding, and we see no benefit for sovereign debtor to provide information on debt that is not included in the SDRM. We also agree with Mr. Portugal and Mr. Shaalan that sanctions should not be imposed by the Fund on a member if information is inadvertently omitted by the debtor, as the whole process of any restructuring involves difficulties in reconciliation and verification of figures.

On the SDDRF, we concur with the staff on the main feature of the SDDRF. We agree with limiting the power of the SDDRF to administering claims and resolving disputes between creditors and debtors, and the need to be accountable as well as transparent with regard to its operation. We also agree that the SDDRF should operate independently from the Executive Board, Board of Governors, and management and the staff of the Fund.

On the issue of designing the selection panel, besides nominations by the Managing Director, the Executive Board should also have the opportunity to propose candidates, and the appointment of the panel should be approved by the Executive Board with a 70 percent, and alternatively, by a simple majority where each Fund member has one vote. Once appointed, the selection panel will identify candidates to be members of the SDDRF and forward the list to the Board of Governors for approval. A similar type of majority should be adopted for a final list of candidates.

On the consistency with the domestic legal system, the staff has proposed that the SDRM would be established through an amendment of the IMF Articles of Agreement. When an amendment of the Articles of Agreement enters into force, members have an obligation to ensure that under their domestic law the amendment will be given full force and effect in their territory. We would appreciate the staff clarification on whether the SDRM would be effective only after every country has made changes to their domestic legislation. We believe that this should be the proper procedure in order to avoid creating loopholes in the event that the domestic legislation is not passed in any particular country.

On the publication of the paper, we share Mr. Wijnholds's and Mr. Shaalan's view that the paper should only be published after the Board has fully consulted with all parties and after all the agreed amendments are incorporated. In conclusion, we would like to emphasize that the SDRM should work in complement with a continued boost toward improving market mechanisms to restructure debt, including the development of comprehensive collective action clauses, in all jurisdictions. This would enhance our efforts to strengthen the international financial architecture.

Mr. Duquesne made the following statement:

Let me join previous speakers and thank the staff for the excellent work done over the past months and for the detailed and comprehensive report before us today. It is so comprehensive that it is more and more difficult to qualify it as work in progress. Let me also praise you, Madam Chair, for your active involvement in this matter. I would briefly say that a number of my points have already been stated by my colleagues in their statements today. In particular, I am in nearly total agreement with the views expressed in Mr. Padoan's and Mr. Bossone's in their statement and I share many points raised by Mr. Wijnholds, Mr. Andersen and Mr. Farelius and, a few minutes ago, by Mr. Bischofberger. I would simply insist on four points.

First, our discussions today make it pretty clear that the staff report does not only provide more details on past proposals but describes a complete change of nature of our approach. At the heart of this change lays the replacement of a general stay on litigation by a less coercive mechanism based on the so-called hotchpot rule. As Mr. Padoan or Mr. Bischofberger when they called the staff's new approach a "soft-SDRM" or "SDRM light" and, like many others, I have serious doubts about the consistency of such a soft-SDRM with the principles and objectives of the statutory approach we have been working on since November of last year, and even with the mandate we received from the IMFC this year.

Indeed, I have listened very carefully to the explanations provided at the outset of today's meeting by Mr. Hagan and Mr. Fisher, but I still believe that we need more detailed information on the pros and cons in terms of efficiency of replacing the general stay on litigation by the staff's proposal to be able to make an informed judgment and decide on this complex issue. And like Mr. Bischofberger, I definitely want to keep both options on the table.

One point strikes me in particular: the whole architecture of our two-track approach on debt restructuring lies on the idea of building a costly and heavy statutory mechanism that would play the role of a last resort solution and above all of a deterrent to provide strong incentives for both debtors and creditors to find cooperative solutions and negotiate prior to the activation of the SDRM and hopefully without the need to activate it. I wonder—and this is probably an euphemism—whether an SDRM built on the staff's new approach would be able to play such a role.

I was convinced by the argument put forward today by Mr. Hagan to justify legally the role of the Fund and the possibility to amend the Articles of Agreement for that purpose. Having said that, and explaining that it is in the core of the activities and the mandate of the Fund, it might be bizarre to write and have ratified a very complex set of amendments to the Articles of Agreement that will try, as much as possible, to limit the role of the Fund.

My second point is on the Paris Club. Of course, the inclusion of the Paris Club into the SDRM is a sensitive issue. As a general position, we are open and ready to explore any venues from the inclusion of official bilateral debt as a separate class to a close cooperation between an independent Paris Club and the SDRM. I would like, however, to insist on three points:

- first, there is a strong difference between any statutory approach and the informal and non statutory nature of the Paris Club that was recalled by many. I am not sure that we could adapt the Paris Club framework to a change of such magnitude ;

- it leads me to my second point: like others, I believe that we should be very cautious in modifying the very mechanisms that have proven their efficiency in ensuring collective action so far. I am all the more worried since, as confirmed by the staff, there is no technical rationale for it ;

- finally, like my neighbor, Mr. Callaghan, I tend to believe that the private sector's concerns run far deeper than can be addressed by including official bilateral debt within the SDRM. If the private sector's assumption is that such an inclusion would lead sovereign creditors to apply the same procedures as private creditors, they could be wrong.

Having said that, I believe that the staff and the Paris Club Secretariat should explore procedures to allow for a close coordination between the SDRM and the Paris Club so that the board may assess more precisely the pros and cons of inclusion versus close collaboration.

Third, the role of the Fund in the SDRM has been decreasing constantly in the successive staff reports. It is all the more surprising that no one doubts the Fund will, explicitly or implicitly, play a central role in such a mechanism. As we have mentioned on previous occasions, this chair has no problem with the bestowal of an explicit role for the Fund within the SDRM. Regarding, for instance, the need for a third body to confirm the activation of the SDRM, I believe, like Mr. Wijnholds, that no one but the Fund could perform such a task and it will play this role anyway through its decision to lend into arrears. More generally on this question of the activation of the SDRM, I do not believe that the risk of a sovereign activating the mechanism while its debt is sustainable is very credible. In any event, a majority of creditors will always be able to vote for the termination of the activation.

This leads me to my fourth and final point. I agree with those directors that think that the SDDRF should not have the power to terminate the operations of the SDRM.

I am more and more convinced that before any publication, the staff report will certainly need a lot of work, and I am wondering whether the staff would be ready to do so during the forthcoming weeks.

Mr. Rouai made the following statement:

We appreciate the personal involvement of the First Deputy Managing Director and staff effort in designing a mechanism to help achieve an orderly resolution of debt crisis as well as the serious attempt at addressing the concerns expressed by Board members, debtors, and creditor countries. Nevertheless, as indicate in Mr. Portugal's statement, several questions need to be clarified. Some of the key features of the proposal may need to be revisited and consultation with the borrowers, in particular, needs to be expanded.

Moreover, as reflected in the recent paper by the private sector representatives, it is clear that the financial industry has strong reservations about the proposal and prefers a market-based alternative. It is important that these concerns and reservations be addressed, in order to achieve a consensus on a workable mechanism. In view of the very nature of the proposed amendment, which is a substitute to what should be decided in the context of a treaty, it is essential that a broad consensus be secured at an early stage. We would be ready to join a consensus on a proposal with appropriate revisions. Although a simple majority in the Board is sufficient to send the proposal to the Board of Governors, it would be wise to wait until a clear majority of at least for 75 percent is supported and clearly convinced about the need for an amendment before confirming that there is a firm proposal on the table for consideration by the Board of Governors. The last thing we want is to rush an amendment on the SDRM and end up into a situation similar to that of the SDR amendment. We would also be concerned if we put into place a SDRM mechanism that is not regarded helpful by debtors and creditors, and we end up with a sequel to the CCL.

This being said, and on the more technical aspect of the proposal, we agree with other Directors on the need to clarify and limit the scope of claims to be covered to avoid over-burdening borrowers with provision of detailed information on debt not to be covered by the restructuring, and to limit exclusion of creditors' claims to cases where they are under the control, and not the influence of borrowers. We also believe that since the proposal aims at protecting the interests of both debtors and creditors, the costs of creditor committees should be shared equally between the two parties. Moreover, we find the proposal of considering provision of incorrect information by the debtor as a breach of obligations under the Articles of Agreement excessively harsh and unjustified. This proposal contradicts the voluntary nature of activating the SDRM, and the right given to creditors not to agree on the request. We have to assume that both debtors and creditors will work in good faith. Moreover, abuse of the system by borrowers will be penalized either by the creditors rejecting their request or by the damage to their reputation in the capital markets.

During previous Board meetings on the SDRM, we have indicated our preference for an evolutionary approach, which starts with a mechanism with a limited number of creditors classes, in particular, those currently perceived to constrain an orderly restructuring process. Such mechanism should, in our view, exclude domestic debt. Because also the Paris Club mechanism is working relatively well, we do not see a need to include official bilateral claims under the SDRM. We urge the staff to consider in the companion paper the important issue of the potential impact of the SDRM on capital flows to emerging market economies and their borrowing costs.

On the SDDRF, we agree that the selection panel to be pointed by the Managing Director should be approved by the Board with a majority of 70 percent.

Finally, we support Mr. Wijnholds's suggestion for the staff to draft a questionnaire which could help our authorities address the issue of the consistency of the SDRM amendment with domestic legal systems. We support the publication of the staff paper, after appropriate editing, as part of our outreach and public information exercise.

Ms. Jacklin noted the points raised by Mr. Wijnholds, Mr. Kiekens, and some other Directors regarding the reasons for giving such deference in the current draft of the staff paper to some of the concerns expressed by the private sector. As Mr. Bischofberger had just recalled, the aim of the SDRM was to foster an orderly debt restructuring process and the return of the issuing countries to private capital markets. Debt restructuring had to be ultimately a voluntary agreement between the creditors and the debtor country in the context of the mechanism that would be devised. At the heart of that exercise was therefore the issue of market participation and market reaction. Moreover, one of the first stated purposes of the SDRM when it had been first proposed by the staff was to create a structure in which a country could come forward at an early stage to work with its creditors and restructure its debt in a way that would be less disruptive, dramatic, and harmful to the issuer and to the capital markets. It seemed evident that this would only be the case, if the market considered invoking the SDRM as less dramatic and less adverse than a statement that the borrower was prepared to default. So far, the private sector had indicated that it considered the SDRM as more adverse because it represented effectively a potential for default combined with the deprivation of contract rights that they would otherwise have. The Board had to consider that issue when assessing the most viable option for an effective mechanism going forward.

While there had been a number of attacks on the SDRM from the private sector, she still remained optimistic, Ms. Jacklin stated. Despite the criticism seen so far, the evolution of the papers since the inception of the debate showed that the discussions had brought about the acceptance by underwriters, investors, and issuers that an orderly debt restructuring process was needed when a country reached an unsustainable level of debt. The debate had thus advanced the understanding of all participants in the market to a degree that should be recognized and appreciated. There was reason to be pleased with that outcome, and it should be noted that considerable progress had been made in what was a difficult process. Today, the understanding among all participants in that process was vastly more sophisticated than a year before. However, it also had to be well understood that the market was essentially at the hear of the process. That was the reason why her chair and her authorities had consistently been concerned that the solutions that the Board was seeking were market-based.

Mr. Wijnholds welcomed Ms. Jacklin's reaction and her optimism and took note of her remarks about a market-based approach. His chair also favored a market-related approach, but it had to be recognized that a statutory approach could not be fully market-oriented. It was however true that all those involved in the process had become somewhat more sophisticated and had learned much from the debate. The recent press briefing by the Director of the External Relations Department seemed to suggest that the private sector was not all that negatively inclined toward the SDRM. That had also been the impression he had got from sources in Europe. Perhaps the staff could provide additional information about contacts with market participants and about their perception.

Mr. Brooke, reacting to comments from Mr. Portugal and Ms. Indrawati about the onerous nature of some of the information requirements being proposed in the context of the SDRM, considered that the transparency and information elements were absolutely crucial, and although there would be a cost for the debtor to gather the information and to publish it, it would be essential for delivering inter-creditor equity. That crucial aspect could not be overlooked in the context of the mechanism.

The Acting Chair (Ms. Krueger) added that the debtor would effectively have to provide such information also in the absence of a mechanism such as the SDRM.

Mr. Mafararikwa said that this chair associated itself with the views of Ms. Indrawati, Mr. Shaalan, and Mr. Portugal.

Mr. Guetat made the following statement:

> We agree on the importance of the rationale of a mechanism to ensure a more predictable and orderly sovereign debt restructuring. Since it involves a wide range of complex and new issues of a legal and financial nature, it will be of utmost importance to build a consensus and fully associate the market participants with designing process. The views of the debtor should also be taken into account. In this context, the outreach scheduled for mid-January, 2003 is welcome.
>
> We should also keep in mind that our work on the SDRM should go hand in hand with that of the contractual approach, notably the inclusion of collective action clauses in international bond contracts. We share the views expressed by Mr. Callaghan on this issue, and let me also say that Initiative countries would be more interested in the contractual approach since they have a long way ahead before they can have access to the international capital markets.
>
> Turning to the issue for discussion, I will be brief and will submit my statement for the record. Let me touch on some points. On the scope of the debt to be included, we would like to reiterate our position stated during the last discussion. Like Mr. Portugal and Mr. Shaalan, we strongly support a mechanism that excludes domestic debt governed by domestic law. And we also share their concerns on the other categories of debt to be included. On the inclusion of the official bilateral claims under the SDRM, our views are close to those expressed by a number of Directors, mainly Messrs. Duquesne, Wijnholds, Callaghan, Mozhin, and Palei. We are of the view that the Paris Club has functioned satisfactorily and has proved to be effective in the restructuring of debt.
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> Finally, on the issue of change in the domestic laws, since the SDRM and the SDDRF could not be established unless the Fund's Articles of Agreement were amended. That will require for some countries a legislative authorization for acceptance, and it would have been preferable to start the consultative process with the legislative bodies of the member countries to garner enough support for the SDRM before moving ahead in the process. We need to make sure that the legislative bodies in many countries will not reject the SDRM.

The Acting Chair (Ms. Krueger), commenting on the issue of collective action clauses, considered that there was general agreement that collective action clauses were complementary to the SDRM and in no way inconsistent with the mechanism. Management thus supported them and urged countries to put them in their bond contracts. However, as requested by the IMFC, the Board was currently focusing on developing the SDRM, and the fact that collective action clauses were not treated in the staff paper did not in any sense imply that there was a lack of support from management or the Fund for the contractual approach. It simply had not been the subject of that paper. If every time a staff paper was presented to the Board, everything that the Fund supported had to be included, Directors would have to read considerably longer staff papers.

Mr. Kiekens agreed that there was no need to have a full discussion of CACs each time the SDRM was discussed. However, it was important to be aware of the possible problems involved in the interaction between an SDRM regime and CACs. Such a problem could, for example, arise if the voting threshold under a CAC was at 90 percent, while the SDRM allowed a decision at a threshold of 75 percent. In such a case, the question arose as to which regime would prevail, given that they could not be regarded as parallel. Hence, while there was no need for a full discussion of CACs, such problems of the interaction between the contractual and the statutory approach had to be considered.

Mr. Yagi wondered how foreign borrowing by the central bank would be treated. The staff appeared to suggest that inclusion of central bank borrowing would be optional and that the consent of the central bank was required if domestic law required it. Contrary to that view taken by the staff, his own view was that when the sovereign had to rely on the debt restructuring, it was not clear why foreign borrowing by the central bank could be excluded, as that would circumvent the mechanism. In his view, it was therefore necessary to include central bank debt as mandatory and not as optional. The independence of the central bank certainly had to be respected, and if its borrowing abroad was indeed closely linked with its core monetary policy task, the staff's position to exclude it or to make that decision optional became understandable. However, there did not seem to be a clear relation between the borrowing abroad by the central bank and the independence of monetary policy, notwithstanding differences across countries according to their respective domestic laws.

The staff representative from the Policy Development and Review Department (Mr. Fisher), responding to additional questions raised by Directors, considered that the apparent monolithic position of the private sector that was reflected in the press release of December 17, 2002 was not indicative of the tenor of the discussions that staff and management had had with private sector representatives. While there was no strong support for the mechanism, there had been a very constructive set of discussions where even those people who had signed the press release saying that no changes to the mechanism could make them accept it, had given up many hours of their time to sit with the staff and talk through the issues and to discuss the form that the mechanism should take if it were to be established. One private sector participant in those discussions had conceded that it was not really possible to be very strongly in favor of collective action clauses and at the same time bitterly opposed to the SDRM. However, such acknowledgements did still not stop those private sector representatives from signing press releases against the SDRM. That could be explained in terms of their functions as heads of trade associations whose views they had to represent, while they as individuals did not necessarily share those views entirely.

Mr. Beauregard considered that a person's opinion as an individual could always differ from his or her opinion as representative of an organization, given that an organization represented different persons and interests. What counted however, was the opinion of those persons as representatives of those organizations, not their personal opinion. It was therefore important that those organizations would also be included in the upcoming workshop so that their points of view could be heard.

The staff representative from the Policy Development and Review Department (Mr. Fisher), responding to the questions raised by Mr. Yagi about the treatment of the claims on central banks and whether they should be optional or mandatory and to what extent that would compromise monetary policy, considered that the mechanism needed to be designed in a sufficiently general way so that it was able to encompass all likely cases. In most cases, central banks did not have large borrowings abroad that were governed by foreign law. There were however some countries where such transactions had been a very important vehicle for borrowing. While he had not checked recent data, central bank borrowing abroad had some years before been the only vehicle through which Hungary borrowed abroad. It had also been a very important vehicle for foreign borrowing for the Philippines. Finally, in some of the central European countries foreign borrowing was conducted through a hybrid structure, to some extent through the central bank and to some extent by the sovereign. It was therefore difficult to determine at the outset whether central bank borrowing abroad would always be excluded. However, the need to deal with those specific cases should not lead one to the conclusion that they must always be included. Whether such practices compromised monetary policy could only be answered appropriately on a case-by-case basis. In all likelihood the answer to that question would generally be no, given that the instruments of monetary control issued by central banks were generally governed by domestic law. In designing a financing program, it was necessary to take account of the ramifications of the coverage, and it was likely that countries aimed to preserve at least one instrument that would continue to be serviced in order to allow the central bank an independent monetary control. Thus, it was interesting to note that in Argentina—notwithstanding the fairly comprehensive interruption in payments—treasury bills continued to be paid to give the government that degree of freedom.

Mr. Yagi noted the staff's view that the described practice did not appear to have a strong impact on monetary policy and wondered whether it was therefore not appropriate to include the foreign borrowing of central banks on a mandatory basis, given that, otherwise, there was an incentive to make the practice of central bank borrowing abroad much more popular than it was at the current stage.

The staff representative from the Policy Development and Review Department (Mr. Fisher) responded that in designing a debt restructuring package one would inevitably try to do the minimal damage to that country's relations with international capital markets. In a situation where a central bank had ongoing routine cross-boarder transactions with international creditors that were not themselves the major source of pressure, it was likely that in order to preserve the ability of the central bank to conduct those operations, including those important to keep the banking system afloat, one would try to preserve them rather than include them under the mechanism. However, there would probably be cases where the conclusion would be to exclude foreign borrowing by the central bank and others where one would want to include them.

With regard to the question raised about claims of financial institutions and interbank debt, the staff representative clarified that the general presumption was that they would be excluded. In cases where such claims were covered by a sovereign guarantee and where they had become sovereign obligations as a result of that guarantee being called following a default they would be encompassed within the SDRM. If those claims continued to be serviced in the normal way, implying that the guarantee had not been called, then they would not be covered by the mechanism under the proposal.

The staff representative from the Legal Department (Mr. Hagan), responding to the question raised by Mr. Bischofberger about the standing registry, noted that the staff regarded that as a good idea and would like to pursue it further. It had not been discussed in the current paper, only to avoid covering too many issues at the same time.

Responding to Ms. Indrawati's question, the staff representative confirmed that to the extent to which a country needed to enact domestic legislation, that would normally be done prior to acceptance of an amendment to the Articles of Agreement. Under the normal procedure a member would communicate the acceptance to the Fund by certifying that it had taken all steps necessary under its domestic laws. If that meant enacting a statute, the statute normally provided that it would become effective once the relevant threshold for acceptance of the amendment had been certified by the Fund.

The Acting Chair (Ms. Krueger) thanked the staff for the work on the proposal, which had, at times, gone well beyond the call of duty. The staff's competence and commitment to the exercise was laudable, and it had been a pleasure to work with them. The current discussion would be concluded in the following Board session with the summing up and with a discussion of a suggestion by management on the issue of publication.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/02/124 (12/18/02) and EBM/02/125 (12/19/02).

4. SUDAN—REVIEW OF OVERDUE FINANCIAL OBLIGATIONS

1. In accordance with paragraph 5 of Decision No. 12769-(02/64), adopted on June 19, 2002, the Fund has reviewed further Sudan's overdue financial obligations to the Fund.

2. The Fund welcomes the policy performance achieved by the Sudanese authorities under the staff-monitored program for 2002 and notes that Sudan has made payments to the Fund in 2002 in line with its stated intentions.

3. The Fund encourages the Sudanese authorities to build on the progress to date in formulating macroeconomic and structural policies for 2003, and urges them to consider

increasing the level of monthly payments to the Fund in 2003 in light of developments in Sudan's balance of payments and taking into account the fiscal and foreign exchange needs of peace.

4. The Fund will again review Sudan's overdue financial obligations to the Fund within six-months of the date of this decision. (EBS/02/206, 12/4/02)

Decision No. 12913–(02/125), adopted
December 18, 2002

5. STAFF RETIREMENT PLAN—PURCHASE OF SERVICE CREDIT FOR PERIODS OF CONTRACTUAL AND OTHER EMPLOYMENT; AND AMENDMENTS TO SUPPLEMENTAL RETIREMENT BENEFITS PLAN

1. At its meeting on December 10, 2002, the Pension Committee considered a set of closely related proposals concerning the purchase of SRP service credits for past period of contractual and other employment.[1]

2. Committee members and the other members of the Executive Board in attendance held a full and frank discussion on the proposals in the staff papers. Committee and noncommittee members generally welcomed the presentation of the proposals, particularly as they were aimed at resolving an important, longstanding issue of equity vis-à-vis the staff. A number of speakers, including the members of the committee, emphasized the desirability of quickly resolving this matter—if possible, before the end of 2002—in order to avoid new complications. Notwithstanding this, a number of speakers who are not members of the committee raised significant concerns regarding the generosity of the proposals. Committee members, supported by *some* other Board members, agreed that the proposals in the staff papers—with the elaborations and clarifications mentioned in paragraph 3 below—should be forwarded to the Executive Board for its consideration on a lapse of time basis.

3. Committee members endorsed the recommendations in the staff papers and agreed that they should be recommended for Board approval as proposed, with two modifications. First, the committee members agreed to recommend that the Fund's cost of the service credits be amortized over the next 7–10 years through special added contributions rate. It is noted that the use of this funding procedure in this particular case is not regarded as a precedent for the funding of any future changes to the Plan. Annual recommendations on such contributions will be made in tandem with the recommendations on the Fund's regular SRP contribution rate. Second, the committee members preferred that arrangements for any contractual employees who are converted to staff in the future more closely reflect the Fund's present policies on categories of employment. For this reason, it is recommended that this set of arrangements on the SRP credit for past contractual service would not apply in the future to any Plan participants whose contractual employment begins after Board approval of the

[1] Staff Retirement Plan—Purchase of Service Credit for Periods of Contractual and Other Employment (RP/CP/02/13, 10/29/02); Staff Retirement Plan—Further Amendment to Section 3.2(c), as Proposed in Connection with the Purchase of SRP Service Credits (RP/CP/02/13, Sup. 1, 11/21/02); and Amendments to the Supplemental Retirement Benefits Plan (RP/CP/02/14, 10/29/02).

present proposals. The staff will prepare and promptly bring to the Committee specific amendments to incorporate this exclusion in the Plan.

4. Accordingly, the Pension Committee proposes that the recommendations in the three staff papers, with the understandings noted in paragraph 3 herein, be forwarded to the Executive Board for approval on a lapse of time basis before the end of the year.

Adopted December 18, 2002

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/02/154 (12/17/02) is approved.

APPROVAL: March 13, 2003

SHAILENDRA J. ANJARIA
Secretary