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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 00/94

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

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Decisions Taken Since Previous Board Meeting

Executive Board Attendance

S. Fischer, Acting Chairman
E. Aninat, Acting Chairman

Executive Directors	**Alternate Executive Directors**
	A.S. Alosaimi
A. Barro Chambrier	D. Ondo Mañe
	S. Thiam, Temporary
T.A. Bernes	P. Charleton
	J.A. Chelsky, Temporary
	J.L. Pascual, Temporary
R.F. Cippà	W. Szczuka
	B. Siegenthaler, Temporary
B. Esdar	R. von Kleist, Temporary
A.M. Jul	
R. Faini	H. Vittas
	D. Nardelli, Temporary
K.-T. Hetrakul	
	S.K. Keshava, Temporary
W. Kiekens	J. Prader
	N. Burnashev, Temporary
O.-P. Lehmussaari	I. Steinbuka, Temporary
K. Lissakers	M. Lundsager, Temporary
	L. Redifer, Temporary
	G. Bauche
	S. Le Gal, Temporary
A. Mirakhor	S. Rouai, Temporary
	M.R. Hajian, Temporary
	C. Rustomjee
	J.M. Jones, Temporary
	G.M. Campos, Temporary
	L. Palei, Temporary
S. Pickford	S. Collins
	H. Hagan, Temporary
	R. Junguito
	J.C. Estrella, Temporary
	O. Himani, Temporary
G.F. Taylor	
	Jin Qi
	Y.G. Yakusha
	A. Kapteijn, Temporary
Y. Yoshimura	M. Yanase, Temporary
	Y. Saito, Temporary

S.J. Anjaria, Secretary
A.S. Linde, Acting Secretary
A. Mountford, Acting Secretary
S.T. Djumena, Assistant
N.M. Hairfield, Assistant
G. Nkhata, Assistant

Also Present
IBRD: A. Abdychev, Office of Executive Director; R. Anand, N.J. Cooke, P.L. Rodriguez, Europe and Central Asia Regional Office; G.B. Lamb, Resource Mobilization Office. Asia and Pacific Department: T.R. Rumbaugh. European II Department: J. Odling-Smee, Director; S.K. Khazai, J.A. Kozack, M. Luecke, F. Luna, P.H. Mathieu, G.C. Pastor, M. Shadman-Valavi, H.J.G. Trines, R.C. York. External Relations Department: C.N. Lotze, W.J. Murray. Fiscal Affairs Department: C. Keller, T. Konuki. Legal Department: F.P. Gianviti, General Counsel; James Jones, H. Morais. Policy Development and Review Department: J.T. Boorman, Director; A.R. Boote, N.L. Happe, G.R. Kincaid. Secretary's Department: T. Turner-Huggins. Treasurer's Department: E. Brau, Treasurer; E. Budreckaite, B.V. Christensen, D.M. Hicks, J. Lin, D.J. Ordoobadi. Office of the Managing Director: L. Alexander, A. Bauer, D.A. Citrin, E.-A. Conrad, P.J. McClellan, R. Muñoz, T. Wolde-Semait. Advisors to Executive Directors: B. Couillault, A.R. Ismael, F. Liu, K. Sakr, J.N. Santos, J.R. Suárez, F. Zurbrügg. Assistants to Executive Directors: A.S. Al Azzaz, V.R. Bashkar, S. Bonomo, J.G. Borpujari, S. Boucher, P.A. Brukoff, R. Burgess, R. Djaafara, T. Elkjaer, E. González-Sánchez, K. Harada, M.S. Hililan, A. Jacoby, B. Kelmanson, B.D.H. Kranen, T.-M. Kudiwu, A. Maciá, K. Ongley, Peh K.H., A.A. Rojas, S. Sharipova, J. Sigurgeirsson, Tong Y., I. Zakharchenkov.

1. FINANCING FUND PARTICIPATION IN INITIATIVES FOR HIPC AND PRGF—UPDATE ON STATUS OF CONTRIBUTIONS AND LOAN RESOURCES

The Executive Directors considered a staff paper on financing of the Fund's participation in the initiatives for Heavily Indebted Poor Countries and Poverty Reduction and Growth Facility—update on the status of contributions and loan resources (EBS/00/188, 8/31/00).

Mr. Couillault made the following statement:

I hardly need to reiterate our strong conviction that completing the financing of the PRGF and the HIPC initiatives remains a major challenge for this institution and the international community, although we made decisive steps last year to wrap up the financing package. This update on the status of contributions and loans, six months after the last review, is welcome but is also a source of concern for my authorities.

As regards bilateral contributions, we are pleased to note that 82 percent of the total pledges are now effective and encourage the countries that are committed to participating in the financing to complete the procedures needed for the remaining SDR 3 billion to become effective, as the PRGF-HIPC Trust is still underfinanced.

Our main concern is the transfer of the remaining five-fourteenths of the proceeds from the gold sales. We note that the American administration is doing its best to obtain congressional authorization to vote in favor of this transfer, but a lot of uncertainty remains. We can only urge them to pursue their efforts. Against this background, my authorities would have strong concerns if the blockage of this transfer were to be at the expense of the interim PRGF. We strongly support the staff's statement that HIPC and PRGF operations should proceed (as planned) and hope that a solution will be found.

On the issue of loan resources for the interim PRGF, we note that there is a need to put together SDR 4 billion to finance the principle of interim PRGF loans. Staff recalls the two alternative ways for addressing this issue, namely to rely on additional bilateral lending or to use the Fund's general resources. We encourage management and staff to approach new contributors to help bridge the financing gap, but would like to reiterate that if these efforts are not successful, we should not hesitate to use the GRA.

Mr. von Kleist made the following statement:

At this point in the discussion I can be brief:

I very much welcome the progress that has been achieved in our joint quest to restore debt sustainability and to reduce poverty in a number of member countries. We also welcome the joint note of the President of the World Bank and the Managing Director of the IMF to the IMFC and the DC.

The staff papers on the subject are excellent, offering a balanced view of the gains and risks inherent in the proposed strategies. I want to highlight a few questions regarding risks that the staff has also pointed out.

Everyone involved is aware of the fact that we are still facing financing shortfalls for the initiatives as they are; these gaps threaten the credibility of our joint effort.

If one or more countries involved fail to reach the goals they are striving for, this could jeopardize the whole operation, damaging not only their own future prospects, but also the good name of the IMF and the World Bank as institutions.

I wish to thank the Managing Director and the President of the World Bank for their personal commitment. I wholeheartedly support the goal put forward by them to get as many countries as possible to the decision point, and ultimately to the completion point, as soon as possible. However, we have much to lose if at any point in time, quantity would go before quality.

The fact that fewer-than-hoped-for countries have until now been able to pass the decision point is not due to the handling by the IMF or the World Bank or the donors, but quite simply due to lack of progress by the concerned countries to own their program in the truest sense of the word. The IMF might consider to make this point somewhat more strongly in public and not readily accept the role of scapegoat, at least in part, of public opinion, if certain quantitative goals are not met.

During an I-PRSP, the country in question, at least formally, receives unconditional—or barely conditional—financing. This period should not be extended too long. In this context, I may add that ownership of a program by a country has to have its limits where the conditionality the Fund deems necessary may be affected. A good track record under a Fund-monitored program for a decent length of time has proven over and again to be the hallmark of a successful reform effort.

I completely agree with the staff that it makes more sense to focus only on a few central reform aspects, to avoid overstretching authorities’ implementation capacities. A stable macroeconomic framework, however, remains the condition sine qua non for successful and sustainable economic development and must always precede any group-specific measures.

Notwithstanding the above, we should be aware that enhancing the impact of public interventions for the poor will often require ex-ante changes in structure, process, and management of public service delivery systems and related budget and accounting systems. Especially in more complex and demanding country cases, due attention should be paid to systemic problems of the public sector, including corruption. With a view to address these problems, gain credibility and underline the seriousness of the effort; for some countries, it might be recommendable for an interim pilot period to visibly introduce special procedures for PRSP expenditures, ensuring proper planning, targeting, spending, and impact monitoring.

On the sunset clause, I could support its abolishment or a two-year extension.

Mr. Nardelli made the following statement:

The paper before us today contains some encouraging news. Only 18 percent of the total pledged bilateral contributions remain to become effective. I would also include among the good news the fact that the Fund's contribution is in an advanced state: the gold transactions have been completed, and more than half of the remaining transfers have already been contributed. If we go back to the tense moments that characterized the finalization of the financing package, I think we can say this is a fairly good accomplishment.

The paper also raises some remaining issues that need to be addressed to ensure full sustainability of the initiative. Notwithstanding the relevance of such issues, I can be brief.

Regarding the decision on the five-fourteenths of the investment income from gold sales, in one of the previous Board discussions we were told by the U.S. chair that this issue should be cleared in October. At this stage we can only urge the U.S. administration to redouble its efforts to secure congressional support for the use of the full proceeds of the gold sales. A delay in obtaining such support could put the financing of the initiative at risk.

On the status of pending contributions, in our constituency there is only one remaining contribution to be finalized, namely from Greece. The Greek authorities are actively considering the release of an additional contribution of a deposit to make their entire contribution effective, but I am not yet in the position to indicate a precise timing for the finalization. However, Greece remains fully committed to covering its quota share of the bilateral contributions.

The question of the additional resources for the interim PRGF is extremely important—and the amounts involved very relevant—and needs to be addressed carefully in our capitals. We agree with the proposed line of action, that is, having staff and management approach potential bilateral PRGF lenders, both current and prospective. In the past we have done our part and more of that will come. We would consider providing additional resources, but nevertheless, it is too early now to say a final word about the result of this process within a short period of time as suggested by the staff. In this connection we think that the idea of the staff to recycle the loan repayments under the current PRGF could be useful to bridge the potential financing gap. Has the staff already elaborated any projections in this respect? I note that in the case of Italy all of the loans provided to the PRGF Trust carry a long-term maturity, expiring well beyond 2008. I wonder whether this is the case for the majority of the remaining contributions.

Mr. Yanase made the following statement:

On the HIPC-PRGF Trust, as other speakers, we strongly feel that the actual disbursement for the Trust is necessary for the Fund to make commitments on debt relief under the HIPC Initiative. We strongly urge those countries that have not yet done so to disburse their commitments and we hope that the remaining five-fourteenths of the profits from gold transactions will soon become usable.

On the question of loan resources for the interim PRGF, I would like to emphasize that Japan has made the biggest contribution for both the loan and subsidy resources for the PRGF. In addition, Japan was one of the first among the G-7 countries to disburse its commitments to the HIPC-PRGF Trust and also contributes through the Japan Administered Account.

I would also like to stress my authorities' commitment to continue making every possible contribution to the Fund in various ways. However, Japan is not in a position to contribute further to the loan resources for the interim PRGF. Our country has already provided more than 40 percent of total loan resources for the PRGF operations to date, and from the perspective of fair burden sharing, this chair expects contributions from other members.

If bilateral contributions do not suffice, I would support the use of the GRA. Since helping the poorest members has become an integral part of the Fund's mission and PRGF has become an essential tool for that purpose, I believe use of GRA for the PRGF is fully justified.

Mr. Alosaimi made the following statement:

The picture that emerges from the staff paper regarding the effective financing for the continuation of the PRGF and the HIPC Initiative is not very encouraging. By November 2000, if neither the five-fourteenths of the investment income from gold sales become available nor additional contributions become effective, there could be underfinancing of subsidies. While this is a serious matter, it should not be exaggerated especially if the Fund has strong assurances that the remaining portion of the investment income from gold and the pledged contributions will become effective in the near future.

That said, I strongly support an early Board approval to use the remaining five-fourteenths of the investment income from gold sales and encourage the U.S. administration to strengthen its efforts to settle this issue. I also encourage bilateral contributors to advance efforts to make their contributions effective. On our part, we are making every effort to expedite the process and I can report that Saudi Arabia is in the final stages of addressing the minor remaining issues to make our contribution effective.

Mr. Jones made the following statement:

We would like to add our voice to those that have indicated that the release of the five-fourteenths of the investment income is important, and to encourage all bilateral contributors to make their contributions effective.

Mr. Rouai made the following statement:

I share Directors' concerns regarding the financing of the Fund participation in the PRGF/enhanced HIPC Initiative. I urge all countries to accelerate their efforts in order to fill the financing gap, and, in particular, the U.S. to complete the legislative process to allow the Fund to use the five-fourteenths of the investment income on the profits from gold sales.

On the financing of the interim PRGF, could the staff confirm my understanding that PRGF-eligible countries will pay, like other members, any agreed surcharge on the rate of charge on their use of GRA resources.

Mr. Prader made the following statement:

I share the "major concern" expressed by Mr. Couillault and others concerning the delay in releasing the remaining five-fourteenths of the gold sale resources as planned. I hope that the country that has not made up its mind and is blocking an early decision by this Board will act decisively soon.

On the issue of securing financing for the principal of the interim PRGF, I strongly agree with the views expressed by the German chair. The Fund should make a serious effort to obtain this financing from bilateral sources before turning to GRA resources, a solution inconsistent with the monetary character of the Fund. I therefore disagree with those who tell the

Fund not to hesitate to use the GRA if the first attempt to obtain money from bilateral sources does not immediately bear fruit. Besides, the countries approached for money to finance the interim PRGF would receive a valuable educational experience concerning the problems of the HIPC/PRGF initiatives and the role and the difficulties of the Fund.

As to the contributions of our own constituency members to the PRGF-HIPC Trust, I wish to report that almost all of these contributions have become effective. Of those that have not, Hungary's contribution will probably become available before the end of the year. Austria's contribution has been unexpectedly delayed by an interesting discussion in the European Central Bank but is expected to be finalized in November.

Mr. Lehmussaari made the following statement:

On the first bullet point, I believe that this question can only be relevant to the U.S. chair and I am looking forward to a constructive response from the U.S. side. This chair has already supported the gold transactions part of the compromise in financing the HIPC Initiative.

On the second bullet point, there are a few countries in my constituency that have not yet completed their pledges. But my authorities, however, are very confident that the obstacles that have been contributing to this situation, many of which have been related to legal aspects, will be overcome during the fall.

On the final bullet point regarding the provision of loan resources for interim PRGF operations, we support a broad approach and not only a recycling approach.

Mr. Chelsky made the following statement:

First, on subsidies, I would like to associate myself with the comments made by Mr. Couillault, particularly on the need to protect the interim PRGF. One positive element that I would like to highlight is that because of the way we structured the off-market gold sales, at least the interest accruing on the five-fourteenths is accruing into that account, so that we are not incurring any opportunity cost due to the delayed decision.

On the principle, we would not want to stand in the way of anyone making a bilateral contribution, but SDR 4 billion is a considerable sum, and I will be frank. My authorities have participated in all three solicitations for loan resources and to no small degree. They will not be participating in any further solicitation or a recycling of existing loans, and it seems highly unlikely given probable participation that we will reach that SDR 4 billion objective. I therefore think we have to accept some reversion to GRA, regardless of whatever conditions other members may want to impose as a result of that.

Mr. Thiam made the following statement:

First of all, we would like to reiterate our concern that the full financing of the HIPC is not yet totally secure. With regard to the financing of the HIPC Initiative, we support the transfer of the remaining five-fourteenths of the income from gold sales in order to allow the Fund to continue its operations.

With regard to the PRGF, we call on management and staff to initiate sooner, rather than later, their contacts with potential bilateral lenders in order to secure the financing of the principle of the PRGF.

As regards the possibility for the Fund to provide loans, rather than grants, to some selected countries, we wonder if this does not go against the spirit of the HIPC, whose objective was to eliminate, and not to create, debt; we would not welcome such an approach and would thus prefer that bilateral contributions be exhausted first.

Ms. Jin made the following statement:

As for the early Board decision on the use of the remaining five-fourteenths of the investment income from gold sales, I would like to join others in urging the U.S. chair to do whatever they can to secure the residual amount available as soon as possible.

With regard to the loan resources for interim PRGF operations, this chair believes that the Fund should seek new creditors for loan resources as well as to explore the possibility of using general resources to fill the gap.

Mr. Kapteijn associated himself with the remarks of Mr. von Kleist and Mr. Prader on the GRA.

Mr. Estrella made the following statement:

We expressed our views in the discussion last week, but I must reiterate that I am particularly concerned about the Fund's capacity to continue providing HIPC assistance through late-2000. It is essential to secure the release of the remaining income of the profit from gold sales, and to complete the processes to make effective those bilateral contributions that are still pending. In this regard, the approval of the U.S. Congress is crucial.

We also need to make more efforts to obtain loan resources for the interim PRGF. Lastly, our main concern is the financing of the participation of some regional development banks, and some non-Paris Club members.

Mr. Siegenthaler made the following statement:

On the transfer of the remaining five-fourteenths of investment income from the gold sales, like Mr. Couillault and Mr. Chelsky, I fear that, while we continue to grant HIPC assistance, we would lack subsidies for the interim PRGF. The financing issue would then once again be put off.

I welcome the staff's intention to inform the Board regularly and more often about constraints in PRGF and HIPC financing. But I would propose that an—unpublished—attachment be added to the country documentation instead of placing it just on the Fund's internal website. This would ensure that those without access to the internal website—like the authorities in our capitals—could also profit from the information.

Regarding the contributions of our constituency, I am pleased to announce that all the contributions have become effective.

On the final issue, the need for securing loan resources of the interim PRGF, I can say that this chair is still open to both possible sources of financing—bilateral lending or the use of the GRA. However, at this stage, Switzerland cannot pledge any contributions because this would require parliamentary approval, which would be rather complicated to get.

Mr. Pickford made the following statement:

I note that the interesting information provided in the paper points out that the PRGF-HIPC Trust fund does not actually run out of resources—in cash terms—until 2004, or perhaps a little later. However, in terms of commitments, it is earlier than that, around 2002, if my reading of the figures is right, so that should not stop us from putting as much pressure as possible in terms of trying to provide full financing for the interim PRGF. I will therefore echo what others have said about the need to press ahead as speedily as possible in terms of resolving the gold issue and in terms of firming up bilateral pledges. Our own pledge is already effective, and quite a large proportion has already been paid in.

On the question of the PRGF loan resources, our position has always been—and I see no prospect of it changing—that we have provided substantial resources through the subsidy element, but we have not provided loan capital. Therefore, I think Mr. Couillault is right that we should go as far as we can in terms of bilateral contributions, although I suspect that we will end up having to reconsider the question of using GRA.

Ms. Hetrakul made the following statement:

On points one and two, I would encourage the bilateral contributors to make all the committed pledges effective. As for the interim PRGF operations, I would encourage approaching new creditors first, before resorting to the GRA.

Mr. Keshava made the following statement:

As mentioned in the paper, the pledged contributions of countries in our constituency have already become effective. We would urge other countries for which the pledged contributions have not yet become effective to take immediate steps to complete the formalities rapidly. Our chair also calls for an expeditious resolution of the issue of the transfer of the five-fourteenths of the invested income from gold sales.

For the interim PRGF, we would prefer the use of bilateral contributions to that of the GRA.

Mr. Suárez made the following statement:

As other Directors, we also have concerns about delays in the release of the remaining five-fourteenths of the proceeds from the gold transactions. We encourage the U.S. to accelerate its approval process.

Regarding bilateral contributions, my Spanish authorities have indicated that they are in the process of completing the legal procedures to fulfill their commitments to the initiative, so those resources may be released soon.

Ms. Lissakers made the following statement:

On the authorization for the release of the remaining five-fourteenths of the proceeds from the gold sales, we are awaiting and working hard toward a positive response from Congress. It is hard to predict the outcome at this stage. All I can say is that the administration is doing everything possible to convince Congress to act affirmatively. My expectation is that this issue will not be resolved until the very last few days of this congressional session. This could be the first week of October, but it could also be later. NGOs and other interested parties are also pushing hard for a positive conclusion. Unfortunately, I do not expect that we will know the outcome before the Annual Meetings.

On the interim PRGF and the GRA, we have contributed to the subsidy account, but not to the loan principle, and we would not expect to do so. This issue has been discussed before, and we have always been open to the

> idea of using the GRA for the loan principle. That would have obvious and significant resource efficiency gains because the reserve could be used for subsidies, thus reducing the need to pass the hat for bilateral contributions. We would therefore be open to that use of the GRA, if the effort to garner bilateral contributions for loan principle falls short, and there appears to be considerable resistance at this point.

The staff representative from the Treasurer's Department confirmed that in case PRGF arrangements during the interim period were financed through the GRA, in the form of extended arrangements, PRGF-eligible countries would also pay the normal charges and surcharges on their use of GRA resources. Charges were uniform for all members.

On providing loans instead of grants for HIPC assistance, the staff was in the process of preparing a paper for circulation to the Board on this issue, which would discuss that option, among others, the staff representative informed.

Mr. Chelsky asked whether the surcharges would raise the subsidy requirement, with the subsidy account having to pay for the surcharge.

The staff representative from the Treasurer's Department responded that that would be one possibility, but the Board had yet to define the modalities for any kind of interim PRGF loans. If the interest paid by the PRGF borrowers continued to be only half a percent, then the impact would be to raise the subsidy requirement by an equivalent amount.

As regards the potential shortage of resources, the Board would face this issue in 2001, when the modalities for interim PRGF loans would have to be put in place, the staff representative said.

Interest income was indeed already accruing on the entire net proceeds from gold transactions, as suggested by Mr. Chelsky, the staff representative confirmed. There were other lenders, in addition to Italy, whose loans to the PRGF Trust carried long-term maturity expiring well beyond 2008.

Mr. Nardelli asked whether the staff could provide indications on how much the recycling of loans could contribute to the necessary loan resources for the interim PRGF.

The staff representative from the Treasurer's Department noted that based on the staff's projections, the repayments falling due would amount to roughly SDR 6.4 billion between 2000 and 2008. Beyond that point, if the available loan resources under the current PRGF Trust were fully committed, an additional SDR 5 billion would fall due beyond 2008.

Mr. Nardelli wondered whether a full recycling of maturing loans would cover the need for loan donors under the PRGF-HIPC Trust.

The staff representative from the Treasurer's Department answered in the affirmative.

The Acting Chairman made the following summing up:

Executive Directors welcomed the update on the status of financing for the PRGF-HIPC Trust. They noted the progress made in making pledged bilateral contributions effective and stressed the urgent need to ensure their full effectiveness, secure the release of the remaining five-fourteenths of the investment income from the net proceeds of gold transactions, and mobilize loan resources for the interim PRGF.

Directors recognized that the Fund could face a dilemma in financing the HIPC Initiative and interim PRGF operations in the near future if the five-fourteenths of the investment income from gold transactions and all bilateral contributions do not become effective soon. Because of the integral link between the HIPC Initiative and PRGF operations, Directors stressed the need to ensure the full financing of both initiatives.

Recognizing that the loan resources available for the current PRGF will be fully committed in 2001, Directors welcomed the proposal to initiate discussions with bilateral lenders on the provision of loan resources for interim PRGF operations during the period 2001–05.

If bilateral contributions proved to be insufficient for the interim PRGF, a number of Directors were willing to contemplate the use of the Fund's general resources for this purpose, while others considered that that would be inconsistent with the monetary character of the Fund.

Directors also welcomed the staff's intention to report to the Board concerning constraints on PRGF and HIPC financing at critical junctures and to regularly update the table on the Fund's internal website showing uncommitted effective resources.

2. INDEPENDENT EVALUATION OFFICE—ESTABLISHMENT AND TERMS OF REFERENCE—REPORT TO INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE

The Executive Directors considered the draft report of the Executive Board to the International Monetary and Financial Committee on the establishment of the independent Evaluation Office and its terms of reference (EBAP/00/105, 9/12/00).

Mr. Bernes stated that during the recent Evaluation Group meeting, attended by all Executive Directors' offices, to review the draft terms of reference, minor adjustments to the text had been agreed upon. The draft report to the IMFC consisted of a factual cover note, reviewing the history of the process of setting up the Evaluation Office (EVO).

Mr. Palei was concerned about Paragraph 6 of the report which seemed too negative about prior external evaluations. He was also not sure if the number of years for which a

Director of the Evaluation Office was appointed had been mentioned in the terms of reference (ToR), and whether a formal decision from the Board would be the outcome of the Executive Board review of the EVO work program.

On Paragraph 6, Mr. Bernes replied that one of the downsides of continuing with independent external evaluations was that those did not facilitate institutional memory.

On the question of the work program, he noted that that was meant to be a collaborative process. The work program would be reviewed by the Executive Board, and the EVO Director would draw conclusions from that review, based upon discussions with management, with appropriate outside groups, and with the Board. However, the Board ultimately possessed the instrument of the budget if it felt its views were not adequately reflected. Nonetheless, that would not constitute an absolute decision on the work program, as that would be within the purview of the Director.

He said the period of appointment of the Director was covered in background material. The draft terms of reference for the Director of EVO contained language with respect to the length of the term of appointment.

He added that the Evaluation Group was proceeding with steps to identify the process for selecting a Director through the involvement of a search firm. The Group would come to the Board with proposals later in the year.

Ms. Lissakers agreed with Mr. Palei that the Board needed to decide on the length of the Director's appointment before recruiting that person. However, it made sense to receive input from a search firm on how to attract the right people before setting the appointment terms. She was happy to proceed as Mr. Bernes had suggested, and agreed to the report.

Mr. Kiekens said that the rules for dismissing the Director were important and formed part of the independence. It had been suggested, as one of the possibilities, that the Director could only be dismissed for unsatisfactory performance and only with a 70 percent majority of the voting power of the Board. If the Board wished to adopt those rules, they should be included in the terms of reference. Also, the fact that the Director could not become a staff member was an important provision to assure independence and should also be included in the terms of reference.

Mr. Bernes explained that the draft terms of reference for the Director had been set out in a document which the Board had considered during the last discussion. The revised terms of reference had been included in the material which was published on the Fund's website for comments; e.g., on the question of termination of the services of the Director, reflecting the advice of legal counsel, the 70 percent majority voting power requirement was modified to a majority of the Board. The draft terms of reference covered all of Mr. Kiekens' points, but a formal decision had not been taken. He suggested that, when the Group came back to the Board with a proposal on a search firm, that would also be the time to finalize the decision on those points.

Mr. Kiekens replied that Paragraph 10 of the report to the IMFC stated that the terms had been discussed and approved by Executive Directors on September 13. It had been proposed not to produce another draft of the terms of reference, and the Board had decided in April to come to a decision before the Prague Annual Meetings. He suggested proceeding with the decision.

Ms. Lissakers agreed with Mr. Kiekens on the terms for removal of the Director and noted that since the Board would be adopting the terms of reference as a decision, the term-limit issue could be addressed at the current stage too. The conditions by which the EVO Director could be removed from office had to be specified in the terms of reference and should be specified at the current stage.

Mr. Bernes said that during the Board's last discussion, the Evaluation Group report had proposed only draft terms of reference for the Director. It had not recommended broader terms of reference. Following the discussion by the Board, the Evaluation Group had been asked to find out whether the terms of reference for the Evaluation Office could be developed for consideration and approval before the meeting of the IMFC. That had culminated in the current report. The reference in Paragraph 10 was a decision with respect to the terms of reference for the Evaluation Office, and not with respect to the terms of reference for the Director.

Ms. Lissakers did not see the need for elaboration of the terms of reference for the Director, except for the contract terms and the means of removal.

Mr. Esdar said that the two-step procedure suggested by Mr. Bernes made sense.

Mr. Kiekens found it surprising to report to the IMFC that the Board had adopted terms of reference for EVO but not for the Director—particularly, as the terms of reference for EVO were, to a certain extent, dependent on the terms of reference for the Director. The position of the Director should be part of that decision.

The Acting Chairman said that the terms of the Director's appointment were a critical element in how EVO would function. Essentially, the outlines of EVO were understood and only a few parameters remained unfinished.

Mr. Taylor agreed with Mr. Kiekens that the length of appointment and means of removal of the Director were integral to the terms of reference and an essential ingredient of the degree of independence.

He noted that in a recent document, on making the Fund's independent Evaluation Office operational, of July 19, Paragraph 5 stated the Director's salary, which did not need to be in the terms of reference. However, the Paragraph continued that the successful candidate would serve for four years, renewable for a second term of three years, but not be eligible for appointment or reappointment to regular staff, and that the appointment may be terminated any time with the approval of a 70 percent majority of the Board. That could be included in the current document.

Mr. Esdar remarked that during the discussion on the first draft in June, all those elements had been discussed. At that time it had been agreed to leave out the more technical questions.

Ms. Lissakers said that she did not sense disagreement about the terms of reference and wondered why the issue could not be resolved by agreeing on a four-year term with a three-year renewal. However, she did not understand the need for the large majority to remove the Director.

Mr. Collins agreed with Ms. Lissakers and said that if all Directors approved, sentences could be drafted, which could be adopted on a lapse-of-time basis later. However, it was a good idea to include sentences on the terms for appointing and dismissing the Director.

Mr. Bernes suggested that in the second paragraph language from the background paper could be added, saying that the Director would serve for a period of four years, renewable for second term of up to three years, and, at the end of the term of service, would not be eligible for appointment to regular staff of the Fund. Also, the Director's appointment may be terminated any time with the approval of the Executive Board.

Mr. Kiekens agreed that the Director should be independent from management and staff, but not from the Board. If the Director was to be independent from the Board, the Board needed to ensure that the Director could only be removed for malfunctioning, but, if the Board wished to have control over the Director, then it could remove that person at any time with a 50 percent majority.

The General Counsel explained that the 70 percent voting majority had been included in the original draft, but that he had objected to that because the Executive Board could not determine its own majorities; the majorities for decision making were determined by the Articles of Agreement. Absent a specific majority, Board decisions were made by a majority of the votes cast. If the Director's contract required a higher majority for his dismissal, the decision to dismiss the Director could still be made by a majority of the votes cast, but then the Fund could be made liable for damages.

Mr. Taylor understood that the Fund could be exposed to damages if it sought to dismiss a Director with an insufficient majority, but wondered why that matter could not be resolved to require a larger majority than allowed under the Articles of Agreement.

The General Counsel explained that the Board did not have the authority to modify the majorities prescribed by the Articles.

The Acting Chairman added that in the event of a vote leading to a 51 percent majority of the Board, then that would have to be accepted, despite the ToR having stated that the majority needed to be 70 percent.

Mr. Collins wondered who would determine the "unsatisfactory performance" of the Director. If it were the Board, then that would not be an objective test. He did not object to adding that phrase in the ToR, but it did not add substance, given that only a 50 percent majority for dismissal of the Director was required.

Ms. Lissakers said that that placed the burden on the Board to show that unsatisfactory performance by the Director existed.

The General Counsel added that that kind of clause also required an arbitration clause, and if a dispute between the Board and the Director were submitted to arbitration, one could not rule out the possibility that the arbitrators would find for the Director and against the Board.

Mr. Yoshimura stated that performance was an ambiguous notion. While the Board may consider someone performing unsatisfactorily, that person may believe that they had been performing well. That would result in a dispute. While the dismissal clause based on misconduct could be considered, he was not so sure whether the Fund was on firm ground on the performance issue.

Mr. Bernes said that the language posted on the website had been agreed by the Board. It had been approved on a lapse-of-time basis. The Board had already agreed to the language and had decided not to be overly specific to meet some of the concerns raised by the legal counsel. He therefore suggested sticking to that language.

On a drafting point, he suggested that, in the first paragraph, the third line from the bottom could be changed to read "complement review and evaluation work in the Fund."

The Acting Chairman stated that a strong majority existed in favor of proceeding with two changes: (i) the removal of "currently underway," and (ii) the addition of two sentences from the previous report. It was recognized that the Board would have preferred to specify good reasons for the dismissal of the Director, but that seemed to be a large legal problem. However, given the need for transparency and public interest in EVO, it could be assumed that a strong incentive for the Board existed to be absolutely sure about such a decision at that stage.

Mr. Palei again expressed his concern about sentence 3 in Paragraph 6. He was of the view that it was not appropriate to characterize the external evaluation of ESAF in such terms. While the Board was critical of the evaluation of research in the Fund, from his point of view, the ESAF evaluation had been of high quality. Therefore, that sentence could be misunderstood by the external evaluators and could be offensive.

Ms. Lissakers suggested dropping the last part of the sentence, "often limited to the practical value of their advice," as it would then read, "among the general concerns raised was that, despite the exceptional expertise in their respective field, external evaluators might lack familiarity with particular areas of the Fund's operation and mandate." That would not sound like a criticism of past experience, but like a general observation about external evaluators.

Mr. Collins agreed with Ms. Lissakers and suggested to substitute "could limit" for "often limited," which was more theoretical.

Mr. Faini suggested the sentence to read, "it may take a long time for external evaluators to become familiar," as that would not pass judgment on previous exercises.

The Acting Chairman suggested replacing, "despite their exceptional expertise in their respective field," with, "despite the generally high quality of the evaluations to date, a lack of familiarity could limit that."

Mr. Palei agreed with that suggestion.

The Acting Chairman noted that although the report to the IMFC did not mention that point, the background paper had specified that the suitability of the recommended candidate for Director of EVO would be discussed with the Managing Director. He extended his gratitude to Mr. Bernes and his colleagues for the work they had carried out.

Mr. Bernes thanked staff, who had been helpful in the process, and his colleagues. He was of the view that the Board had come together on another step forward in the evaluation process. Now, having taken a decision on the terms of reference, he wondered whether that decision would be posted on the website before the Annual Meetings, as large interest existed in the outside community on that issue.

Mr. Kiekens stated that the Fund had decided that when the Board concluded policy items, it issued a public information notice, which was composed of the background section and summings up or decision. Therefore, the current decision should be made public, perhaps including introductory remarks referring to previous publications or press communications.

The Acting Chairman said that the report to the IMFC would be published.

3. KYRGYZ REPUBLIC—2000 ARTICLE IV CONSULTATION; POVERTY REDUCTION AND GROWTH FACILITY—FIRST AND SECOND REVIEWS, AND WAIVER OF PERFORMANCE CRITERIA

The Executive Directors considered the staff report for the 2000 Article IV consultation with the Kyrgyz Republic, the first and second reviews under the second annual arrangement for the Kyrgyz Republic under the Poverty Reduction and Growth Facility, and the Kyrgyz Republic's request for waiver of performance criteria (EBS/00/182, 8/30/00;

Sup. 1, 9/12/00). They also had before them a background paper on selected issues in the Kyrgyz Republic and a statistical appendix (SM/00/197, 8/30/00).

Mr. Cippà submitted the following statement:

At the outset, I would like to thank the staff for presenting in the report, and in the accompanying selected issues paper, a very thorough and balanced assessment of the recent economic developments in the Kyrgyz Republic. My authorities agree with the staff that 1999 was a difficult year for the Kyrgyz economy but a serious effort has been made since then to regain macroeconomic stability and bring the PRGF-supported program back on track. The difficulties experienced in 1999, including the large depreciation of the domestic currency and the temporary resurgence of inflation, reflected to a large extent the lingering effects of the Russian crisis that were compounded by trade and other measures introduced by some of Kyrgyzstan's neighbors in the aftermath of this crisis. The government had also to deal with the adverse consequences of the intrusion of foreign rebels in the south of the country in summer of 1999 (unfortunately, similar problems, albeit on a significantly smaller scale, reemerged in August of the current year). However, it needs to be stressed that already last year one could also observe some more positive economic developments, like the acceleration of GDP growth to 3.6 percent, increase in international reserves (to the equivalent of 3.2 months of imports), and a moderate reduction in the current account deficit. While the overall fiscal deficit increased from 10.8 percent in 1998 to 12.8 percent of GDP last year, mainly on the account of a large increase in the externally financed public investment program (PIP), the primary balance improved over the same period from a deficit of –1.4 percent to a surplus of 0.4 percent of GDP.

The authorities responded to the deterioration of macroeconomic conditions by tightening the monetary policy, starting from the second half of 1999, and by adopting a budget for the current year that provides for a further increase in the primary surplus and for a drastic reduction (by almost 6 percent of GDP) in the overall fiscal deficit. Several measures had also been introduced to address the widespread problems in the banking sector and to accelerate the implementation of the structural reforms program. The overall results achieved so far this year are very encouraging and point to the possibility of exceeding the program targets in many areas. After accelerating to 7.4 percent in the first half of this year, the GDP growth rate for the whole year is now expected to reach about 5 percent, twice as much as projected under the program. The continuation of a tight monetary policy helped to reduce inflation to only 4.7 percent in the first eight months of 2000 and the CPI-measured inflation for the whole year is now expected to be below 15 percent. Taking aside some minor pressures that emerged earlier this month, the exchange rate remained largely stable over the last 12 months, and the central bank continued to accumulate foreign exchange reserves. Due to the weak revenue performance at the beginning of this year, the implementation of the fiscal program was somewhat uneven, but thanks to the subsequent improvement in tax collection, the respective performance criterion for end-June was observed, while the PC on the overall fiscal deficit was missed by a small margin. However, given the continuation of the satisfactory revenue performance in July–August period and some special factors, as indicated below, that explain the small overshooting of the overall deficit target, my authorities remain confident that there are still good prospects for reaching the fiscal targets set for the end of this year.

My authorities are fully cognizant that strengthening of the revenue performance is of crucial importance for assuring the medium-term sustainability of the fiscal position. However, it has to be recognized that such factors as the very low level of average incomes and widespread poverty, sizable share of the largely tax-exempt agriculture, very difficult financial position of many industrial enterprises, and, more recently, weakness of many financial institutions significantly limit the prospects for achieving a large and speedy progress in raising tax revenues. There is also not much scope for raising the general level of tax rates, so the main route to higher revenues must lead through broadening the tax base, reducing the scope for exemptions and abuse, and strengthening tax and customs administration. My authorities regret that some of the tax reform measures envisaged under the program could not yet be implemented due to the lack of Parliament's approval, but the proposals to increase the retail sales tax rate and to include excises and customs duties in the VAT base, along with several other fiscal measures, have already been resubmitted for parliamentary consideration. Additional revenues are also expected from the already approved tax on sales from free economic zones to the domestic market, from the increased patent tax on casinos and other highly profitable activities, and from the proposed higher license fees for sales of alcohol. The issue of increasing the land tax rate will also remain on the government's agenda, but in the Kyrgyz Republic, as in most other countries, the proposals to increase taxation of agriculture face many political and administrative hurdles.

Being aware that no "wonders" can be expected in the short run on the revenue side, my authorities recognize that they have to maintain a tight grip over the public spending. The government was largely successful in containing the current expenditures both in 1999 and so far in the current year, despite the parliamentary election that was held in February. Given this positive track record, my authorities are quite confident that the risks of additional spending pressures, in the run-up to the forthcoming presidential election, that are mentioned in the staff appraisal, will not materialize. Unfortunately, the compression of current spending has not only resulted in falling ratios of spending on health and education and in a drastic decline in real wages in the public sector (that has been only partially reversed by the recent 20 percent wage increase) but has also led to the occasional emergence of payments arrears. The authorities confirm, however, that at this time all domestic arrears at the central level that emerged on a larger scale in the first half of 1999 and reemerged, to a smaller extent, in the first quarter of 2000, have been cleared. The same concerns the pension arrears that had been eliminated before the recently announced pension increase. However, the earlier agreed schedule of eliminating pension arrears by end-1999 proved, as admitted by the staff, to be overly ambitious, and our authorities had to request a waiver for the non-observance of the relevant performance criterion at end-March and at end-June 2000.

The difficulties with maintaining the agreed level of capital expenditures that led to the non-observance of the end-June performance criterion on fiscal deficit resulted from both the lumpiness and larger-than-expected seasonality of some investment projects and from some apparent weaknesses in forecasting and controlling the level of PIP-related spending. The first problem should be, to some extent, resolved in the later part of this year when the spending on some of the investment projects (like the construction of the Bishkek-Osh road that has to be suspended during the winter) will be reduced. The second problem is being addressed by the establishment in the Ministry of Finance of a special PIP unit and by several other measures that are described in Paragraphs 8 and 9 of the authorities' supplemental letter. I believe that taking into account the relatively small scale of the deficit overshooting (0.2 percent of GDP), the reasonable prospects for reaching the end-year targets, and the actions implemented by my authorities to deal with the problem of insufficient control, there are good reasons to grant the requested waiver. One could also argue that higher-than-programmed capital expenditures could be seen as a "lesser evil" than excessive current spending. The problem seems to be not so much with the absolute level of capital investments—because given the current state of Kyrgyzstan's economic and social infrastructure the investment needs are almost unlimited—but with the right assessment of the absorptive capacity of the Kyrgyz economy, with proper prioritization of investment projects and with ensuring adequate financing terms and good coordination among external creditors and donors. Given the current level of external indebtedness, the Kyrgyz Republic has to maximize the share of very concessional financing (with a preference for grants) and avoid contracting any new financing (including from international financial institutions) on market terms. I would like to ask the Fund's management and staff to support my authorities in conveying this message to the international donor community.

My authorities welcome staff's broadly positive assessment of the monetary policy being implemented by the NBKR since mid-1999. Further tightening of this policy, introduced from the beginning of this year, allowed the observance of all monetary performance criteria and helped to significantly advance the disinflation process. The recent introduction of NBKR bills should contribute to enhancing the flexibility in conducting the monetary policy. My authorities agree with the positive assessment of the managed floating regime and intend, in principle, to limit the official interventions to smoothing out unwarranted fluctuations similar to such that emerged at the beginning of September. In this last case, NBKR's limited intervention quickly helped to restore relative calm on the foreign exchange market. With the monetary policy largely under control, the NBKR management had to focus its attention on resolving the widespread problems in the banking sector. Progress in this area has been manifested, among others, by the adoption of the comprehensive bank restructuring program that was prepared with the help of the Fund, by the closure of one more large bank and the partial recapitalization of another bank, and by the recently implemented decision to raise to 50 million som the required minimum capital of the Kyrgyz banks. The ADB-sponsored external audits of several banks are proceeding, and the NBKR is on schedule with completing by end-September the on-site inspections of five additional banks.

The large depreciation of the som in 1999 combined with the drop in export values and with the new, mostly PIP-related, external borrowing resulted in a significant worsening of all debt and debt-service indicators. The debt-to-GDP ratio, which at the outset of the program in 1998 was projected to reach 68 percent this year, is now expected to jump to the level of about 120 percent. The significant increase in the debt-service burden, the very substantial decline in export revenues (by more than 40 percent in 1998–99), and the difficult fiscal position all contributed to the recent emergence of arrears on external debt payments to some of the bilateral creditors (Russia, Turkey, and Pakistan). To address this unfortunate, but unavoidable, development, my authorities have already entered into very serious negotiations with all concerned bilateral creditors seeking a mutually acceptable solution to this problem. An agreement with Russia providing for the rescheduling of arrears stemming from 1999 was signed in June 2000, and the Russian authorities have publicly expressed their willingness to favorably consider the request for a comprehensive rescheduling of the remaining Kyrgyz liabilities. Pakistan has also already consented to a medium-term rescheduling of its claims on the Kyrgyz Republic, and good progress has been made toward reaching a formal rescheduling agreement with Turkey. The strong efforts and progress made by my Kyrgyz authorities in seeking understandings with all bilateral creditors and the goodwill shown by the creditor countries fully justify, in my view, a favorable consideration of the requested waiver for the non-observance of the performance criterion on external debt-service arrears.

In addition to entering into negotiations with foreign creditors, my authorities are implementing several measures aimed at improving the management of external debt and restricting the issuance of state guarantees. The draft of the new law on the State debt that imposes strict limits on external borrowing has already been submitted to the Parliament. A technical assistance project aimed at strengthening the debt-management unit in the

Ministry of Finance and improving the database for external obligations is also being implemented with the financial support of the Swiss government. However, in light of the very inflexible structure of Kyrgyzstan's external debt that is dominated by obligations to international financial institutions, the possibilities of lessening the debt burden, even with the most sophisticated debt-management techniques, are quite limited. In this context, my authorities are awaiting with great interest the proposals and conclusions that will be formulated in the paper on debt in low-income countries of the CIS that is currently being prepared by the staff of the Fund and the Bank. I would also like to stress that despite the pressures on the balance of payments, my Kyrgyz authorities are determined to proceed with the liberalization of the external trade in line with their WTO commitments. At the beginning of this year the average tariff rate was reduced from 9.18 percent to 5.21 percent, and the maximum rate from 50 to 20 percent. The Kyrgyz Republic already has one of the most liberal trade regimes among the BRO countries and has been assigned the highest rating (1) within the Fund's assessment of trade restrictiveness. Unfortunately, the potential benefits from the WTO membership are, for the time being, significantly reduced by the fact that four out the Kyrgyz Republic's six main trading partners are not yet members of this organization.

On the structural front, besides the earlier-described efforts to restructure the banking sector, reforms in many other areas are also under way. This includes reducing regulations on entry and operation of businesses and enhancing the competitive environment, improving the financial condition of utilities (gas and electricity) and commencing their privatization, and strengthening the social protection system to preserve a minimum acceptable utility service level of access for the poorest groups of society. These reforms will be supported by the upcoming World Bank's structural adjustment credit. The government will continue its reforms in the agricultural sector. This will include the elimination of the moratorium on land sale by the end of this year. The privatization of the remaining small and medium-sized enterprises is proceeding at a steady pace, and efforts are being made to accelerate the privatization of some of the large state monopolies. Unfortunately, the first attempts to sell part of Kyrgyz Telecom proved to be unsuccessful due to the lack of serious offers from foreign investors. My authorities intend to proceed with this transaction after resolving some of the outstanding issues with the current privatization advisor. The generally satisfactory progress in implementing structural reforms has been confirmed by the observance of most of the structural performance criteria and benchmarks. The criterion regarding licensing has been largely implemented with the prohibition of sublicensing and with the proposal to reduce by half the number of activities that are still subject to licensing. As indicated in the staff report, the remaining doubts concerning the implementation of the government's decisions and proposals with regard to licensing should be clarified in the course of this month.

Reduction of poverty remains the highest priority for my Kyrgyz authorities. They are very concerned by the further increase in the incidence of poverty that was observed after 1995, despite the relatively high growth rates achieved during that period. The preparation of the poverty-reduction strategy is well under way with close involvement of the civil society and donors. Several important national workshops have taken place, including on poverty reduction and social assistance, on growth prospect and strategies, and on governance. In the next few months, the results of these consultations will be consolidated and form the basis for the elaboration of a comprehensive strategy.

My Kyrgyz authorities are confident that their program of reforms will have a major impact on the country's economic situation as well as on reducing poverty. They remain committed to economic reforms which, they believe, will help place the Kyrgyz Republic on a path to stable and sustained economic growth.

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

The staff has presented a fair and candid analysis of the economic developments in Kyrgyz Republic. Indeed, 1999 was a difficult year to the authorities which had to deal with adverse terms of trade and spillover effects of the Russian financial crisis. Significant slippages in the fiscal area led the program offtrack in the beginning of 2000. Nevertheless, growth momentum was sustained in 1999 at 3.4 percent of GDP and strengthened in 2000. With the acceleration of economic growth and strengthening of revenue collection, the program was restored later this year. Besides, the authorities managed to accelerate the reform process in many areas.

Performance in the monetary area produced the most impressive results. All monetary performance criteria for end-March and end-June were observed. This result was achieved despite the difficult external environment in which the NBKR's authorities had to operate. The inflation rate was brought down from 40 percent in 1999 to 7.1 percent in June 2000—its lowest level since 1990. Finally, NBKR reserves increased by $53 million (or one month of imports), although they are still at a low level of 3.5 months of imports. We concur with staff that NBKR should continue to maintain a tight monetary stance with objectives of containing inflation and preventing depletion of foreign exchange reserves. Interventions in the forex market should be limited to only smoothing unwarranted exchange-rate fluctuations. The authorities are to be commended for the introduction of National Bank bills which give them a valuable instrument of indirect monetary control. It is encouraging that despite sharp depreciation of the som of about 35 percent vis-à-vis the U.S. dollar, the REER rate remains broadly unchanged from its 1999 level, suggesting that external competitiveness was not eroded. Finally, on monetary issues, there were some calls to reduce independence of the central bank. NBKR's independence should be preserved, and we urge the authorities to resist such pressures.

Developments in the fiscal area fell short of expectations. We share staff's concerns that strong recovery in revenue collection in May–June may appear to be short-lived and needs to be sustained. More reforms are needed on both the revenue and the expenditure sides. On the revenue side, the revenue base needs to be further expanded, particularly in light of the already large and increasing debt burden. Tax revenue in relation to GDP is low even among CIS countries and has shown continuous decline from 15 percent of GDP in 1995 to less than 12.5 percent in 1999. In this connection, it is regrettable that the Parliament rejected proposed changes to the tax code aimed at raising revenue collection. Steps to improve tax and customs administration are also pending. We urge the authorities to push ahead these issues as soon as possible. On the expenditure side, we welcome steps to improve expenditure controls, most notably, the introduction of the expenditure warrant system. We commend the authorities for their success in containing expenditures in 2000 and for the clearance of domestic arrears. We welcome emphasis placed by staff on the need to refocus expenditures in the 2001 budget towards social areas. We hope that pressures to increase expenditures on the eve of upcoming presidential elections in October will be resisted. Finally, on fiscal issues, it is regrettable that the debt relief provided by Russia and Pakistan will be used to finance an increase in wages, although we understand the rationale behind such a decision.

Perhaps the most important area of concern is the size and the operations of the Public Investment Program (PIP). It already accounted for 9.5 percent of GDP and for 65 percent of total external budget financing in 1999, contributing to a rapid increase of public and publicly guaranteed debt. At the same time, its size is likely to increase further as projects amounting to an additional $230 million are under way. The higher PIP-related expenditures were the primary source of non-observance of the budget deficit target in end-June this year. Therefore, we welcome steps to improve control over the operations of the PIP, namely the establishment of a unit in the Ministry of Finance for prioritization and monitoring current projects, and the appointment of the ADB resident advisor. Should these measures not suffice to put effective control over the expenditures, we would urge the authorities to suspend non-priority projects in order to achieve fiscal objectives.

On restructuring of the banking sector, some steps have been made in recent times, although progress is still short of expectations in light of the severity of the problem. Banks accounting for 50 percent of total assets of the banking system and 54 percent of total deposits are classified as either insolvent or problematic. Thus far, the progress has been limited to liquidation of one bank and recapitalization of another by its owners. In this regard, the establishment of the DEBRA—an agency which will be dealing with restructuring and liquidation issues—is a step in the right direction. Hopefully, this will expedite recapitalization and restructuring of Kairat Bank—the country's largest bank. Financial burden of this operation should not be carried by NBKR but by the government. Such resources should be made available in the 2001 budget. The authorities should continue to address governance issues in the banking sector.

On the external issues, the overall balance of payments improved somewhat, and the current account deficit declined this year, but the prospects appear to be less favorable than previously expected. Kumtor gold mine will start phasing out its operation earlier than envisaged. This will lead to a gradual deterioration of the current account from 2004 onwards in line with an increase in debt-service payments. At the same time, it is unlikely that financing for such deficits will be available in light of the country's very limited repayment capacity and already large amount of external debt. The stock of debt rapidly increased over the years reaching $1.4 billion at end-1999 or 112 percent of GDP. Debt rescheduling provided by Russia and Pakistan is only a temporary solution to the problem which is complicated by the composition of debt—more than 50 percent of the stock of debt is owed to multilateral institutions, including the Fund. It might be necessary to deal with that problem in the very near future, and we noted that the Fund staff is preparing some proposals in this area.

The authorities should proceed further with structural reforms. Some steps already undertaken are encouraging, most notably in the public-sector and energy-sector reforms. However, further efforts are needed to reinforce the authorities' commitment to structural reforms. Such efforts must include steps to proceed with further privatization, reduction of the size of the public sector, and pension-system reform. More emphasis should be placed on improving the business environment through changes in the legislation and further simplification of licensing procedures.

Kyrgyz Republic maintains a very liberal trade regime and was the first country in the BRO region to join WTO in 1998. However, mostly for political reasons, there are ongoing trade problems with Kazakhstan and Uzbekistan which are well articulated by staff in Paragraphs 83 to 84 of the Selected Issues paper. In this connection, we urge the authorities to continue negotiations with neighboring countries to find acceptable compromise.

Finally, it is important to continue improvement of statistical database.

With these remarks, we support completion of the reviews, including the request for waivers for non-observance of performance criteria, and wish the authorities well.

Mr. Campos made the following statement:

The Kyrgyz economy faced a difficult year in 1999 and, although GDP grew by 3.6 percent, most macroeconomic indicators worsened significantly. Inflation increased by 40 percent, the fiscal deficit grew from 9.5 percent of GDP to about 12 percent of GDP, both exports and imports slumped, and structural reforms slowed. However, the economic situation appears to have improved considerably in recent months. GDP growth accelerated to 7.4 percent, inflation was only 4.7 percent in the first eight months of 2000, and the exchange rate has remained stable. This was largely owing to the efforts made by the Kyrgyz government to stabilize the economy and bring the program on track. Notable in this regard is the fact that monetary policy has been kept tight and that the government and the national bank remain committed to this policy stance, which has contributed to the relative stability of the exchange rate, reduced inflation, and restored confidence in the domestic currency.

The adoption by the Kyrgyz authorities of a comprehensive restructuring program for the financial and banking sector is also welcome. Indeed, the full implementation of this program will be important to attract the resources necessary for the development of the economy.

On the final side, it is worth mentioning that fiscal revenues recovered, while current expenditures were contained, despite a 20 percent increase in civil-servant wages. I welcome the authorities' commitment to achieve the original program deficit target for 2000. The introduction of the expenditure warrant system is also a step forward to improve expenditure control. I encourage the authorities to reduce the size of the PIP and to establish appropriate criteria for the selection and privatization of PIP-related expenditures.

Regarding the recent civil-servant wage increase, I fully understand the reasons for such an increment, which will contribute to improving the income levels of public-sector employees, reduce corruption, and improve the poverty situation. I welcome the ongoing preparation by the Kyrgyz authorities of a comprehensive poverty-alleviation strategy in consultation with the civil society and donors.

In the area of structural reforms, I welcome the recent progress in reforming the energy sector, as well as the approval of the legislative amendments to allow private ownership of land. However, I encourage the Kyrgyz authorities to review the recently published legislation regarding the agricultural sector. I welcome the commitment to reforms in this area, as well as the measures to improve the business environment, including continued privatization and simplification of licensing requirements.

Looking ahead, the authorities have a challenging fiscal adjustment to carry out over the medium term. Indeed, the external outlook is worrisome, as both the debt- and debt-service-to-GDP ratios are projected to remain high, even after the relief from the recent rescheduling. In light of this, I strongly encourage the authorities to press ahead with further fiscal adjustment over the medium term, as well as to pursue with vigor the program of reforms. It is important that the authorities, with the assistance of the staff, continue to explore ways to reduce the debt service, including debt relief and alternative mechanisms.

In view of the steps taken by the authorities to bring the program on track and the recent positive economic developments, I support the authorities' request for the completion of the first and second reviews under the PRGF arrangement and request for a waiver of the non-observance of the performance criteria on pension arrears and the cumulative budget deficit at end-June 2000, for the non-observance of performance criteria on external arrears, and for the non-observance of structural performance criteria on licensing for end-June.

Ms. Lundsager made the following statement:

The Kyrgyz Republic faces daunting challenges to place its stabilization efforts on a sustainable path by containing its high external debt and large fiscal deficits. While the authorities have taken some steps in the right direction, much more needs to be done to stabilize the situation. The precariousness of the current environment underlines the importance of adhering to program targets, and the request for numerous waivers regarding missed fiscal and structural benchmarks is a disturbing sign that this program is not yet back on track. Unfortunately, the commitment of the authorities to implement and to adhere to the most necessary reforms has been repeatedly called into question by inaction on certain issues and a rollback of other reforms. Furthermore, while we recall there was an informal country matters update on Kyrgyz recently, it might have been useful to have a Board discussion in late spring or summer, even if the first review could not have been concluded then, in order to reinforce calls for policy improvements, instead of combining two reviews at this time.

The high level of external debt is a serious concern that threatens to undermine the Kyrgyz Republic's stabilization efforts. The increase in the debt-servicing burden this year and projections for it to remain high over the medium term are alarming, especially since the Kyrgyz Republic failed to meet its more modest debt-servicing requirements last year. Reported agreements to reschedule debt-service arrears are a positive step, and we noted in the staff supplement that arrears that emerged earlier this year were eliminated. We understand that the authorities are evaluating their external debt situation to determine the best way forward. Clearly one element of that must be limited recourse to accumulating external debt.

The debt situation has a critical bearing on fiscal performance. Fiscal adjustment has been at the core of this program, and while we recognize that the fiscal target for this year is ambitious, actual performance has been very weak: the fiscal deficit remained over 12 percent of GDP for the first half of this year, and even with this high target, a waiver is needed. The indications in the staff supplement that revenue performance has remained satisfactory recently is good news; but since most of the programmed revenue measures were not adopted, there does not appear to be a workable strategy to reduce the deficit to 7 percent of GDP by year-end. Also, given the likely need for fiscal outlays to deal with the banking system problems, what are prospects for further fiscal improvements next year?

On the expenditure side, the Public Investment Program (PIP) appears to be a key driver of excessive spending, as it totals about 25 percent of total government expenditures in the first half of 2000. This is clearly too large given the Kyrgyz Republic's external debt and debt-servicing ratios, even if the program is financed by concessional lending. We recognize the steps taken recently to control the PIP but are worried that many of the larger projects in the PIP will require high follow-on maintenance costs, further complicating the fiscal situation. Sustained fiscal adjustment will be quite difficult without a clear setting and implementing of PIP priorities. Frank discussions with donors will be required to ensure a manageable investment program with future sustainable debt-servicing costs.

Structural issues are also key to this program and the transition to a market economy. We are in broad agreement with the staff and welcome progress on restructuring the banking sector, pension reform, and allowing private ownership of land. But the staff notes that implementation of structural reforms "has frequently lagged and opportunities for graft and corruption abound. As a result, the business climate remains relatively unfriendly." This is particularly worrisome and implies that the considerable efforts by the Fund and other donors made in recent years have not produced the desired results. In that regard, what is the status of the President's program to combat corruption and economic crime? Delays in reforming the licensing systems are particularly discouraging, given their impact on corruption. These and governance issues more generally are important to generating confidence in the economy. Without meaningful progress, foreign and domestic investment will be very slow to materialize; without a viable private sector emerging, poverty reduction will be very difficult.

The Kyrgyz government still retains stakes in many large industrial enterprises, hindering their restructuring and presenting a further drain on limited fiscal resources. The slow pace of privatization since 1997 is another worrying sign about the authorities' commitment to structural reform. The authorities need to take a more realistic approach regarding the value of their national assets and seek to attract strategic investors through transparent and competitive tenders.

We agree with the staff that reforms in the utility sector are necessary, especially as implicit price subsidies on electricity, heating, and gas were as high as 9 percent of GDP and that there has been erosion in real tariff rates. The increase in electricity tariff rates by 40 percent this year and the rise in gas prices are positive steps. It was disturbing to learn that some reforms, including the electricity tariff adjustments, have been subsequently rolled back. Furthermore, the two presidential decrees issued in April regarding the agricultural sector, subsidized loans, and tax deferrals, are a step backward.

With the PRGF now in its second year, formulating a PRSP is an important step in advancing the Kyrgyz Republic's poverty-alleviation strategy. We were surprised that we did not see an interim PRSP with this review, but as I now understand it, this program was approved based on a PFP. Still, could not the authorities have developed an interim PRSP at this time? They have already indicated their willingness to engage with civil society.

We understand that the authorities and the staff have been following up, per the Fund's guidelines, on the misreporting of reserves discussed by the Board in February. We commend the authorities for their cooperation on this issue and urge the staff to continue to follow this issue closely. We also welcome the authorities' strong commitment to an open trade regime.

Owing to our concerns over debt, fiscal, and structural issues, and our judgment that the authorities have not undertaken a critical mass of reform steps to put the economy on a sustainable track, we are abstaining on the proposed decision.

Mr. Hagan made the following statement:

I said in my last statement on the Kyrgyz Republic that I was unconvinced that the program could be carried out as intended. Having read the paper for this discussion, I remain of that opinion. In the previous discussion, both I and Mr. Kiekens raised some issues about the policy mix that the Fund and the international community in general use for the countries of Central Asia, or former FSU countries more generally. Having read the current paper, I am not comfortable with the policy mix that the Fund is following. I do not have an alternative policy mix to suggest, but the paper leads one to the conclusion that things are not getting better in the Kyrgyz Republic.

I note that the growth rate has improved quite sharply since the Board last discussed the Kyrgyz Republic; however, the background paper refers to it as moderate but unbalanced economic growth. This is a country, as Mr. Campos, Ms. Lundsager, and others have pointed out, where debt has quickly become a major issue over a short period of years. I do not see in the paper or program any sustainable answer to the debt problem. It is therefore essential to look at the medium- to long-term outlook before considering this program again.

We are happy to approve the decision today and grant the waivers. As I said in my last statement, it would be understandable if the program were not carried through as intended. In many respects, the authorities are making their best efforts to carry through this program, but there are difficulties and elections are approaching. Thus, we will not join the U.S. in abstaining, but we do have concerns about the program, where it is going, and whether it is the best course for the Kyrgyz Republic at this point.

I would agree with Ms. Lundsager that we would have expected to see more discussion of the development of the PRSP in this document. Although it is still under preparation, there have been a number of consultations and a flavor of that would have been helpful.

Mr. Hajian made the following statement:

At the outset, we thank Mr. Cippà for his helpful preliminary statement. At the time of approving the second annual arrangement under the PRGF, this chair noted the difficult conditions Kyrgyz Republic was facing. In 1999, while real GDP growth picked up to about 3.5 percent, inflation soared from 18 percent to 40 percent, revenues declined, and fiscal deficit grew along with build-up of some new arrears. The balance of payments improved as lower imports more than offset export revenue losses owing to lower prices of gold, energy, and grains. This year, the Kyrgyz Republic incurred external arrears.

Compared to 1999, the prospect for the year 2000 has considerably improved, mainly in response to corrective measures taken by the authorities. The real GDP growth is stronger than previously expected as agriculture remains buoyant and other sectors also show positive signs. Moreover, with a continued tight monetary policy and a relatively stable exchange rate, inflation is expected to reduce substantially. Nevertheless, meeting the fiscal revenue targets remains challenging.

We welcome the determination of the authorities in implementing the PRGF program and achieving its overall objectives. The authorities should be particularly commended for substantial tightening of monetary policy. This has played a significant role in making progress toward bringing the program back on track. We welcome the steps that have been and are being taken in addressing macroeconomic imbalance, particularly in the fiscal area, including the improved control over the public investment program. In view of the progress made, we support the authorities' request for waivers and the completion of the first and second review under the PRGF arrangement. We broadly agree with the staff appraisal and make a few comments for emphasis.

Fiscal consolidation has emerged as the most difficult task in the Kyrgyz Republic's battle for stability and its path to sustainable growth. The Kyrgyz authorities need to enhance their fiscal efforts to increase revenue through broadening the tax base, increasing tax rates, and improving tax administration. We welcome the authorities' intention to resubmit the proposed changes to the retail tax and the VAT for parliamentary consideration. It is also encouraging to note the additional fiscal efforts made by the authorities, and the steps taken in improving tax and customs administration. These efforts need to be pursued more forcefully.

While progress has been made with respect to expenditure control, the foreign-financed public investment program (PIP) remains a serious source of problems. The system of project selection criteria, outlined in Box 1, is welcomed and needs to be enforced diligently. As staff point out, future maintenance and operation expenditures related to these projects could be very large, with a potential crowding-out effect on other expenditures. For more effective control on these expenditures, creditors should be engaged in discussion of the appropriate size of the PIP and the need for a better coordination among donors. Expenditure mix is also a source of concern. Significant decline in total expenditure on education and health in the past few years is regrettable and needs to be corrected.

Finally, the urgent need for a more rapid progress in structural reform cannot be overstated. Further reforms on the banking and energy sectors, as well as improvement in business environment and privatization in the broad sense, are needed.

With these remarks, we wish the authorities well in implementing their program.

Ms. Steinbuka made the following statement:

During the previous discussion in February, I expressed a number of reservations about the projections underlying the PRGF arrangement and estimated risk to the program implementation as being very high. Unfortunately, the actual situation and economic outlook fully correspond with my worst perceptions. If macroeconomic indicators do not improve and structural reforms continue to be implemented at a slow pace, it would be hard to imagine how the successfully started transition in Kyrgyz Republic could be brought to a successful end. It is highly regrettable that the first review of the program could not be concluded and, even now, when the program is back on track, several performance criteria are not observed. In light of the coming elections, the risk to further implementation of the program remains high. We appreciate the recent efforts of the authorities in accelerating reforms. However, like Ms. Lundsager and Mr. Hagan, I have serious reservations and do not feel comfortable with the strategy of implementation of the program. Therefore, I would rather add my voice to those who are of a mind to abstain. Still, the proposed decision could be supported if the fiscal and structural situation improves.

The fiscal situation remains worrisome. Despite some increase in tax revenues and elimination of budgetary arrears, significant improvements are needed, on both the revenue and expenditure sides. With regard to the revenues, I am particularly concerned about weak tax administration. Given the widespread tax avoidance, the improvement of tax collection could significantly improve the fiscal situation. However, most likely, tax collection could not be substantially improved in the short run. This is why the only way to raise budget revenues is an increase in revenue base. Like Mr. Mozhin and Mr. Zakharchenkov, I regret that the Parliament rejected changes to the tax code aimed at raising the revenue base. I also wonder whether revenues generated from free economic zones are a substantial source of income. In transition countries, free economic zones rather play a role of "tax havens." Is the Kyrgyz case different? As to expenditures, the PIP is indeed oversized and does not seem consistent with domestic co-financing and outstanding external arrears and debt.

On the structural issues, I welcome the recent progress in the public sector, pension reform, and energy-sector reform. At the same time, it is regrettable that the overall progress was slow, particularly in privatizing large state enterprises. Like the staff, I am very much concerned with an increase of various forms of state aid in the agricultural sector. An increase in state interventions is the worst medicine against inefficiency in the agricultural sector and a waste of resources under an unsustainable fiscal situation.

I am also convinced that the best way to handle various problems, including external imbalances, is the consistent strengthening of such policies as property rights, the rule of law, institution-building, and the prevention of corruption. The Kyrgyz economy faces many obstacles, including serious governance problems and administrative inefficiency. Further decisive policies in the institutional area are needed to combat corruption and to make the business climate friendlier.

Unemployment and poverty remain the core problems. Healthy growth is the main source for human development and job creation. The restructuring, primarily in the agricultural and energy sectors, and strengthening institutional capacity, should also help in creating jobs and eliminating poverty.

Mr. Yakusha made the following statement:

First of all, I would like to thank Mr. Cippà for a very candid and comprehensive preliminary statement.

Last year, 1999, was a difficult year for the Kyrgyz Republic, as the country was affected by a combination of external shocks and an inadequate policy response to these shocks. Some mistreatment (on the trade side) of quite an open, land-locked, and relatively small Kyrgyz economy by some much larger neighbors, seem to warrant the attention of the Fund and may need to be reflected in the summing up. Because of broad conflicts, the message coming from the first country of the region, who joined WTO, is not that clear and may be even discouraging for other countries that are trying hard to join the WTO. We may on balance want to express appreciation for several important creditors and donors, who continue to provide project financing, temporary debt relief, and assistance of other sorts.

We broadly share the thrust of the staff appraisal and support the proposed decision. It is encouraging to observe signs of improvement this year, which have been achieved despite some continuous difficulties in the area of external security of the country. The highest-ever rate of growth has been especially encouraging, as well as the achievement of the notable disinflation and clearing of some budget arrears. The unfortunate derailment of the program soon after the first disbursement in this context seems to be somewhat out of line with the general trend towards overall improvement of the macroeconomic indicators for the Kyrgyz Republic.

To this end, if one would look at the structural side of the program, the agenda for reform looks impressive, but the recent implementation record has not been that good. Without more consistent and credible efforts on the structural front, the recently achieved fiscal improvement cannot be sustained. In particular, the authorities need to redouble their efforts of capturing agribusinesses into the tax net, even if substantial results are not achieved at the very start of the process. Otherwise, they risk a moral hazard through entrenching the expectations about the non-taxable nature of a very important part of their economy.

We would also like to urge the authorities to exercise prudence with respect to any new borrowing as the level of external debt seems to be excessive even after the recent rescheduling with several major creditors. A heavy debt burden calls for even more consistent efforts in collecting revenues and enforcing the rule of law and uniformity of treatment of taxpayers. The Kyrgyz Republic has not been scoring well on governance if judged by different indexes. Despite the often distorted simplification of all those indexes, there is evidence that the authorities need to pay more attention to improving the business and investment climate.

Last, but not least, on previous occasions our Chair expressed some skepticism over the over-ambitious PIP, and we take note that the staff now shares this concern. We would like to urge the authorities to proceed with prioritization of the related projects and to improve control over their implementation, and possibly to scale back PIP.

Ms. Saito made the following statement:

Although the Kyrgyz Republic seems to be one of the countries that has been implementing numerous reform measures since 1991, many areas remain in which change seems slow.

The fiscal sector is key for the Kyrgyz economy; and in completing the first and second reviews under the Poverty Reduction and Growth Facility, it is worrisome that there has been another slippage in the performance criteria of the budget deficit. Although tax revenues improved during May and June, the track of stable revenue growth is still elusive. Given also the difficulty in imposing new tax measures before the presidential elections, it will be important to closely monitor the implementation status of the various fiscal measures presented in the program. Nevertheless, we are encouraged to see the authorities' commitment to implementing sound macroeconomic management as seen in their restraining current expenditures, as well as their tight monetary policy. Also, in light of the positive macroeconomic figures (although some of the positive indicators could be attributed to recovery from the Russian crisis), we would like to fundamentally support the staff's view, with comments in a few areas.

We share the staff's concern about external debt repayment ability and fiscal consolidation. As there is a weak base for income in foreign currency, and little room to restructure foreign debt any further (because most of its foreign obligations are from international financial institutions), it will be imperative for the authorities to conduct sound economic policies while bearing in mind that there is no headroom for further external financing.

As has been mentioned by other chairs, we believe that more work is required in the context of the Public Investment Program (PIP). In this sense, we welcome the authorities' establishment of the PIP unit in the Ministry of Finance, a necessary and welcome move, especially given the size of the PIP relative to the budget. We believe it paramount to strengthen the capacity of this unit, and in turn it will be essential to further analyze the necessity of projects in light of the present economic situation and the change in circumstances from the onset of these projects. Needless to say, prioritization of projects is crucial. The government budget system should be improved so as to properly reflect PIP-related expenditures to the medium- to long-term external debt repayment outlook, and it would be desirable to see the authorities' increased cooperation with the World Bank and the ADB in this area. I would like to also stress the importance of technical assistance in this area.

Regarding the Poverty Reduction Strategy, we believe this to be an area of high priority. We therefore would like to ask for the authorities' prudence in allocating revenue to such social areas, so that it will not merely lead to the widening of expenditures. In relation to this, we concur with the staff for the need to streamline and eliminate privileges and subsidies; this should be done urgently.

With these remarks, I support the proposed decision, including the request for waivers for non-observance of the performance criteria, to complete the first and second reviews of the PRGF program.

Mr. Burnashev made the following statement:

This year has been challenging for the Kyrgyz authorities. They have to be commended for their commitment and resolution to continue necessary reforms in a difficult environment. Their efforts combined with improved external environment and strong regional rebound uplifted the Kyrgyz economy. I share the staff's assessment that under the circumstances the authorities have achieved the maximum feasible of what they could have achieved to secure macroeconomic stability. However, as other chairs, I have serious reservations about the effectiveness of the current Fund program for the Kyrgyz Republic. Since I generally agree with the issues raised by the previous speakers, I would like to discuss the elements vital for overall success of the reform process. In February, this chair noted an importance of putting the economy firmly on the track of achieving medium-term fiscal and external viability. Given the size, location, and structure of the Kyrgyz economy, this is crucial for buttressing it against unexpected external shocks, achieving sustainable economic growth, and reducing widespread poverty.

To their credit, the authorities have started to implement necessary adjustment measures to stabilize the fiscal position after last year's substantial expenditure overruns. In the first half of 2000, both current and capital expenditures have been reduced. It appears, however, that the main problems lie not only on the expenditure side, but also on the revenue side. Weak tax and non-tax collection and unsuccessful attempts to reintroduce and enforce the necessary legislation greatly constrain the choice of the available options for the authorities to achieve necessary fiscal correction.

Given the expected budget revenues over the medium term, if the authorities are to succeed with adjustment, it is imperative for them to continue fiscal consolidation and institute proper expenditure controls over operations of the central and local governments, and large governmental parastatals. It appears to me that this has been so far their Achilles' heel.

Despite extensive discussion on the issues of expenditure controls, including by this Board on a number of occasions, as far as I understand, the staff record no substantial progress. Instead, one has to deal with persistent expenditure overruns, weak fiscal discipline of the government at every level, larger public deficits, and rising-at-an-alarming-rate public debt. To me this is indicative of the deep problems with the fiscal institutions, and I wonder whether we should strongly recommend to the authorities to consider an establishment of operationally independent treasury, with sufficient insulation from spending pressures arising elsewhere. Indeed, the best way to discipline the government and the Parliament to start living by their own means might be to deprive them of the opportunity to spend and borrow monies indiscriminately. Following an example of some developing countries, an independent treasury and central bank might be the best watchdogs of preserving the country's macroeconomic stability.

Not the least important issue is the quality of public expenditures. Again from analysis of the tables in the staff report, it appears that the authorities have certain leeway to redirect some of the current expenditures from propping up inefficient public enterprises towards essential social services, including pension and social payments. Among the capital expenditures, the largest share falls at Public Investment Program. Let me address this issue separately.

The staff shows that the share of PIP outlays largely financed by government external borrowing rose sharply from 3.7 percent of GDP in 1997 to 9.5 percent of GDP in 1999. It is expected to slow down somewhat at the level of 6.2 percent in the year 2000 and further to 5.8 percent in the year 2001. Staff in Box 1 of the report raise some very important issues that I would like to discuss now.

To start with, I am truly amazed by the fact that prior to embarking on the PIP in as early as 1994, the fiscal authorities had not first put in place the special monitoring unit in the Ministry of Finance or established the government coordinating agency. The staff tell that only recently they completed the inventory of the foreign-financed PIP projects, appointed a special, foreign-financed PIP advisor, and embarked upon the program of prioritization and fiscal consolidation. At the same time, simple calculations show that just in the last four years, from 1997 to 2000, they have externally borrowed and spent 23.7 percent of GDP to finance the PIP. In addition, the staff report that the authorities are in negotiations with a number of foreign lenders to add up more projects into the pipeline.

Mr. Cippà and Mr. Abdychev in their preliminary statement provide some arguments why the authorities consider capital spending overruns as a "lesser evil" to excessive current spending based on "almost unlimited investment need of the Kyrgyz economy," and the current strategy of maximizing the share of very concessional financing and minimizing the financing on market terms. Well, certainly this strategy is not without the costs. On my side, I would like to warn them that they should not fall in the old trap and avoid ending up one day deeply indebted with all the funds spent on capital expenditures and no resources to maintain the built-up infrastructure. As past experience teaches, such strategy may be corrosive for both economic prospects of the country and confidence and reputation of its policymakers. As for international donors, their absorptive capacity to forgive the old debts and grant new financing, thus bearing the market risks of the decisions by the Kyrgyz authorities, may prove to be quite limited.

It is clear that the country's external viability cannot be achieved without external support and debt rescheduling. External debt continues to rise rapidly, and the authorities have not yet undertaken the necessary adjustment measures to stabilize it. Moreover, the staff projects that the country's external position remains highly fragile and may well deteriorate in the future.

Clearly, the country will certainly need the comprehensive debt solution as debt financing as expense of running external arrears is not an option. The staff report shows that the authorities have yet not exhausted the available options of stabilizing the external position. Let me give a concrete example. Box 3 of the report discusses the Kumtor gold mining project, where the government owns two-thirds of the shares. Due to initial miscalculation of the reserve base, the company decided to scale back its production plans and to start retiring the debt quicker. The contract with the foreign partner specifies that gold profits will be accrued in the budget only after the debt is retired. Now, in the light of the country's precarious external position, why can the government, who the control stake thus effectively should exercise the full control over the company, not renegotiate the initial terms to increase the budgetary outlays from the project in the immediate future to finance external debt servicing? This is just one example, and I am sure there may be others, as the government maintains the stakes in other enterprises, that both the staff and the authorities could identify to ease the external debt situation.

This example shows that any comprehensive debt solution should be discussed in the context of comprehensive study of how the international community can more effectively assist the poorest CIS countries in Central Asia and the Caucasus. Let me now cite what this chair has said at the previous Board meeting in February: "It is clear that the case of the Kyrgyz

> Republic raises principal issues about the effectiveness of the Fund's strategy, as well as the strategies devised for that country by the World Bank and other multilateral and bilateral creditors. Ten years of generous financial support have not improved the living standards of the Kyrgyz people, but burdened them instead with a debt overhang. We must ask ourselves whether during the past decade, the balance between financing and adjustment has been correct."
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> Blaming the authorities alone for the past mistakes would not be the best option, in case we really wish to continue supporting the country's development, especially now when it faces challenging external and domestic environments. I therefore support the proposed decision but would like to reiterate strongly the request to the staff to present the Board, as soon as possible, with the results of the study of effectiveness of the Fund-supported programs in the poor countries of Central Asia and the Caucasus.

Mr. Le Gal said that he agreed with the request by several speakers to have a study on the Fund's impact in the region.

The staff representative from the European II Department confirmed that an anti-corruption program had been announced the previous year, but it had not been based on an analysis of the sources of the corruption and thus had not been effective in dealing with the problem. The government had been trying to focus on small criminals rather than on the most important issues in fighting such corruption, although it recognized that something more had to be done. Governance was one of the main topics in one of the workshops held under the World Bank's comprehensive development framework earlier in the year, and it would be a main focus of the strategy being developed by the government. The authorities had asked the World Bank to help with a structural adjustment credit to address governance issues, and diagnostic studies for that would be started later in the year, so it was hoped that by 2001, there would be a more comprehensive program in place to deal with some of the governance issues. The Fund program included various measures to help in the area of improving governance—for example, through improvements in licensing—so the government was being encouraged to move quickly.

Fiscal policy was an area of concern to the staff, particularly because the revenue measures had not been put into place and revenues continued to lag, the staff representative noted. The staff had been discussing a range of tax measures to be included in the program in the next year, and there would have to be a further reduction in the budget deficit in order to deal with the debt problem. The staff and authorities were aware that there was a need for further adjustment, which would be part of the next program. However, adjustment alone would probably not be enough to solve the debt problem that existed, and the staff was looking at other ways of dealing with it. A paper on the debt in low-income countries in the Commonwealth of Independent States (CIS) would be presented to the Board in the next few months.

As to whether the free economic zones were tax havens, under the program, the staff had made significant progress in improving the taxation of enterprises in those zones, the staff representative explained. New legislation had recently been passed making all of the transactions of enterprises in the free economic zones in the domestic market fully taxed, like every other activity, which was helping to improve revenues. Free economic zones were also in the process of being fenced and limited in size. Enterprises in those zones were taxed to a certain extent.

Although there had been good progress made on expenditure control, much still needed to be done, the staff representative related. The overruns, particularly in the past year or two, had been in the public-investment program. The staff hoped that with the new unit and a clearer focus on the issue, the situation would improve rapidly.

A preliminary draft of an interim PRSP had been prepared by the government two weeks earlier, but had not been made available in time for the Board meeting, particularly because the government had had some difficulty assimilating all of the information collected from the various workshops that had been held, the staff representative reported. A joint mission from the World Bank, Fund, ADB, and UNDP would visit the country the following week to help the authorities with the technical aspects of the PRSP, including the costing of various proposals. The staff was therefore optimistic that there would be a relatively good document soon, at least in time for the next program.

Mr. Cippà made the following concluding statement:

> Let me thank the staff for the detailed answers to the questions raised and the Board for supporting the authorities' request for waivers and concluding the reviews of the program. I also thank the Board for the frank and constructive discussion on the difficult prospects for the Kyrgyz Republic and the advice expressed in regard to economic policies.
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> The situation in the country is objectively difficult. The program went offtrack for a while at the beginning of this year, to a large extent owing to the Russian crisis. The authorities were able to regain macroeconomic stability, even if it remains fragile. It is wise for the Board to proceed with Fund support, a decision that recognizes the commitment of the authorities as well as the progress achieved thus far, which is considerable, given the circumstances. Some Directors concluded that that was not enough or that the strategies followed were wrong. The authorities will take these concerns as incentives to do better in the future to regain the full consensus of the Board.
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> I shall not go into detail on the authorities' response to the deterioration of macroeconomic conditions, as I already produced a fairly long preliminary statement. The crucial issue is fiscal sustainability, in particular the strengthening of fiscal revenues. The numbers in that regard are low, even in comparison with neighboring countries. Raising them is not an easy task, given the increasing poverty in the country.
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> The authorities are aware that the broadening of the tax base is necessary, as is the reduction of exemptions and abuses. Unfortunately, not all

tax measures envisaged under the program could get the necessary parliamentary support, but the authorities will not give up and hope to go back soon to Parliament with another fiscal package. In my preliminary statement, I wrongly stated that this package was already resubmitted. That was a mistake and I hope that it will not count as misreporting.

The commitment of the authorities is even clearer on the expenditure side. In all respects, the reduction of current expenditure has been quite drastic, perhaps even too drastic, in light of the serious social impact of these measures.

Many Directors raised the problem linked with capital expenditure, in particular the level of PIP. That is a difficult issue. The need for that investment is undeniable. Given the current state of the Kyrgyz economy infrastructure, it is even difficult to talk about prioritization, but the authorities understand all of the concerns linked to the fiscal position.

The large depreciation of the som in 1999—compared with the drop in export values and with the new, mostly PIP-related, external borrowing—resulted in a significant worsening of old debt and debt-services indicators, as well as the reemergence of some arrears on external debt repayment. As explained in the staff paper, negotiations are taking place with the affected bilateral creditors. I take this opportunity to convey to them the authorities' gratitude for their constructive and helpful attitude.

The medium-term prospect for the indebtedness of the country is not bright. That is both because of the foreseeable developments in the current account and because of the inflexible structure of Kyrgyzstan external debt, which is dominated by obligations to international financial institutions. Sustainable answers to the debt problem are necessary. The authorities are awaiting with great interest the conclusions of the paper on debt in low-income countries of the CIS currently being prepared in collaboration with the World Bank.

On the WTO issue, I can only share the remarks made by Mr. Yakusha.

To conclude, let me, on behalf of my authorities, thank the Board and management for their continued support and the staff for its indispensable help provided during this difficult period.

The Acting Chairman made the following summing up of the discussion on the 2000 Article IV consultation:

Executive Directors agreed with the thrust of the staff appraisal. They noted that the Kyrgyz economy faced a difficult year in 1999, including the effects of the Russian crisis as well as trade restrictions by some trading partners. As a result, most macroeconomic indicators worsened. However, policy actions to stabilize the economy together with an improved external environment were beginning to bear fruit, as witnessed by some recent performance, in particular, the pickup in economic activity and relatively low inflation. Directors commended the authorities on recent developments, but urged them to pursue fiscal consolidation, ease the debt burden, and implement further structural reforms.

Directors agreed that the stance of monetary policy has been appropriately tight, and this has contributed to the relative stability of the exchange rate. They recommended that the authorities continue to pursue their present monetary and exchange rate policies. Several Directors noted that the central bank and the government have responded slowly to problems in the banking sector. Nonetheless, they welcomed recent actions in this area, including the adoption of a comprehensive bank restructuring program and urged the authorities to continue on this path to reestablish confidence in the banking system.

While the fiscal situation deteriorated in 1999 and the overall budget deficit rose, Directors noted that progress was made, in particular, in eliminating budgetary arrears. They also noted the authorities' efforts to strengthen public finances so far in 2000 and that achievement of this year's budget deficit target would signify a substantial adjustment. Nonetheless, they expressed concern that revenue performance remains relatively weak. Directors were disappointed that Parliament had rejected most of the tax measures that had been envisaged for 2000 to raise revenues relative to GDP. They urged the authorities to make every effort to adopt these and other measures to expand the tax base and to improve tax administration as soon as possible. These were key issues that needed to be addressed in the 2001 budget, if not before.

Directors commended the authorities for expenditure restraint and urged them to resist spending pressures in the remainder of 2000, especially in the run-up to the presidential elections. While understanding the reasons for the recent wage increase, they regretted that it was not possible to take further compensating revenue measures. Furthermore, given the current fiscal position, Directors stressed the need to carefully consider the composition of expenditures in 2001 and beyond, paying particular attention to the need to alleviate poverty. In this context, they looked forward to the interim Poverty Reduction Strategy Paper (PRSP) expected early next year and a full discussion of these issues in the PRSP.

Directors expressed serious concern about the size of the foreign-financed public investment program (PIP), both because of the high level of external debt and debt service, and the significant future costs for operation and maintenance of these projects. They urged the authorities to improve control over the very ambitious PIP, to engage creditors in a discussion of its appropriate size, and to consider the terms of future borrowing.

Directors also expressed concern about the deterioration in the Kyrgyz Republic's medium-term balance of payments outlook and the worsening of the main external debt indicators. They noted that even with a rescheduling of part of the nonconcessional debt, the debt-service burden remains high, especially over the next several years, and there is no clear prospect for finding a sustainable answer to the external debt problem. Directors encouraged the authorities to maintain efforts to bolster the fiscal position, explore ways to further reduce the debt burden, including by improving debt management, severely limiting the contracting of new debt, and by pursuing more vigorous structural reforms to enhance the investment climate and the productive and export base.

Directors regretted the slowdown in structural reforms in 1999, especially with respect to large-scale privatization and the modernization of the legal and regulatory framework. They underscored the importance of regaining structural reform momentum in order to both improve economic performance and to reduce the vulnerability of the Kyrgyz economy to external shocks. In this regard, Directors welcomed the recent progress, albeit on a small scale, in public sector reform and the beginning of restructuring of the energy sector. Nonetheless, they felt that much more should be done to improve the business environment, including through privatization and further simplification of licensing requirements, make further and more substantial public sector reforms, and address shortcomings in the application of business law and corporate governance to create an environment more conducive to private sector-led growth.

Some Directors called for a staff general study of the impact of the Fund's programs in transition economies of that region.

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

The Acting Chairman made the following summing up of the discussion on the review under the PRGF:

Executive Directors expressed regret that the PRGF arrangement had gone offtrack in the first few months of the year and several performance criteria had not been observed. However, they welcomed the fact that, subsequently, the authorities had made efforts that brought the problem broadly back on track.

Directors expressed particular concern that the fiscal program remained weak and that Parliament had rejected most of the revenue measures that had been envisaged under the program. They urged the authorities to make every effort to adopt these revenue measures as soon as possible and to find other ways to increase the revenue base. In view of the heavy debt-service burden and the concomitant need for further fiscal adjustment, the next program for the Kyrgyz Republic would need to contain such measures. Directors urged the authorities to keep the program on track in the run-up to the presidential elections.

Several Directors expressed serious concern about the debt situation. Debt and debt-service ratios are projected to remain high, in particular on the fiscal front. They encouraged the authorities to work with creditors and Fund staff to seek a sustainable solution. They noted the large public investment program and associated debt component, which will require a rationalization and scaling down of projects. They called for close cooperation with all creditors.

While welcoming some recent progress in reforms in the energy sector and in reforming the public sector, Directors noted that much remains to be done to create a more business-friendly environment, reduce corruption, and attract foreign investment. They expressed regret that the program's structural performance criteria on improving the licensing system had not been met, although some steps had been taken.

Directors welcomed the fact that the authorities are preparing a Poverty Reduction Strategy Paper, together with civil society and donors. They encouraged the authorities to carefully assess the priorities for development, while taking into account the limited fiscal resources and the need for a cautious borrowing policy.

The Executive Board took the following decision, with two abstentions from Ms. Lundsager and Ms. Steinbuka:

The Kyrgyz Republic has consulted with the Fund in accordance with Paragraph 2(e) of the second annual arrangement for the Kyrgyz Republic under the Poverty Reduction and Growth Facility (PRGF) (EBS/00/11, Sup. 2) and Paragraph 27 of the memorandum attached to the letter dated January 22, 2000, from the Prime Minister and the Chairman of the National Bank of the Kyrgyz Republic.

The letters dated August 30, 2000, and September 11, 2000, from the Prime Minister and the Chairman of the National Bank of the Kyrgyz Republic shall be attached to the second annual arrangement for the Kyrgyz Republic, and the letter dated January 22, 2000, shall be read as supplemented and modified by the letters dated August 30, 2000, and September 11, 2000.

Accordingly,

(a) Paragraph 2(a)(vii) shall be amended to read as follows: "the ceiling on outstanding stock of external debt of less than one year," or

(b) "the performance criteria for September 30, 2000, and December 31, 2000, referred to in Paragraph 2(a) of the second annual arrangement for the Kyrgyz Republic shall be as specified in Table 1 attached to the letter dated September 11, 2000."

(c) the following shall be added to Paragraph 2(b):

"(iv) with respect to the fourth loan, the completion, by September 30, 2000, of on-site inspections of five financial institutions, in addition to the eight institutions inspected as of June 30, as specified in Table 2 attached to the letter dated August 30, 2000; or

(v) with respect to the fifth loan, the elimination, by December 31, 2000, of the moratorium on land sales, as specified in Table 2 attached to the letter dated August 30, 2000."

The Fund decides that the first and second reviews contemplated in Paragraph 2(e) of the second annual PRGF arrangement for the Kyrgyz Republic are completed and that the Kyrgyz Republic may request disbursement of the second and third loans referred to respectively in Paragraphs 1(b) and 1(c) of the arrangement, notwithstanding the non-observance of the end-March 2000 performance criteria on tax collections, budgetary arrears, pension arrears, and external arrears, the end-June 2000 performance criteria on the cumulative budget deficit and on pension arrears, and the structural performance criterion on licensing regulation, as set forth in Paragraphs 2(a)(iii), 2(a)(iv), 2(a)(v), 2(a)(vi), 2(a)(x), 2(b)(ii), and 2(c) of the arrangement, on the condition that, with respect to the disbursements subject to the performance criteria specified above, the information provided by the Kyrgyz Republic on performance under these criteria is accurate (EBS/00/182, Sup. 1, 9/12/00).

Decision No. 12299-(00/94), adopted
September 13, 2000

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/00/93 (9/8/00) and EBM/00/94 (9/13/00).

4. MALI—INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—COMPLETION POINT UNDER THE ORIGINAL HIPC INITIATIVE

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

(i) the conditions specified in Paragraph (ii) of Decision No. 11796-(98/99) adopted September 15, 1998 (EBS/98/150), for Mali to reach the completion point have been met; and

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

Accordingly, the Trustee decides that, in accordance with Section III, Paragraph 3(e) of the PRGF/HIPC Trust Instrument (the "Instrument"), the equivalent of SDR 10.8 million shall be made available by the Trustee to Mali in the form of a grant that shall be paid on September 11, 2000, to an account for the benefit of Mali established and administered by the Trustee in accordance with Section III, Paragraph 5(b) of the Instrument. The proceeds shall be used by the Trustee to meet Mali's debt-service payments on its existing debt to the Fund as they fall due, in accordance with the schedule specified in the table attached hereto. (EBS/00/163, Sup. 2, 9/8/00)

Decision No. 12300-(00/94), adopted
September 8, 2000

5. MALI—ENHANCED INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—DECISION POINT

Based upon the updated external debt sustainability analysis for Mali (EBS/00/163, 8/11/00), the Fund as Trustee (the "Trustee") of the Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations (the "Trust"), established by Decision No. 11436-(97/10), adopted February 4, 1997, decides:

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

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

(a) Mali has satisfactorily implemented the policy reforms described in Box 9 of Mali's Decision Point Document under the enhanced HIPC Initiative (EBS/00/163, 8/11/00);

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

(c) Mali has prepared a Poverty Reduction Strategy Paper and its overall progress in poverty reduction is broadly acceptable;

(iii) that the external debt sustainability target for Mali is 150 percent for the present value of debt-to-exports ratio;

(iv) that in accordance with Section III, Paragraph 3(a) and 3(b) of the Instrument, the equivalent of SDR 33.6 million of assistance shall be made available by the Trustee to Mali in the form of a grant to permit a further reduction in the net present value of the debt owed by Mali to the Fund;

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

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

(b) the Trustee will provide to Mali as interim assistance the equivalent of SDR 0.69 million which shall be made available by the Trustee to Mali in the form of a grant that shall be paid on September 11, 2000, to an account for the benefit of Mali established and administered by the Trustee in accordance with Section III, Paragraph 5 of the Instrument; and the proceeds of the grant shall be used by the Trustee to meet Mali's debt-service payments on its existing debt to the Fund in accordance with the following schedule: 4.8 percent of repayment obligations as they fall due; and

(vi) that in accordance with Section III, Paragraph 3(e) of the Instrument, the Trustee shall disburse the remainder of the assistance committed to Mali under Paragraph (iv) of this decision at the completion point, together with interest on amounts committed but not disbursed during the interim period, calculated at the average rate of return per annum on investment of the resources held by or for the benefit of the Trust. (EBS/00/163, Sup. 2, 9/8/00)

Decision No. 12301-(00/94), adopted
September 8, 2000

6. SIERRA LEONE—PURCHASE TRANSACTION—EMERGENCY POST-CONFLICT ASSISTANCE

The government of Sierra Leone has requested a purchase of an amount equivalent to SDR 10.37 million (10 percent of quota) under the Fund's policy on emergency post-conflict assistance.

The Fund notes the performance under the 2000 Fund-supported program and the intentions of the government of Sierra Leone as stated in the memorandum of economic and financial policies, dated November 25, 1999 (EBS/99/217, Appendix III), and the letter dated

August 3, 2000, from the Minister of Finance together with its attached tables (EBS/00/180, Appendix I), and approves the purchase in accordance with the request.

Decision No. 12302-(00/94), adopted
September 8, 2000

7. SIERRA LEONE—EXCHANGE SYSTEM

Sierra Leone maintains an exchange restriction subject to Fund approval under Article VIII, Section 2(a) in the form of a tax-clearance certificate required for payments and transfers for certain types of current international transactions. In view of Sierra Leone's intention to eliminate this exchange restriction, the Fund grants approval of the retention of the exchange restriction until the next Article IV consultation.

Decision No. 12303-(00/94), adopted
September 8, 2000

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, by Advisors to Executive Directors, and by Assistants to Executive Directors as set forth in EBAM/00/118, Supplement 2 (9/7/00), EBAM/00/122, Supplement 1 (9/7/00), EBAM/00/122, Supplement 2 (9/7/00), EBAM/00/125 (9/7/00), and EBAM/00/126 (9/11/00) is approved.

APPROVAL: June 1, 2001

SHAILENDRA J. ANJARIA
Secretary