March 6, 1997
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 96/37

10:00 a.m., April 15, 1996

Contents

Executive Board Attendance

M. Camdessus, Chairman
A. D. Ouattara, Acting Chairman
P. R. Narvekar, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. A. Al-Tuwaijri	O. A. Himani, Temporary
	A. Fayolle
	L. Fontaine, Temporary
	V. J. Fernández
I. Clark	C. X. O'Loghlin
	C. K. Duenwald, Temporary
B. S. Dlamini	T. Berrihun, Temporary
H. Evans	J. Shields
K. P. Geethakrishnan	H. B. Disanayaka
E. R. Grilli	N. Coumbis
	L. M. Cheong
D. Kaeser	
A. Kafka	
W. Kiekens	J. Prader
	M. Nemli, Temporary
	H. A. Barro Chambrier
K. Lissakers	B. S. Newman
	M. W. Ryan, Temporary
	D. G. Loevinger, Temporary
H. Mesaki	
A. Mirakhor	
	A. G. Zoccali
S. Schoenberg	B. Esdar
	R. von Kleist, Temporary
A. S. Shaalan	Y. Y. Mohammed
	G. M. Iradian, Temporary
E. Srejber	B. Andersen
	A. V. Mozhin
E. L. Waterman	J.-H. Kang
J. de Beaufort Wijnholds	
Zhang Z.	Song J., Temporary

L. Van Houtven, Secretary and Counsellor
M. Cuc, Assistant
S. Bhatia, Assistant

Also Present

IBRD: S. Boonma, Latin America and the Caribbean Regional Office; L. Ferreira, Africa Regional Office. African Department: E. A. Calamitsis, Director. External Relations Department: S. J. Anjaria, Director; P. J. Bradley, M. E. Hansen, D. R. Hawley, J. Starrels, B. J. Mauprivez. IMF Institute: S. El-Khouri. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; H. Elizalde, L. E, Nordgaard. Middle Eastern Department: P. Chabrier, Director; M. D. Knight, Deputy Director; T. Cordella, A. Salehizadeh, V. C. Thai, R. A. Valdivieso. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; S. B. Creane, M. Fisher, N. L. Happe, A. C. Kouwenaar, K. H. Lee, S. M. Nsouli, C. Puckhatikom, N. Tsaveas. Research Department: D. T. Coe, P. Wickham. Secretary's Department: A. Mountford. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; D. Gupta, Deputy Treasurer; Y. Atsumi, E. Decarli, C. A. Hatch, D. Hicks, B. A. Hindawi, K. M. Kenney, F. M. Meek, P. R. Menon, I. Otker, H. Treichel. Western Hemisphere Department: C. M. Loser, Director; G. Bindley-Taylor, E. A. Faal, S. P. O. Itam, A. S. Linde, L. Schmitz. Office of the Managing Director: J. A. Quick, Personal Assistant; D. Burton. Advisors to Executive Directors: M. Alemán, P. Cailleteau, R. F. Cippa, A. Cserés, S. S. Farid, T. K. Gaspard, J. Guzmán-Calafell, M. Heinonen, A. R. Ismael, J. John, J. Justiniano, R. Kannan, W. C. Keller, J. Leiva, J. C. Martinez Oliva, M. F. Melhem, S. N'guiamba, S. O'Connor, J.-C. Obame, T. Oya, A. V. Vernikov. Assistants to Executive Directors: C. Austin, R. D. Bessone Basto, J. G. Borpujari, P. I. Botoucharov, A. G. Cathcart, A. L. Coronel, D. Daco, J. Dagustun, J. C. Estrella, A. Galicia-Escotto, D. Giga, M. Giulimondi, R. Glennerster, C. M. Gonzalez, A. Guennewich, D. S. Hakura, O. Issaev, P. Jilek, H. Kaufmann, E. Kouprianova, K. Kpetigo, N. L. Laframboise, B. M. Lvin, T. Lwin, J. Mafararikwa, I. Moon, A. R. Palmason, H. Paris, G. P. Ramdas, S. Rouai, D. Saha, F. A. Schilthuis, G. Schlitzer, Song J., Y. Tahara, V. Trivedi, L. B. J. van Geest, V. Verjbitski, M. Yiu, E. Zamalloa.

1. GUYANA—ENHANCED STRUCTURAL ADJUSTMENT FACILITY—SECOND ANNUAL ARRANGEMENT

The Executive Directors considered Guyana's request for the second annual arrangement under the enhanced structural adjustment facility (EBS/96/46, 3/18/96; Cor. 1, 3/22/96; and Sup. 1, 3/18/96). They also had before them a policy framework paper for the period 1996-98 (EBD/96/30, 3/12/96).

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

> The Guyanese authorities have provided the following updated information on recent developments, which is consistent with the thrust of the staff report and appraisal (EBS/96/46).
>
> In regard to macroeconomic developments, real GDP grew by 5 percent in 1995—compared with the estimate of 4.5 percent included in the staff report—mainly due to higher rice output.
>
> Guyana met all end-1995 indicative financial benchmarks for the public sector, with the overall deficit of the nonfinancial public sector at 8.5 percent of GDP (as estimated in the staff report). Revenue of the sugar company (GUYSUCO) exceeded original projections, compensating for a faster-than-anticipated execution of public investment projects. External financing was close to projections and the indicative limit on public domestic debt was observed.
>
> Preliminary information for the first quarter of 1996 suggests that the financial program remains broadly on track. Inflation was at an annual rate of 8.5 percent at end-February, interest rates have declined from 15.5 percent at end-1995 to 13 percent, the exchange rate has remained stable, and gross official international reserves were at the targeted level of US$252 million at the end of March.
>
> On the structural benchmarks for March 1996, the authorities are in the final stages of redrafting those sections of the Exchange Control Act that have become outdated since the recent liberalization of Guyana's exchange regime; the redrafted Act will be tabled in Parliament for approval on April 18.
>
> As part of the transition towards open-market techniques of monetary control, the Bank of Guyana has (i) developed a framework for reserve money programming to facilitate liquidity management; and (ii) increased its margin for rediscounting of treasury bills to encourage interbank trading.
>
> In March, the authorities introduced balance of payments report forms for public enterprises and commercial banks, and have compiled the relevant balance of payments data series for 1992-94.

Regarding other structural reforms, since the issuance of the staff report, structural reforms in other areas have progressed as envisaged or ahead of schedule.

In March, the government initiated the privatization of the electricity company (GEC) by inviting international tenders for a core investor. Also, four international firms have been short listed to evaluate GEC and, based on their proposals, one will be chosen to prepare an information memorandum for the privatization of GEC.

On March 27, the government approved the privatization of Guyana Stockfeeds, Guyana National Printers, and the sale of government shares in the National Bank for Industry and Commerce.

A cost-sharing formula for bank supervision has been approved by the Bank of Guyana and guidelines on inspection fees and costs were sent to the banks on March 28. Other supervision guidelines on licensing, branching, capital adequacy, and loan loss provisioning have been finalized and submitted to the Parliamentary Counsel.

Under the Financial Institutions Act, which was passed in June 1995, notices on minimum capital requirements for nondepository and trust companies were gazetted on March 20, 1996. Regulations that implement the Act for nondepository financial institutions and trust companies were gazetted on March 29, 1996.

Concerning relations with external creditors, negotiations on the settlement of debts outstanding to the OPEC Fund have intensified in recent weeks. The Guyanese authorities have offered an up-front payment, and financing options for the settlement of the remaining balances are under discussion.

The Guyanese authorities have been in contact with the government of Trinidad and Tobago in order to discuss modalities for regularizing debt-service payments and progress is expected on the occasion of a high level delegation visit to Trinidad and Tobago in May.

Mr. Kafka made the following statement:

My authorities wish to express their thanks to the staff for its helpful and supportive comments and suggestions made during the recent negotiations of the second annual arrangement under the Enhanced Structural Adjustment Facility (ESAF). Under the first annual ESAF arrangement, Guyana has turned in an outstanding performance. This is in line with the experience since mid-1988 when Guyana first adopted an economic recovery program with a bold shift to market-oriented policies, backed by careful financial and fiscal policies as well as important structural reforms, including considerable liberalization of economic policies. Rapid growth in the context of increasing monetary stability and a strong balance of payments performance resulted in a considerable accumulation of international reserves from a low level. Guyana remains well poised and firmly committed to continue this process in order to rehabilitate Guyana's economic and social infrastructure and to cope with its heavy debt burden, for which it expects the continued support of the international financial community. Guyana has met all the indicative targets under the program supported by ESAF with margins.

As background, since 1989, with support by bilateral donors and multilateral agencies, the restructuring of the Guyanese economy has involved the removal of controls, the liberalization of the exchange and trade system, and substantial reduction in the fiscal and external imbalances. After more than a decade of deterioration, real GDP growth averaged about 7 percent a year in 1991-94, inflation decelerated sharply, and the external position has strengthened considerably, with significant gains in exports and increased foreign direct investment, and international reserves have reached a comfortable level.

As to economic developments in 1995, real GDP grew by 5 percent in 1995, despite temporary production bottlenecks in gold, and bauxite and inflation declined to 8 percent. The nonfinancial public sector deficit was contained at 8½ percent of GDP, notwithstanding a significant increase in capital outlays. The strengthening of public savings reflects an increase in tax revenues, a tight control of noninterest current expenditures, and a decline in interest obligations. The external current account deficit widened from 9 percent of GDP in 1994 to 12 percent of GDP in 1995 because of imports associated with the large increase in public sector investment. Official gross reserves stood at US$269 million at end-1995, equivalent to eight months of imports.

Also, as described in the staff report, important structural reforms were implemented in 1995 in the spheres of financial sector reform and legislation, tax administration, trade system, public enterprise management, and in the privatization of state enterprises. Despite the success achieved in recent years, the country's situation is by no means a simple one. As a very poor country—with an average income of less than $700—considerable effort will have to be made to continue on the path of growth. Although the population growth rate is zero, this is the result of a high rate of emigration, which in a sense involves a social loss because Guyana's rather good education system benefits to an extent the recipient countries rather than Guyana herself. To make progress, Guyana must raise both public and private net savings which are presently negative. While the situation is difficult and foreign assistance indispensable, the dramatic manner in which the economic situation has been turned around in recent years from an accelerating income loss is encouraging. If external assistance continues to be available, the annual financing need by the economy to sustain a 4–5 percent real growth rate, which in Guyana means real per capita increases of the same rate, requires support of an amount of less than 200 million dollars a year which is not by any means impossible to find, if a stock-of-debt operation on Naples terms with "topping-up" is also undertaken.

As regards the economic program for 1996, my authorities intend to consolidate the substantial progress achieved under the first year program of the

ESAF. They will continue to pursue prudent fiscal and wage policies, together with sound credit policies. They remain committed to increasing the efficiency of the public sector through further market-based structural policy reforms, and aim to secure comprehensive debt restructuring. Real GDP is targeted to grow by about 7 percent and inflation to decelerate to less than 6 percent.

The fiscal program aims to improve revenue collection by strengthening tax administration while at the same time reorienting and containing current outlays. Public sector saving is expected to increase to about 10 percent of GDP in 1996 to permit increased investment. The public sector deficit of about 8 1/2 percent of GDP is expected to be financed mainly from external assistance and divestment proceeds. My authorities will continue to seek ways to balance the need to maintain a salary structure that can attract skilled professionals into the public service and the requirement of wage restraint to contain inflation. To this end, the Government will in 1996 adopt a civil service reform involving new pay adjustment and redundancy strategies to streamline the public sector in line with the recommendations of donor agencies.

My authorities' objective to intensify the pace of privatization gained momentum over the last two months. The Government approved the privatization of five enterprises—inter alia in the financial sector—and is in the process of selling or liquidating four other companies that were brought to the point of sale in 1994. In March my authorities initiated the process of privatizing the electricity company by inviting international lenders for a strategic core investor to formally express interest in the company, and a major bauxite-mining company, LINMINE, is being prepared for privatization.

With regard to financial sector policies, my authorities' aim is further to reduce inflation and meet the international reserve targets through prudent monetary and credit policies.

My authorities recognize that the existence of a viable financial sector is critical to sustained economic growth. The Bank of Guyana will continue to maintain a flexible interest rate policy and strengthen monetary management with assistance from the Fund, in order to encourage greater competitiveness in the financial system. To this end, and as a precursor to the commencement of open market operations, the Bank of Guyana moved in February of this year from bi-weekly to weekly auctions of treasury bills and is completing work on refining liquidity management.

On the external side, the Government believes that Guyana's development will be best served by an export-oriented strategy. My authorities are committed to maintaining a flexible exchange rate policy within the context of a liberalized exchange, trade and foreign investment regimes. Final steps will be taken in 1996 toward the integration of the official and the cambio exchange markets and the Exchange Control Act will be repealed to ensure consistency with the current liberalized regime.

The external current account deficit is expected to decline steadily in the medium-term mainly reflecting a strong recovery of exports and an expansion of the production of tradables. The overall balance of payments deficit would narrow somewhat and to close the gaps my authorities intend to secure further debt relief from the Paris Club and comparable treatment from other creditors.

Guyana's debt burden continues to be high and in the absence of debt relief would rise sharply after the year 2000. The Paris Club will consider, in May 1996, a stock-of-debt operation on Naples terms with "topping-up" of previously rescheduled concessional Paris Club debt. To achieve external viability, Guyana will continue to require substantial creditor and donor support beyond the ESAF period that ends in 1998 to finance the rehabilitation and much needed expansion of Guyana's physical and social infrastructure. While my authorities appreciate the debt relief that has already been offered by several creditors in recent years, they agree with the staff that Guyana's debt burden will remain high even after a stock-of-debt operation.

As part of their debt management strategy, my authorities intend to pursue a prudent external borrowing policy that will continue to eschew commercial borrowing, seek concessional loans, and eliminate debt created under the External Payments Deposits Scheme with financial support form multilateral agencies and the donor community.

Social policies will continue to emphasize achieving sustainable progress and poverty reduction. The Social Impact Amelioration Program (SIMAP), initiated in December 1988, will be reorganized to improve efficiency and ensure that benefits are well targeted to reach Guyana's rural population. In the environmental area, an Environmental Protection Agency will begin to operate in September 1996, with support from international donor agencies and non-governmental organizations.

Statistical services are expected to improve considerably with Fund technical assistance in the balance of payments area at the Central Bank in 1995. National Accounts are expected to benefit from official development assistance technical assistance. Public enterprise statistics and public sector investment program design and monitoring will improve at the Ministry of Finance through donor support in 1995.

Mr. Duenwald made the following statement:

Guyana's achievements since the inception of the Economic Recovery Program in 1988 are commendable. In large part reflecting the policies under that program, which consisted of fiscal consolidation, a firm monetary policy, and significant structural reforms, economic growth in recent years has been solid, inflation has fallen, and the external position has strengthened. However, as is clearly pointed out by the staff, Guyana continues to face a host of near- and medium-term challenges that will require further progress in macroeconomic stabilization and structural reform, as well as considerable multilateral and bilateral financial assistance, as noted by Mr. Kafka. In this context, the overall picture painted of Guyana's continuing adjustment efforts leads this Chair to readily support the request for the second annual arrangement.

In the macroeconomic area, the Guyanese authorities have preserved their hard-won credibility with regard to their commitment to pursue prudent policies. Tight quantitative limits and indicative targets under the programme for 1995 have been satisfactorily observed. This is reflected in the performance of certain key indicators. There was continued strengthening of both the Central Government and the public sector current balances and stronger than programmed containment of the overall public sector deficit. While monetary aggregates were somewhat more expansionary than programmed, 12-month inflation was practically on target, having been halved to 8 percent, and a welcomed easing of interest rates accompanied the strong reduction of inflation. It is gratifying to note that at the same time, Guyana continued its positive growth performance into 1995, albeit, as projected last year, at a less robust rate than in the recent past. Aided by stronger export performance and the impact of exceptional financing, the reserve cushion has been reinforced, reaching eight months import cover.

Regarding structural reforms, we commend the authorities for improving their response to repeated calls in the past for structural measures to keep pace with macroeconomic performance. We are encouraged that the interval between the end of the first annual programme in June 1995 and the presentation of the current request for the second annual programme was used by the authorities to substantially improve the record on the structural front. Of particular significance here were the actions taken towards unification of the exchange rate, modernization of the financial system, and to advance public enterprise reform, particularly the strategic Guyana Electricity Corporation, the Guyana Sugar Corporation, and Government operations in the bauxite sector. We also note that the preparation of a new Bank of Guyana Act is in full swing, but are somewhat surprised at the one-year time lag between scheduled Cabinet approval and expected Parliamentary approval. Looking to the future, but in the context of concerns expressed by this chair in the past about the crowded schedule of structural measures, we now welcome the selective and more focussed nature of the structural reforms programmed for implementation in 1996.

The overall outturn in 1995 on both the structural and macroeconomic fronts provides a broadly positive platform from which to launch the second annual arrangement, even though very difficult times still lie ahead. One particular point to note is that the anticipated moderation of the average growth rate is already taking effect, even though the need to reduce poverty more rapidly would be well served by maintenance of the more robust average growth rate achieved during 1991–94. The challenge here is to stimulate sources of growth outside the traditional sectors. Hopefully, the maintenance of fiscal and monetary discipline and the pursuit of purposive structural reforms will create the environment to generate additional increments of growth while continuing to maintain the downward trend in inflation. We would encourage the staff and the authorities to review this concern closely during the period of the second annual arrangement, with a view to seeing how the bottlenecks to higher sustainable growth might be feasibly removed.

Ultimately, of course, the key challenge facing Guyana is that of maintaining steady progress on the long and difficult journey towards external viability. This calls for the maintenance over many years of strong domestic policies complemented by adequate international financial support, particularly of a concessional nature. I commend the authorities for policy performance strong enough to make it very likely that there will be a Paris Club stock of debt operation on Naples terms later this year. Of course, it will be vital for non-Paris Club bilateral creditors to match this assistance, since Paris Club creditors account for only 15 percent of Guyana's public external debt. Even so, in the absence of "topping up," the staff projects that Guyana's external debt burden would become sustainable only in 2005. This is, of course, a measure of the severity of the domestic and external imbalances Guyana started to correct seven or so years ago. It is also perhaps a measure of the extent to which current concerns with the problem of debt sustainability need to be further examined.

We wish the authorities well in their future endeavors.

Mr. Song made the following statement:

I would like to commend the Guyanese authorities for their significant progress in reducing macroeconomic imbalances and implementing structural adjustment measures since the adoption of the economic recovery program. While real GDP has been growing at a robust pace, impressive reduction in the inflation rate has laid down solid groundwork for faster growth in the years to come. We appreciate the authorities' efforts in intensifying structural reform along the lines of the current Fund- and Bank-supported programs and expect a fundamental restructuring of the economy will be realized through continuous efforts.

Since I am in general agreement with the main thrust of the staff report, I would like to make some comments on the fiscal and the monetary policies for emphasis. On fiscal policy, while the sharp reduction in the fiscal deficit contributed to macroeconomic stability, the existing weakness in the fiscal and social infrastructure and the high external debt will prevent the fiscal account from further strengthening without an effective structural reform program. In this regard, comprehensive public administration reform will be conducive to an improvement in fiscal management efficiency. The increase of public investment is also deemed necessary.

Regarding monetary policy, the authorities' efforts to improve monetary management will strengthen the institutional framework of the financial sector, and emphasis on the use of indirect instruments, including interest rate adjustment and securities markets developments, will be conducive to the enhancement of financial efficiency. While the government's initiative for revision of the Bank of Guyana Act will increase central bank independence, the restructuring of the central bank external debt has become a pressing requirement.

Concerning external sector developments, we appreciate the forthcoming Paris Club contribution to Guyana's external debt restructuring. While sustained external viability depends fundamentally on solid improvements in the current account balance, timely external concessional capital flows will be necessary to enable Guyana to reach debt sustainability at an early date. I would like to concur with the staff in emphasizing the importance of multilateral and bilateral support for economic structural adjustment in Guyana.

In conclusion, we support the Board's approval of Guyana's request for a second annual arrangement under the ESAF-supported program. I would like to wish the authorities further success in the future.

Mr. Shields made the following statement:

I support the proposed decision. Nevertheless, two important areas of concern remain. One is the pace of structural reform, and the second is possible constraints on future growth caused by the present debt position.

But, first, I would like to congratulate Guyana on the macroeconomic side of their recent performance. There has been a strong turn-around in fiscal policy and in monetary policy, accompanied by important liberalization in the private sector and in the foreign exchange regime. Their implications have already been brought out through positive supply responses. Also, the macroeconomic imbalances have been corrected to a major extent. Nevertheless, structural reform has so far not proceeded as fast as one would have wished. Although there were administrative problems and capacity problems in the early stages, our main worry concerns the government's commitment to the structural reform. The main message that the Board should convey this morning is that the government needs to focus far better on specific structural reforms. It may be preferable to concentrate on a smaller area, but to ensure its complete implementation.

The analysis of debt sustainability makes the case for Guyana's request for a stock-of-debt reduction on Naples terms in the Paris Club, with comparable treatment by non-Paris Club creditors. It will be extremely important that Paris Club stock treatment be implemented in full, including full topping up of previously rescheduled debt. Unless this actually happens, Guyana's debt position will remain difficult over the next five to ten years. It is also very important to note the reliance on comparable treatment from non-Paris Club creditors, and I would be grateful if the staff could elaborate more on what is likely to happen as far as non-Paris Club creditors are concerned. Have we, for instance, any evidence that so far they have had a good record in following comparability clauses in previous Paris Club agreements? We need to know the likelihood of their settling on similar terms.

My other concern about Guyana's debt sustainability outlook is that the projections rest on optimistic assumptions about some of the underlying factors—for example, import growth is somewhat slower than GDP growth. That may not be realistic. Furthermore, sensitivity analysis shows that if export growth is just one percent less than assumed, then even under the optimistic debt assumptions, Guyana's debt service ratio would remain well above 20 percent in 2004.

In light of these high sensitivities, we will need to monitor closely Guyana's debt position. It may turn out, at some later stage, that Guyana might warrant further consideration in the context of the proposed Bank-Fund debt initiative.

Finally, I wonder if the staff has any views on the effects of the debt overhang at the moment. Could a substation reduction in the debt overhang act as a trigger for attracting private funds from abroad?

Mr. Fayolle made the following statement:

Guyana's economic performance under the ESAF-supported program continues to be impressive. The authorities of Guyana are, therefore, to be commended for such promising results, and the support of the Fund as well as the rest of the international community is certainly deserved.

I will limit my intervention to three specific issues: First, with regard to fiscal policy, I would like to stress two aspects. The streamlining policy in the public sector should be pursued, and progress in tax revenue performance is paramount. The results already achieved are encouraging, but the effective tax base will still have to be broadened by strengthening tax and customs administration, increasing the number of registered taxpayers, and reducing, if not eliminating, remaining tax exemptions. I welcome in this respect the technical assistance provided by the World Bank and the IDB, as I believe that no other kind of technical support could is more warranted in this country.

Second, like Mr. Shields, I urge the authorities to fully adhere to the public enterprise restructuring program so as to remain consistent with the government's fiscal strategy. While positive steps have been taken towards privatization of the electricity company, the expected increase in the current primary surplus of the sugar company does not make reform any less urgent.

Finally, the staff has provided us with very useful analysis on the medium-term prospect and debt sustainability. The fact that under the assumption of debt relief from the Paris Club for a stock-of-debt reduction under Naples terms and comparable treatment from other bilateral creditors Guyana's external debt burden would eventually be reduced to a sustainable level, is a very comforting result which deserves to be strongly emphasized. I am, therefore, pleased to attest to the readiness of Paris Club creditors to consider granting debt relief to Guyana during the course of this year, and I firmly encourage other bilateral creditors to move toward comparable agreements.

Mr. Nemli made the following statement:

The Guyanese authorities are to be commended for fine performance, and for meeting all the quantitative performance criteria and financial benchmarks for 1995. However, the economy's persistent and serious weaknesses and Guyana's heavy dependence on external assistance underlines need to continue prudent macroeconomic policies and accelerate structural reform efforts.

The authorities have managed an impressive reduction of macroeconomic imbalances in recent years, while maintaining high real growth and a comfortable level of international reserves, sharply reducing the public deficit, the current account deficit and the inflation rate. At the same time they have accomplished important structural changes.

But these successes should not cause us to overlook the remaining weaknesses. True enough, the public deficit fell from 31 percent of GDP in 1991 to 13 percent in 1995, while the current account deficit declined from 37 percent of GDP to 12 percent during the same period, but the current levels of both deficits are still very high. Similarly, even though the external debt-to-GDP ratio fell from 607 percent to 328 percent, the latter is still very high. Widespread poverty, inadequate physical and social infrastructure, and the scarcity of skilled labor clearly show that there remains much for the Guyanese authorities to accomplish.

Now let me make few specific observations.

There is a very close, nearly one-to-one parallelism between Guyana's public deficit and current account deficit, reflecting the inadequacy of domestic savings. It is further notable that for each year, the sum of the current account deficit and the increase in international reserves moves in parallel with the sum of that year's balance of payment support and total debt relief. These observations all show that the fiscal deficits and increases in international reserves are being financed from external assistance. This high level of external assistance also keeps the inflation rate relatively low in spite of the high public deficit.

The overriding task of the Guyanese authorities is to overcome the imbalances that require such heavy reliance on external assistance. Increasing domestic savings, cutting the public deficit further, and building up the private sector as the engine of growth will be crucial for success.

The most important tasks in the fiscal area are strengthening tax administration and rationalizing public employment and wage structure. Monetary control should continue to accompany the fiscal adjustments. In the financial sector, stronger autonomy for the central bank and speeding up the development of a secondary market in treasury bills will make monetary policy more effective and the financial system more efficient. The structural reforms should also be accelerated, Especially the restructuring and rehabilitation of public enterprises, which is important for encouraging private sector driven growth.

Social safety nets and poverty alleviation are other very important areas that need urgent attention from the authorities. Poverty remains widespread, and the incomes of approximately two-thirds of the poor people are below what is needed to purchase a minimum low-cost food basket. Salaries decreased by 35 percent in real terms from 1989 to 1994 despite a real growth rate of 28 percent. This increases the urgency of addressing poverty and income distribution problems. It is time to reorganize the Social Impact Amelioration Programme, which has had limited success since 1988, in order to improve its efficiency.

The prudent macroeconomic policies and structural reforms are the only viable solutions to Guyana's severe economic problems. But the problem of extremely high external debt makes it impossible in the short term for Guyana to succeed without the continued support of international community. I believe that the Guyanese authorities have demonstrated their commitment to sound macroeconomic policies and structural reforms, and that they have earned this much needed support from the international community.

I support the proposed decision and wish every success to the Guyanese authorities.

Mr. Ryan made the following statement:

Despite Guyana's high growth rates in recent years, the fragility of Guyana's medium- and long-term prospects are revealed by its high debt levels, deteriorating infrastructure, and a hesitant commitment to fundamental reforms. We have observed in the past that Guyana needs more reforms and more debt relief. These needs are starting to be addressed to varying degrees. Some questions and concerns persist, however:

We note some recent policy movement on public enterprise reform and privatization. However, there is still some ambiguity regarding plans for privatizing the electric company and GUYSUCO. It is not clear, for example, what sort of timetables are envisaged? Tangible and steady progress toward privatizing both enterprises would go far in signaling the Government's strong commitment to reform. The planned expansions and upgrading of equipment at both enterprises provide a good opportunity to move swiftly from private management to private ownership.

Along these lines, we note that the improvement in the overall fiscal balance of the non-financial public sector depends importantly on a substantial turn-around in the operating balances of public enterprises. How assured is this improvement (equivalent to over three percent of GDP)? Are there contingencies in the event of shortfalls?

We note the increase in personnel costs in the budget (as a share of GDP). We are encouraged by civil service downsizing planned for 1996 as well as salary rationalizations designed to retain skilled personnel. It is not clear, however, whether budgetary savings are expected from these actions over time. Could the staff offer some clarification?

We would be interested in knowing a bit more about the economic impact of the environmental accident and the subsequent closing of the OMAI gold mine. There is no mention of the accident in the report, including the sections on the environment.

Finally, we can associate ourselves with much of what Mr. Shields said regarding the potential contribution of the IFI's to the restructuring and reduction of Guyana's sizable external debt burden.

We can support the proposed decision.

Mr. Esdar expressed support for the proposed second annual ESAF arrangement, noting the encouraging performance in the first year and the strong program for the second year. The administrative capacity of the public sector needed to be strengthened. The authorities' intention to introduce a merit-based pay reward system and to limit across-the-board wage increases to projected inflation in the public sector was welcome as a way of linking wages to job performance. The medium-term objective should be to increase further the rate of the merit component in order to strengthen efficiency of the public sector and to provide incentives for highly qualified employees.

Mr. Himani made the following statement:

I welcome the progress made by Guyana under the current ESAF program and find myself in broad agreement with the staff appraisal. Despite the success achieved under the Economic Recovery Program, the tenets of Guyana's economy remain weak. Placing the economy on a more sustainable path continues to require significant further progress in addressing the macroeconomic imbalances and structural reform.

It is encouraging to see that with appropriate debt relief by bilateral creditors and continued reform, external debt sustainability could be achieved in the not too distant future. This said, Guyana will clearly continue to require concessional financing. In this connection, the ability of multilateral institutions to continue to provide Guyana with concessional financing will depend on Guyana's record in servicing its debt to these institutions

I support the proposed decision and wish the authorities continued success in their efforts..

The staff representative from the Western Hemisphere Department said that Trinidad and Tobago was Guyana's largest bilateral creditor. In the past, it had offered rescheduling terms that were comparable, or slightly better, than those offered by the Paris Club in 1989. Trinidad and Tobago had recently expressed interest in participating in the upcoming Paris Club meeting, and it was likely that it was prepared to offer rescheduling terms similar to those of the Paris Club. The resolution of the present debt overhang would favorably affect foreign investment—an important consideration in the government's plan to divest more enterprises.

The question of commercial debts, which the authorities were determined to address in the current year, would especially be relevant to that strategy.

The export growth projection was vulnerable to changes in external conditions, the staff representative acknowledged. The forecast assumed that, while the traditional sector exports would taper off, exports from other sectors—agriculture, manufacturing—would accelerate, producing an overall growth rate of 3.5 to 4 percent annually. The rate of import growth was expected to converge to GDP growth rate over the long run.

Regarding the schedule of privatization and reforms at GEC, the staff representative indicated that the government had requested submissions from several international consulting firms interested in acquiring equity in the company. A firm would then be selected to prepare the Company for privatization. Meanwhile, internal reforms continued at GEC, with a view to improving operational efficiency in the areas such as billing and metering, as well as increasing production. A substantial revenue increase was forecast for 1996. At GUYSUCO, progress with respect to privatization had been mixed. Employment had been reduced from 31,000 to 22,000 and efficiency gains had continued to be made every year since 1991. The government and the company managing GUYSUCO had been discussing a medium-term investment program designed to modernize the sugar sector and bring the cost of sugar production down to world market levels to make GUYSUCO competitive without access to preferential markets. The structural reforms of GUYSUCO were being prepared in cooperation with the World Bank. A Bank mission was expected to visit Guyana in June.

The cyanide leak at OMAI had been less severe than initially assumed, the staff representative continued. Cyanide concentration had turned out to be low and no serious damage to fish and adjoining villages had been reported. Production had reopened at the end of January after a new—and technically safer—retaining pond had been built and after an international commission had certified that the new safety criteria had been met.

A severe shortage of skilled manpower had been constraining the pace of structural reform in the country, the staff representative said. Under the circumstances of poor staffing and low salaries in the Government, external technical support from bilateral donors and multilateral agencies was especially important. Their contribution since 1995 to the privatization effort and civil service reform had been measurable. For example, revenue collection had improved in 1995, with customs tax revenues increasing by 24 percent, 5 percentage points more than had been targeted. The income tax department had been computerized, and collection enforcement had become much stricter. As a result, income tax revenues had increased by 37 percent compared with the projected increase of 14 percent. Further tax collection improvements were expected in 1996. On the expenditure side, the implementation ratio in the investment budget had grown from 63 percent in 1994 to 81 percent in 1995, mainly owing to improved coordination between line departments and the Ministry of Finance. Coordination between donors and the government in project management was expected to improve further as a result of a meeting planned for May.

Several factors had hampered the progress in privatization despite the government's good intentions, the staff representative continued. Those had included deficient ownership records, a problem that had been compounded by a shortage of government lawyers and a backlog of court cases. Recently, the outlook had improved with the provision of technical assistance by India, and the process of drafting of legislation was expected to accelerate. The

Bank of Guyana Act was expected to be discussed by the Cabinet in June. It would likely take another year to prepare the final full legal draft and brief all the principal social groups before it could be tabled in Parliament.

The Executive Board took the following decision:

1. The Government of Guyana has requested the second annual arrangement under the Enhanced Structural Adjustment Facility.

2. The Fund has appraised the progress of Guyana in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, which ended in July 1995, and notes the updated policy framework paper for Guyana (EBD/96/30).

3. The Fund approves the second annual arrangement set forth in EBS/96/46, Supplement 2.

Decision No. 11243-(96/37), adopted
April 15, 1996

2. DJIBOUTI—1995 ARTICLE IV CONSULTATION; AND STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1995 Article IV consultation with Djibouti and Djibouti's request for a 14-month Stand-By Arrangement in an amount equivalent to SDR 4.6 million (EBS/96/53, 3/29/96). They also had before them a statistical annex (SM/96/78, 4/3/96).

Mr. Barro Chambrier made the following statement:

Djibouti's economic and financial situation which began to deteriorate in the early 1990s continued to be difficult in 1995, despite the adoption by the authorities of tight fiscal policy during the previous two years. To reverse this trend, the authorities embarked on a medium term strategy aimed "at returning the country to a more stable macroeconomic environment while creating the conditions for the resumption of sustained growth and employment, external payments viability and poverty alleviation" as noted in the staff report. As part of this strategy, a series of measures were introduced in October 1995 to reduce the fiscal deficit as well as to set the stage for a more comprehensive program of economic adjustment and structural reforms.

This medium-term program of adjustment which was prepared with the assistance of the staff emphasizes further tightening of financial policies, acceleration of structural reforms, liberalization of the labor market and strengthening of the social safety net. In support of this program, the Government of Djibouti is requesting Fund's assistance in the form of a 14-month stand-by arrangement. It is to be noted that all of the prior actions have already been taken and that the program is being effectively implemented.

Consistent with the medium term strategy, the program aims at achieving the following objectives for 1996: (i) stabilize real GDP growth, after a decline of 3.1 percent in 1995, (ii) reduce the external current account deficit(excluding official grants) from 17.9 percent of GDP, the previous year, to 15.4 percent in 1996, and (iii) increase international reserves to an amount equivalent to 5.2 months of imports from 4.8 months in 1995.

The authorities recognize that fiscal adjustment has to be the cornerstone of the program; consequently, the 1996 program emphasizes measures aimed at reducing outlays, particularly the wage bill. Personnel costs which include the military have increased rapidly since 1991, reflecting mainly the civil strife and lax budgetary procedures. To ensure a permanent reduction in the wage bill, the authorities are implementing both a demobilization program and a civil service reform.

The demobilization program, in view of its major impact on the budget, is being given full priority. Over 9,000 defense and security personnel will be affected by the program which will start in June 1996 and last over 18 months. The difficulty of this decision should not be underestimated in view of the lack of employment opportunities, and the shortage of funds to retrain the released personnel. Nevertheless, the authorities agree with the staff that there is no justification for maintaining the number of soldiers at the current level and that it is unsustainable from a budgetary standpoint, as personnel expenditure absorbs about 80 percent of Government revenue. In this regard, the authorities are working closely with the World Bank to obtain foreign financial assistance, the availability of which will determine the pace of the demobilization. As noted in the authorities' memorandum, severance pay only has been tentatively estimated to be equivalent to 2.4 percent of GDP, and the country's very limited financial resources do not allow them to undertake this effort on their own. My Djibouti authorities expect that the courageous and difficult decision taken in this area will encourage donors' support, as success with the demobilization program is the key to achieving fiscal sustainability.

Concurrently with this program, the authorities have undertaken an audit of the civil service with a view to removing irregularities which have cropped up over the years. The authorities expect through this measure alone, to reduce personnel expenditure by about 0.5 percent of GDP. While the objective is also to reduce the size of the civil service, the authorities intend to ensure that the needs of the education and health sectors are appropriately met. The Government is also reviewing the wage policy of the public sector as well as the policy regarding benefits, especially the housing allowances. Outlays for materials and supplies and transfer payments will also be curtailed in 1996. It is expected that the measures being introduced will enable a reduction in outlays equivalent to about 4.9 percent of GDP in 1996.

On the revenue side, the authorities envisage a reform of the tax system with a view to increasing its elasticity, efficiency and equity. The objectives are also to reduce tax-induced distortions, combat fraud and eliminate ad hoc exemptions. As described in the staff report, the authorities have taken a number of revenue-enhancing measures which should contribute to an improvement in revenue in 1996, albeit by a modest amount. Moreover, with the completion of the work of the Fund technical assistance on taxes, the authorities intend to introduce soon a comprehensive program of tax reform. Reform of customs administration will also be undertaken this year, with external technical assistance.

My Djibouti authorities will also give attention to the elimination of domestic and external arrears. They have set up a timetable, outlined in Annex V of the staff report to address the problem of arrears, with priority being given to an early elimination of arrears on external debt services.

In the monetary sector, maintaining the integrity of the currency board remains the primary concern of the authorities. While they expect that the fiscal discipline measures being implemented will help them in this goal, the Government will also limit its borrowing from the Central Bank and refrain from borrowing from commercial banks. It will also ensure strict compliance with its schedule of loan repayments. Moreover, interest rates will continue to be market-determined and the authorities will ensure that liquid international reserves exceed the required 100 percent coverage of currency issue and other currency board liabilities. The Central Bank, in order to ensure that the banking system remains sound so as to maintain Djibouti's attraction as a commercial and financial center, will strictly enforce the existing prudential regulations and it will take steps to strengthen its supervisory capabilities .

In the external sector, the authorities have simplified and lowered tariffs for port services, and they are developing, with external assistance, a regional-transportation plan aimed at improving the efficiency and competitiveness of Djibouti in the area so as to take advantage of regional developments.

There is also an urgent need to intensify structural reforms aimed at strengthening the economy's supply response and its employment creation potential. In this context, the authorities plan to liberalize the labor laws to make the labor markets more responsive to market conditions. Moreover, the authorities also intend to reform the key public enterprises which play an important role in the economy of Djibouti. The authorities are of the view that although the enterprises are generally profitable, they can be made more competitive and have, therefore, requested World Bank assistance in the preparation of an action plan for their reform. Initially, the reform efforts will focus on the five largest enterprises: the port, the airport, the electricity company, the water company and telecommunications.

Finally, with the strong measures already implemented, the Djibouti authorities have demonstrated their strong determination and commitment to implement fully the adjustment and economic reform policies. However, they would note that the program can only succeed if adequately supported by technical assistance and additional concessional external financial assistance, especially regarding the demobilization program. In this regard, they are hopeful that their efforts will meet with donors' approval. Moreover, the Djibouti authorities, with the assistance of the Fund and World Bank staff, are preparing a macroeconomic framework which builds on the present program. They hope that it could form the basis for a three-year program that could receive Fund support under the ESAF, in the near future.

Mr. Iradian made the following statement:

I welcome the request by the authorities for Fund support under a stand-by arrangement. This should provide the necessary policy framework for corrective measures to be undertaken. Unfortunately, the general improvement in the domestic political situation over the past two years was not reflected in a sufficiently ambitious government effort to redress the unsustainable internal and external imbalances. Real GDP declined for the third consecutive year, the unemployment rate increased further, and domestic arrears continued to build up. To preserve Djibouti's competitiveness as a transit and regional financial center and to promote the private sector investment needed to enhance employment, it is vital that stronger corrective financial policies and structural reform measures be undertaken.

In this connection, I share the trust of the staff appraisal, and believe that the adjustment and economic reform policies for 1996-97, as described in appendix II, are adequately strong and deserve Fund support. The staff correctly underscores the urgency of improving the budgetary situation, including that of large domestic payments arrears, and stresses the need for further containment of current expenditures. The emphasis placed on addressing structural reforms aimed at strengthening the supply responsiveness of the economy and enhancing its employment creation potential is well placed.

Fiscal adjustment should rely primarily on a significant reduction and restructuring of budgetary expenditures given the already high tax revenue and expenditure to GDP ratios, which are the highest among sub-Saharan countries. Wages and salaries alone account for 70 percent of current expenditure and 23 percent of GDP—a high level by any standard. Average wages in the public sector are almost double those in the private sector (not counting substantial housing and other benefits enjoyed by government employees), and are significantly higher than the average wages in neighboring countries. These are compelling factors that call for a permanent reduction in the wage bill through the expeditious implementation of the demobilization program and reform of the civil service. The World Bank, in particular, could play a major role in providing assistance to address these issues.

With respect to the exchange system and the financial sector, I commend the authorities on their open exchange and payments system, as well as their policy of freely determined interest rates. Nevertheless, I am concerned at the large spread between deposit and lending rates indicated in Table 35 (SM/96/78). I am also concerned about the continued lack of confidence in the Djibouti Franc as reflected in the ratio of foreign currency deposits to total deposits, which rose from 38 percent in 1992 to about 50 percent in 1995 (Chart 3). I would be interested to hear the staff's comments on these issues.

There is little scope for using the exchange rate as an active instrument to promote diversification given the characteristics of the economy—a very narrow production base and limitations on the size of the internal market. However, in the absence of a reduction in aggregate demand pressures and of major structural reforms, the exchange rate peg would be more difficult to maintain. There is, therefore, an urgent need to contain domestic costs, reduce fiscal imbalances, and remove labor market rigidities.

With respect to the medium-term outlook, I am less optimistic than the staff on an early recovery in economic activity as shown in Table 10 (EBS/96/53). The assumed modest resumption of investment activities and small projected improvement in net exports would not be sufficient to reverse the decline in economic activity, since the expected reduction in domestic consumption would more than offset the projected gains in net exports and investment over the next few years. Recovery in economic activity will crucially depend on the acceleration of structural reforms in addition to macroeconomic stabilization. Therefore, I urge the authorities to eliminate existing barriers on transit trade soon, and to speed revision of the labor code with a view of reducing the existing cost rigidities. Also, Djibouti's poor natural resources base gives added importance to the improvement of the quality of its human resources for its growth potential. Unless health and education--in particular, technical training--are enhanced significantly, the shortage in qualified labor will continue to limit the economy's growth. An improved human resource base should enable Djibouti to maintain its competitive strategic position vis-à-vis other emerging centers in the region.

The challenge facing Djibouti is a difficult one and will require steadfast policy implementation. Djibouti will continue to depend on concessional assistance from the international community in the medium-term. There is little scope for policy slippages given the size of its domestic arrears, the scale of its present structural weakness, and the vulnerability of the economy to external shocks. Strong cooperation from all units of the Government is required to provide timely data to help the authorities monitor closely economic developments and policy implementation, and to meet the reporting requirements of the Fund.

With these remarks, I support the proposed decision and wish the authorities success in facing the challenges ahead.

Mr. Berrihun made the following statement:

The staff report shows clearly how difficult Djibouti's recent economic and financial situation has been, the internal armed conflict and regional instability being the main aggravating factors. Indeed, for an economy that was already beset by a weak institutional structure and limited national resources, these exogenous shocks meant a heavy blow to the authorities' effort to actively engage in the promotion of economic growth and macroeconomic stability. There can be no doubt about the urgency of a comprehensive program which aims at improving the economic and financial situation of the country. The program before us provides that.

The prior actions that have been taken in the context of the 1995 supplementary budget should help to get the proposed program off to a good start and help to instill business confidence. Improving fiscal performance will be necessary for both arresting the continued decline in economic growth and achieving a sustainable high rate over the medium term. This requires a reasonable approach involving revenue and expenditure measures and a rationalization of expenditure priorities. In this regard, I note that the expenditure policy is directed at reducing the wage bill and unproductive outlays. In a country that is poor and has witnessed a continued drop in real per capita income, this is, indeed, a bold and difficult decision. In order to facilitate its smooth implementation, it will be necessary to ensure that measures to help minimize the inevitable social impact are put in place. In this connection, I welcome the recent survey of government employment and wages as an important step in that direction. On the other aspects of public expenditure, I am pleased to note the intended reorientation of spending priorities towards health and human resource development and protection of the needs of the most vulnerable groups.

Turning to structural reform issues, I have little to add to the staff's points on the need to accelerate the pace of the reform of key public enterprises and the labor market. I point out that the high priority attached to industry restructuring with a view to enhancing its competitiveness is encouraging. The authorities should also continue to strengthen the enabling environment for private sector investment by improving the regulatory framework and fiscal, financial, and social infrastructure. Together with an anticipated improvement in the public finance situation, this should lead to a recovery of investment from its present low level.

I welcome the special attention that the authorities are devoting towards correcting the weakness of macroeconomic data and economic management. In this respect, I note that technical assistance from various donors, including the Fund, has already been requested. The expected assistance from the Fund, particularly in the area of tax system reform, should significantly contribute toward achieving fiscal sustainability over the medium term.

As rightly pointed out by the staff, even with vigorous implementation of the program, Djibouti's economy will remain vulnerable to external shocks. Therefore, the country will continue to need concessional assistance from the international community.

I support the proposed decision and wish the authorities success in their difficult endeavors.

Mr. Himani made the following statement:

I welcome Djibouti's request for a stand-by arrangement. Djibouti is confronting a daunting challenge of adjustment and reform. Economic developments have been marked by fiscal and balance of payments deficits, domestic arrears, and declining competitiveness for several years. These developments reflect to an important degree regional and domestic events.

The authorities have seized the opportunity offered by improved stability to embark on a determined adjustment and reform program. Policy is rightly focused on fiscal consolidation. The priority accorded to reduction of the wage bill, retirement of arrears, and reform of the tax system should improve the structure of the budget and enhance confidence. Further improvements are now in prospect, as the reforms initiated in the supplementary budget for 1995 have been reinforced with additional budgetary adjustments as well as a number of structural reforms.

It is encouraging that the adjustment effort is envisaged as part of a comprehensive strategy for strengthening the economy's potential through structural reforms. An easing of structural rigidities is critical. In this regard, I welcome, in particular, the proposals for reform of the port and other public enterprises, removal of regulatory hindrances to an efficient functioning of the labor market, and an upgrading of the country's administrative and managerial infrastructure. At the same time, given the magnitude of the challenge, the economy will likely remain fragile and require efforts extended well beyond a single stand-by arrangement. The current program should set the stage for a medium-term program that can be supported under the ESAF.

Djibouti's policy framework is the outcome of ongoing cooperation with the Fund and the Bank. In this connection, I would be interested in learning more regarding the nature and scope of prospective World Bank assistance to Djibouti. A country like Djibouti that is undertaking significant structural reforms deserves the strong and full support of the World Bank.

The commitment of the authorities to adjustment and reform is evident from the efforts already underway. Confidence in the program is further enhanced by the country's well-established commitment to a liberal economic system.

I fully support the proposed decision and wish the authorities all success in the difficult task ahead.

Mr. Loevinger made the following statement:

I want to commend the authorities and the staff for putting together both a strong stabilization arrangement and an impressive medium-term plan. Yet, even though it is ambitious, there will still be large financing gaps during the next several years. A follow-on program will obviously be needed, both to help ensure that the fiscal consolidation stays on track and to leverage the necessary official financing.

Still, I would urge the staff not to rush into an ESAF-supported program. Djibouti has no track record regarding Fund programs. It does, however, have a track record involving external arrears to both bilateral and multilateral creditors.

Provided they can stay on track, a follow-on ESAF needs to focus on a sustainable recovery, as the proposed stand-by would at best stabilize production. This will require increasing both investment and national savings, which remain low as a percentage of GDP.

The staff and the authorities have thus suitably made fiscal consolidation the centerpiece of the program. With public investment already low, it is good to see that the staff and the authorities focus on cuts in current spending and, in particular, cuts in the public sector wage bill. Cutting the wage bill needs to be achieved both by reducing employment and cutting non-wage benefits. Despite the cuts already made, non-salary benefits make up too large a part of public sector compensation.

The proposed demobilization must also be a priority in any follow-on program. We note though, that the proposed demobilization of 9,000 soldiers would still leave the number of military personnel above pre-war levels and wonder why the government cannot go further. We also wonder whether the staff believes the scope is to reduce civilian employment.

We remain concerned that 1996 measures rely too heavily on one-time measures such as repayment on government loans, and real estate sales. It also appears that some of the measures to reduce the deficit in 1995 simply accelerated revenues from and delayed payments into 1996. We hope this was not the case with the additional measures taken in 1996.

Finally, I want to emphasize the importance that the Government stop funding itself through domestic arrears and "forced contributions." According to the staff report, domestic arrears appear to have been counterproductive, by causing difficulties for private suppliers they have eroded the tax base. Arrears also appear to have pushed up the spreads between lending and deposit rates, which will have a further negative effect on domestic investment. During the development of any follow-on program, I urge the authorities to consider whether this is scope to accelerate the reduction of arrears.

We wonder why the port has been losing traffic to competitors. Perhaps the authorities should consider privatizing the port and setting up a port authority to regulate its operations. I also urge, in any follow-on arrangement, the authorities consider privatizing the airport, telecommunications company and other state enterprises in productive sectors.

In addition, if it is not completed by the time an ESAF-supported program is in place, it is important that an ESAF arrangement include labor reforms such as easing restrictions on hiring and firing.

Finally, the lack of data on the real sector and prices certainly increase the difficulty of developing and monitoring suitable economic policies. I urge the authorities to work closely with bilateral donors and staff to improve data capabilities.

Mr. Fontaine made the following statement:

I welcome the authorities' decision to address Djibouti's severe macroeconomic imbalances and deeply rooted structural weaknesses in the context of a Fund program. My authorities are prepared to support this program through financial and technical assistance.

I commend the staff for its productive policy dialogue with the authorities. This dialogue has helped the authorities to realize that maintaining the currency board arrangement and their liberal exchange and payment system to which they are attached imply strengthening fiscal policies and addressing structural rigidities in the economy. Alternative policies, as those implemented during recent years, could not but lead to cumulative contractions of GDP and an escalation of poverty in Djibouti. The proposed program is a coherent one, emphasizing fiscal adjustment and structural reforms. While demanding, it is the right path to take since I agree with the staff that there is little scope for actively using exchange rate policies in Djibouti.

The program bears certain risks. I am encouraged, however, by the strong up-front measures taken by the authorities in the context of the supplementary budget adopted last October and the number of reforms aimed at ending what Mr. Barro-Chambrier called "lax budgetary procedures". The budget for 1996 places the right emphasis on a sharp reduction in the wage bill, by 4.5 percent of GDP. To be sustained, recent measures should, however, be supplemented by a comprehensive civil service reform. The recent survey of government employment and the remuneration system form a good basis for moving ahead. The authorities should also devise a coherent demobilization program that could convince donors to support it.

Translating commitment into actions will also defy the authorities' weak economic and financial management capacities. In this context, the design of the program including sequenced disbursements and a detailed timetable of structural benchmarks and measures is appropriate as it should help the authorities to correct any deviation. Implementation of the program will require extensive external technical assistance that can be helpful if implementing agencies collaborate actively and recommendations are promptly implemented by the authorities.

Djibouti's adjustment program relies heavily on economic and sectoral reforms where IDA assistance is of the utmost importance. I am somewhat concerned that the extension of IDA activities, including those aimed at addressing the social costs of adjustment, has been made contingent on continued implementation of economic reforms whereas IDA's involvement is critical for progress to be made in this area.

Strengthened collaboration between IDA and the Fund is called for in the months ahead so as to fully elaborate the reform agenda in support of which I would find it appropriate to consider an ESAF-supported program. The end of 1996 seems an appropriate time frame for Djibouti to demonstrate the needed track record of policy performance. I wish the authorities well.

Mr. Prader made the following statement:

During the 1994 Board discussion of Djibouti's Article IV consultation, our chair urged the authorities to launch an effective package of measures aimed at stabilizing and restructuring their economy. We are glad Djibouti has finally embarked on a program of economic adjustment and reform. The program for 1996, on which today's request is based, seems to address a number of outstanding issues. Given the magnitude of some macroeconomic and structural imbalances presently facing the economy, we hope the successful implementation of the program will quickly guide the country to a more comprehensive medium-term framework.

Every effort must be made to halt the further deterioration of the economic and financial situation. The fiscal side of the program holds the key to its success. The staff rightly observes that the 1995 supplementary budget and the stronger policy stance of the 1996 budget are promising steps toward achieving fiscal sustainability in the medium term. But without rapid progress with demobilization of the military, there cannot be a sustained reduction of government expenditures. Since many civil servants will see their living standards fall as a result of the targeted reduction in the fiscal deficit for 1996, there will be a repetition of 1995's strong pressures from the trade unions to cancel or modify some of the proposed measures. We realize that the stakes are high for the government at this time, but there is no alternative to staying the course, if the overall credibility of the government's policies is not to be undermined. As emphasized by Mr. Iradian, there is little or no room for policy slippages.

The adjustment envisaged in the current account from a deficit of 17.9 percent of GDP in 1995 to a deficit of 15.4 percent in 1996 is not particularly strong by any definition. So far, my understanding of Fund programs has been that they are aimed at achieving a sustainable balance of payments position. Or is this goal of a sustainable balance of payments being postponed to a future ESAF arrangement? This would mean a redefinition of the concept of balance-of-payments sustainability in the Fund's stand-by instrument. Therefore I share the U.S. chair's concern not to rush into an ESAF-supported program before the ground has been carefully prepared for such a program.

Mr. von Kleist made the following statement:

Since we largely agree with the staff's assessment of the current economic situation and the future prospects of Djibouti, we can support the proposed stand-by arrangement. In doing this, we trust that the remaining balance of payments gap can be closed as envisaged by the staff.

Djibouti's current economic difficulties are enormous. While external factors undoubtedly aggravated the situation, much of the blame has to be attributed to the local policy mix. Since previous speakers have covered much of the ground, I will just raise a few issues.

I do not want to challenge the use of a currency board in general for a country like Djibouti, as long as domestic inflation remains close to the rate prevailing in the pegged country. Considering the country's close ties to France, however, it seems unusual to tie the domestic currency to the U.S. dollar. The charts on page 17 demonstrate vividly that this arrangement has not brought Djibouti much stability in its real or nominal effective exchange rate.

Regarding data issues, we share the staff's and other speakers' concerns about the severe weakness of many of the statistics. We would encourage Djibouti to seek technical assistance from the Fund to help rectify these shortcomings. In that context, we question whether the use of the consumer price index for French expatriates is a reliable indicator for price developments concerning the majority of the population.

Last October's supplementary budget for 1995 was a first step in the right direction toward fiscal prudence. I am worried, however, that the fiscal measures for 1995 and 1996 were largely back-loaded. If I read Table 6 on page 12 correctly, on balance, revenue actually decreased and expenditures increased in 1995, whereas the hoped-for consolidation only begins only during 1996. The risk of a program getting off track is highly correlated with a degree of back-loading of reform measures.

One last comment on Djibouti's balance of payments. It is notable that imports varied between 36 and 44 percent of GDP during the past few years, whereas exports of locally produced goods only amounted to between 3 and 4 percent of GDP. This is clearly not sustainable. I support Mr. Prader's comments on this issue.

Mr. Song made the following statement:

We are in general agreement with the staff analysis and policy advice. I share many of the remarks made by the previous speakers. We would like to support the Djibouti authorities' request for the Stand-By Arrangement and the proposed decision.

In light of the challenges confronting the authorities in their future structural adjustment program, a positive ESAF contribution by the Fund in the near future is highly recommended.

We would like to wish the authorities success in their future efforts.

The staff representative from the Middle Eastern Department attributed the relatively large differential between bank lending and deposit interest rates to two factors: an increasing portion of nonperforming loans associated with accumulation of arrears by public enterprises and government suppliers; and, the banks' high operating costs—due partly to rigidities in the labor market and inefficient judicial process. The rise in the share of foreign currency deposits reflected erosion of business confidence, which the full implementation of the government program was designed to restore.

Turning to the question of the reduction in public service labor force, the staff representative indicated that the government was giving priority to the demobilization of military personnel, considering that their present numbers were no longer justified in the current peace conditions. The authorities were also prepared to reduce civil service staff as part of civil service reform to be undertaken with the help of the World Bank. Tax reform was also on the government's agenda—the present tax system, characterized by many exemptions, had been criticized on equity grounds. The staff expected to discuss with the authorities the findings of a recent Fiscal Affairs Department mission.

The decline of traffic through Djibouti's port could be partly attributed to a decline in overall economic activity as well as to the emergence of Berbera as an additional competing port, the staff representative continued. In addition, the port's relative attractiveness to international business had suffered, largely as a result of cumbersome administrative procedures in both Djibouti and Ethiopia, that hampered road transport between Addis Ababa and Djibouti. To address the problem, the government had reduced the number of tariffs from 300 to seven, aligning them with those of the competing port of Assab. The granting of truck driving licenses had been liberalized with a view to facilitating the transit trade to Ethiopia. Being a modern port, and the only one able to handle container traffic in the region, Djibouti's port was expected to retain its competitive advantage in the future.

Noting that the presently constructed consumer price index was not a reliable measure of domestic consumer inflation, the staff representative emphasized the need to develop and improve the quality of economic data. Both France and the African Development Bank had been approached to provide the necessary technical assistance in that area.

The staff representative from the Policy Development and Review Department observed that consideration of a possible ESAF arrangement for Djibouti would take into account, within the context of the guidelines, two important elements: first, the establishment of an appropriate track record by Djibouti, including its policy performance under the Stand-By Arrangement; and, second, the drafting of a comprehensive medium-term macroeconomic and structural adjustment program, many elements of which the staff was attempting to define in cooperation with the World Bank staff. Those included measures to make a durable improvement in the fiscal position, including, for instance, the reform of the civil service in Djibouti, the redirection of certain resources towards priority sectors, the already starting strengthening and expenditure control, and the improvement in public investment programming. In addition, there were the issues of public enterprise reform, and the liberalization of the labor market.

Mr. Barro Chambrier made the following concluding statement:

I would like to reiterate my Djibouti authorities' firm determination to implement policies that will improve in a permanent way the economic and financial conditions of the country. The list of prior actions already taken and the strength of the program attest to this determination. My authorities do not underestimate the task ahead of them. They are very much aware that success will depend on a steadfast implementation of the measures envisaged and that progress in economic stabilization is essential to restoring price stability and for underpinning the exchange rate.

The limited resource base of the country and the lack of opportunity to diversify output makes the authorities' efforts more difficult. Moreover, competition has also started to develop in areas of transportation and other services where Djibouti had a relatively important advantage. However, the return to more stable conditions in the region give the authorities an opportunity to address the deep-seated structural rigidities that require far-reaching reforms over a number of years. It is the authorities' firm intention to address these rigidities starting under the present program and hopefully continuing as soon as feasible under a more comprehensive program that could receive Fund support under the ESAF. This will, in particular, give greater opportunity for authorities to undertake the pressing need for the labor market reforms, the public enterprises reform, and other structural measures.

However, they would note that progress in those areas would be much easier to achieve once the issue of demobilization and civil service reform is addressed. External financial assistance will be essential to allowing the authorities to complete these reforms quickly. World Bank assistance will also be critical to that effort.

Overall, my Djibouti authorities share the view that further progress in financial stabilization is essential and would allow them to concentrate their efforts on improving conditions for private sector investment and sustained economic growth.

Finally, I would like to thank Directors once more for their support, and I will convey their comments fully to my Djibouti authorities.

The Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. Noting the serious imbalances facing the economy of Djibouti and the sizable decline in real GDP in recent years, they welcomed the authorities' decision to initiate a major corrective effort in a medium-term context. They stressed the central role of fiscal consolidation in the authorities' adjustment and reform strategy aimed at establishing a more stable macroeconomic environment while creating the conditions for the resumption of a sustained growth in employment, external payments viability, and poverty alleviation.

Directors welcomed the adoption of the 1995 supplementary budget and the targeted reduction in the 1996 budget deficit as promising steps toward restoring fiscal sustainability. They were encouraged by the authorities' determined actions taken to this end, including, notably, the cut in the nominal wage bill.

Directors underscored the importance of the recent comprehensive survey of wages and benefits in the government sector, and hoped that this would lead to a reduction in public sector salaries. They welcomed the authorities' decision to phase out the Government's large stock of domestic arrears, which would be essential to restoring Djibouti's financial integrity.

Directors emphasized the importance of supporting fiscal adjustment by the rigorous implementation of structural reforms. They underscored the critical importance of early action on demobilization and reform of the civil service. They welcomed the measures aimed at improving the transparency of budget management, and encouraged the authorities to promptly adopt an action plan for tax reform. Emphasis was also placed on structural reforms aimed at improving the competitiveness of the port and the efficiency of public enterprises.

Directors observed that the exchange rate regime had served Djibouti well, and commended the authorities on the maintenance of an open exchange and payments system. They stressed that the sustainability of those important features of Djibouti's economy depended crucially on the rigorous implementation of tight demand management policies, the acceleration of structural reform, and the maintenance of a flexible interest rate policy.

Directors noted that full implementation of the program supported by the stand-by arrangement was essential to establishing confidence in the Government's policies. Given the severity of the financial and structural imbalances, the sizable stock of domestic debt and arrears, and the vulnerability of the economy to external shocks, there was no room for policy slippages.

Directors noted that the success of the authorities' medium-term strategy would depend not only on the establishment of a sound track record through the implementation of the program, but also on adequate concessional external financial assistance. Directors emphasized the importance of maintaining the competitiveness of Djibouti's economy. To that end, increased labor market flexibility, wage restraint, and a strong human resource base were essential. Directors urged the authorities to take additional corrective actions as needed to ensure achievement of the program's objectives.

Directors emphasized the importance of strengthening the macroeconomic database and economic management. They urged the authorities to fully adhere to the recommendations set forth under the technical assistance programs to improve the statistical system and to encourage strong cooperation among government agencies to ensure a timely information flow.

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

The Executive Board took the following decision:

1. The Government of Djibouti has requested a Stand-By Arrangement for the period from April 15, 1996 to June 14, 1997 in an amount equivalent to SDR 4.6 million.

2. The Fund approves the Stand-By Arrangement set forth in EBS/96/53, Supplement 1.

Decision No. 11244-(96/37), adopted
April 15, 1996

3. POSSIBLE NEW ARRANGEMENTS TO BORROW

The Executive Directors discussed progress in the new arrangements to borrow initiative.

Mr. Grilli made the following statement:

On Wednesday, April 3, a number of countries with a record of macroeconomic stability and financial strength met in Paris in a meeting chaired by Mr. Draghi to consider ways in which to achieve the objective of supplementing the resources available to the Fund for coping with international financial emergencies. The meeting, which was the first multilateral meeting following a number of informal bilateral consultations among potential participants, was a response to the Interim Committee's request expressed last October in the proposal for a doubling of the resources currently available under the General Arrangements to Borrow (GAB). The significance of the meeting goes beyond the needed purpose of providing additional resources to cope with an international liquidity crisis. It constitutes strong evidence of increasing international cooperation among the participating countries, based on frank and constructive discussion and on the basis of a common understanding of their shared responsibility in helping foster international monetary stability.

In the course of the meeting, the participants agreed that the Fund should remain a quota-based institution and that it should have adequate resources to carry out its basic functions. The Eleventh Quota Review should be supported by all Fund members. At the same time, they took the view that the expansion of resources to cope with the threat to the stability of the international monetary system should be achieved through the establishment of new financing arrangements, and these arrangements would only be used in exceptional situations.

All participants indicated their potential willingness to take part in these arrangements provided that satisfactory modalities could be finalized, and they agreed to meet again in May. In order to make progress prior to that meeting, they established a subgroup, which has already conferred on two occasions and which will be reporting to the full group. Further consultations among the representatives in the subgroups are expected. We will report to the Board on these developments, and we also anticipate that the Interim Committee will be informed of what has happened so far in an appropriate manner.

The Chairman said he welcomed the consensus on the need for the Fund to remain a quota-based institution and the view that the new arrangements would not be considered a substitute for the Eleventh Quota Review. The Interim Committee setting, perhaps the lunch discussion among Ministers, could provide an ideal occasion for advancing the process.

Mr. Geethakrishnan inquired about the details of Australia's recent proposal.

Mr. Waterman indicated that he was not in a position to add anything substantive to the discussion at that point. Australia's position was guided by the principle that any new participants in GAB had to be treated equitably in relation to the existing participants.

Mr. Fernández made the following statement:

I welcome this opportunity to inform the Board of Spain's views related to ongoing discussions between countries involved in the task of developing financial arrangements with the objective of doubling the amount currently available under the GAB to respond to financial emergencies. This is an initiative of the Group of Seven, presented in Halifax, and which my authorities fully support.

The Interim Committee meeting on October 8, 1995 emphasized the importance that all participants should be treated equally, and agreed that expanded borrowing should not be a substitute for a quota increase. This Chair has pointed out that the Executive Board and the Fund as an institution have the right to be kept informed on the status of the negotiations periodically. Now this item will be taken at lunch by the Interim Committee meeting at the end of this month. We consider the Fund to be a party directly affected by the ongoing negotiations, and the views of the institution on the matter are highly appreciated.

As has been the case with the increase of quotas, the sale of gold, et cetera, different countries have different views, and that is also true with respect to ways of achieving the objective of doubling the amount of resources under the GAB. On April 3, 1996, the first meeting of present participants in the GAB financing arrangement and other countries involved in the effort of doubling GAB resources took place. This was a positive step forward since until then there had been some misunderstandings about the views of some of the parties. A small group was created to expedite the negotiations. Recommendations made by the small group need to be supported by a general meeting of all parties concerned. New meetings have been scheduled to continue the negotiations.

The position of my Spanish authorities on this subject can be summarized as follows: the most simple and straightforward solution would be to enlarge the present GAB. My authorities would like to know the reasons why present GAB members so strongly oppose the simple expansion of the GAB. In fact, these reasons have never been explained or even clearly stated. The solution would guarantee that the equal treatment principle between countries is fully respected, and at the same time contributions by present participants in the GAB will be taken fully into account in the doubling of GAB resources.

From the beginning, our position has always been—I may refer, for instance, to my statement of July 27, 1995—that we are willing to participate in a new set of borrowing arrangements, despite it being a more complex alternative, providing certain principles are respected. The Australian proposal of creating a new set of arrangements independent from the present GAB for an amount of approximately 37 million SDRs is consistent with the key principle of equal treatment. Under this proposal, the new set of lines of credit would be separated from the GAB lines of credit. In our view, the agreement in principle made at the Paris meeting and the small group teleconferences mentioned by Mr. Grilli leave all options open. Further negotiations are required to narrow down differences among the parties interested.

Finally, we have also indicated several times that the doubling of GAB resources ought to be a flexible and efficient instrument for responding to financial emergencies.

Ms. Cheong said that it was important not draw the conclusion that the expansion of resources to cope with a threat to the stability of the international monetary system could be achieved only through the establishment of a new financing mechanism. Rather, it should be achieved through a quota increase, and with the new financing mechanism supplementing the quota increase.

The Chairman indicated he would convey to the Interim Committee the importance the Fund attached to rapid progress in the negotiations, and invite Ministers to exchange views on the issue.

After adjourning at 12:10 p.m. the Executive Board reconvened at 4:00 p.m.

4. ENHANCED STRUCTURAL ADJUSTMENT FACILITY—OPTIONS FOR CONTINUED FINANCING—FURTHER CONSIDERATION

The Executive Directors considered a staff paper on key elements of options for financing a continuation of ESAF operations (EBS/96/59, 4/5/96).

The staff representatives made the following statement:

This note comments on several issues raised by Executive Directors at yesterday's informal discussion on the ESAF--the projections for the demand for ESAF resources, possible "sun-setting" options, and the continued use of loans from bilateral creditors to the ESAF Trust for financing the principal of ESAF operations during 2000–04.

Some Executive Directors have questioned the projections of demand for ESAF resources during the period 2000-04, based in part on past use of ESAF resources. There are several factors that should be taken into account.

The relevant basis of comparison is the past use of all concessional resources from the Fund, i.e., not just ESAF Trust resources but also including SAF resources. Commitments of SAF and ESAF Trust resources have averaged about SDR 1 billion annually from the start of ESAF operations in 1988. This average includes the large commitment to Zambia in 1995 reflecting mainly the encashment of rights accumulated under policy performance during the preceding four years, a period in which, had it not been for the arrears, Zambia would likely have been making use of ESAF resources. Zambia will likely continue to be in need of ESAF assistance over the projection period.

In projecting ESAF demand, the staff has taken into account the probabilities of use of ESAF resources based on recent estimates by the Fund's area departments. In contrast to previous projections of demand for ESAF resources, there is the additional assumption that actual disbursements under three-year arrangements will take place over four years instead of three years.

This assumption lowers projected annual use.

No contingency amounts have been incorporated into the projections to allow for possible adverse developments in exogenous factors, such as commodity prices, which might affect balance of payments needs and therefore the demand for ESAF resources. There is also no account taken of the impact on ESAF demand of the debt initiative for the heavily indebted poor countries now under discussion.

With these assumptions, any margins that may have existed in earlier projections have effectively been eliminated.

The number of ESAF-eligible countries has risen from 62 in 1988 to 79 at present.

Finally, SDR 1 billion in annual commitments during 2000–04 would represent a decline by about 20 percent in real terms compared with the average of commitments during 1991-95.

Based on these factors, the projected demands for ESAF resources through 2004, in the view of the staff, represent a minimum basis for consideration of ESAF funding modalities.

In regard to "sun-setting" options, under all financing options, the Special Disbursement Account (SDA) would build up balances that, at a certain point, could be used either for "self-sustained" ESAF operations—that is, a permanently revolving pool of concessional loan resources in the SDA—or for subsidizing GRA loans. Under the latter approach, annual GRA commitments could conceivably exceed those possible under a self-sustained ESAF, at least for a period. However, depending on the pace of GRA use, SDA resources could over time be exhausted in payment of subsidies. This is illustrated in a recent ESAF paper where, under modified Option 1, GRA financing with subsidies from the SDA could sustain annual commitments of SDR 1 billion from 2005 through 2038, by comparison with a self-sustained ESAF of SDR 0.8 billion per year. The use of the GRA for loan principal would allow greater flexibility than the self-sustained ESAF for varying the amounts of annual commitments, but at the expense of the concept of a self-sustained or permanent ESAF in the SDA. Under modalities using the SDA for principal, if lending were at annual levels above that feasible under a self-sustained ESAF, SDA resources would run out after a few years, and would not become available again until reflows start a few years later.

Questions were raised regarding the possibility of seeking new bilateral loans, as under the existing ESAF Trust structure, to finance ESAF commitments during 2000-04. If new bilateral loans of SDR 5 billion were extended to the ESAF Trust, these additional ESAF Trust obligations might need the protection of the Reserve Account. This could delay by four years, to 2009, the point at which Reserve Account balances would exceed Trust obligations (the cross-over point) and would become available to finance self-sustained ESAF operations. However, self-sustained ESAF operations could start in early 2005 (i.e., after the previous cross-over point in 2004), financed by early transfers from the Reserve Account into the SDA on an "as-needed" basis. In that case, the protection from the Reserve Account for ESAF Trust creditors would be 58 percent at end-2004 (as against 100 percent protection in the absence of bilateral loans and early transfers from the Reserve Account). The protection would be between 60 and 70 percent during 2005-14; after 2014, both the outstanding ESAF obligations and the Reserve Account balances would be negligible, both reaching zero in 2017.

Whether such an approach could be a feasible option would depend on whether existing and new lenders would be prepared to provide the needed financing with reduced Reserve coverage, with additional security in the form of a gold pledge or possibly through other mechanisms.

The Chairman made the following statement:

Our work is at an advanced stage, and I believe we must now focus on a blending of the various elements that will best meet our objectives. There are several general conclusions on which most, if not all, Executive Directors are agreed. A continuation of ESAF operations is essential and is broadly agreed. I speak here not of permanence but of continuation, for a substantial period and in a way that will leave our successors with the flexibility they will need at a future point to decide whether operations should be further sustained. We must have clearly in mind the context for our efforts, in particular the budgetary constraints facing many of our members, and avoid entering too much into a competition for scarce resources. At the same time, we must have a realistic appreciation of the problems of our poorest members and ensure that what we decide is on a scale relevant to their needs and adjustment efforts; we need to aim to be in a position to meet demands of about SDR 1 billion annually during 2000–2004 and continuing demands at or close to that level for some substantial period thereafter. And the clear identification of financing arrangements is increasingly urgent, particularly in light of the lead time needed to put the financing in place and the need for a secure base from which to consider the Fund's participation in the debt initiative.

In light of these conclusions and the considerations noted above, I would suggest, for your consideration, a proposal composed of the following elements.

First, we would consult with existing and potential lenders regarding their preparedness to provide further lending of SDR 5 billion to the ESAF Trust for commitments in the period 2000–2004, taking into consideration the security provided by the Reserve Account as well as possible modifications of the existing gold pledge and of the Fund's general undertaking to ESAF lenders so as to include explicit reference to gold. If, however, those consultations were to lead to the judgment that a further round of borrowing is not feasible, we would then revert to use of the Fund's General Resources Account to finance the principal of ESAF-type operations during the relatively short period 2000–2004 under arrangements in the Extended Fund Facility.

Second, we would institute special periodic reviews, perhaps annually, of the evolution and adequacy of all of the Fund's precautionary balances, both in the General Resources Account and the ESAF Trust, to ensure that these balances are in line with the risks that we face. If the principal of interim operations were to be financed from the General Resources Account, consideration would be given to additions to precautionary balances and possibly to merger of some part of SCA-2 with SCA-1.

Third, for subsidies, we would agree to use the investment income on profits from the sales of up to 5 million ounces of the Fund's gold—some of you will see this as excessive and others will think it too small—and seek SDR 1 billion in subsidies from bilateral sources. We would seek broad—ideally, universal—participation but, as in the past, avoid rigid "burden-sharing" formulas and would bear in mind the contributions many members have already made and continue to make to the ESAF. Here I have particularly, but certainly not exclusively, in mind several contributions promised during the negotiation of the ESAF expansion but not yet made. I have also in mind contributions from countries that were not in a position to help earlier but whose situations have improved significantly in the last few years.

Fourth, as a potentially important component of bilateral contributions, we would continue to consider the role that could be played—either as grants or as interest-free deposits—by refunds of balances in SCA-2. But, of course, we would plan to proceed with such refunds only if it became clear that that course would indeed facilitate substantial bilateral contributions by our members.

Finally, we will in any case embark on a major review of the effectiveness of ESAF programs, with a view to learning where we can improve and ensuring that we do the best we can in support of the adjustment programs of our poorest members. Here, the point has been made that outside experts may have a valuable contribution to make in the evaluation of our efforts.

Some of you will no doubt have difficulties with some aspects of this proposal. But I believe it balances reasonably the interests and concerns that have been expressed during our debates and would meet the objective we all share of securing a viable and credible continuation of ESAF operations.

Extending his remarks, the Chairman asked Directors to comment on his proposal by indicating whether they: (i) accepted the proposal; or (ii) accepted it as a second-best option; or (iii) accepted it as a second-best option, ad referendum; or (iv) accepted it as a second-best option, but in their personal capacity as Fund officials; or (v) abstained, but would recommend it in their personal capacity; or (vi) abstained; or (vii) rejected the proposal.

Mr. Wijnholds remarked that the proposal struck a careful balance between the varying preferences of Directors. In the spirit of reaching a compromise on the issue, he was willing to support the proposal in his personal capacity.

Mr. Kafka noted that, under the proposal, members could make voluntary bilateral contributions to finance the ESAF subsidy, either by providing SCA-2 refunds or by making additional contributions. He had yet to consult with members of his constituency, but he considered that they would be amenable to making available SCA-2 refunds for the ESAF.

Mr. Mirakhor asked for clarification of the relationship between the Chairman's proposal and the Fund's role in the debt initiative. He wondered whether the amount of gold sales envisaged under the proposal would be sufficient to cover the Fund's involvement in the debt initiative.

The Chairman noted that a continuation of the ESAF was essential to enable the Fund to play its role in the debt initiative. It was, therefore, necessary to ensure that adequate financing for the ESAF was available for the periods ahead to enable the Fund to support the adjustment efforts of the heavily indebted poor countries. If the Executive Boards of the World Bank and the Fund approved the framework on the debt initiative, the two institutions would work in the months ahead to finalize the details of that initiative. Sales of up to 5 million ounces of the Fund's gold, together with bilateral contributions, should be sufficient to meet the subsidy requirements for the ESAF in the period 2000-04.

Mr. Fayolle observed that the proposal did not include the option of an early use of resources from the Special Disbursement Account to finance the subsidy component in the interim period. He asked for further information about the security that would need to be provided to new lenders if the loan component were financed through further lending to the ESAF Trust.

The Chairman noted that security to new lenders of the ESAF Trust would be provided through both the ESAF Reserve Account and the existing gold pledge. In addition, there was the possibility of making explicit in the Fund's general undertaking to ESAF lenders itself the possible use of gold to meet the claims of ESAF creditors if there were protracted delays in payment.

The Deputy General Counsel remarked that, when the ESAF had been extended and enlarged in 1993, the security provided by the Reserve Account had been extended to new loans to the ESAF Trust. If the Board agreed that the loan component during the period 2000–04 should be financed through additional lending to the ESAF Trust, the current Reserve Account could once again provide security for new loans to the ESAF Trust; however, the understandings reached with existing lenders would need to be taken into account.

Mr. Fayolle asked whether the proposal included a scheme to change the existing gold pledge from a last line of defense to an early line of defense.

The Director of the Policy Development and Review Department observed that there were two issues relating to the gold pledge: first, whether the existing gold pledge should be broadened to cover ESAF loans unrelated to the encashment of rights; and second, whether the gold pledge should be activated as an early or last line of defense. If the Board decided to use a gold pledge, those two issues would need to be resolved.

Mr. Evans stated that he agreed with the three principles outlined by the Chairman in his proposal, namely, the importance of a continuation of ESAF operations, the need to bear in mind the budgetary constraints faced by a number of countries, and the importance of ensuring adequate financing to enable the Fund to participate in the debt initiative. He supported most of the elements of the proposal, except the one on bilateral contributions. In the light of the severe budgetary constraints faced by a number of countries, financing for the subsidy component, in his view, should come from the sale of about 10 million ounces of the Fund's gold—appropriately "ring fenced"—with bilateral contributions being provided either through SCA-2 refunds or on a purely voluntary basis.

Mr. Kaeser remarked that, while he could support most elements of the Chairman's proposal—including use of the GRA—he found it difficult to accept the element requiring gold sales by the Fund. It would be difficult to convince legislatures in member countries of the need to provide bilateral contributions, if the Fund were seen as willing to sell its gold. For the same reason, it would be difficult to convince the authorities of the need to make SCA-2 refunds available for financing the ESAF subsidy. His chair continued to favor "stretching" the existing ESAF resources.

Mr. Coumbis observed that he could also support most of the elements of the proposal—including use of the GRA. However, as his authorities remained opposed to gold sales, he could not accept the Chairman's proposal. Moreover, he considered that there was no urgent need to resolve the financing issue, as the current ESAF was expected to last through 1999. Deferring the financing issue until later would also allow the Board to get a better picture of the actual demand for ESAF resources during the period 2000–04.

The Chairman remarked that, in view of the lead time necessary to put the financing in place, it was important to reach a decision on financing the ESAF as early as possible.

Mr. Mesaki stated that his authorities supported the use of the GRA for financing the loan component. They would need to reflect on the proposal to finance the loan component through new lending to the ESAF Trust. He considered that that element of the proposal should be given careful thought, as there might be considerable risks involved. On the sale of gold to finance the subsidy component, he shared the views of Mr. Coumbis and Mr. Kaeser. He would have to refrain from expressing his chair's final position on the Chairman's proposal, pending further consultations with his authorities.

Mr. Schoenberg observed that, if contributors were unwilling to make additional loans to the ESAF Trust, the loan component would have to be financed through the GRA. If the GRA provided resources for the loan component, the proposal before them was identical to option 1, which the Board had considered earlier and which his authorities did not favor. With respect to his views regarding the Chairman's proposal, it would not be useful to depart from his authorities' position, which he had stated on earlier occasions.

The Chairman recalled that Mr. Schoenberg had indicated that morning, at the informal discussion, that his authorities might consider the possibility of providing further lending to the ESAF Trust. Other Directors had also expressed interest and support for the proposal to finance the loan component through the ESAF Trust; he was thus optimistic that members would extend new loans to the ESAF Trust.

Ms. Lissakers, noting that the Chairman had stressed a continuation and not the permanence of the ESAF, remarked that press reports had quoted a Fund spokesperson as saying that a permanent ESAF was essential for the Fund's contribution to the debt initiative. She considered that the statement by the Fund's external relations representative should have been consistent with the Chairman's statement. With respect to financing the ESAF, she asked for additional information about the security that would need to be provided to new lenders and the implications for the self-sustained ESAF, if the loans in the interim period were financed through the ESAF Trust. The staff had noted in its paper (EBS/96/59, 4/5/96) that, if the existing Reserve Account provided security to new lenders to the ESAF Trust, the beginning of the self-sustained ESAF would be delayed until 2009. She wondered how the subsidy component would be financed if bilateral contributions fell short of the SDR 1 billion currently sought. Finally, noting that the Chairman had stressed the need to avoid rigid burden sharing, she asked whether past contributions to the Fund's gold would be a factor in assessing burden sharing.

The Chairman stated that the Fund's gold came from member countries, a portion of which would be used to finance the ESAF subsidy. It was important to ensure universal participation in financing a continuation of ESAF-type operations, rather than to engage in precise calculations about burden sharing.

The Director of the Policy Development and Review Department made the following statement:

> The staff began its work by asking a straightforward question: when would the resources in the ESAF Reserve Account be sufficient to cover all of the claims of the ESAF creditors, and then become available to finance the ESAF on a self-sustaining basis? That was the crossover point. It was 2005 under the current operations. The question then was: how to finance the interim period? The proposition underlying the analysis was that the creditors to the ESAF Trust effectively wanted that the protection of their claims be allowed to rise to

100 percent before resources were transferred from the Reserve Account to the SDA to finance the ESAF on a self-sustaining basis. And the signals from creditors have generally remained, until recently, along those lines.

However, if there is an additional SDR 5 billion in lending to the ESAF Trust for financing ESAF loans in the period 2000-04, and if resources in the Reserve Account are preserved to provide 100 percent security for outstanding claims, it is only in 2009 that the balances in the Reserve Account exceed Trust obligations, and, at that point, Reserve Account surpluses can be transferred to the SDA to finance ESAF operations. That leaves a need to finance operations in the period 2000-04. If the financing needs were met by further lending to the ESAF Trust—requiring further protection by the Reserve Account for creditors—a repetitive process would result, leading to an extended delay in the start of self-sustained ESAF operations.

Some of the ESAF creditors have indicated that their willingness to accept less than 100 percent protection from the Reserve Account, particularly given the additional elements that the Chairman has mentioned, namely, the possibility of broadening the gold pledge or modifying the pledge to make explicit the use of gold in the event that the resources in the Reserve Account are insufficient. So that has introduced a new element of flexibility. If creditors are willing to provide that flexibility, the staff will have to do further simulations on the modalities for financing the ESAF. The Board will need to agree on the assumptions on which the staff will base its further work showing the degree of protection that would be afforded residually, which has to do with the pace at which the resources of the Reserve Account are taken out as ESAF commitments are made to borrowing countries. The initial calculations show that, at least for a considerable time in the future, until the remaining claims of the ESAF creditors are quite small, the residual protection that would be afforded by the Reserve Account under this kind of scheme remains substantial and is, in fact, higher than what has been provided to creditors to date.

Mr. Clark made the following statement:

Like Mr. Evans, agree on the general principles. This is an extremely important issue, and there are some new elements in the proposal, which are going to require some further examination. I agree that we should keep the pressure on and try to keep the process moving ahead.

Canada would not be capable of committing more bilateral credits at this point, but the Chairman has skillfully provided other avenues for satisfying the bilateral element. As I mentioned earlier on the SCA-2, the position of my Canadian authorities has been that they are not in favor of this. I personally think that the difficulties in the Canadian Parliament would be considerable; however, the political difficulties facing my authorities would not be any greater than the political difficulties that the authorities of some of my colleagues would face regarding gold sales. In my view, Canadians, being fair-minded people, might well think that, if SCA-2 refunds are necessary to ensure a continuation of the ESAF, they might agree to make those resources available.

With respect to the seven positions outlined by the Chairman, while I do not reject the proposal, I cannot accept it either. However, I will work hard to try to get a result which is a low number rather than a high number on the Chairman's list.

Mr. Al-Tuwaijri welcomed the Chairman's proposal, which he believed struck a suitable compromise between the differing views of Directors. His authorities agreed that a continuation of the ESAF was essential. He was not in a position to comment on the details of the proposal, as he had not yet consulted his authorities. However, he would make a recommendation to them.

Ms. Srejber considered that the proposal to finance the loan component through additional lending to the ESAF Trust was interesting and deserved further study. In that context, it would also be important to study the impact of such financing on the ESAF's Reserve Account. Some countries in her constituency were amenable to making bilateral contributions to the subsidy account, based on reasonable burden sharing. Her authorities considered that the option of using SCA-2 refunds should also be examined further. However, some countries in her constituency would need parliamentary approval to make those refunds available for the ESAF subsidy, while one country would not need legislative approval for use of the investment income. She had indicated her constituency's views on gold sales earlier; one country in her constituency had a prohibition against gold sales.

Mr. Shaalan made the following statement:

While we all seem to be agreed on the importance of a continuation of ESAF, we seem to be in some disagreement on how we can make the ESAF a continuing instrument for our less fortunate members.

Our position is as follows. First, as you know, we have no problems with the use of GRA resources to fund the principal. Second, we have supported in the past a modest amount of gold sales. I will have to admit that I did not focus on the definition of a modest amount, but I will be happy to discuss it with members of the constituency and see whether there is any room to go beyond the five million ounces.

With regard to SCA-2, as I mentioned this morning, four members of the constituency I represent have agreed for refunds to be invested by the Fund, and for the income to go to the subsidy account. I shall be in touch with the other five to get their views. I shall also mention to them the impasse that seems to be in existence now with regard to GRA resources and bilateral loans, and ascertain their views on bilateral loans.

Finally, in my personal capacity, I would definitely endorse the overall proposal, and I shall talk to members of my constituency to get their support as well.

Mr. Kiekens, speaking in his personal capacity, noted that the proposal presented by the Chairman was a good and well-balanced proposal. On the loan component, he wondered whether there was any link between the use of GRA and the quota increases under the Eleventh

General Review of Quotas. With respect to the subsidy component, the proposal to combine bilateral contributions with gold sales was well balanced. However, he was concerned that, if the Fund were to decide to sell gold, bilateral contributions would not be forthcoming. He wondered how shortfalls in bilateral contributions would be made up, and whether it would be possible to ensure that financing for the ESAF was as well balanced as the Chairman's proposal.

The Chairman remarked that quota increases under the Eleventh Review would be discussed by the Interim Committee. On ESAF financing, every effort would be made to ensure that it was well balanced. As he had observed earlier, the universal participation of the membership was essential for a continuation of the ESAF, and he was confident that it would be possible to obtain SDR 1 billion from the 181 countries that were Fund members. From the point of view of donor countries, the ESAF was an extremely useful instrument because it enabled them to support adjustment programs in developing countries at a relatively low cost.

Mr. Kiekens suggested that, in order to ensure that financing for the ESAF balanced the Fund's contributions with bilateral contributions, one possibility would be to make gold sales conditional on bilateral contributions.

Mr. Fernández stated that he could support the proposal in his personal capacity. Some countries in his constituency were concerned about using SCA-2 resources for financing the subsidy, as those were bilateral resources. As his chair had stated in the past, burden sharing should be quota based. However, if the Board agreed that SCA-2 refunds should be made available for financing the subsidy, and, pending further consultations with his authorities, he could support use of those resources. His authorities supported the sale of a modest amount of gold and were ready to provide bilateral contributions.

Mr. Barro Chambrier said that he welcomed the proposal and appreciated the efforts being made to ensure continuation of the ESAF. He agreed with the Chairman that the ESAF was critical for supporting the adjustment efforts of the low-income countries. His chair had supported option 1 earlier; however, in a spirit of compromise and in the hope of achieving a consensus, was willing to support the proposal before them.

Mr. Evans suggested that the figures for the subsidy component should be expressed as a range of numbers rather than as a single number. Although he preferred the option of a gold sales to a gold pledge; nevertheless, as several chairs favored a pledge over sales, the option of a gold pledge should not be disregarded.

The Chairman noted that the proposal envisaged potential use of 8 million ounces of the Fund's gold—3 million under the existing pledge and 5 million in gold sales.

Mr. Zhang made the following statement:

> I can agree with the principles the Chairman has mentioned. I believed that a continued ESAF is the most important principle. And a continued ESAF, as I view it, will play a very important role in the HIPC program. In this context I would like to thank the Chairman for his efforts to work out the proposals after repeated informal discussions during the last weeks, particularly the last few days.

The basic positions of this chair are as follows. We can go along with the use of the GRA to finance ESAF as principal. We can also agree with the sale of a moderate amount of gold.

In general I can say that we can support any constructive proposal to make ESAF a continued ESAF.

As for bilateral contributions, we have difficulties as do other members. However, we have made reports and recommendations to our authorities. And my authorities would like to take an active attitude on constructive proposals to make ESAF a continued one.

Ms. Srejber remarked that she agreed with Mr. Coumbis that, as the current ESAF was expected to last until 1999, there was still time to reach a decision on financing the ESAF in an interim period, the debt initiative notwithstanding. On financing, her authorities favored an additional gold pledge to gold sales.

The Chairman noted that a gold pledge exposed the Fund to the risk of gold sales and use of the profits, while under gold sales the profits could be left intact and only the investment income used.

Mr. Dlamini expressed appreciation for the Chairman's—and his colleagues—efforts to find a middle ground for financing continuation of the ESAF, which would benefit greatly a number of countries in his constituency. His chair could go along with the Chairman's proposal regarding financing the principal, and could also accept most of the elements of the proposal on financing the subsidy component. However, it was difficult for him to indicate clearly the views of members of his constituency on the use of the balances of SCA-2, as he was waiting to hear from his authorities.

Mr. Mesaki said that he agreed with Mr. Evans that the gold pledge option should be considered further. As there was still time to reach agreement on the financing of the ESAF, it was not necessary to narrow the options on the use of gold.

Mr. Coumbis remarked that he agreed with Mr. Mesaki. Furthermore, the probability that the Fund would be called upon to sell gold—under the gold pledge option—was remote. In any event, there was still time to discuss the issue further.

Mr. Schoenberg said that retention of the gold pledge option would make the proposal more attractive. He agreed with Mr. Coumbis that there was no urgent need to resolve the issue of ESAF financing, as the resources under the current ESAF were expected to last until end-1999.

The Chairman observed that, at its October 1995 meeting, the Interim Committee had called for an early resolution of the ESAF and debt issues. Although it had been expected that the debt initiative would be finalized by April, a decision on the debt initiative would probably be deferred until the Annual Meetings. For the Fund to be able to participate in the debt initiative, it was essential that financing for the ESAF be on a firm footing.

Ms. Lissakers noted that the staff's analysis had shown that, if the loan component were financed though additional lending to the ESAF Trust, the corresponding gold pledge would need to be extremely large, about 30 million ounces. It would be more accurate to refer to gold sales as gold investment, as the corpus would be invested and only the income generated from the investments would be used for the subsidy. Also, she asked for more information about the impact of sun-setting the self-sustained ESAF based on the availability of ESAF resources after 2004.

Mr. Evans noted that, if the loan component were financed through the GRA, the corresponding gold pledge would be about 4.1 million ounces.

Mr. Mirakhor agreed that, if the loan component were to be financed through the ESAF Trust, the corresponding gold pledge would be sizable. He could support the Chairman's proposal as a second-best solution, but in his personal capacity pending approval from some of his authorities who were considering the possibility of making available SCA-2 refunds for the ESAF subsidy. It would be easier to ascertain his authorities' views on the financing modalities, as the proposal before them was more precise than earlier proposals that the Board had considered. Finally, he noted that the proposal envisaged contributions from members who were neither creditors nor debtors to the Fund.

The Chairman said that both options should be kept open—sun-setting, that is, the eventual termination of the self-sustained ESAF—and sun-rising, the continuation of the ESAF to deal with potential new demands for concessional resources. The financing arrangements for the interim and self-sustained ESAF should leave enough flexibility to allow management and the Board to decide in the future whether or not ESAF operations should be sustained.

Ms. Lissakers observed that the assumption underlying ESAF-supported programs was that they were successful in promoting adjustment; hence, a provision to limit the time horizon for the availability of concessional resources should be considered. By agreeing to put in place a self-sustained ESAF for an indefinite period, Directors would, in effect, be taking away from their successors the choice of whether or not to continue the ESAF instrument.

The Chairman commented that it was impossible to foresee the kinds of situations that could arise in the future. The Fund should be equipped to deal with unforeseen developments, such as new conflicts or sudden swings in commodity prices. He recalled that, when the ESAF had first been created, no one had envisaged that there would be a need to continue with a concessional facility beyond the initial stage. However, in 1993, it had been necessary to extend and enlarge the ESAF.

Ms. Lissakers observed that the ESAF was not the appropriate instrument to assist countries emerging from chaos or facing commodity shocks; the Fund had other instruments to assist countries in those situations.

Mr. Zoccali stated that his authorities supported a continuation of the ESAF. They also supported the use of the GRA and the sale of a modest amount of the Fund's gold. Gold sales would be both transparent and would limit the amount of gold pledged. He shared Mr. Fernández's views on SCA-2. Finally, he could accept the Chairman's proposal as a second-best solution, but in his personal capacity as a Fund official.

Mr. Fayolle said that he would need to reflect on the proposal before them. However, his chair could support the use of the GRA for the loan component. Like Mr. Kaeser, he was concerned that gold sales would discourage bilateral contributions, and he, therefore, agreed with Mr. Mesaki that the option of a gold pledge should remain on the table.

Mrs. Cheong noted that her chair had indicated earlier its support for the continuation of the ESAF and its preference for gold sales rather than a gold pledge. She could also support the proposal presented by the Chairman. On making available SCA-2 refunds for the ESAF, she considered that the authorities of the countries in her constituency would be more favorably disposed to it if they were also given the option of providing to the ESAF the entire amount or a portion of their refunds in the SCA-2 account.

Mr. Waterman stated that he agreed with the general principles outlined by the Chairman. With respect to the financing modalities, his chair supported the use of the GRA and preferred a gold pledge to gold sales, particularly if the loan component were financed through the GRA. However, his chair would not rule out the possibility of agreeing to gold sales. Like other speakers, he considered that bilateral contributions would be difficult to obtain. He had not yet consulted the countries in his constituency about SCA-2 refunds, but he considered that they would be agreeable to making those resources available for the ESAF. With respect to the Chairman's proposal, he preferred to abstain, but would recommend to his authorities that they support the proposal in order to move the discussion forward.

Mr. Mozhin said that his chair would support a consensus when it emerged. His authorities strongly favored a gold pledge over gold sales.

The Director of the Policy Development and Review Department observed that the idea of a gold pledge had first arisen in the context of the early use of the SDA resources to finance a portion of the subsidy requirement in the interim period. The assumption was that, if Reserve Account resources were transferred early to the SDA, ESAF creditors would require security for their outstanding claims, which would be provided by the gold pledge. The proposal that the Chairman had presented envisaged new lending to the ESAF Trust to finance the loan component. In order to provide security for the loans from the ESAF Trust for the interim period, the Chairman had suggested modifying the existing gold pledge to make the commitment to sell gold explicit, as well as broadening the existing pledge to cover all ESAF obligations. The proposal also included a provision for sales of up to 5 million ounces of gold to finance one half of the subsidy component. However, if Directors preferred a gold pledge as an alternative to gold sales, that would affect adversely the resources in the SDA and, hence, financing for the self-sustained ESAF.

Mr. Mirakhor wondered whether use of the SDA to finance a portion of the subsidy component in the interim period would affect the rate of charge and the Fund's income position.

The Deputy Treasurer observed that, under option 2, which had been discussed by the Board earlier, one half of the subsidy component would come from SDA resources and the other half would be financed through bilateral contributions, including SCA-2. Under that option, SDA resources would be used to subsidize ESAF-type operations, but they would not be transferred to the GRA.

The Deputy General Counsel added that the rate of charge would be uniform for all members. The subsidy would not be transferred to the GRA, but to ESAF-eligible members to subsidize their use of GRA resources. Thus the rate of charge and the Fund's income position would be unaffected.

Mr. Geethakrishnan, welcoming the proposal, said that he could support most of its elements. However, he could not make a firm commitment until the details of the financing modalities were clear, except to note that the options in the first half of the Chairman's list broadly reflected his position on the subject. On SCA-2, he would like further information about the details of the use of those refunds. He observed that Directors were in agreement on three issues: first, all Directors supported the continuation of the ESAF; second, all agreed on the need to review the effectiveness of ESAF-supported programs; and third, all Directors agreed that a portion of the financing for the ESAF would have to come from the Fund's resources.

Mr. Coumbis asked the staff what the size of the gold pledge would be, if the subsidy component were financed through the SDA and the loan component through the GRA for a period of 20 years at an annual rate of SDR 0.8 billion.

The Director of the Policy Development and Review Department said that the staff would provide Directors with that information.

Mr. Evans noted that a sunset provision for the ESAF deserved to be explored further. The use of the SDA in the interim period would adversely affect the self-sustained ESAF only if ESAF operations were sustained indefinitely.

Ms. Lissakers stressed that it was important to ascertain Ministers' views on the subject of a sunset provision for the ESAF.

The Chairman noted that including a sunset provision in the proposal on financing a continuation of the ESAF would be tantamount to accepting at the outset that bilateral contributions would not be forthcoming. He considered that the option of sun-setting and sun-rising should be left open, to provide them with the flexibility to meet the future demands of the membership. The history of the world was one of countries' fortunes rising and declining, and it was important that the Fund have sufficient resources to meet the unforeseen demands of its membership. Furthermore, under his proposal, a review of ESAF-supported programs would provide occasion to consider whether or not the ESAF should be continued.

Ms. Lissakers noted that a sunset provision did not imply that bilateral contributions would be unavailable for financing the subsidy. In her view, terminating the self-sustained ESAF would enable the Fund to meet larger commitments during the lifetime of the self-sustained ESAF.

Mr. Schoenberg commented that, when the ESAF had been first created, there had been the expectation that the facility would expire after some years. It was somewhat frustrating to learn that there was little hope of the facility expiring before the next 25 years.

Ms. Srejber considered that, even if the ESAF were terminated, their successors could reinitiate operations, if the need arose. On the argument that sun-setting the ESAF would give their successors less flexibility, it was possible to make the opposite argument as well, namely, that continuation of the ESAF indefinitely would leave their successors with less room for maneuver.

Mr. Waterman stated that there should be a sunset provision. He agreed that countries' fortunes changed, but given that the standard of living in the past 25 years had improved worldwide, he was confident that the situation 25 years hence would be substantially better than it was currently.

Mr. Coumbis stressed that Ministers' views should be sought on the gold pledge option and on sun-setting the ESAF.

Ms. Lissakers noted that the inclusion of a sunset provision would make it easier to reach agreement on financing for the ESAF. She was often reminded by her colleagues in the U.S. Congress that the ESAF had originally been designed as a temporary facility. A sunset provision would also enhance the credibility of the ESAF and make it easier to obtain the consent of legislatures for financing the ESAF. She was confident that the Fund would find innovative ways of meeting the challenges of the future.

After a brief discussion, it was agreed that the proposal would be forwarded as part of the Managing Director's report to the Interim Committee on financing a continuation of ESAF-type operations. Directors agreed to meet on Wednesday, April 17, to discuss the draft report.

APPROVAL: March 13, 1997

REINHARD H. MUNZBERG
Secretary