March 8, 2001
Approval: 3/15/01

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 99/130

10:00 a.m., December 8, 1999

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

M. Camdessus, Chairman
S. Fischer, Acting Chairman
S. Sugisaki, Acting Chairman

Executive Directors	Alternate Executive Directors
S.M. Al-Turki	A.S. Alosaimi
	D. Ondo Mañe
	T.-M. Kudiwu, Temporary
	J.A. Chelsky, Temporary
	T. Turner-Huggins, Temporary
	P.R. Fenton, Temporary
	H. Oyarzábal
	E. González-Sánchez, Temporary
R.F. Cippà	F. Zurbrügg, Temporary
	J. Schaad, Temporary
B. Esdar	W. Merz, Temporary
	D.H. Kranen, Temporary
	A.G. Zoccali
	M. Pérez dos Santos, Temporary
	P. Cabezas, Temporary
R. Faini	J. Spraos
	C.A.E. Sdralevich, Temporary
K.A. Hansen	O.-P. Lehmussaari
	Nguyen Q.T., Temporary
	S.N. Kioa, Temporary
V. Kelkar	A.G. Karunasena
W. Kiekens	S. Çakir, Temporary
K. Lissakers	M. Budington, Temporary
	G. Bauche
	I. Mateos y Lago, Temporary
A. Mirakhor	S. Rouai, Temporary
J.P. de Morais	C. Rustomjee
A.V. Mozhin	A. Lushin
	S. Vtyurina, Temporary
S. Pickford	S. Collins
	V. Dhanpaul, Temporary
	A. Maciá, Temporary
A.S. Shaalan	
	J.N. Oh
Wei Benhua	A.Y.T. Wong, Temporary
	E.J.P. Houtman, Temporary
	I. Dragulin, Temporary
Y. Yoshimura	M. Yanase, Temporary
	S. Hinata, Temporary

S.J. Anjaria, Secretary
A. Mountford, Acting Secretary
J. Prust, Acting Secretary
C. Andersen, R. Gudmundsson, G. Nkhata, S. Soromenho-Ramos, Assistants

Also Present

IDB: L. Bracowicz, Regional Operations Department. IBRD: D. Dowsett-Coirolo, Latin America and the Caribbean Regional Office; Y. Ansu, A. dePlaa, J. Larson, H. Lopez, J. Sokol, Africa Regional Office. African Department: E. Hernández-Catá, Associate Director; P.A. Acquah, Deputy Director; A. Basu, Deputy Director; G.J. Almekinders, B.W. Ames, C.M. Browne, J. Fajgenbaum, N.M. Henstridge, H. Hino, M. Katz, S.P. Leite, V. Moissinac, I. Thiam. External Relations Department: G.V. Bhatt, W.J. Murray, N.V. Shastry, S.J. Willson. Fiscal Affairs Department: S.E.U. Ahmad, B. Bingham. Legal Department: F.P. Gianviti, General Counsel; W.E. Holder, Deputy General Counsel; H. Elizalde, H.V. Morais, B. Steinki. Monetary and Exchange Affairs Department: L.I. Jacome Hidalgo. Policy Development and Review Department: J.T. Boorman, Director; N.L. Happe, K.H. Kang, I. Kapur, G.R. Kincaid, L. Nielson, S.S. Rizavi, J. Seade, H. Tadesse, N. Thacker. Secretary's Department: P. Gotur, B.A. Sarr. Treasurer's Department: E. Brau, Treasurer; B.S. Newman, Deputy Treasurer; J.E. Blalock, K. Boese, B.V. Christensen, J.C. Corr, P. Ganesh, D.M. Hicks, B.E. Keuppens, J. Lin, S.T. Lurie, A.K. McGuirk, S. Sriramachandran. Western Hemisphere Department: H. Arbulu-Neira, M.A. DaCosta, J.C. Di Tata, E. Jenkner, V.A. Mercer-Blackman, C.A. Paiva, P. Sorsa, F. van Beek. Office of the Managing Director: N.H. Bradshaw, J.A.P. Clément, D.A. Citrin, J. Hudson, K. Wilairat. Advisors to Executive Directors: M.A. Ahmed, P.A. Akatu, B. Couillault, A. Del Cid-Bonilla, S.S. Farid, A.R. Ismael, M.F. Melhem, H. Mori, J. Ntamatungiro, J.N. Santos, G. Schlitzer, M.R. Shojaeddini, M. Sobel, I.M. Woolford. Assistants to Executive Directors: S.A. Bakhache, T. Belay, J.G. Borpujari, P.A. Brukoff, R. Djaafara, M.J. Fernández, N.K. Gueorguiev, K. Harada, M.S. Hililan, C. Josz, A. Kapteijn, B. Kelmanson, S.K. Keshava, K. Kpetigo, J. Mafararikwa, Y. Moussa, K. Ongley, C.-P. Schollmeier, R.J. Singh, A. Sutt, M. Walsh, P. Winje, I. Zakharchenkov.

1. SECOND SPECIAL CONTINGENT ACCOUNT (SCA-2)—TERMINATION AND ESTABLISHMENT OF ADMINISTERED ACCOUNT TO HOLD SCA-2 BALANCES; AND OFF-MARKET GOLD TRANSACTIONS AND DECISIONS

The Executive Directors considered the staff paper on the procedural aspects and decisions related to the termination of the Second Special Contingent Account (SCA-2), the establishment of an administered account to hold SCA-2 balances, and off-market gold transactions (EBS/99/215, 11/29/99; and Sup. 1, 12/3/99).

Ms. Lissakers made the following statement:

Today's decisions are an important milestone in our long and arduous effort to fully finance the IMF's contribution to the international debt relief effort and to enhance the HIPC Initiative. I want to take this opportunity to recognize the Managing Director's enormously patient, steady, and dogged leadership in moving toward today's decisions.

I also want to thank the staff for their tremendously hard work, and particularly their efforts to provide us with the needed information and clarification as we negotiated with the U.S. Congress to try to get the authorizations necessary for me to support today's proposed decisions. They have been tremendously cooperative throughout and helpful.

I can support the full set of proposed decisions, Mr. Chairman. Let me just make a few specific comments.

On the nonreimbursement of administrative costs for the PRGF, we fully support the proposal to continue to forego reimbursements of these expenses.

On SCA-2, I have been instructed by the Secretary of the U.S. Treasury to vote to support the proposed decision to terminate the SCA-2 on the condition that the funds attributable to the United States' participation in the SCA-2 will be used only for debt relief. I have formally conveyed these instructions to the IMF staff and management today.

Concerning gold, we can support the proposal in the December 3 paper related to the investments on the profits of gold, and we look forward to returning to the issue of investment policy for the resources held in the SDA early next year.

As we indicated in the earlier discussion, we strongly concur with staff's recommendations to leave unchanged the rates of remuneration and charge following the transaction and to allow for lower net income and less rapid accumulation of reserves given the Fund's liquidity position as well as the strong cushion provided by the SRF income.

On subaccounts, we also concur with the planned arrangements outlined in Attachment III that will provide a transparent basis for management of funds, including those being earmarked under the PRGF-HIPC Trust, and we, of course, support the sale of the amount of gold as proposed—outlined in the decisions and the staff paper.

On legislative action, we have shared with all Directors the U.S. legislation relevant to these proposed decisions. As the staff papers indicate, and as I highlighted in my recent note, the Congress has reserved its decision on authorization of our vote on the transfer of five-fourteenths of the investment income generated by the proceeds of the off-market gold sales. Congressional leaders have indicated that they intend to return to this issue in the spring. This will provide the Congress with an opportunity to review the initial progress made in the implementation of the enhanced HIPC as well as the PRSP and PRGF reforms. The legislation itself stresses the importance of a strong start to the enhanced HIPC and the new PRSP/PRGF efforts.

The Fund and the Bank have jointly adopted a series of fundamental reforms to strengthen the HIPC Initiative and to reorient Bank and Fund program support for our low-income members. It is absolutely essential in my view that these reforms get off to a very strong launch with the very first cases to come forward under the new PRGF and enhanced HIPC to establish firmly the new principles for our assistance including our focus on governance, public participation, transparency, accountability, and the priority given to concrete poverty-reduction efforts.

Beyond the HIPC-related reforms, I believe that the full range of reforms called for in the U.S. legislation can be quite positive, including the call for publication of operational budgets with a lag and for the establishment of a standing independent evaluation unit. We look forward to advancing these proposals in coming months.

The Chairman thanked Ms. Lissakers for her words of appreciation, which he felt the staff certainly deserved.

Mr. Houtman made the following statement:

It seems to me that most of us would agree that completion of a fully funded financing package for both the HIPC Initiative and the interim PRGF is a matter of utmost urgency. The fact that we were able to agree on the financing package during the last Annual Meetings was promising. Although we were not happy with parts of the financing proposals (i.e., the revaluation of gold), we have eventually not stood in the way of reaching a consensus by the Board.

I join Ms. Lissakers in praising the Managing Director and the staff for their enormous efforts to get this deal done. I also appreciate the tireless efforts that the U.S. Chair and the U.S. Administration have undertaken to get approval from Congress for this financing package. Thus, it is unfortunate that it now seems necessary to review the modalities once again because of the changes made in Congress. Although this chair does not want to endanger progress regarding the HIPC Initiative, the proposed revisions are cause for concern. I would like to be convinced that these revised modalities do not jeopardize the financing of both the HIPC Initiative and the interim PRGF nor lead to smaller bilateral contributions. While I welcome the statement by Ms. Lissakers on the content of the conditions set by Congress, I would also welcome some more elaboration on the background of these conditions and on the likelihood of these conditions being adequately met. I would also appreciate staff's views on these issues.

To be more specific, there are two aspects that I find worrisome:

First, I think we need to address now the possibility of a decision not to release the additional five-fourteenths of investment income this spring and the possible consequences of such a decision. I would be interested to learn how this could impact on bilateral pledges that have been made conditional on the gold transactions or on full financing and what the consequences for HIPC and interim PRGF would be.

Second, although staff states that the earmarking of the gold-transaction investment income for HIPC would not jeopardize the interim PRGF, I am concerned that there might be a chance that expected bilateral contributions are discouraged if the donors know that their contribution is used for PRGF only or mainly, instead of HIPC. I would like to stress that I attach a high priority to the financing of the interim PRGF. The bilateral contribution of the Netherlands to the PRGF-HIPC Trust has been made conditional on self-sustainability of the PRGF.

These are my main points concerning the substance of the financing package. As regards the proposed decisions themselves, I have some difficulties with the proposed text:

With respect to Decision No. 1, I would have preferred a different language. I believe the phrasing is somewhat misleading. The text now implies that we expect that the full amount of SCA-2 resources will be made available for the PRGF-HIPC Trust. However, a number of countries, including the Netherlands, have decided not to provide SCA-2 refunds but to pledge money from other sources. For the Netherlands, this can be understood from our contributions so far and from our wish to keep reserves separate from concessional PRGF financing.

With respect to Decision No. 4, second paragraph, final sentence, I would also prefer a rephrasing. Without a decision on the use of the remaining five-fourteenths of profits, the financing of HIPC and interim PRGF is still not adequately secured. I propose to introduce a deadline to prevent this issue from dragging on any longer than is strictly necessary. If the Board does not explicitly decide that the remaining profits cannot be used for HIPC, they should automatically be transferred to the PRGF-HIPC Trust. A suggested deadline would be May 31, 2000.

If there is interest from other Directors, I would be pleased to propose some specific language for these amendments. With respect to the other proposed decisions, I do not have any problems.

Mr. Wei made the following statement:

At the outset, I join previous speakers in our appreciation of the Managing Director's tremendous personal efforts in mobilizing sufficient resources for the Fund to finance PRGF-HIPC operations. We welcome today's discussion of the procedural aspects and decisions related to the termination of SCA-2, and the establishment of an administered account to hold SCA-2 balances and off-market gold transactions. More than two months have passed since this year's Annual Meetings, in which Governors hailed the Fund's ability to reach a decision in solving the issue of ESAF-HIPC operational financing. However, given the fact that progress in finalizing the procedures is rather slow, there are still some uncertainties about the settlement of full financing for supporting PRGF-HIPC operations. In this context, today's meeting is important since it will pave the way for the continuation of PRGF-HIPC operations.

I can support all the proposed decisions; however, I would like to make just one brief remark for emphasis.

As demonstrated in Table 1 on page 2, bilateral pledges, including SCA-2 balances, are SDR1.5 billion. This means that bilateral pledges account for almost a 40 percent share of the total PRGF-HIPC financing. While we understand many countries will need to go through internal approval procedures, we would urge that those contributing countries—especially the major developed countries—accelerate the process and that their contributions be untied and unconditional. We learned from the paper that another decision will need to be adopted by the Board in order that the remaining part of the investment income of the proceeds from the sale of the gold will be made available to the PRGF-HIPC Trust account when the U.S. Executive Director is ready to cast such a vote. Otherwise, we will have a problem of a shortfall of about SDR600 million on an as-needed basis. However, we are encouraged by Ms. Lissakers' statement that her authorities will make their best efforts so that she will be able to do so in the Spring of 2000.

Ms. Lissakers pointed out that the congressional authorization permitting the U.S. chair to support the gold decision would not allow her to support Mr. Houtman's revisions to Decision No. 4.

The Chairman noted that Mr. Houtman had expressed a preference but also demonstrated some flexibility and a sense of compromise in his statement on this point.

Mr. Cippà made the following statement:

Today's meeting offers the much-welcomed chance to proceed with the decisions necessary to implement the scheme agreed upon some months ago for financing the PRGF and HIPC Initiatives. We appreciate the fact that sufficient bilateral contributions have finally been secured, though we still regret that the initial principle of bilateral financing of concessional Fund lending and debt relief had to be breached. All in all, we can go along with the proposed decisions, with the possible amendment proposed by Mr. Houtman regarding the addition of a deadline on the decision to use the remaining five-fourteenths of the proceeds of gold sales.

At this stage, I have only two short remarks on the issue of gold revaluation. It is important to remember, first of all, that these transactions will increase the Fund's operating costs. Mitigating these effects by reducing the income allocated to reserves may solve the problem for the current financial year. The proposed gold transactions, however, do not imply a one-time effect only on the Fund's income position. They are operational costs that will be incurred year after year. Therefore, even if reserves are currently high due to the income from credit granted under the SRF, the rate at which reserves are increased annually may have to be adjusted in the future. In this case, this means that, at the end, the additional operational costs implied by the Fund's participation in the HIPC Initiative will have to be offset by an adjustment of the rate of charge. This is an unfortunate outcome of an exercise that lacked transparency from the beginning.

Another point relates to the use of the profits from the gold transactions. We should like to recall that no earmarking of the proceeds has been formally discussed at the Board. The instrument under which the PRGF-HIPC Trust was set up allows for its division into separate accounts. The reason for this provision was to offer countries contributing to the Trust the possibility of designating their payments for a specific use. However, the profits from the proposed gold transactions stem from the Fund's general resources. It is, therefore, in principle, up to the Board to discuss and decide on their specific use. It is regrettable that this matter has been presented to the Board as a given fact.

The same applies to the awkward decision of splitting up the use of the proceeds into fourteenths. The current financing package was clearly presented to us as a whole, and consent should also be given to it as a whole. From this perspective, it is not easy to see how exactly the proposed scheme is to be interpreted. Does it mean that the package today on the table is underfinanced? In this regard, I share the concerns of Mr. Houtman about possible consequences on bilateral contributions. I also look forward to having more explanation about the conditions under which the remaining part of the proceeds will be made available.

What makes the matter all the more unsatisfying is the fact that it is presented to us in a take-it-or-leave-it manner. Discussions to reach this compromise have by now taken so long that those who should actually make the decisions are in fact left with the unpleasant choice either to give their consent to what is being proposed or to put the whole financing of the enhanced HIPC Initiative once again at risk.

Mr. Dhanpaul made the following statement:

We welcome today's discussion to review—and if possible approve—the proposed draft decisions required to implement the financing package that will enable the Fund to finance the HIPC Initiative and the continuation of PRGF operations. Indeed, it is a great satisfaction to finally reach an agreement on all of the elements of the financing package that will enable the Fund to make its contribution to the HIPC Initiative.

Therefore, we fully support the decisions proposed. We also wish to reiterate that Brazil is willing to participate in the off-market gold transactions by repurchasing on December 14, 1999, in gold rather than in currencies.

Let us make, however, one comment for emphasis. When we began to discuss the financial and operational modalities of off-market transactions in gold by the Fund, the staff remarked that the acceptance of gold instead of currencies in payment of repurchase obligations enlarges remunerated positions and, consequently, increases the Fund's net operating expenses. This would, without mitigation, result in a higher rate of charge on the use of Fund credit. As agreed by the majority of the Board at that time, this cost should not be borne by the members indebted to the Fund; therefore, we fully agree to mitigate the impact by a reduction in the Fund's net income target.

The Chairman welcomed Brazil's readiness to participate in the off-market gold transactions.

Mr. Milleron made the following statement:

I fully associate myself with Ms. Lissakers and others in thanking you for a job well done. I support the proposed decisions and also Mr. Houtman's amendments, subject to ensuring their consistency with Ms. Lissakers' reservations. I certainly hope that contributors will not impose too many restrictions on the use of off-market gold transactions, as this will complicate a process that has already been too complex.

Mr. Hansen made the following statement:

We welcome the passage of legislation in the U.S. Congress, which allows the United States to vote in favor of off-market sale of gold. In this connection, we must, however, caution against attaching national conditions to financing solutions that have been agreed by IMF members and would like to point out that, if other member countries follow suit, it may become impossible for the Fund to operate in an efficient manner.

This being said, and with a view not to be repetitive, I fully support the messages conveyed by Mr. Houtman and Mr. Cippà, as well as their suggestions for changing Decision No. 1 and Decision No. 4.

I would also want to thank the Managing Director for his perseverance and personal engagement to get this initiative going. I would also like to thank the staff for their dedicated work and notably their patience in explaining to us all the complexities of the HIPC.

Mr. Esdar made the following statement:

I would like to start by commending staff for the well-prepared and brief paper. I have no problem supporting the decisions at all. With regard to modifications proposed by Mr. Houtman on Decision No. 1, it should be possible to introduce the words "or equivalent." On Decision No. 4, I look forward to seeing how we can reconcile the concerns of Ms. Lissakers and Mr. Houtman, but I could go along with the consensus.

I have only one worry, and that is with regard to the splitting of the gold decision. I believe that the package will only achieve its full impact if all its elements are implemented fully and without hesitation. I refer, in this regard, to the various burden-sharing caveats, including our own. I hope we do not have to reopen the whole package. I am nevertheless encouraged by Ms. Lissakers' remarks, and the efforts of her authorities to come to a conclusion rapidly.

With regard to the German contributions, we have suggested some points to staff. I was informed today that, if these points do not pose any problems, then my authorities are prepared to write the check as soon as possible.

Finally, this chair may not be famous for congratulating, but I wish to explicitly join Ms. Lissakers in thanking you and the staff for your efforts to make the impossible possible.

Mr. Oyarzábal made the following statement:

I would like to associate myself with the comments of Ms. Lissakers as regards the efforts deployed by the staff and management. This chair supports the proposed decisions.

The establishment of a temporary administered account after the early termination of the SCA-2 properly accommodates the position of those countries that need time to complete a number of legal and political procedures before they can transfer the remaining balances.

The Post-SCA-2 Administered Account also seems appropriate for those members that have not yet decided whether they will be using their SCA-2 balances to contribute to the Trust or not. However, I believe this should be made more explicit in the Sample Communication No. 2 in Attachment I to the paper, which, at present, appears to be basically for those countries that have taken the decision to contribute but are only waiting to complete administrative and legal requirements.

Mr. Chelsky made the following statement:

Thank you for your efforts to bring us to this point. For the most part, we support the proposed decisions, with the following comments.

First, we share the underlying frustration that is evident in Mr. Houtman's comments. That being said, the best that we can do at this point to ensure that the full financing becomes available—given the nature of the conditions that the U.S. Congress has imposed—is to move expeditiously in transforming the ESAF and making the PRGF as effective as possible. I think our greatest hope for ensuring that the financing moves smoothly is to make strong progress on that point.

With respect to the proposed change to Decision No. 1, we, too, are in a similar situation to Mr. Houtman's authorities and believe that the decision would be more accurate if it were amended along the lines suggested.

Finally, with respect to Mr. Cippà's comments about the transparency of a portion of the financing package—and the fact that we have not yet resolved the issue of how to address the costs that are going to be imposed on the institution in future years—I wish to reiterate this chair's position that, for the adjustment, we would be looking for a fairly heavy reliance on the rate of remuneration, rather than on the rate of accumulation.

Mr. Rouai made the following statement:

Today is another milestone in the process of securing the Fund's contribution to the financing of the PRGF and the HIPC Initiative, and I would like to join others in thanking management and staff for their efforts.

I endorse the set of decisions and only have two comments. First, I would appreciate some details on the calendar for the gold transactions. Second, I note that this set of communications presented by the staff in Attachment I is different from the attachment to the letter we received in our various offices. I would welcome staff's elaboration on the reasons for the difference.

Mr. Yanase made the following statement:

I would like to express my appreciation for the efforts made by Executive Directors' offices in securing commitments.

I support the proposed set of decisions, but if possible I would like to see an amendment to Decision No. 1 in the sentence implying that the full amount of the SCA-2 refunds will be made available for financing the PRGF-HIPC Trust.

As regards the conditions of the U.S. Administration, I wish to associate myself with Mr. Chelsky in particular. I understand the frustration expressed by other Directors, but the only practical way out is to move ahead and to focus on making clear progress. In this regard, we will rely on management, staff, and the U.S. chair to keep the Board informed on any developments in this regard.

Finally, I am pleased that we have finally come to this final decision on the financing for the HIPC Initiative and PRGF.

Mr. Nguyen made the following statement:

We thank management and staff for their efforts to secure approval for this package. We highly appreciate the staff's useful paper on procedures and decisions to be taken to implement the enhanced PRGF-HIPC Initiative. We support all the proposed decisions prepared by the staff. For the sake of transparency, we support the proposal that each subaccount should be separately disclosed in the published financial statement of the PRGF-HIPC

Trust and that those accounts should be audited by the external auditing firm selected under Section 20 of the Fund's Bylaws.

Mr. Collins made the following statement:

It goes without saying that I share the sentiments about your role and that of the staff in this process. We support all the decisions, and the proposed amendment to Decision No. 1 also sounds sensible. I would, however, like to hear more debate as regards Decision No. 4, although I doubt that it would be carried, in view of the U.S. position.

I hope the United Kingdom will be able to transfer its balances directly to the PRGF-HIPC Trust, but we should be able to confirm that to staff later today.

Finally, I hope that the United States will come forward with the remaining five-fourteenths in the spring.

Mr. Shaalan made the following statement:

I have often noted that you rarely give up prematurely. The fact that we are able to meet today to finalize these decisions is a testimony to your productive perseverance and, of course, to that of the staff.

I have no difficulties approving the decisions, but I would favor an amendment of Decision No. 1, if possible, in line with Mr. Houtman's proposal. With regard to Decision No. 4, all I can say is we have to live with the congressional realities. This, unfortunately, is the way things are. Thus, given that reality, I will go along with the decisions.

Mr. Faini made the following statement:

This is an extremely important milestone, which was not easy to reach, and the somewhat convoluted language of some of the decisions is a clear testimony to the difficulties and the compromises that have been made to come to this point. We have all been witnesses to the relentless efforts on your side to make this possible. At some point, I felt almost like those cardinals in Rome that were forced by the people in Rome to elect the Pope by being locked in the room for days, until they came to a decision. We should be really grateful.

It is unfortunate, however, that some of the uncertainties about the financing package have not yet been dissipated and that we will have to come back to some aspects. There is some uncertainty not only on the financing but also on the conditions attached to the transfer of the remaining five-fourteenths of the investment income generated by the proceeds of the off-market gold sales.

Having said that, while my constituency does not have any concern with respect to Decision No. 1, given the reservations expressed by others, I think we should amend it, and I support the proposed decisions.

Mr. Zoccali made the following statement:

Allow me also to express special acknowledgment from my authorities to you and the staff for your efforts to find a workable compromise that will enable the Fund to continue PRGF operations. In the same cooperative spirit, this chair is prepared to support the six decisions outlined in the staff document together with that in Supplement I, governing the investment of currencies to be received by the SDA from the proposed off-market gold sales as a package. We offer this support, not because we find that this is an optimal financing mix—in terms of the size of the bilateral contributions or the earmarking and phasing conditions attached by some members—but to assure the expeditious implementation of the requirements.

Regarding the modifications that have been suggested, we can support Mr. Houtman's suggested changes.

On the issue of the mitigation of the effects of the Fund's off-market gold transactions on the rate of charge, allow me to share fully the comments expressed by Mr. Cippà. Finally, we wish to thank Ms. Lissakers and her authorities for the efforts that they have made to reach a satisfactory solution. As do Mr. Esdar and others, we hope that all elements of the package will be implemented as agreed.

Mr. Kiekens made the following statement:

I join other Directors in their praise for your own, and the staff's, tireless efforts to complete the financing of the Interim ESAF and HIPC Initiative.

In your memorable summing up on these issues of September 19, 1996, already more than three years ago, you stated that you were confident that the needed majority would support gold sales "to secure full financing for these initiatives." The draft decisions proposed today unfortunately do not secure the full financing, since five-fourteenths of the investment income derived by investing the proceeds of the gold sales is not yet made available for the HIPC Initiative. Clearly, the conditions agreed upon for gold sales three years ago are not in place. However, for the sake of compromise and in a spirit of political realism, I support proposed decisions Nos. 1 through 4 and 6 and do not oppose proposed decision No. 5. I would like to make the following comments.

I certainly deplore the decision of the U.S. Congress requiring a provision in Decision No. 4 that restricts—to nine-fourteenths of the total return from the investment of the proceeds of the gold revaluation—the portion that can be used for debt relief. This means that SDR 600 million out of the SDR 3.9 billion needed to finance the interim PRGF and the HIPC Initiative is still not secured. Although not the best possible outcome, this is much better than what sometimes appeared likely during the difficult negotiations between the U.S. Administration and Congress. I am confident that our U.S. colleague and her authorities will do their utmost to obtain congressional consent for financing the remaining gap as soon as possible.

Member countries should now take the final legal or procedural steps needed to make their bilateral contribution available to the PRGF-HIPC Trust without delay. The HIPC countries should lose no time in qualifying for debt relief. Accomplishing these tasks will strengthen the hand of our U.S. colleague in seeking congressional approval for the rest of the financing needed for the HIPC Initiative.

There is no rational justification for reacting to the gold operations by reducing the rate at which the Fund accumulates reserves—at present 2.5 percent per year. There are many indications that in recent years credit risks for the Fund have increased, not declined. As I said, I will not oppose, for the present fiscal year, proposed Decision 5 that reduces the Fund's accumulation of reserves by an amount corresponding to the result of applying the SDR interest rate to the nominal value of the gold sold. This decision is only for the present fiscal year. It should not be seen as a permanent solution of this issue for years to come. I request every year a well-documented and thorough discussion of the Fund's credit risks and the reserve accumulation required for prudent management. I am confident, Mr. Chairman, that the Board shares my concerns and can agree with this request, to be reflected in your summing up.

The Chairman asked if Mr. Kiekens was recommending a fully documented discussion on the rate and level of accumulation of reserves in the next fiscal year.

Mr. Kiekens stressed the need to avoid viewing the decision as valid for the next 20 years. A fully documented and free discussion would be essential every year. The main idea was that the decision should not constrain the Board—legally or politically—in deciding on the appropriate rate of accumulation, which needed to take into account the evolution of risks that the Fund faced.

The Chairman agreed that the rate of accumulation of reserves needed to be reviewed on the basis of the Fund's balance sheet every year, no matter what decisions were taken during the ongoing Board discussion.

Mr. Houtman stated that he fully supported Mr. Çakir's view on this issue.

Mr. Al-Turki made the following statement:

I join other Directors in welcoming today's meeting to finalize the decisions that will enable the Fund to finance its share of the HIPC Initiative and the continuation of PRGF operations. Reaching this point has not been an easy process. However, the fact that we are at this point is a tribute to the cooperative nature of this Institution and to the tireless efforts of you, Mr. Chairman. Your determination and dedication, Mr. Chairman, were instrumental to this successful conclusion. Staff also deserve credit for their creative solutions, which helped keep the process on track.

I can support the draft decisions that formalize the compromises that have been reached. While I share the concerns expressed regarding the earmarking of the investment income of the profits from gold sales to the HIPC Initiative, I can go along with it, subject to the understandings and explanations in paragraph 19 of the paper.

Mr. Lushin made the following statement:

We appreciate our meeting today, which makes a decisive step to finalize the long and challenging work to ensure financing of the PRGF and HIPC Initiatives. The Board has already intensively discussed the issues on which the decisions are to be made, and on most of them a consensus has been reached. We support the financing package and endorse the proposed set of decisions required to implement it.

Let me make just two specific comments.

We support Decision No. 4 that gives effect to the off-market sale of gold. That said, we strongly believe that this exceptional step will really be the one-off measure as declared in the Communiqué of the last Interim Committee meeting.

We endorse Decision No. 5 to mitigate the effect of off-market gold sales on the rate of charge for FY2000 through a slower pace of reserve accumulation. However, for the future fiscal years the solution to this problem is still to be found, and we believe that a reasonable balance should be achieved between adjustments in the rate of remuneration and the rate of charge.

The Chairman confirmed that Decision No. 5 related to FY2000 only, leaving open the solution for future years, which still needed to be discussed.

Mr. Kelkar made the following statement:

I support the proposed decision and wish to associate myself with the comment made by a previous speaker that increasing charges should not be made in future years. The cost may be offset in future years, either through a reduction in the target or in reserve accumulation.

Mr. Oh made the following statement:

There is nothing left for me to add, except to join in praising the Managing Director and staff and to state, for the record, that we support all the proposed decisions. We would have no problem going along with the consensus on an amended Decision No. 1.

Mr. Collins endorsed Mr. Çakir's comment on the importance of firm implementation and of bringing the "good" cases forward as quickly as possible, both for its own merits and for the demonstration effect for the Congress.

Without questioning the intent of Decision 5, Mr. Collins wondered why it did not indicate specifically the percentage by which the net income target would be reduced. This would make the decision more comprehensible, particularly to readers outside of the Boardroom.

The Chairman commented that opacity of language was sometimes useful.

Mr. Ondo Mañe made the following statement:

We support the proposed decisions. We hope that the U.S. Congress will approve the transfer of the remaining five-fourteenths of the investment income generated by the proceeds of the off-market gold sales as soon as possible. Mr. Chairman, given the importance of the facility to this chair, allow me to express our heartfelt appreciation to you and the staff and many Executive Directors for securing this financing. We also thank bilateral donors and other contributors for the contributions to the Trust Fund, and we hope that countries will soon be able to benefit from the facility.

Ms. Lissakers said that she shared other Directors' disappointment that only the use of nine-fourteenths of the investment income generated by the proceeds of the off-market gold sales had been approved but was fairly confident that the approval for the other five-fourteenths would be obtained expeditiously. The Board needed to review the financing before the Spring Meetings in 2000 to evaluate progress made on securing the complete package. The U.S. chair would keep the Board abreast of any developments on the Congressional approvals.

On the general role of the U.S. Congress in the context of this type of decision, the U.S. chair did not need to make any apologies, Ms. Lissakers emphasized. The Articles of Agreement stipulated that an 85 percent majority of the total voting power was required for the Fund to engage in gold transactions. While this gave the United States a right of veto, it also gave the other 15-plus percent of shareholders the same right. The founders of the institution had embedded this protection for all shareholders in the Articles of Agreement.

With regard to the Congressional authorization process for the U.S. chair's support for the decisions, the Congress was fully aware that the decisions involved the mobilization of the GRA for the benefit of a subset of members, Ms. Lissakers explained. Under those circumstances, the U.S. Constitution required certain budgetary procedures, which were fully transparent, although perhaps arduous, frustrating, and, sometimes disappointing. However, given the nature of the resources affected in this case, these procedures were not only a defensible but also an admirable aspect of the U.S. Constitutional procedures.

With regard to Decision No. 1, it would have been useful to be informed of Mr. Houtman's proposal before the Board meeting, Ms. Lissakers remarked. She was nevertheless sympathetic to the concerns expressed and could support the modification if the words "or equivalent" were inserted in the third line between "resources" and "will thus."

The staff representative from the Treasurer's Department confirmed that the proposed gold transactions would not have a one-time effect on the Fund's income, and that the adequacy of the Fund's reserves would be reviewed annually in the context of the discussion of the Fund's income position.

The staff did not expect the earmarking of gold and certain bilateral contributions to discourage other bilateral contributions. There was ample room for members to argue that their contributions would finance both the HIPC Initiative and the PRGF subsidies. Few resources had been earmarked for the HIPC Initiative, and the staff was not aware of any further consideration being given to earmarking beyond what had been reported in the staff paper.

On the sample communications, the staff had been in contact with all OEDs and the 160 SCA-2 contributors over the past week, and the wording had been revised on the basis of the comments received thus far to reflect what was considered appropriate for the individual contributors, the staff representative noted. These consultations would continue in the days ahead, and the staff was ready to clarify any further issues bilaterally.

The staff representative from the Treasurer's Department noted that the initial staff proposal on the mitigation of the costs of the off-market gold transactions to the Fund and to members had been to rely on a reduction in the rate of remuneration. Subsequently, a proposal had been put forward that the costs be shared between the rate of charge and the rate of remuneration in a ratio of 2:1. Then, the United States had made the proposal that the costs should be borne by the Fund through a reduction in the net income target. Decision No. 5 related only to FY2000 because the Board still needed to take decisions on a number of issues related to the financing, including the burden-sharing arrangements. The staff intended to prepare a background paper on these issues, which could be discussed before the April review of the HIPC/PRGF financing issues.

For the off-market gold transactions, a fairly aggressive timetable was foreseen, the staff representative pointed out. A repurchase transaction by Brazil was scheduled on December 14. In order for the repurchase to take place in gold, rather than in currencies, the Board needed to approve the related decisions no later than at the close of business on December 9, 1999. This would allow for instructions to be given to the member with three days' notification, according to the usual practices. The transaction with Brazil, which was valued at SDR 1.4 billion, would generate half of the profits required. A number of transactions would also take place with Mexico, between December and March 2000. The final transaction with Brazil would take place on February 5. The staff hoped that the transactions would be completed by April 5.

The Chairman suspected that many Directors had not known about the deadline with Brazil and suggested that the staff should regularly inform the Board of the calendar of operation so as to avoid surprises.

Mr. Collins asked why Decision No. 5 did not directly mention the percentage by which the net income target for FY2000 would be reduced. That would provide more precise information on the costs to the Fund.

The staff representative from the Treasurer's Department said that the exact figure could not be determined with precision since it would depend on a number of factors, including the exchange rate, the price of gold, and the timing of the transactions. It was currently estimated at SDR 70–75 million.

Ms. Lissakers pointed out that a number of members, including Canada, had not yet completed their legislative and administrative procedures for the transfer of SCA-2 balances. She urged those members to keep the Board fully informed of the status of their contributions.

The Chairman commented that, given all the efforts made by members, there was sufficient reason to be fairly confident that the appropriate decisions—including the U.S. decision on the transfer of the remaining five-fourteenths of the investment income generated by the proceeds of the off-market gold sales—would be taken as soon as possible. The time had come for the Board to take its responsibilities and to consider that it had the needed assurances for going ahead. While stressing the need to avoid compromising the quality of operations, the best way of encouraging full financing of the initiative, was, indeed, as noted by some Directors, by moving expeditiously to ensure convincing progress on implementation. Management and staff would be counting on the perseverance of all members' authorities, particularly the U.S. authorities, to ensure that the elements of the package fell into place in a timely manner, the Managing Director noted. He was reassured by the assurances received during the discussions and by the Board's spirit of pragmatism, political realism, and compromise.

The General Counsel, commenting on the proposed changes to Decisions No. 1 and 4, noted that there was a tight linkage between the release of SCA-2 resources to the Fund and contributions to the PRGF-HIPC Trust, but the contributions could be funded either with these same resources or with an equivalent amount. He suggested that the text of Decision No. 1 should begin as follows:

> "Considering that there is no longer need for retaining precautionary balances in the Special Contingent Account 2 (SCA-2) and with an expectation that these resources will thus become available, or an equivalent amount will be made available to supplement those in the PRGF-HIPC Trust..."

Ms. Lissakers said that she would have to confirm her agreement to this proposal at 2:30 p.m., after she had verified with the U.S. Treasury legal experts if the formulation was acceptable.

The Chairman proposed that Decision No. 1, with this amendment, would be adopted at 2:30 p.m., without further notice, if the U.S. Treasury confirmed its agreement.

As regards Decision No. 4, Mr. Houtman's concerns had been noted, but in view of the Constitutional problem for the U.S. chair, it might be advisable to maintain the decision as proposed by staff, the Chairman recommended. He called on the U.S. chair to convey to her authorities the strong concerns of several Directors on this issue, as well as the Board's determination to put the reformed ESAF and the enhanced HIPC in motion as rapidly and as effectively as possible. It was also important for the U.S. Administration to note the Board's expectations that there would be no major difficulties in obtaining the next five-fourteenths.

Mr. Houtman, echoing Mr. Shaalan's view that the Board just had to live with the political realities of the U.S. Congress, stated that in view of Ms. Lissakers's position, he would support the decision as proposed in the staff paper. This outcome nevertheless raised questions for other future decisions. The U.S. legislation spelled out some other specific conditions, including the publication of the operational budget, which in the past had not been supported by a majority. What would be the consequences if a majority could not be obtained the next time this issue was discussed?

Ms. Lissakers pointed out that it was not the political realities of Congress that had prevented the U.S. agreement on the amendment but the budgetary and legal realities of the U.S. budget process. As regards the other conditions of the legislation, including the publication of the operational budget, U.S. law required the Treasury to instruct the U.S. chair to deploy every effort to bring about such changes in the Fund, Ms. Lissakers indicated. Substantively, the publication of the operational budget would not be an undesirable modification. The legislation proposed a quarterly publication of the operational budget with a one-year lag to avoid some of the market sensitivities that had been highlighted in previous discussions. It would be fully consistent with the internal transparency efforts that the institution had launched.

The Chairman pointed out that this was an instruction to the chair and not an obligation for the Board to deliver. He thanked Mr. Houtman for his spirit of compromise.

Mr. Collins stressed the need for clarity on what the Board was deciding in respect to Decision No. 5 and to determine what the effect on the income position of the gold transaction would be. He wondered what would the income have been in the absence of gold transactions. Did that depend on whether the repurchases were made in currencies or SDRs?

The staff representative from the Treasurer's Department explained that the effect on the Fund's income position would depend on the exchange rate and the timing. If these transactions took place on the last day of the financial year, there would be no effect on the position in that year because the Fund would not forego any interest-free resources. However, if the transactions took place earlier, the effect would be more significant, as the transactions would affect the use of the Fund's interest-free resources. The precise effects would only be known at the end of the year, at which time the Board would be informed.

Mr. Collins accepted that staff would only know retroactively what the precise effect was but wondered if the effect would be known uniquely or if it depended on whether the countries participating in the gold transactions would have affected the repurchases.

The staff representative from the Treasurer's Department noted that normally these repurchases took place in either SDRs, dollars, or other usable currencies. In this case they would take place in gold, but the effect would be the same, since the SDR rate and the rate of remuneration would be the same.

The Chairman made the following informal concluding remarks:

> Today, you have taken a number of decisions to complete the necessary steps to put in place the financing package for the PRGF and HIPC Initiative. I would like to thank you all for your kind appreciation of what we have tried to do, and, indeed, I would like to join all of you in expressing my thanks for the tireless efforts of the staff, as well as my appreciation for their imagination and their readiness to adapt to the complex requirements of all your countries.
>
> I also wish to take this opportunity to thank all of you for your relentless efforts to bring the financing of this initiative to a successful completion. Your hard work was crucial, not only in mobilizing the contributions but also in promoting understanding of some of the complicated and not immediately transparent steps that we have had to take to reconcile various concerns.

While I am not a great supporter of the veto right, here or in other fora, it has merit when it brings countries to a deeper understanding of national concerns. You will recall, in this regard, that in September 1996, the word veto was not pronounced, but another group of countries exercised it. This is, indeed, an illustration of the admirable spirit of compromise and consensus that is one of the marks of this institution. Compromise and consensus have helped the Fund to put together this financing package and to be the first international institution that has been able to fully finance its contribution to the HIPC Initiative.

I would suggest that EXR issues a brief statement later today, after 2:30 p.m., informing the public that the necessary decisions have been taken to finance both the continuation of the PRGF and the Fund's contribution to the HIPC Initiative.

A significant amount of follow-up work needs to be done to complete the necessary legislative or administrative procedures in member countries, and to finalize bilateral contributions and a number of deposit agreements between the contributors and the Fund.

I am hopeful that next spring, the U.S. Congress will authorize the U.S. Administration to support the transfer of the remaining five-fourteenths of the investment income generated by the profits from gold sales from the SDA to the PRGF-HIPC Trust for the financing of the HIPC Initiative. On the management side, we willingly take the challenge to be exemplary in implementing this new strategy. The staff will monitor these developments closely and report back to the Board on progress in this area.

The staff will also seek consensus from lenders to the PRGF Trust loan account for the quarterly transfers related to the nonreimbursement of the GRA and from the Board when the decision becomes effective.

Finally, I would like to thank the authorities of Brazil and Mexico for agreeing to participate in the off-market gold transactions. We will keep the Executive Directors informed if and when these transactions will take place.

Once again, all my thanks for your efforts in reaching this important milestone.

Mr. Çakir stressed the need for careful wording in the press release to avoid giving the impression that the interim PRGF and the HIPC Initiative had been fully financed and that the transfer of the five-fourteenths was no longer necessary.

Ms. Lissakers said that she fully agreed with Mr. Kiekens.

The Executive Board took following decisions:

Early Termination of SCA-2

Considering that there is no longer a need for retaining precautionary balances in the Special Contingent Account 2 (SCA-2) and with an expectation that these resources will thus become available, or an equivalent amount will be made available, to supplement those in the PRGF-HIPC Trust, the Fund decides to terminate the SCA-2 established by Decision No. 9471-(90/98), adopted June 20, 1990. (EBS/99/215, 11/29/99)

Decision No. 12060-(99/130), adopted
December 8, 1999

Establishment of Administered Account

1. Pursuant to Article V, Section 2(b), the Fund adopts the Instrument to Establish the Post-SCA-2 Administered Account that is annexed to this Decision (see Attachment).

2. The provisions of the Instrument may be amended by a decision of the Fund with the concurrence of the members that have transferred resources remaining in the account at the time of such decision. (EBS/99/215, 11/29/99)

Decision No. 12061-(99/130), adopted
December 8, 1999

ATTACHMENT

To fulfill its purposes, the International Monetary Fund (the Fund) has adopted this Instrument to establish an account in accordance with Article V, Section 2 (b), which shall be governed and administered by the Fund in accordance with the terms and conditions of this Instrument.

1. The Fund hereby establishes an account (the Account) for the temporary administration of resources transferred to the Account by a member following the termination of the SCA-2, while deciding on the final disposition of those resources.

2. The SDR shall be the unit of account. Transfers may be made in or exchanged for SDRs in accordance with such arrangements as may be made by the Managing Director for the holding and use of SDRs by the Account.

3. The resources of the Account shall be invested, and the proceeds of investments reinvested, at the discretion of the Managing Driector. The Managing Director is authorized (i) to make all arrangements, including establihsment of accounts in the name of the International Monetary Fund, with such depositories of the Fund as may be necessary to carry out the operations of the account, and (ii) to take all measures necessary to implement the provisions of this Instrument.

4. The Fund shall transfer all or part of the resources received from a member, together with the member's pro rata share of the investment returns, to the PRGF-HIPC Trust, or otherwise in accordance with the member's instructions.

5. The assets held in the Account shall be kept separate from the assets and property of all other accounts of, or administered by, the Fund. The assets in the Account shall not be used to discharge or meet any liabilities, obligations, or losses incurred by the Fund in the administration of such other accounts.

6. Subject to the provisions of this Instrument, the Fund, in administering the Account, shall apply mutatis mutandis the same rules and procedures as apply to operations of the General Resources Account of the Fund.

7. No charge shall be levied on the members for the services rendered by the Fund in the administration, operation, and termination of this Account.

8. The Fund shall maintain separate financial records and prepare separate financial statements for the Account.

9. The external audit firm selected under Section 20 of the Fund's By-Laws shall audit the operations and transactions of the Account. The audit shall relate to the financial year of the Fund.

10. The Fund shall report on the assets and property and on the operations and transactions of the Account in the Annual Report of the Executive Board to the Board of Governors and shall include in that Annual Report the report of the external audit firm and the External Audit Committee.

11. The Account shall be terminated upon completion of the transfers contemplated in paragraph 4.

12. Any questions between a member and the Fund arising hereunder shall be settled by mutual agreement.

Prescription of SDRs

In accordance with Article XVII, Section 3, the Fund prescribes that (i) a participant or a prescribed holder, by agreement with a participant or a prescribed holder and at the instruction of the Fund, may transfer SDRs to that participant or prescribed holder in effecting a transfer to or from the Post-SCA-2 Administered Account or in effecting a payment due to or by the Fund in connection with financial operations under the PRGF-HIPC Trust or under an administered account established for the benefit of the PRGF-HIPC Trust; (ii) operations pursuant to these prescriptions shall be recorded in accordance with Rule P-9. (EBS/99/215, 11/29/99)

Decision No. 12062-(99/130), adopted
December 8, 1999

Off-Market Gold Sales, Acceptance of Gold in Payment of Repurchase Obligations and Use of Proceeds of Gold Sales Placed in Special Disbursement Account

1. The Fund stands ready to sell gold held by it on August 31, 1975, to generate an amount equivalent to SDR 2.226 billion for the Special Disbursement Account ("gold profits"), but not to exceed 14 million troy ounces of fine gold, to members willing to buy such gold and that meet the following conditions: (i) have repurchase obligations falling due to the Fund, (ii) represent that they will not sell the gold so acquired in the market, and (iii) represent that they intend to use the gold so purchased to make payments in gold to the Fund in connection with a repurchase obligation falling due on the day of the gold purchase. Each sale shall be made for U.S. dollars at the U.S. dollar price per troy ounce of fine gold at the morning fixing price in London three business days prior to the value day of the sale, and the value of the U.S. dollar in terms of the SDR shall be as determined under Rule O-2(a). Payment shall be made on the same value day of the related repurchase obligation. In accordance with Article V, Section 12(c), the Fund has consulted with the United States for whose currency the gold will be sold.

2. In accordance with Article V, Section 12(f), an amount of the proceeds of gold sales equivalent at the time of sale to one SDR per 0.888671 gram of fine gold shall be placed in the General Resources Account. Any balance over this amount, but not to exceed the equivalent of SDR 2.226 billion, shall be held in the Special Disbursement Account and invested in accordance with Article V, Section 12(h). Of the proceeds of such investments, only nine-fourteenths (9/14) of the equivalent of SDR 1.76 billion on an "as needed" basis shall be transferred, as needed, to a separate subaccount of the PRGF-HIPC Trust and shall be used exclusively to provide debt relief from the Fund under the HIPC Initiative to members that

qualify for such relief or, if not needed for such purpose, shall be used to replenish resources from other sources that have been used for such relief. The remaining five-fourteenths (5/14) of proceeds from investments equivalent to SDR 1.76 billion on an "as needed" basis shall be kept, and reinvested, in the Special Disbursement Account until a further decision on their use is adopted.

3. The Fund stands ready to accept gold in payment of repurchase obligations from a member that has acquired gold from the Fund in accordance with paragraph 1 of this decision, up to the amount that has been sold to the member under paragraph 1 of this decision. Gold received in payment by the Fund under this decision shall be valued in terms of the SDR on the basis of the U.S. dollar price per troy ounce of fine gold at the morning fixing price in London three business days prior to the value day of the payment, and the value of the U.S. dollar in terms of the SDR shall be as determined under Rule O-2(a). (EBS/99/215, 11/29/99)

Decision No. 12063-(99/130), adopted
December 8, 1999

Mitigation of Cost to Fund of Off-Market Gold Transactions for FY 2000

For the purpose of paragraph 2 of Decision No. 11944(99/49), adopted April 30, 1999, net income shall be calculated without taking into account the effect on income of accepting gold in payment of repurchase obligations falling due to the Fund authorized by Decision No. 12063-(99/130). (EBS/99/215, 11/29/99).

Decision No. 12064-(99/130), adopted
December 8, 1999

PRGF Trust Reserve Account–Transfer to PRGF-HIPC Trust

For financial years 2001–04, no reimbursement shall be made to the General Resources Account from the PRGF Trust Reserve Account (through the Special Disbursement Account) for the cost of administering the PRGF Trust.

One fourth of the estimated cost shall be transferred to the PRGF-HIPC Trust at the end of each financial quarter ended July 31 and October 31, 2000, January 31 and April 30, 2001, July 31 and October 31, 2001, January 31 and April 30, 2002, July 31 and

October 31, 2002, January 31 and April 30, 2003, July 31 and October 31, 2003, and January 31 and April 30, 2004. (EBS/99/215, 11/29/99)

Decision No. 12065-(99/130) PRGF, adopted
December 8, 1999

Special Disbursement Account—Investments

The first sentence of Decision No. 7990-(85/81), adopted May 28, 1985, shall be amended to read as follows:

"The Managing Director shall place in investments, denominated in SDRs, with the Bank for International Settlements (BIS), the currencies received by the Special Disbursement Account from gold sales and, pending their use, the currencies received by the Special Disbursement Account as a result of the termination of the Trust Fund, unless the Managing Director considers that the terms offered by the BIS on an intended deposit denominated in SDRs are not sufficiently attractive." (EBS/99/215, 11/29/99)

Decision No. 12066-(99/130), adopted
December 8, 1999

2. HONDURAS—1999 ARTICLE IV CONSULTATION; POVERTY REDUCTION AND GROWTH FACILITY—REVIEW, MODIFICATION, AND WAIVER OF PERFORMANCE CRITERIA; AND INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—PRELIMINARY ASSESSMENT OF ELIGIBILITY

The Executive Directors considered the staff paper on the procedural aspects and decisions related to the termination of the Second Special Contingent Account (SCA-2), the establishment of an administered account to hold SCA-2 balances, and off-market gold transactions (EBS/99/215, 11/29/99; and Sup. 1, 12/3/99).

Mr. Carstens and Mrs. Del Cid-Bonilla submitted the following statement:

We thank Fund management and staff for their continuous assistance and support to Honduras in the aftermath of Hurricane Mitch and during the preparation and implementation of the first annual arrangement under the ESAF and the preliminary assessment of debt sustainability.

Over the past several years, Honduras has implemented a number of reforms aimed at stabilizing the economy, achieving faster economic growth, and improving social conditions. These reforms have been supported by the Fund under ESAF and staff monitoring programs, and by IDA and the IDB through a series of adjustment and technical assistance operations. From 1991 to 1998, real GDP growth averaged 3.7 percent, the overall balance of the public sector improved markedly (ending in a virtual equilibrium in 1998), and inflation started to cede.

The structural reforms introduced during this period aimed at raising the efficiency of the public sector and enhancing private sector participation through deregulation, as well as trade and financial liberalization. Among these reforms stand out the approval of the Public Sector Modernization Law, the sale of a large number of state-owned enterprises, the creation of the framework Law for the Electricity Subsector, and the introduction of the Telecommunications Law. Significant progress was also achieved in establishing an open trade regime and liberalizing the financial and exchange systems. During the year following Hurricane Mitch, further progress was made in the areas of privatization, civil service reform, and the financial system.

Honduras also made significant progress in the social area over the last decade. Prior to Hurricane Mitch, public expenditure in the social sectors was equivalent to 8 percent of GDP, a high proportion relative to other countries with a similar level of income. Public social expenditures have been channeled mainly to programs designed to expand health care and education facilities and enhance the quality of these services. Two main special programs have been created to combat poverty: The Social Investment Fund (FHIS), which has become the government's principal instrument for financing small-scale community civil works and has supported important social programs, and the Family Assistance Program (PRAF), which directly compensates vulnerable groups through five different programs. The results in the area of preventive health are impressive when comparing the period 1980–89 with the period 1990–96. In fact, between these periods, the percent of population with access to safe water increased from 50 to 65 percent, main immunizations for children under 12 months rose from 57 to 93 percent, and the percent of population with access to sanitation increased from 32 to 63 percent.

Honduras has also made considerable progress in primary education, having a gross primary enrollment slightly higher than the Latin America and Caribbean average. The government started in 1994 a National Plan for Education Development, whose main objective is to increase the quality of basic and vocational education and decentralize some of the functions of the ministry of education. From the period 1980–89 to the period 1990–96, the illiteracy rate decreased from an average of 32 to 27 percent, while elementary school enrollment increased from an average of 78 percent to an average of 89 percent.

The progress across the board that Honduras was showing was suddenly curtailed by a natural disaster of large proportions. Hurricane Mitch devastated the country with a gruesome toll of approximately 5,700 people killed, 447,000 displaced, and direct economic damages calculated in US$3.8 billion. The productive and social infrastructure was severely damaged, and since then, the government and the population in general have concentrated on confronting the enormous challenge of rebuilding and transforming the Honduran nation. Doubtlessly, this significant development conditioned the macroeconomic performance of the country and imposed huge obstacles for the progress in structural reforms.

It is worth remarking that Honduras has not been left alone to fight against an extremely adverse scenario. From the beginning, the international community has shown tremendous solidarity, backing Honduras with financial and technical support. Much of this assistance was formalized in May 1999 in Stockholm, where the government presented a master Plan for the National Reconstruction and Transformation. In such meetings, six basic principles that would lead to the transformation and reconstruction of the nations affected by Mitch were established, giving place to a long-term association between the donor countries and Central America. To make possible the achievement of the objectives established in Stockholm, financial support was committed. As of September 1999, the government had subscribed or advanced negotiations for an estimated amount of US$1.7 billion, without including resources obtained during the emergency period.

Our authorities have given the highest priority to transparency and accountability in the use of domestic and external resources. To assure the fulfillment of these two conditions, the government has concentrated its efforts on strengthening audit, control, and accountability mechanisms. As part of these efforts, the government, with support from the Inter-American Development Bank, has established an Efficiency and Transparency Program that focuses on procurement, project inspection, training of technical staff, and strengthening of existing institutions. Our authorities are also seeking approval of a Law on Illicit Gains by Public Officials, which will require all public officials to submit sworn declarations of assets at the start and end of their terms in office. The government has also supported the social monitoring initiatives presented by civil society and the processes of decentralization and consensus building, the latter through the Civil Society Participation Commission for the Reconstruction and Transformation of Honduras (formed by representatives of different sectors). With respect to effort coordination in this regard with the international community, a Consultative Group Monitoring Commission was established, composed of the local representatives of Canada, Germany, Spain, Sweden, and the United States. This commission works jointly with the government and has as a main objective the following up of the Stockholm Declaration principles.

In spite of the extensive damage to the country's social and economic infrastructure caused by Hurricane Mitch last year, the government continued to be strongly committed to maintaining sound macroeconomic policies and accelerating the path of structural reforms, while at the same time starting the reconstruction plan and attending the needs of the most vulnerable groups of the population. Only five months after the hurricane hit Honduras, the government subscribed a new ESAF program with the Fund. The first review of the program shows the full commitment of our authorities to accomplish the objectives and targets set in the program. All macroeconomic quantitative benchmarks for June and September were observed, and significant progress was achieved in the implementation of structural reforms.

Notwithstanding the progress already achieved in several fronts, Honduras's social indicators are among the weakest in the region. Severe insufficiencies in social development still prevail, exacerbated by the damage caused by the hurricane last year. To sustain progress in its social and economic development, Honduras urgently needs to free up resources currently devoted to the servicing of its external debt. According to the preliminary debt sustainability assessment prepared by Fund and Bank's staff, Honduras's external debt burden is unsustainable from a fiscal point of view, representing as a matter of fact a large obstacle for the reconstruction and transformation process of the country. Getting as soon as possible to the decision and completion points within the framework of the HIPC Initiative is key for Honduras's success in its development and poverty reduction strategies.

Our authorities considered it extremely important to build the institutional and operative framework for the reconstruction process so as to assure transparency and accountability in the use of resources and be able to prepare priority projects accurately. This preparatory work caused initial delays in the reconstruction program and led to a slower-than-envisaged growth of domestic demand, but currently private investment and activity are recovering, inflation has declined, and the international reserve position has strengthened significantly. Real GDP for the year as a whole is expected to decline by 3 percent, as envisaged in the program.

A sound macroeconomic policy continued in place during the past months, allowing for better-than-envisaged performance in the monetary and fiscal areas. In the monetary area, end-September inflation closed at 10.5 percent, 1.5 percentage points below the rate envisaged in the program. Gross international reserves strengthened further, reaching about four months of imports of goods and services, the highest level in all the decade.

In the fiscal sector, the government was very successful in strengthening fiscal administration and implementing a stricter enforcement of the provisions of the tax code in force since June 1998. This was possible through the adoption of strong administrative measures as organizational changes in Customs, direct intervention of Customs by the Revenue Executive Direction, and reorganization of in-transit merchandise. In addition, import control was established through the National Revenue Register. The government has also strengthened its auditing mechanisms for controlling income and sales taxes. A broadening of the tax base and a strict control on current expenditures complemented these efforts. As a result of these actions, current government revenue for the year is projected to exceed the level in the program by more than 2½ percentage points of GDP, and—taking also into account the better-than-projected financial performance of the decentralized public agencies—the deficit of the nonfinancial public sector for the year is expected to close at 6 percent of GDP, lower than the 8.3 percent originally envisaged. These results in the fiscal front reflect the government's responsibility in applying sound macro policies, a more remarkable fact if we realize that lower public revenues would represent larger debt relief for the country under the HIPC Initiative.

Important progress was also made in the implementation of the structural reforms contemplated in the program, especially in the areas of privatization, civil service reform, the regulatory framework for banks, and transparency in the use of public funds.

With regard to the privatization program, the government is ready to sell 51 percent of the Telecommunications Company and, to this end, the invitation for bids was issued on November 12. The privatization process is expected to be finalized by April 2000. In addition, the government has established a tariff structure in line with long-term marginal costs in the electricity sector and has subscribed an agreement with the Investment Financial Corporation (IFC) appointing this institution as the investment bank for the privatization of the electricity distribution. The legislation needed for this privatization is expected to be approved during the first quarter next year. The government has also removed the obstacles for granting concessions to the private sector for the management of public works and airports and seaports services and will soon design a plan aimed at enabling private-sector participation in road construction and in the provision of water supply services. Due to reconstruction needs, the first stage of the social security reform suffered some delay, but our authorities intend, in collaboration with the World Bank, to complete an action plan for the separation of health and pension accounts by the time of the second review of the ESAF program.

In the area of civil service, the government made important progress in human resource management, public employment rationalization, and in implementing a new salary policy destined to retain skilled staff. The operation of the Integrated Financial Management System in the areas of debt management, programming, and budget formulation and execution was also initiated.

In the financial sector, our authorities reacted promptly and effectively to a problem of a small, private bank, avoiding a negative impact on the rest of the financial system. The bank was first intervened and then entered into a liquidation process. Within this context, the Congress approved at the beginning of October a temporary law for financial stabilization, creating a Fund for deposit insurance with full guarantee by the government for a transitory period of three years. This fund eventually will be replaced by a limited deposit insurance scheme funded and administered by banks within the context of a more integral reform. In addition, the regulatory framework was strengthened, allowing for the regulation of commercial banks' trust funds and stock market operations; and limiting banks' external indebtedness, related lending, and offbalance-sheet transactions. The government is fully committed to further deepening the modernization of the financial system, and, to this end, it has already initiated negotiations with the World Bank for a sector loan to support a stronger program.

For the medium and long term, Honduras faces the enormous challenge of achieving sustained reduction in poverty, through an acceleration of economic growth and an increase in the efficiency and equity of social expenditures. The agenda to attain these ambitious objectives is very extensive—given that besides implementing policies aimed at a rapid recovery in economic activity and the maintenance of macroeconomic stability, it is essential to rapidly advance in the pending structural reforms and improve the social conditions. Our authorities are committed to continue pursuing sound macroeconomic policies for consolidating macroeconomic stability by lowering inflation in a sustainable way, raising national savings, and further strengthening the external sector. To this end, they will strengthen fiscal policy mainly through further improvements in tax administration, a firm application of the penalties available under the tax code, and a full reexamination of tax exemptions. In addition, the government will maintain strict control over nonpriority outlays.

To foster larger private-sector investment, structural reforms will be deepened by moving forward the pending privatization of public enterprises, strengthening the financial system, modernizing the public sector, and further integrating Honduras into the world economy. In line with the schedule agreed in the context of the Central American Common Market, the government will continue the lowering of import duties.

The further strengthening of public administration is also a key element of the reform program. In this regard, our authorities will continue the actions already started in the areas of human resource management, public employment rationalization and salary decompression program, and in implementing the Integrated Financial Management System (SIAFI). Beginning in 2000, a Public Investment System (SISPU) will be adopted with the purpose of centralizing investment information and establishing mechanisms for monitoring and evaluating investment projects.

The efforts to strengthen the financial system will continue during 2000–01, and, to this end, the government will complete the work already started for the strengthening of the regulatory framework and supervision. Specifically, as has already been mentioned, it will submit to congress by the end of this year legislation proposals to establish a permanent deposit insurance scheme and to regulate the stock exchange and insurance companies. The government also will continue with regular and consolidated inspections of banks and finance companies. The introduction of a regulatory framework for pension funds and of tighter regulations of banks subsidiaries also form part of the priority agenda.

One of the main priorities for the medium term will be to reduce the vulnerability of the country against natural disasters. Among the actions contemplated to attain this objective is the improvement of natural resource management and rural development and of disaster preparedness and mitigation actions. For the former, the efforts will focus on targeting poor areas, strengthening decentralized institutions, and undertaking sustainable watershed management. With regard to the latter, the government has requested IDA assistance to design a program that would include capacity building, vulnerability assessments, and identification of flood-prone areas. This assistance will build on a regional effort in partnership with IDB to support the Center for Prevention Disasters in Central America.

In the area of transparency, our authorities will continue with the actions already started. In particular, with IDB, IDA, and other donors' support, they will focus on strengthening audit, control, and accountability mechanisms—reinforcing the Office of the Comptroller General and the Office of Administrative Probity. As part of this effort, and through the Efficiency and Transparency Program, the government is designing a project inspection program by independent auditors, training technical staff, and strengthening existing institutions. Beginning in October this year, with financing from USAID, three international accounting firms began to audit a sample of projects. Our authorities will also increase efforts for strengthening the judicial system.

Our authorities have among their most important priorities the development and implementation of a comprehensive, long-term poverty reduction strategy with a strong emphasis on improving the quality of social services, strengthening the social safety nets and rural development, and protecting the most vulnerable groups of the population. To this end, social policies will be reinforced—particularly in the areas of management and implementation capacity of the line ministries—and the decentralization process will be strengthened. As a part of its preparatory work for the Poverty Reduction Strategy Paper, the government has begun work on reassessing social conditions and poverty in the posthurricane period. The PRSP will be developed during 2000 through a participatory process as a comprehensive strategy to reduce poverty. The FHIS and PRAF programs will continue to be important tools for the poverty reduction program.

Honduras's external debt and debt-service remain unsustainably high and would certainly delay rebuilding the physical and social infrastructure damaged by Hurricane Mitch, notwithstanding the improvement in recent years due to prudent macroeconomic policies and debt rescheduling from bilateral creditors. Debt relief under the HIPC Initiative would help to provide financing for critical social and infrastructure programs. In particular, it will enable the government to accelerate and intensify its reconstruction efforts, as well as improve primary education, preventive health care, and urban and rural infrastructure—all of these essential for reducing poverty on a sustainable basis and improving Honduras's social indicators. Therefore, it is extremely important to make an early decision so as to provide Honduras with the maximum possible assistance in order to support the reconstruction and transformation efforts. In this context, the government hopes that under the HIPC Initiative, debt relief could be granted in an as-much-as-frontloaded manner as possible to help ease the high fiscal burden of debt-service payments.

Our authorities want to reiterate their gratitude to the International Community for its continued support to Honduras's stabilization and reform efforts and for the significant financial, technical, and humanitarian assistance received following Hurricane Mitch.

Extending her remarks, Mrs. Del Cid-Bonilla noted that Honduras had a track record of implementing sound macroeconomic policies and structural reforms, while simultaneously working toward reducing poverty. The government remained firmly committed to deepening those reforms despite the challenge of reconstruction and transformation that the country was faced with in the aftermath of Hurricane Mitch. To assist that process, it was of vital importance that Honduras reach the HIPC decision point as soon as possible in 2000 and that it benefit from interim assistance.

Mr. Shaalan and Mr. Himani submitted the following statement:

Honduras has performed well under the current ESAF-supported arrangement. Indeed, the performance is particularly encouraging when seen against the background of the devastation of Hurricane Mitch last year. The dual tasks of reconstruction and economic reform, following a shock equivalent to the country's entire 1998 GDP, can easily stretch the policy capacity of most countries. The authorities' perseverance during these difficult times is a testimony to their strong commitment to the reform effort.

We broadly concur with the staff appraisal and support the staff recommendations regarding Honduras's eligibility for the HIPC initiative. Therefore, our comments will be selective.

We welcome the reforms the authorities have made in the fiscal area. These include both consolidation measures, as well as measures designed to enhance the efficiency of the revenue system and expenditures at a time when the claims on the public sector are exceptionally high. Total government expenditures, as a share of GDP, is not low in Honduras. In this regard, we find the focus on expenditure rationalization in the consolidation process to be entirely appropriate. It is worth noting that the public enterprise sector appears from page 2 of the Article IV report to be a significant source of income for the budget. It is not clear, however, how the net budgetary contribution of this sector will evolve as the privatization process moves forward. The contribution may well decline or may even increase, depending on the sequence of the privatization of certain firms. Given the uncertain impact of the privatization process on the budget, potential risks as well as measures to address them need to be identified. While the risks to the budget are contained at this time, more ambitious measures in enhancing the efficiency and elasticity of the tax system need to be in place to ensure the authorities' ability to respond in a timely manner to revenue shortfalls.

Turning to the financial sector, we welcome the authorities' efforts to restore confidence in the banking system, following the failure of Bancorp. Although Bancorp's size was small, the repercussions on the financial system as a whole seem to have been significant. In addressing the immediate fallout from a bank failure, it is important to ensure that policies are not driven by the exigencies of the moment and that measures undertaken are well focused on the underlying weaknesses of the banking system without creating undue potential liabilities on the public sector. In this context, we support the staff on the introduction of a deposit insurance scheme. However, it is important to bear in mind that such schemes can create moral hazard risks and that confidence in the banking system can only be maintained over the long run through appropriate regulatory and supervisory framework.

Honduras's external position will remain vulnerable for some time. Assistance under the HIPC initiative is an important complement to the authorities' own efforts towards ensuring more sustainable external accounts. In this regard, maintaining a competitive external environment is critical, and we share the views of staff regarding the need for careful monitoring in this area. We are particularly encouraged by the measures undertaken to further liberalize trade, including in particular the recent abolishment of the export taxes. We also welcome the government's commitment to seeking greater access to export markets through regional trade arrangements. We encourage the authorities to move further in unilateral trade liberalization, as suggested by staff, and hope that their own efforts are appropriately recognized by all of Honduras's trading partners.

Mr. Shojaedini submitted the following statement:

We thank the staff for a well-written report and the HIPC preliminary document. We also thank Mr. Carstens and Mrs. Del Cid-Bonilla for their comprehensive and helpful statements. Clearly, Honduras has made significant strides in improving macroeconomic management and implementation of structural reforms. Despite the devastating effects of Hurricane Mitch, the economy is responding favorably to a solid track record of reform efforts. We are pleased to note that there have been signs of a gradual turnaround in economic activity in the second half of the current year. Reflecting prudent fiscal management and appropriate monetary policy, the stabilization objectives have been achieved under the program as inflation has declined, and the exchange rate has become stabilized. The authorities deserve to be commended, not only for the management of the macroeconomic policies but also, as is recounted in Mr. Carstens and Mrs. Del Cid-Bonilla's statements, for their efforts to address the social conditions which deteriorated as a result of the hurricane.

We agree with staff that the Honduran economy continues to face significant challenges, the most important of which is to achieve a sustained economic recovery that would help improve the living conditions for a population, three-quarters of which live on less than $2 per day. However, as staff points out, even with prudent economic policies and a favorable external environment, the annual growth rate is projected to remain at about 5 percent; that would merely improve the country's per capita income to a level that is less than that of the fifth-poorest country in the region. Thus, we agree fully with staff that sound policies by themselves will not be sufficient to alleviate poverty, and Honduras will continue to need substantial international concessional assistance over the medium term, including debt relief and the Fund's assistance under the PRGF.

Looking ahead, fiscal policy will clearly be of enormous importance. The emphasis should continue to be on a strong revenue administration based on improved compliance and a further broadening of the tax base, instead of higher taxes. On the expenditure side, we welcome the focus on shifting resources to the social sector and would urge the authorities to avoid slippages in spending (especially wages) in the run-up to the next presidential primaries that could reverse the progress in fiscal consolidation made thus far.

Supported by a sound fiscal performance, the monetary policy aimed at controlling the monetary base has been successful. It would be important to maintain these policies in order to achieve the further declines in inflation contemplated in the program. Nevertheless, one would have expected that the nominal and real interest rates on bank lending would have declined as the inflation rate was lowered. If they persist, such high interest rates could be expected to affect private investment, especially for small- and medium-sized businesses that have little alternative access to financing. High interest rates and interest spreads could be reduced over time through greater efficiency in the financial system. In this connection, it is crucial that the authorities establish the basis for greater efficiency and a restoration of confidence by bringing supervisory and prudential standards in line with international norms. We agree that a credible deposit insurance scheme financed by banks could be an important element in this process.

The relative stability of the exchange rate has been an important factor in the country's overall macroeconomic performance since 1997, and we share the view that, at this time, the exchange arrangements appear appropriate. However, with adequate and sustainable growth likely to be based on recovery in the export sector, we share the staff paper's concern about the need for careful monitoring of country's export competitiveness.

Finally, the eligibility of Honduras for assistance under the Enhanced HIPC initiative is well established in the paper. Clearly, the country needs substantial external assistance if it is to have a chance at poverty alleviation. We note that a recent study by Harvard Institute for International Development suggests that slower growth in Honduras has been related to its external debt burden, and that without significant debt relief, and assuming a conservative population growth rate of 2.5 percent per year, the GDP of Honduras "will have to grow at a constant rate of about 6 percent per year during the next 40 years simply to reach the income per capita that Costa Rica has today."[1] We therefore strongly support the eligibility of Honduras for assistance under Enhanced HIPC Initiative and agree with staff's proposal regarding the decision point. Also, we fully support staff's recommendation for providing interim assistance and endorse the proposed policies for a floating completion point.

Mr. Morais submitted the following statement:

Since 1992, under successive Fund-supported programs, Honduras has established a strong track record for pursuing sound macroeconomic policies and structural reforms. Indeed, Honduras deserves to be commended for

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[1] Esquivel, Gerardo, et.al. "The External Debt Problem in Central America: Honduras, Nicaragua, and the HIPC Initiative" HIID, Development Discussion Paper No. 645, August 1998.

staying the course of policy reform over the last year, despite the catastrophic impact of Hurricane Mitch in late 1998 on its population and economy. Economic activity is recovering; inflation has declined to single digits for the first time in five years; the foreign reserve position has strengthened; and progress has been made in privatization, civil service reform, financial sector management, and toward addressing the immediate social needs. Prospects for continued progress in the rest of 1999 are also encouraging, and, in this connection, we welcome steps taken recently to correct the slippage in compliance with the structural performance criteria. The authorities' intention to continue the momentum for reform in 2000 is also reassuring.

Challenges facing Honduras in meeting reconstruction and development needs are formidable. In particular, despite successive rescheduling agreements with Paris Club creditors and the considerable progress in implementing reforms, the fiscal burden of the external debt remains substantial. Staff's analysis demonstrates that, in 1998, the NPV of debt-to-revenue ratio is estimated at 338 percent and would decline only to 247 in 2002. The medium-term projections for the balance of payments are subject to uncertainties and are highly sensitive to changes in growth and export performance. The baseline scenario assumes increased efficiency of investment which may not necessarily materialize as expected. Under such circumstances, the ratios could remain at levels much higher than are assumed in the baseline scenario.

Honduras meets the threshold required for HIPC eligibility under the fiscal/openness criterion as the export-to-GDP ratio and the central government revenues-to-GDP ratio in 1998, at 47 percent and 18 percent, respectively, exceed the corresponding ratios of 30 percent and 15 percent, established under the Initiative.

Honduras has also already established a track record, as indicated in the staff document, for more than three years. Moreover, particularly due to the heavily adverse impact of the recent hurricane, the country's needs have become more acute. Early debt relief is therefore critical so that reforms are not put at risk by continued high debt and debt-service burden. It has been the view of this Chair that countries that are committed to policies aimed at growth enhancement, and poverty reduction should benefit from early and deep debt relief. Obviously, unsustainable debt diverts resources from desperately needed social investment, slows growth, and reinforces dependence on aid.

We can thus support the staff's and management's recommendation that Honduras reach a decision point in 2000. Against the background of the pressing social needs of Honduras and the impetus given to deeper, faster, and broader debt relief by the Cologne Summit in mid-1999, we would urge that the decision point in the case of Honduras be set earlier than later in 2000.

Moreover, given the urgent reconstruction and social development needs as well as the strong record of policy implementation since 1992, Honduras deserves consideration of a shorter second stage than the usual three-year period. The country will also need sufficient assistance during the interim period.

On the policies to which a floating completion point should be tied, we can support the conditions laid out in Box 6 of the staff document. In this connection, while we recognize the importance of pursuing exceptional actions on an accelerated basis for moving the completion point forward, we are of the strong view that considerations of need should also be given considerable weight in deserving circumstances. Countries for which the social and developmental needs are immediate and acute, such as Honduras, are clearly deserving of early debt relief.

Mr. Pickford made the following statement:

I welcome the opportunity to discuss another country under the enhanced HIPC Initiative and look forward to reviewing more cases in the near future. I agree with the waivers that have been requested in order to conclude the first review of the PRGF-supported program, given the progress that Honduras has made with respect to both macroeconomic and structural reforms and given also the specific measures that the authorities have adopted in order to address the deficiencies related to the requested waivers.

Overall, I agree with the analysis set out by the staff in the preliminary HIPC document. Honduras has clearly had much to deal with over the last year, and the impact of Hurricane Mitch has had a devastating impact, not only on the economy but also on the population and the environment. The uncertainty surrounding the impact of the hurricane has complicated the debt sustainability analysis. Nevertheless, on the information that we do have, I agree with the staff that the debt-to-revenue ratio indicates eligibility under the enhanced HIPC initiative. I therefore look forward to a decision point for Honduras in 2000, provided that the program is still on track and that the authorities press ahead with key structural reforms.

Also, given the pressing social needs in Honduras, it is entirely appropriate that interim assistance be provided between the decision and completion points. In order to deliver that assistance rapidly, a decision point should be considered as soon as possible in 2000.

The preliminary document rightly notes that governance and transparency are key issues for Honduras, not only for reasons related to its development strategy but also in the context of donor support, and I particularly welcome, in this regard, the establishment of an efficiency and transparency program, as well as the authorities' intention to introduce a law on illicit gains by public officials.

Given the importance of ensuring that resources released under the enhanced HIPC Initiative—assuming that we reach the next stage satisfactorily—flow effectively and quickly into poverty reduction, it is essential to be clear about the targets that the authorities will be setting, as well as the specific areas where action is most needed. In that light, I was a little concerned to read about the difficulties associated with setting detailed quantitative benchmarks in the social sector at this point in time and urge the authorities to work together with the Fund and Bank staffs and other multilateral development institutions to provide a reliable data set on which to base those targets. I look forward to positive developments in this area at the time when we consider the decision point document.

The extent and depth of poverty in Honduras, which has been exacerbated by the hurricane, means that in order to achieve a sustained reduction in poverty, the authorities should build on their track record of policies and social sector investment. I would in that regard welcome more information from the staff on recent progress toward developing a comprehensive Poverty Reduction Strategy Paper (PRSP).

One of the issues for discussion is the policies to be considered when determining the timing of the floating completion point. I agree with the broad terms on the policy set out in Box 6 of the preliminary document, but I think we should consider these issues in more detail at the time of the decision point. We also clearly need to consider carefully the issue of both multilateral and bilateral burden sharing,

Let me end by reiterating that I look forward to considering the decision point document as soon as possible next year. I wish the authorities much success.

Ms. Turner-Huggins made the following statement:

We can support the proposed decision and will address the issues posed in the HIPC document. First, let me join others in commending Mr. Dacosta and staff for their compact report. I wonder though if staff would consider not circulating the statistical appendix to the Board and begin to post these on the Fund's website.

Like others, I commend the authorities for their determination to pursue sound and corrective policies under extreme circumstances. In the period ahead, which includes an election cycle, we cannot underscore enough the need to retain the focus developed so far under the ESAF.

Turning to HIPC, our views are the following. First, we can agree with staff that Honduras is HIPC eligible for all of the reasons previously stated by others and by Mr. Carstens in his preliminary statement. On the question of the final HIPC document, we can also go along with the staff's proposal of the three conditions as outlined on page 30, paragraph 79. For our part, we would wish to have assurances as part of the final document that progress on the PRSP has indeed been achieved as well as a timetable on when to expect the document. We wish to reiterate the importance of adequate broad-based consultations with civil society to promote ownership. We can accept a slight delay in the development of the PRSP, if such a delay is required to ensure wide consultation.

On interim assistance, we can also support the staff's suggestion about providing support between the decision and completion points, as this would enable the government to concentrate resources to helping those affected by Hurricane Mitch and the recent floods and to financing other reconstruction needs.

On the floating completion point, we have no problems with the items in Box 6, page 28 of the preliminary document as these are generally appropriate. We stress the importance of bringing HONDUTEL to the point of sale and look forward to the finalization of the process by April 2000, as indicated by Mr. Carstens. The steps to work with IFC are also encouraging with regard to the electricity sector. In the areas of the financial sector and governance, we would like to see progress in the legislative and regulatory framework as well as in the area of improved transparency.

We would like to emphasize the importance of broad and participatory consultations with civil society in the development of the anticorruption plan and PRSP. We would also like to see significant progress in their implementation prior to the floating completion point. The work so far under the program on improving efficiency and transparency in government purchasing/acquisitions—with technical assistance from the IDB, and expected to be completed over the next six months—is a step in the right direction. The challenge remains to translate this to other areas, including strengthening the office of the comptroller general and office of administrative probity. The anticorruption plan should be developed as soon as possible and not developed over time as proposed in paragraph 9.

Having said all this, the staff should take care to avoid conditionality overload and aim at a practical and implementable adjustment program, owned by stakeholders.

Finally, we have some concerns about an adequate level of financing for Honduras over the next few years, arising out of expectations that are being created with the prospects of debt relief under the HIPC Initiative.

While we imagine that many of these issues will be addressed in February at the CG meeting, we suggest that donors begin to think about how to fill the financing gap should the HIPC debt relief operation fall short. This concern comes against the background of recent requests that we are aware of, by Honduras for continuance of the Central America Emergency Trust Fund in order to help them meet debt service to multilateral creditors. Staff may be able to update us in this regard.

Lastly, we wish the authorities every success in the period ahead.

Mr. Zurbrügg made the following statement:

I fully agree with the staff's assessment regarding the macroeconomic framework. The only assessment that appears to be somewhat optimistic is the assumption that Honduras will be able to achieve a long-term growth rate of 5 percent so rapidly, especially when taking into account the damage to infrastructure caused by Hurricane Mitch and the slow pace of reconstruction. However, I have no problem in accepting the requested waiver and agree with the proposed decision. I would like to highlight a few points that we consider crucial for a successful continuation of the program.

First, the upcoming elections will constitute a tough test for the authorities' reform efforts. Wage increases and delays in reforms in sensitive areas constitute a real threat, as demonstrated in the previous pre-election period. It is important to firmly resist such pressures. Given that the Board is agreeing to grant a waiver with respect to the privatization of HONDUTEL, we expect the future pace of privatization to be in full conformity with the schedule agreed with the Fund.

The failure of Banco Corporativo has underlined the importance of ensuring adequate supervision in the financial sector. While Mr. Carstens and Ms. Del Cid-Bonilla described the problem as resolved, we should be careful not to downplay the negative impact this has had on public confidence in the financial system as a whole. I accordingly welcome the planned strengthening of the regulatory framework. I fully concur with the staff that restoring confidence will necessitate a rigorous follow-up, particularly regarding the deposit insurance scheme. The structural assistance that will be provided by the World Bank will be an element in the reform efforts, and I count on close cooperation between the Fund and the Bank also in this matter. The substantial presence of Bank staff here at the meeting indicates that this will not be difficult to achieve.

Addressing the social needs is crucial. I welcome the effort to involve civil society in the implementation of the poverty reduction strategy. Once it has been fully developed, the PRSP will provide the necessary framework to address poverty in all its dimensions. It will be useful to have a concrete action plan that is embedded in a realistic time frame. I concur with the staff in urging rapid progress.

Transparency and governance are issues that this chair will follow closely. I welcome the first steps that have been taken—as noted by Mr. Pickford—and those planned under the efficiency and transparency program. However, Honduras will still have to make significant efforts in this area. According to the Transparency International Corruption Index, Honduras remains among the most corrupt countries in the world.

Let me now turn to the enhanced HIPC Initiative. We agree with the previous speakers that Honduras is eligible for assistance and that the decision point can be reached in 2000, given continued satisfactory performance under the PRGF. Considering the heavy fiscal burden of Honduras's debt—which is set to increase further over the next few years—I also agree that Honduras should receive interim assistance. The modalities for such assistance, including the timing and amount of debt relief, should be defined beforehand and in a clear and transparent manner.

Like Mr. Pickford, I broadly agree with the points mentioned in Box 6 of the preliminary document regarding the measures needed to reach the completion point. However, it is also clear that these points must be spelled out in more detail.

Finally, two minor points on the preliminary HIPC document. We note the macroeconomic assumptions of the debt sustainability analysis but would like to question the future rate of import growth and transfers, which is assumed to remain constant in real terms throughout the projection period. Given that the reconstruction process will take at least two to three additional years to accomplish, it is doubtful whether the import rate will remain constant in the years to come. The same holds true for transfers, especially given the general tendency toward reducing aid flows. I would like to encourage the staff to monitor this closely and stand ready to revise these assumptions if necessary.

Since the amount of debt relief is calculated already at the decision point under the enhanced HIPC Initiative, I would appreciate the staff's comments regarding the financing of debt relief for Honduras, especially with respect to the need for further creditor assurances and equitable burden sharing between multilateral and bilateral creditors.

With these comments, I commend the authorities for their impressive performance. I hope that they will perform equally well also in the future.

Mr. Sdralevich made the following statement:

Let me first of all express our understanding for the exceptionally difficult circumstances facing Honduras in the aftermath of Hurricane Mitch, which hit the country just over a year ago. In our view, program performance has been broadly satisfactory despite the distress arising from the disaster. Hence, we are ready to support the waiver for the performance criteria.

We found the staff paper very complete and informative. We would ask the staff, however, to provide an update on the current status of the 2000 budget law, which we understand should be shortly submitted to Congress. Also, in light of the financial difficulties of Bancorp, we would also find it useful to have some preliminary information on the conclusion of the World Bank assessment of the financial system mentioned in the staff paper.

With regard to a point this Chair has raised in the past, we appreciate the steps taken by the staff to ensure that the current situation of reserves relative to targets gives the authorities more flexibility in their reconstruction efforts.

On the basis of the current program and of the previous staff-monitored program, as well as on the unsustainability of the external debt, we consider Honduras eligible for HIPC assistance. We encourage the authorities to proceed with the preparation of the Poverty Reduction Strategy Paper, which is a concrete step in signaling their commitment to the social goals that are an essential part of the HIPC initiative. In this context, let me praise the effectiveness of the health and education programs implemented by the government—a good omen for the fruitful employment of the extra resources that will be made available in the future by the HIPC debt relief.

In the perspective of a satisfactory track record necessary for the HIPC initiative, we would, however, like to remark that it will be extremely important for the authorities not to deviate from the path established by the program. We particularly encourage the authorities to avoid any fiscal and structural slippage during the coming election campaign, as has already happened in the past.

Lastly, we consider reasonable the timetable and the conditionality proposed by the staff for the decision point, as well as the concession of interim assistance. In this regard, could we have some details on the timing of the decision point during 2000?

With these remarks we would like to support the completion of the review and wish the authorities continued success in their endeavors.

Mr. Lehmussaari made the following statement:

As regards the Article IV report, I broadly share the views presented in the staff appraisal, and I am not going to repeat the main points here. On the completion of the first review under the ESAF arrangement, I can go along with the request for waivers for nonobservance of the two structural benchmarks. However, the delay of the important pension and health care reforms is regrettable. More importantly, the fact that the missed structural performance criterion for end-June 1999 is not included as a structural performance criteria for end-December 1999 is even more regrettable. Maybe the staff could comment why this criteria is omitted. Given the importance of the reforms in this area, the momentum must not be lost. Therefore, the completion and approval of the action plan for this reform by April 2000 should be included as a prior action for the second annual arrangement under the current ESAF program.

Turning to the issues for discussion in the HIPC document, I can be very brief. This chair considers Honduras to be eligible for assistance under the HIPC framework with a decision point in 2000. This position is, of course, based on the assumption that Honduras is fulfilling the criteria in the ESAF-supported program and that Honduras is making satisfactory progress both in implementing the privatization program and in framing the Poverty Reduction Strategy Paper.

On interim assistance, I look favorably at the staff's recommendation to provide interim assistance, in particular, given Honduras substantial reconstruction needs in the wake of Hurricane Mitch.

On key reforms to be monitored under the floating completion point, all reforms listed in Box 6 in the preliminary document are important for the future development in Honduras. Therefore, a substantial achievement in these reform areas should be a condition for reaching the completion point. I would like to highlight two areas that, to my mind, the authorities should give a high priority.

First, improved governance, transparency, and accountability are vital to maintain the current goodwill among the international donor community. As the staff report clearly points out, concessional financing is necessary to close the remaining financing gap.

Moreover, improved governance, transparency, and accountability are vital to attract foreign direct investment. Some welcome steps have already been taken by the authorities, but the projected increase in foreign direct investment appears to be limited. Clearly, further efforts to make the economic environment in Honduras more favorable to foreign direct investment will play an important role in promoting sustainable growth in the long run.

Second, the health of the financial sector is crucial to promote growth. Recently, the solvency of the system has received much attention. However, for the medium term, it is necessary to ensure that sound competition is also promoted in the banking system. Without a well-functioning financial sector that can offer sufficiently financing on reasonable terms, much needed strong economic growth would be difficult to attain. In this context, I note with concern that the average lending rates remain close to 30 percent, despite a decline in the treasury bill rate. With inflation approaching single digits, real lending rates remain at nearly 20 percent—which, if maintained over time, must choke off private sector growth. A similar point was made by Mr. Shojaeddini in his statement.

Against this background, it is important that the staffs of the IMF and the World Bank will present a detailed description of actions for improving governance, promoting growth, and reducing poverty in the final HIPC document. I believe it is appropriate to stress that improved governance will—as set out in paragraph 39 of the staff report —reassure donors supporting and should be a condition for Honduras reaching its completion point.

Finally, it is also important to work out contingency plans for measures to be taken in case the exogenous assumptions underlying the main scenario turn out differently than projected.

Ms. Perez made the following statement:

After the devastation caused by Hurricane Mitch, the Honduran authorities have been making great efforts to put their economy back on a sustained, noninflationary growth path. For this year, a fall of 3 percent in GDP is forecasted, inflation has remained largely under control so far, and gross international reserves will increase from the equivalent of almost three months of imports of goods and services at end-1998 to almost four months at end-1999. Private consumption will fall, and with government consumption and gross fixed investment increasing as a result of the reconstruction effort, a rise in domestic demand is envisaged over the year. This is the reason for the rise in imports, which will be accompanied by a fall in exports. The reconstruction effort will also contribute to the 5 percent growth forecasted for the year 2000. A concessional loan such as the ESAF has been key to helping support the government's stabilization program and to providing a framework for a broad-based reform effort.

Preliminary data show that the macroeconomic developments and policies through September 1999 were in line with the objectives agreed to under the program, and most of the quantitative benchmark criteria through June and September were tackled. However, two end-June performance criteria relating to privatization in the telecommunications sector and reforms of the social security scheme were not observed. Based on the determined actions recently taken by the authorities to address and correct the slippages in complying with these both of performance criteria, we support the authorities' request for waivers of nonobservance.

Since we broadly agree with the assessment and policy recommendations made by the staff, we will limit our comments to a few particular issues.

The fiscal deficit target for 1999 has been set at 6.2 percent of GDP, within the 8.3 percent target agreed last March in the ESAF. Current revenue and tax income are budgeted to remain consistent with last year's total. The latter was possible, despite the economic contraction following Hurricane Mitch, due to the increase in the sales tax last year. However, the projections seem somewhat optimistic given the declining sales tax collection, an increase in the minimum wage, and higher capital expenditures in the second semester. A fiscal deficit around the Program target might be more likely. We commend the authorities' efforts to adhere fully to the overall fiscal objectives of the program. In this line, the authorities' reform effort to make fiscal policy more transparent and accountable might help reduce the influence of short-term political pressure in a electoral year. For the next budget period, the authorities should focus on trimming the fiscal deficit.

On the financial sector, commendable effort has been made to strengthening supervision of the financial system and bringing the regulatory framework more closely in line with international standards. This would give support to the troubled financial sector and help minimize bank failures in the future. We encourage the banking superintendence to put pressure on financial institutions to comply with the new Basle disclosure and banking regulations. Financial institutions that do not comply, or those that have been seriously weakened by nonperforming loans, should be merged. We are convinced that the implementation of these measures will promote the consolidation of the banking sector.

On external issues, the exchange rate has remained stable this year, and a continuation of this trend over the short term is envisaged. The projected worsening of the external account deficit of up to 9.4 percent of GDP for this year raises some questions about the medium-term viability of the external accounts, as well as about the international reserves level. The high level of international reserves from relief-related capital inflows should be sufficient to offset temporary deterioration in the current account linked to the reconstruction effort. However, over the medium run, Honduras's external position will only be viable with a more dynamic export sector. In this regard, the authorities' intention to avoid an appreciation of the real exchange rate and to further liberalize the trade regime is encouraging since this will promote export sector competitiveness. To strengthen private-sector confidence and competitiveness, as well as to promote investment in the economy as a whole, the authorities should focus their efforts on pressing forward with the privatization of the key sectors—including telecommunications and electricity—as agreed to in the structural measures under the ESAF. This would also reduce Honduras's high dependence on foreign aid and mitigate the vulnerability of the country's productive sectors to future natural disaster.

Regarding the issues for discussion on the HIPC preliminary document, this chair concurs with the Honduran authorities' and the staff's view that to ensure sustainability over the medium term, given the heavy external debt burden, Honduras should be eligible for assistance under the Enhanced HIPC Initiative. This mechanism would help release the necessary resources to lower poverty and strengthen the fiscal position in the medium term. We also support the staff's and management's view that Honduras will meet the conditions for reaching a decision point in 2000 as long as all prior conditions detailed in paragraph 67 are fulfilled. We are looking forward to the final HIPC document, which will contain detailed recommendations relating to the basic conditions needed to be fulfilled before Honduras reaches its completion point. At this stage, like Mr. Lehmussaari, we would suggest that staff consider social security reform among the key issues to be monitored under the floating completion point. As was pointed out in the staff report, these reforms are well advanced, and separation of the pension and health fund is envisaged for early 2000. We support the staff suggestion of providing interim assistance between the decision and the completion point, being aware of the damage caused by Hurricane Mitch and the substantial structural needs of the country.

With these comments, we endorse the proposed decision and wish the authorities further success in their reconstruction efforts.

Mr. Hinata made the following statement:

This chair broadly supports the thrust of the staff appraisal of the macro economic situation in Honduras, but I would like to comment on a few points.

Like other speakers, I feel it is commendable that economic performance has improved due to the authorities' sound macroeconomic management under the ESAF program, despite the adverse effects of Hurricane Mitch. However, I regret that two end-June performance criteria concerned with structural reform were not met as scheduled, and that one of them has still not been observed. I believe the authorities have positive intentions in achieving several issues, including privatization, civil service and social security system reforms, and improvements in social services. I hope this momentum toward reforms will be maintained.

The authorities have succeeded in containing inflation with a sound fiscal performance and with their monetary framework aimed at limiting base money growth through open market operations. Regarding the 2000 economic projections, the fiscal deficit and base money will be enlarged. Moreover, imports will increase. Notwithstanding these projections, inflation will be lowered from 11.9 percent to 11 percent. I would like to hear the staff comment on how this can be achieved.

With these remarks, I support the proposed decision related to the first review under the ESAF.

Turning to the issues on HIPC, it is clear that debt relief under the HIPC Initiative will contribute to reducing the debt burden of Honduras. On the other hand, given that Net Present Value (NPV) of total external public debt outstanding at end-1998 is estimated at US$3.2 billion, debt sustainability analysis shows that the NPV of debt-to-export ratio is estimated at 147 percent in 1998. The NPV of debt-to-revenue will decline to 247 percent in 2002 without a HIPC Initiative. These figures are lower than the target of each ratio after the HIPC Initiative. Under such circumstances, I wonder at the necessity to rush to benefit from the HIPC Initiative, while there are many countries whose debt situation are worse than Honduras.

In addition, the staff report mentioned that it is unlikely that the details of the economic program for 2000 will be finalized until the second review of the ESAF scheduled for next April. This chair strongly believes this economic program is very important in light of the staff and management recommendation that a decision point is reached in 2000. I would like the staff to provide us with a detailed explanation and its view on this situation.

Therefore, I want to stress that we need to discuss this issue of the HIPC Initiative for Honduras in depth while considering other indebted countries before making our final decision. In conclusion, while this chair favors the view that it is premature at this stage to decide whether Honduras can reach a decision point in 2000, with respect to the G-8 Communiqué of the Köln Summit, we can reluctantly go along with the Board consensus.

Mr. Milleron made the following statement:

As far as the appraisal of past economic performance is concerned, I am broadly in agreement with staff, so I shall limit myself to a few comments.

First, it seems to me that the staff somewhat underestimated the fiscal achievements. To me, it is quite remarkable that the government managed to improve savings in spite of a 3 percent contraction of GDP. It is also worth noting that it managed to raise current revenue by 2.5 percent in excess of the program, against the background of the chaos caused by Hurricane Mitch. True enough, current expenditure increased slightly more rapidly than planned, which might make it more difficult to reduce the fiscal deficit in forthcoming years; as well, the delays which reconstruction spending suffered will have a detrimental effect on the pace of the reconstruction process. But, all in all, ending the year with a fiscal deficit almost 29 percent smaller than programmed is rare enough to be commended.

Second, regarding structural reforms, very significant steps have been taken, albeit with some delay. We agree, therefore, with the proposed waivers on related performance criteria, with the understanding that the first stage of the reform of the social security system will have been completed by the time of the second review.

Turning now to policy discussions, we share the staff's views on everything that concerns external policies. By contrast, we feel the fragility of the domestic economy is somewhat underestimated by the report. The fact that Honduras has done quite well in complying with the program does not mean that the severe imbalances which made a program necessary have disappeared. Both the current account and the public sector deficits remain high, in proportion to GDP. And inflation, though seemingly stabilized, is likely to remain in the vicinity of 10 percent for the foreseeable future. This means it would be premature to relax the constraints observed so far in the conduct of fiscal, monetary, and structural policies.

In this context, I am not sure it is reasonable to support the fiscal policy envisaged by the authorities, which would widen the fiscal deficit by 1.5 percent of GDP. Such a policy would be inconsistent with the concurrent efforts to reduce the country's indebtedness and—given that over the next year GDP growth is expected to jump by 8 percent—it would involve a rise in public expenditure which the government may not be able to handle. In addition, relaxing the constraint on public expenditure in an election year could yield a slippage of uncontrolled magnitude.

We welcome the authorities' commitment to dedicate more resources to the social sector but believe this enhanced effort should be achieved through a reallocation of resources rather than through increased public spending. In particular, we would like reconstruction spending to be more focused on poverty alleviation than in the past.

Furthermore, if Honduras is to reach a sustainable growth path, it is essential that the momentum for structural reforms does not fade, even in the run-up to the presidential election. The first priority, in this connection, is certainly the reform of the social sector. But both the staff and the authorities seem to be well aware of that; they have worked to identify the problems and designed a plan to tackle them, so the challenge they face is mainly one of implementation.

By contrast, there is an area of structural reform that is absolutely crucial to restore investors' confidence in the country and to improve growth prospects but which is treated seriously neither by the staff nor by the authorities' memorandum of economic policy. It is the area of good governance and transparency. The staff's report does allude to the efforts made by the authorities with respect to procurement and contracting procedures. This is an important step, particularly against the background of substantial aid inflows. But given the country's poor record in this area, it might take significantly more than that to solve the problem of a perceived widespread corruption. Short of a comprehensive reform plan, based on a real understanding of the phenomenon, the problem will not disappear. Bolder and time-bound commitments by the authorities in this respect would have been preferable, but in view of the detailed assurances given by Mr. Carstens and Mrs. Del Cid Bonilla in their preliminary statements, I hope that even without structural benchmarks we will see significant progress by the time of the next review.

Finally, I am concerned that the 5 percent rate of growth projected for next year might be slightly overambitious, especially since, apart from reconstruction outlays, there are no hints in the report as to what growth drivers will be.

With these remarks, we approve the completion of first review under the ESAF arrangement.

Let me now turn to HIPC issues.

We support the principle of Honduras's eligibility for assistance under the HIPC initiative, according at least to the fiscal criterion. However, it should be underscored that the country's track record is somewhat mixed: only two ESAF arrangements were concluded, of which one suffered considerable slippages and the other was signed only a few months ago. Therefore, I would welcome some clarification regarding the policy implications of the reasons that led the staff to decide that the decision point for Honduras could be reached as early as 2000, whereas other candidates were denied such a lenient stance. In other words, is this meant to be a precedent and if not, how are we going to explain that in the future?

Having said that, in view of the daunting social needs of Honduras, we do support a decision point in 2000. But we feel the conditions set by the staff should have been more demanding and more specific, particularly with regard to the poverty reduction strategy. In this connection, we would like the final HIPC document to set out in much more detail the reforms that must be implemented before the completion point can be reached, particularly with regard to privatizations, financial sector reform, governance, and transparency. In addition, we fully support the staff's proposal to make the completion point conditional on the provision by the authorities of a full-fledged poverty reduction strategy and of a preliminary report on the implementation of this strategy.

Finally, I would like to lay some emphasis on the fact that the amount of assistance requested for Honduras under the HIPC initiative amounts to US$676 million (i.e., a cancellation rate higher than 90 percent). This is a heavy burden that must be borne equally by the various creditors. In this connection, I would appreciate it if staff could elaborate on the terms of the commercial debt buy-back operation, particularly with regard to the principle of comparability of treatment. It would also be of considerable help to have a clear view of where multilateral creditors stand regarding their participation in the funding of the cost of Honduras's eligibility for the HIPC initiative.

Ms. Budington made the following statement:

Honduras's performance during 1999 has been commendable, particularly in context of the very difficult conditions created by the unprecedented devastation to both human capital and physical infrastructure in the wake of the hurricane. We would agree in particular with the points made by Mrs. Mateos y Lago regarding the impressive performance on revenue in this regard. We can accept the waivers recommended by staff in terms of the structural performance criteria. In this context we would emphasize that 1999 has been an exceptional year, and it will be critical for Honduras to ensure that the structural adjustment agenda is implemented fully, including the expected steps in the telecom and electricity sectors, civil service reforms and delayed social security reforms. This follow-through is particularly important in light of HIPC, and we believe that firm progress will be essential prior to the final decision point.

I have five specific points. First, in the banking sector, the intervened bank—Banco Corporativo—is relatively small, and the staff report suggests the authorities' view that this is not a systemic problem. We would appreciate staff's assessment on this point in light of the government's decision to take the extraordinary step of guaranteeing all banking system deposits for a three-year period. We agree fully with the staff on the importance of a broad-based agenda of reform in the banking sector, including in the context of World Bank assistance, but we are concerned that there needs to be appropriate mechanisms in place now to ensure that risky lending is constrained. This is particularly important given the full insurance that is being extended.

Second, we agree fully with other chairs in terms of the importance of a firm strategy to address governance concerns and to support greater transparency in public decision making. The IDB program in this area is crucial. The information contained in Mr. Carstens' and Mrs. Del Cid-Bonilla's statements is very helpful. As others have stated, this is a critical challenge for Honduras both in terms of the ongoing concerns in this area that are evidenced by the private-sector rankings of Honduras and the need for strong systems of accountability going forward. This, too, will have to be an important area for follow-up in the run-up to the final decision point.

In this context, the government faces a critical challenge given the enormous strain it is under to advance the post-Mitch reconstruction agenda. It would be helpful to understand why MBD disbursements have been lower than expected and to what extent they are related to insufficient capacity. I would jump ahead a bit and say this should be considered very carefully when considering interim assistance. The profile of such assistance should reflect a presumption of neutrality and careful consideration of absorption capacity and medium-term debt sustainability.

We would emphasize the importance of IMF in coordination with relevant organizations to discuss with the Honduran authorities issues related to labor standards. Violation of workers' freedom of association and collective bargaining rights within Honduras's export processing zones (EPZs) remain a concern. We are encouraged that the Ministry of Labor is participating in a regional program with the IDB to improve the technical capabilities in the enforcement of labor laws but note that technical assistance must go hand in hand with firm efforts to enforce the existing labor laws.

Finally, both the IDB country papers and World Bank CAS for Honduras recognize the link between the damage from Hurricane Mitch and environmental and land use policies before Mitch, and indicate the need to pursue a reconstruction agenda with this in mind. We note the emphasis on this in the initial HIPC documents, and we encourage the staff to work closely with the World Bank to be sure that the policies embedded in the PRGFs are fully consistent with these goals.

Turning to HIPC, we agree with Honduras's eligibility and with a presumption of a decision point in 2000 tied to continued momentum on a full range of reforms. I think it is a bit premature to get too specific on timing within the year of 2000, but I agree with those who have emphasized the need for substantial progress and indeed a very well-fleshed-out start on the PRSP in advance of that decision point, and here I would emphasize the importance of continued momentum in reaching out to civil society as part of this process.

Also, we would agree with Ms. Turner-Higgins' emphasis on the importance of a clear time frame in the decision document for the PSRP. In terms of the required steps outlined in Box 6, this list needs to be fleshed out, and I would note some concern with the lack of mention, which I am sure is just an oversight, of continued performance against the macroeconomic criteria in the program, and here I would note the importance of follow-up on the authorities' commitment to further trade liberalization.

I think the first point under the privatization process should be overtaken by events since our expectation is that the telecom company will be brought to sale by April 2000, and I hope including it in this list does not reflect a pessimistic view on that outcome. Finally we agree with others who have emphasized the importance of governance and transparency in regard to this agenda.

Mr. Merz made the following statement:

I can be brief since I broadly share the staff's analysis and main recommendations. Let me also thank staff for all the work done so far.

Staff correctly points out that Honduras's economic performance had been broadly satisfactory since the approval of a three-year ESAF arrangement in March 1999. It is certainly encouraging that inflation and overall fiscal performance has been better than programmed. On the other hand, delays in structural reforms and the related requests for two waivers in the area of telecommunication and social security are a matter of concern. We are therefore pleased to note that the slippage in the privatization in the telecommunication sector was corrected, and we hope that the action plan for the separation of the accounts of the social security system will be finalized as soon as possible.

On the fiscal front, the good performance is, however, not only related to a bold policy implementation. Public expenditures in 1999 will be lower also due to delays in the reconstruction program so that a shift of public expenditures into the fiscal year 2000 will occur. Against this background and also in light of possible spending slippages in the run-up to the next presidential primaries, the authorities should continue their efforts to strengthen expenditure controls, broaden the tax basis, and improve the tax administration in the framework of the budget for 2000. In this context, we would also appreciate some information by staff on the nature of operational losses of the central bank, which influence the combined public sector balance as shown in Table 1 of the staff report.

All in all, we can support the conclusion of the first review under the ESAF and accept the request for the two waivers.

Turning finally now to the preliminary HIPC considerations, we consider Honduras eligible for assistance under the enhanced HIPC Initiative based on the fiscal/openness criteria. We also support the timing of the decision point under the conditions, as laid down in the staff document.

Ideally the Poverty Reduction Strategy Paper (PRSP) should be finalized before the decision point. This may not be entirely possible for the first country cases, as we are still in a transition phase. What we would like to see, however, is substantial progress towards the PRSP.

We also agree with the staff's recommendation to provide interim measures by multilateral creditors between the decision and the completion point. But one should keep in mind that in the aftermath of Hurricane Mitch, the Paris Club has already granted Honduras a moratorium on debt service payments until the end of 2001.

On the issue of the floating completion point, I share the remarks made by Mr. Pickford.

The staff representative from the Western Hemisphere Department noted that recent data pointed to an upturn in economic activity in 2000. For instance, indicators of economic activity from August 1999 were higher than the same period in 1998, which preceded Hurricane Mitch. Other, albeit less significant, indicators pointed to rising employment in the agricultural sector, and the construction sector continued to exhibit strong growth, as reconstruction in the wake of the hurricane continued. According to data from September 1999, exports were also increasing slightly. Overall, the staff was confident that a recovery was under way, and it had accordingly forecast that the economy would grow by 5 percent in 2000.

The fiscal program for 2000 was still being reviewed by Congress and would not be finalized until December 1999, the staff representative continued. Following approval of the budget, it would be incorporated into the PRGF-supported program that the staff planned to present to the Board in March or April 2000.

The staff was projecting an increase in both base money and output, while velocity would remain unchanged, the staff representative related. The staff was also expecting an improvement in the supply of commodities, which carried a large weight in the consumer price index. Combined with the authorities' commitment to continued fiscal prudence, an inflation target of 8 percent for 2000 did not appear to be overly ambitious.

Mr. Kudiwu asked whether the projected growth rate of 5 percent would be sufficient to reduce poverty.

The staff representative from the Western Hemisphere Department replied that the projected growth rate for 2000 had taken into consideration the findings of a World Bank study on the economy's capacity for growth. While a growth rate of 5 percent over the medium term would make only a limited impact on poverty levels, the staff was expecting that increased investment, including foreign direct investment, would help lift the growth capacity of the economy. It was hoped that new data, which would become available in March 2000, would reveal an improvement in the economy's growth capacity.

The Fund, the World Bank, and the IDB had recently sent a joint staff mission to Tegucigalpa in order to continue discussions with the authorities and with representatives from civil society on the formulation of a comprehensive PRSP, the staff representative noted. The government intended to have a first draft of the strategy ready by May or June 2000. While there might not be a consensus on all the elements contained in the Interim PRSP, the intention was to define the modalities for the consultation process with donors, international financial institutions, and nongovernmental organizations that would eventually result in a PRSP.

A recent World Bank staff mission had discussed possibilities for reforming the financial sector with the authorities, the staff representative continued. The Bank staff, which had played an important supervisory role in the financial sector even before the hurricane, had already discussed a number of its suggestions with the authorities, including how to tighten inspection and establish a deposit insurance scheme. The authorities were currently reviewing the staff proposals.

When the reform of the social security system was first undertaken, the authorities had hoped to finalize the separation of accounts fairly rapidly, as a first step toward a more comprehensive reform, the staff representative stated. However, the reform had been delayed because of Hurricane Mitch, from which it had taken longer than expected to recover. The consultation process in support of the reform had also been more protracted than had originally been anticipated. The private sector, which had played a large role in its capacity as employer, was now close to reaching an understanding with the labor organizations on how to move forward. The action plan proposed by the staff in the context of the new Fund-sponsored program was based on a more realistic assessment of the time it would take to complete the consultation process needed to ensure that the reform of social security would be implemented successfully.

The authorities wished to reach the HIPC decision point as early as possible in 2000, the staff representative continued. The staff expected to have completed the decision point document around June 2000. Honduras was not being treated any differently from other countries, and the assessment of its eligibility under the enhanced HIPC Initiative was based solely on the authorities' track record in implementing reforms.

While the recent bank failure in Honduras had a limited impact on the banking system as a whole, it was important not to understate the magnitude of any failure, however small, in a country with a banking system that was as fragile as Honduras's, the staff representative noted. The Fund and the Bank had both provided technical assistance as soon as the problems in Banco Corporativo had become apparent, in order to restore confidence in the banking system as rapidly as possible. As a result, the operational losses of the central bank were relatively small in 1999 and related mainly to the bank's own operations. No further losses were expected in 2000.

The authorities and the staff were committed to ensuring that the principles of equitable burden sharing under the enhanced HIPC Initiative were met, the staff representative stated. Some institutions—including the Central American Bank for Economic

Integration (CABEI)—might, however, encounter difficulties in meeting their obligations under the Initiative, although the amount owed by Honduras to the Bank was relatively small in comparison with, for instance, Nicaragua. The World Bank was currently planning a visit to the CABEI to discuss its possible contributions to the enhanced Initiative.

A buy-back operation involving the commercial banks was currently being discussed with the authorities, the staff representative related. The World Bank was providing technical assistance.

Mr. Winje asked why real interest rates were as high as 30 percent and whether anything was being done to lower them.

Mr. Zurbrügg noted that it might be necessary to develop a more generalized approach to burden sharing among regional lending institutions, as that issue had arisen not only in relation to Honduras but also in relation to a number of other countries that had large arrears to non-Paris Club creditors.

The staff representative from the Western Hemisphere Department replied that high, real interest rates were prevalent throughout Latin America and reflected the risk perceptions of investors. In the case of Honduras, interest rates had increased in the wake of the hurricane, which had negatively influenced bank portfolios. While the authorities were currently strengthening banking sector regulations, high real-interest rates also reflected the continued lack of competition among banks. The interest rates would begin to decline once economic recovery had taken hold, inflation had declined, and financial sector reform had strengthened competition in the banking sector; however, the process might take some time. In the case of El Salvador, which had a stronger record of macroeconomic performance than Honduras, nominal rates for loans currently stood at 15–16 percent, even though inflation was no more than 1 percent.

The staff did not have access to information concerning the capability of the CABEI to contribute its share of the debt relief that Honduras would be eligible for under the enhanced HIPC Initiative, the staff representative concluded. The amounts owed by Honduras to other bilateral creditors were relatively small, and the authorities had been servicing those loans on a regular basis. They were planning to undertake negotiations with those creditors as soon as Honduras reached the decision point.

Mrs. Del Cid-Bonilla noted that there was no indication so far that the CABEI would be able to cover its share of the debt relief that Honduras (and Nicaragua) were eligible for under the enhanced HIPC Initiative. The CABEI had recently asked the World Bank to assist it with an evaluation of its financial situation. Even though the amount owed to the CABEI by Honduras was much smaller than that owed by Nicaragua, it threatened to unravel the financing of the debt relief that Honduras was eligible for under the enhanced HIPC Initiative, and it was therefore of paramount importance that the Fund address the wider issue of burden sharing.

After adjourning at 1:15 p.m., the Executive Board reconvened at 3:00 p.m.

Mr. Kudiwu made the following statement:

The Honduran authorities are to be commended for their continued efforts to maintain a good track record of macroeconomic and structural reforms, especially after the devastating effects of Hurricane Mitch in late October 1998. Like the other speakers, we are also pleased to note that for the rest of 1999 prospects appear favorable.

With regard to the ESAF program, it is encouraging to note that Honduras's economic performance has been broadly satisfactory during the nine months ending September 1999. As a result of the implementation of appropriate macroeconomic policies, economic activity has started to recover gradually from the hurricane-related damage, inflation has declined, and the level of the international reserves has increased. In addition, all the quantitative benchmarks for June and September 1999 were met. On the structural front, although two structural performance criteria set for end-June 1999 were not met, significant headway was made in other areas, particularly the privatization program, civil service reform, financial system supervision, and transparency in the use of public funds.

Taking into account the actions already implemented and the authorities' continued commitment to adjustment process, we support their request for waivers for nonobservance of the two structural performance criteria and the completion of the first review under the ESAF arrangement.

Looking ahead, we recognize that the Honduran economy remains fragile and that considerable challenges lie ahead, including the need for reconstruction and social development. To address these challenges, the authorities will need to intensify their efforts to maintain a stable macroeconomic environment through prudent financial policies and to deepen the structural reforms. However, we also share the view expressed in Mr. Shojaeddini's preliminary statement regarding the importance of substantial international concessional assistance over the medium term, including debt relief and the Fund's assistance under the PRGF.

In the fiscal area, efforts aimed at strengthening revenue administration through compliance with the tax code and a further broadening of the tax base are appropriate. However, the authorities should also exercise strict control over current expenditure. In light of the low level of the capital expenditure expected in 1999, we welcome the authorities' intention to boost its level under the 2000 budget in order to speed the pace of the reconstruction program. With the coming presidential elections, it is important for the authorities to resist claims for large government wage increases. We would also encourage the authorities to address the problem of the social security system.

In the monetary area, prudent policies have helped to contain price pressures. It is critical that the authorities continue to follow a tight monetary policy in order to reduce inflationary pressures and maintain the stability of the exchange rate. It is also important that the authorities continue their efforts to strengthen the financial system and to take steps aimed at restoring confidence in the wake of the failure of Banco Corporativo. In this context, we agree with staff that they should quickly adopt legislation to establish a deposit insurance scheme and introduce regular supervision over stock exchange transactions. Regular inspections of banks to ensure adherence to capital requirements are also important measures that should be taken.

In the area of structural reforms, the authorities have done much; however, a number of measures need to be taken especially as regards the capitalization of the Hondutel, the management of the airports, and the participation of the private sector in electricity distribution. The authorities have indicated their commitments to these measures, and we encourage them to complete these reforms as quickly as possible. Efforts at improving governance and transparency should also be continued.

On the HIPC Initiative, although significant progress was achieved in policy implementation and successive rescheduling agreements were reached with creditors, Honduras's external debt remains heavy, as evidenced by the high public-sector debt to exports and debt service to exports ratios. We therefore concur with staff on the eligibility of Honduras under the HIPC Initiative based on the fiscal/openness criteria. We can go along with the staff proposal to consider the decision point in the year 2000, on the basis of the conditions set in the staff report. We support the staff's recommendation for providing interim assistance between the decision and the completion points. Moreover, in light of the urgent need facing the economy, namely the need for reconstruction and social development, we support the proposed policies for a floating completion point.

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

Mr. Çakir made the following statement:

It is encouraging to see the Honduran economy recovering from Hurricane Mitch. Despite the massive destruction, the sound policies of the authorities have gone far to stabilize and reform the economy.

And even though a number of performance criteria were missed, most economic indicators are broadly in line with the program, all quantitative benchmarks have been met, and the authorities are determined to make up the missed performance criteria. The government's launching of the telecommunications company privatization confirms my confidence in the strength of its commitment to the macroeconomic program. I can go along with the staff proposal that waivers be granted for the missed performance criteria.

We understand that the government will be able to privatize the telecommunication company by mid-2000. Can the staff tell us how the proceeds of this privatization will be used? Have the authorities considered using them for debt reduction?

The accomplishment of the tax administration in exceeding the program target by over 2.5 percent of GDP was remarkable. Indeed, considering the history of Honduran revenue collection, the program itself may represent a slight overshooting.

Following the liquidation of Banco Corporativo, the passage of legislation providing a government guarantee for all bank deposits is welcome. But its three-year life may be worrisome for the health of the banking sector since so long a term could lessen the incentive to run a well-managed as opposed to a poorly managed bank. It might be worthwhile for the authorities to consider a shorter transition period.

Honduras's external debt and debt service remain unsustainably high, and debt relief under the HIPC Initiative is necessary to provide the financing for critical social and infrastructure programs. I strongly support Honduras's eligibility for assistance under the enhanced HIPC Initiative.

Mr. Maciá made the following statement:

Despite the devastating effects of the hurricane, the Honduran authorities have made serious and sustained efforts to achieve the macroeconomic objectives and targets envisaged in the program, and have taken steps to achieve economic recovery and strengthen the external reserve position. Export indicators point to a recovery in the banana and coffee sectors, as well as in the maquilla textile industry.

As sustained by the staff, overall fiscal performance has been better than expected, limiting nonfinancial public sector deficit, strengthening tax administration, revamping reconstruction efforts of social and economic infrastructure, and upholding resources destined to the social sectors and poverty-stricken areas. The structural reform performance under the program has been satisfactory. All quantitative benchmarks for June and September were observed, and inflation has been contained to single digits. In the banking sector, authorities responded appropriately to restore confidence in the system through strengthening regulations and capital requirements, further bank audits, and pursued legislation for deposits insurance, inspection of finance companies, and regulations for trust funds. Given the above, we support the authorities' request for waivers for the nonobservance of the two structural criteria.

Structural reforms are being implemented to conclude sales of shares of HONDUTEL and to open to the private-sector road construction, ports and airports management, electricity distribution, and the water sector. In addition, specific actions with assistance from the IDB are in progress to enhance transparency and governance in the public sectors' operations and procurements and to strengthen the judiciary.

We welcome the initiative of Honduras to pursue assistance under the HIPC Initiative, given the critical social and economic conditions reflected in the staff preliminary document. With a per capita income of US$730, a high debt burden of 74 percent of GDP, and a heavy debt service, Honduras is the third-poorest country in Latin America and the Caribbean Region. Its key indicators are considered worse than the regional averages, and 47 percent of the population lives on less than US$1 a day. About 60 percent of the indigenous population has no access to safe water, and about 91 percent lack basic sanitation, with extremely high illiteracy rates.

With Honduras' sound track record on implementing macroeconomic policies and structural reforms and their sustained efforts to reconstruct basic and social infrastructure, this chair supports the consideration of a final HIPC document in 2000—provided that Honduras fully implements the necessary conditions—and supports, as well, the provision of interim assistance between the decision and the completion point.

We wish the authorities every success in their difficult endeavor.

Mr. Dragulin made the following statement:

The current ESAF-supported program has been performing well. We therefore agree with the proposed decision. It is also reassuring that, after the disastrous disruptions caused by Hurricane Mitch, the economy offers convincing signs of improvements, reflecting the continuity in the reform policies that have felt prominently since early '90s. Since I share the general thrust of the staff reports, I will limit my intervention to a few comments related to the current PRGF program and the participation to the HIPC Initiative.

Fiscal performance in the first semester was better than projected. This favorable outcome is mainly explained by improved tax administration and financial position of the public sector agencies. This is encouraging in view of the paramount importance fiscal position detains in the general macroeconomic policy framework. Ongoing efforts to improve the fiscal performance derive not only from the debt pressures but also from the vulnerability of the economy to adverse shocks. The wage bill is seen as a sensible component of budget expenditure in the year 2000. The staff considers that "an increase in the wage bill ... would be unavoidable" and recommends high vigilance in the run-up to the November 2000 elections. Since I also am in agreement with this approach, I am asking whether the program under the ESAF needs to incorporate some specific wage targets.

My second comment will address monetary and exchange rate policy. I agree that monetary policy should remain prudent, even if this stance might keep real-interest rates high. However, this level has reflected more the weak credibility of policies and less the tightness of monetary policy. Regarding the exchange rate, while I accept that supply constraints (output disruptions caused by the hurricane) are a major explanation for the recent evolution of exports, I can not disregard the real appreciation of the domestic currency over several years, which, if not reversed, may affect external competitiveness and pose a vulnerability problem.

Turning to the HIPC Initiative, our chair agrees with Honduras participation; the country is indeed eligible for HIPC-debt relief under the fiscal/openness criteria with a debt-to-revenue ratio of 322 percent as of December 1999 (Tables 9 and 11), or 305 percent assuming a Paris Club rescheduling this December (Table 12).

We agree to a decision point in 2000, conditional on the PRGF-supported program being on track after the second review, satisfactory progress on key reforms, and on the development of a Poverty Reduction Strategy Paper. Honduras enjoys a good track record since early 1990s, but this was shadowed by policy slippages primarily at the time of elections (in 1996). Prudent macroeconomic policies next year, when there will be presidential primaries in November, will be of particular importance in approaching the decision point.

It is quite remarkable that, without debt relief, the debt-to-revenue target would drop below the sustainability threshold after 2001 (258 percent in 2001, and 237 percent in 2002), as evidenced by the figures in table 12. After the adaptations to the HIPC Framework, a decrease between the decision point and the completion point is no longer relevant. At the decision point, we should use the latest actual data available, as was agreed upon during the last Annual Meetings. This could lead to lower debt relief for Honduras and would consequently free up resources for more pressing cases.

At the time of the Annual Meetings, the governors agreed to the principle of interim assistance between the decision point and the completion point. However, so far we have not received detailed information as to how this type of assistance will be provided by international financial institutions. Are there new developments in this area?

With these remarks, I wish the authorities success on the road of reconstruction and reforms.

Ms. Vtyurina made the following statement:

Let me begin by saying that we were pleased to read staff papers presented for today's discussion. The performance of the Honduras economy has shown favorable results, as it was expected under the program and which is especially commendable in the aftermath of Hurricane Mitch. We support the review under the ESAF and a waiver of performance criteria. I would like to make brief questions on the growth projections and on the points raised by the staff in the HIPC document.

This year, the GDP is expected to decline by 3 percent, as it was envisaged by the program, and rightly so since the economy has been seriously damaged by the hurricane. The projections for the year 2000 show that the GDP growth is projected to be 5 percent and continue so for the next five years. While the staff argues that such growth should be supported by the recovery in banana sector, robust growth of shrimp and maquilla industries, as well as in construction and tourism, we find these projections somewhat optimistic for the year 2000, as well as for the next years to come. We would suggest a more cautious approach in making projections, especially since the average growth under the favorable conditions of the past five years was around 3 percent; and now when the country has a long recovery process ahead, it is doubtful that the economy will rebound so fast. Staff comments are appreciated.

In regards to the HIPC document, we consider Honduras eligible for assistance under the HIPC Initiative based on the fiscal/openness criteria. Also, we commend the authorities for making considerable efforts in improving debt position through rescheduling with bilateral creditors, clearing its interest arrears, and restricting itself to accumulation of only concessional terms. The adherence to the implementation of strong macroeconomic and structural reforms supported by the ESAF program is also a very important factor. We urge the authorities to continue to preserve a good track record under the ESAF, especially through the implementation of the structural reforms in the energy, water, health, and education sectors. The improvements in social indicators should remain the main priority of the Honduran authorities since the country remains third poorest in the region. We agree that providing interim assistance between the decision and completion points would be essential following the implementation of the necessary reforms. In regards to the key reforms to be monitored under the "Floating Completion Point," we believe that table 6 had adequately reflected the main priorities that need to be considered, and we await a more detailed layout of the reforms in the next HIPC paper. We have one question regarding the assumptions adopted in the document on future projections of external flows. The authorities have expressed their concern about their validity since the year 1998 was an exceptional year of financing. It would be helpful to hear staff comments on this issue.

With this said, we wish the authorities success.

Mr. Alosaimi made the following statement:

At this stage of the discussion, I will be very brief and limit myself to the HIPC document. I support staff's recommendation regarding the eligibility of Honduras for assistance under the enhanced HIPC Initiative. Indeed, this assistance is necessary to help the country address the significant challenges in the aftermath of Hurricane Mitch, especially in financing the social and infrastructure programs. To this end, and in view of Honduras's strong track record of policy implementation and structural reform, I agree with the proposed decision point and also to provide assistance during the interim period.

The staff representative from the Western Hemisphere Department stated that the authorities were under pressure to use the proceeds from the privatization of HONDUTEL for poverty reduction, given the deterioration of social conditions in the wake of Hurricane Mitch. The authorities had recently indicated their intention to include that issue in the consultation process with civil society. It had also been proposed to use the proceeds for debt relief, but those considerations were still at a preliminary stage.

The staff representative from the Policy Development and Review Department noted that the World Bank had proposed to provide interim assistance to Honduras, based on the assumption of a 50 percent baseline debt relief.

Mrs. Del Cid-Bonilla noted that the authorities were aware of the need to deepen structural reforms and maintain macroeconomic stability. The authorities had, for instance, requested a study of the financial sector from the World Bank in order to speed up reform in that particular sector. The authorities also intended to present draft legislation for a revised deposit insurance scheme to Congress before the end of 1999 that would be financed and administered by the banks themselves. New legislation on the regulation of capital markets and insurance was also being prepared.

With respect to the issue of transparency, it was important to note that the rating given to Honduras by Transparency International had been based on information that was not completely up to date, Mrs. Del Cid-Bonilla remarked. The Congress had recently requested that the Controller General, in cooperation with the National Procurement System and the Office of Administrative Property, prepare a comprehensive report on the corruption cases that were currently being investigated, which would subsequently be submitted to Transparency International.

With respect to fiscal policy, the authorities had managed to improve revenues significantly through a strict enforcement of the tax code and through a successful implementation of the customs reform, which included improved import controls and regulation of transit merchandise; the authorities had also strengthened procedures for the auditing of income and estate taxes, Mrs. Del Cid-Bonilla stated.

The authorities had also committed themselves to completing a first draft of the PRSP by May 2000, Mrs. Del Cid-Bonilla concluded.

The Acting Chairman made the following summing up:

> Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for their efforts to preserve economic stability in the difficult period following last year's devastating Hurricane Mitch, noting that under the Poverty Reduction and Growth Facility (PRGF) arrangement, inflation had been reduced; the international reserve position had strengthened; and progress had been made in privatization, public-sector reform, and in tackling the most pressing social needs. However, Directors observed that Honduras still faced significant challenges in the period ahead and stressed the need to further consolidate macroeconomic stability; speed up the implementation of structural policies; and address the social conditions, which had become more difficult following the hurricane.
>
> Directors welcomed the fiscal performance achieved in 1999. They stressed that an adequate level of public savings was an essential counterpart to the significant inflows of external assistance aimed at restoring the country's physical and social infrastructure. In this connection, they urged the authorities to maintain firm control over spending and, in particular, to resist pressures for excessive increases in the wage bill in the period leading up to the presidential primaries to avoid undermining fiscal consolidation over the medium term. Directors also urged the authorities to give a high priority to shifting budgetary allocations toward the social sectors, particularly by reducing those subsidies and transfers not specifically targeted to the poor. They supported the ongoing efforts to strengthen tax administration, broaden the tax base, and set appropriate public sector tariffs.
>
> Directors noted that the government's objectives of promoting a sustained economic recovery and bringing inflation further down would require a combination of sound fiscal policies and judicious use of open-market operations. These policies had helped lower significantly the treasury bill rate, although a few Directors were concerned that persistent high real-interest rates on bank loans could adversely affect a recovery in private investment. Directors noted that timely actions by the authorities to address the problem in a small private bank was instrumental in preventing adverse effects on the rest of the financial system. They stressed that in order to further strengthen confidence in the banking system, the authorities should

give high priority to approving the legislation to establish a credible deposit insurance scheme and enforcing prudential and supervisory regulations. Directors welcomed the authorities' intention to seek technical assistance in these areas.

Directors observed that, based on existing conditions and recent indicators, the current exchange arrangement in Honduras appeared adequate. While the main constraints to an export-led recovery at this time were the damaged road network and other infrastructure, they agreed that it would nevertheless be important to monitor closely developments in competitiveness.

Directors welcomed the recent advances in the government's privatization program, particularly in the telecommunications, infrastructure, and airport sectors. They stressed the need to conclude these initiatives promptly and to move forward with the privatization of electricity distribution. Such actions would permit increased private investment, provide resources to help address poverty and other pressing social needs, and allow the authorities to focus their attention on the reconstruction program.

Regarding other structural reforms, the key priorities for 2000 would be to promptly initiate measures to strengthen the social security scheme, continue to restructure the civil service, and maintain confidence in the banking system by bringing the regulatory framework closer in line with international standards.

Directors welcomed the initial steps made by the authorities to enhance transparency and accountability. They stressed the importance of improving governance, both to sustain the goodwill that Honduras enjoys in the donor community and to help attract higher levels of foreign direct investment. Directors welcomed the authorities' effort to create wider opportunities for consultation with civil society on strategies for reconstruction and for addressing poverty. They stressed that continued close attention to these broad goals would be important, particularly in view of Honduras's eligibility under the HIPC Initiative. Directors looked forward to discussing Honduras's poverty-reduction strategy and encouraged the authorities to complete the work currently being done on poverty assessment.

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

The Executive Board took the following decision:

1. Honduras has consulted with the Fund in accordance with paragraph 2(d) of the three-year arrangement for Honduras under Poverty Reduction and Growth Facility (PRGF) (EBS/99/37, Sup. 1) and paragraph 3

of the letter dated March 10, 1999, from the minister of finance and the president of the central bank.

2. The letter from the minister of finance and the president of the central bank dated November 12, 1999, with its attached memorandum, shall be attached to the three-year PRGF arrangement for Honduras, and the letter dated March 10, 1999, from the minister of finance and the president of the central bank, with its attached memorandum, shall be read as supplemented and modified by the letter dated November 12, 1999, and its attached memorandum.

3. Accordingly, the following new provisions shall be added to the PRGF arrangement for Honduras:

(a) a new paragraph 1(cc) shall be added to read as follows:

"(cc) During the second year of the arrangement, the third disbursement under the arrangement, in an amount equivalent to SDR 16.15 million, will be made available on May 1, 2000, or earlier, upon completion of the second review under the arrangement, at the request of Honduras."

(b) a new paragraph 1(dd) shall be added to read as follows:

"(dd) the phasing of, and the conditions for, further disbursements during the second year of the arrangement will be established in a review to be completed not later than end-April 2000."

(c) a new paragraph 2(aa) shall be added to read as follows:

"(aa) Honduras will not request the disbursement of the third loan referred to in paragraph 1(cc) above, if the Managing Director of the Trustee finds that the data as of end-December 31, 1999, indicate that any of the ceilings and floors referred to in paragraph 2(a)(i) to (v) of this arrangement as specified in Tables 4 to 8 of the memorandum attached to the letter of November 12, 1999, were not observed."

(d) A new paragraph 2(bb) shall be added to read as follows:

"(bb) if Honduras has not carried out by end-December 1999 its intentions with regard to the following structural performance criteria:

(i) the completion by the banking commission of CAMEL-based inspections of 12 banks,

(ii) the issue by the central bank of regulations governing the investment trust (fideicomiso) activities of banks, and

(iii) the submission to congress of legislation setting up a partial deposit insurance scheme and establishing regulations over stock exchange activities, as specified in Table 2 of the memorandum attached to the letter of the minister of finance and the president of the central bank of November 12, 1999."

(e) a new paragraph 2(dd) shall be added to read as follows:

"(dd) The Fund decides that the review contemplated in paragraph...of the letter of the minister of finance and the president of the central bank has been completed."

4. The Fund decides that the review contemplated in paragraph 2(d) of the three-year PRGF arrangement for Honduras has been completed, and that no further understandings are needed for Honduras to request the disbursement of the second loan under it. (EBS/99/208, 11/24/99)

Decision No. 12093-(99/130), adopted
December 8, 1999

3. MANAGING DIRECTOR—ACCEPTANCE OF AWARD

The Executive Board approves the acceptance by the Managing Director of the Order of Merit from the government of Poland.

Adopted December 8, 1999

4. NIGERIA—1999 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report on the 1999 Article IV consultation with Nigeria (SM/99/276, 11/17/99). They also had before them a statistical appendix (SM/99/280, 11/24/99).

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

> This statement summarizes information on macroeconomic and policy developments in Nigeria that became available after the staff report (SM/99/276) was circulated to the Executive Board on November 17, 1999. The thrust of the staff appraisal remains unchanged.
>
> Macroeconomic developments in 1999 and the outlook for 2000 remain broadly as reported in the staff report. Social tensions remain high, and there are no clear signs of a pickup in economic activity. However, the 12-month rate of consumer price inflation remains low—at 2.2 percent in September 1999—and is projected to stay at about this level through end-1999. Nigeria's gross international reserves at end-1999 are projected at US$4.8 billion, as earlier reported. Inflows of foreign exchange from the sale of oil will be higher as a result of the recent rise in world oil prices, but there will be a substantial shortfall in the collection of petroleum profit tax on account of various offsets permitted under the current joint-venture agreement with the oil companies. Moreover, debt service payments in 1999 could exceed the program target of US$1.8 billion, as the authorities have begun to clear as much as possible arrears on post-cutoff-date debt to Paris Club creditors by the end of 1999.
>
> Significant progress has been made towards meeting the undertakings during the period of informal monitoring. Box 4 of the staff report is updated below.

Box. Nigeria: Undertakings During the Period of Informal Monitoring.

Action	Target Date	Status as at Dec. 7, 1999
1. The achievement of central bank financing of 9 billion between June and December 1999 (i.e., net repayment of 9 billion by the government).	End-1999	Net financing of 10 billion now expected.
2. Execution of the monetary program.	End-1999	All targets met at end-October (target for Net International Reserves (NIR) was missed at end-September).
3. A shift to a market-based exchange system.	End-Nov	Done.
4. Debt service payments of US$1.8 billion in 1999.	End-1999	Expected to be met by early December.
5. The announcement of a privatization program.	End-Oct	Done.

6. The adoption of an effective anticorruption bill.		Expected by mid-December.
7. The completion of investigations into financial malfeasance under previous administrations.	End-Dec.	Investigations ongoing.
8. An external audit of the foreign exchange transactions of the central bank, as well as of the financial accounts of the Nigeria National Petroleum Corporation (NNPC).		The audit for 1998 transactions of the CBN has been completed. In addition, the audit for transactions through May 1999 is expected to be completed by end-1999. The audit of the 1997 accounts of NNPC was completed by the auditor; the draft audit for 1998 has been prepared but not yet signed.
9. Full inventory of domestic arrears.	End-Dec.	Outstanding.
10. Initiation of timely publication of key financial statistics of NNPC and the central bank.		Pending the establishment of the format for publication.

As regards the undertaking to complete the investigations into past financial malfeasance by end-1999, the Attorney General has indicated that such investigations are ongoing and, by their nature, completion is not to be expected for some time. He assured the staff that the various investigations are being pursued vigorously, and a progress report will be given to Fund staff by end-March 2000. In the meantime, a special panel appointed by the President has now reviewed about 4,000 contracts awarded during the previous administration and recommended the cancellation of some US$1 billion worth of contracts and the renegotiation of other contracts valued at US$4.6 billion.

The authorities moved to a market-based exchange system on October 25, 1999. Nigeria's multiple-currency practice was subsequently eliminated on October 28, 1999, with the discontinuation of the weekly Autonomous Foreign Exchange Market (AFEM). The only remaining exchange restriction—the foreign exchange embargo on exporters who fail to repatriate export proceeds—was eliminated on December 7, 1999. Accordingly, Nigeria intends to accept the obligations of Article VIII, Sections 2, 3, and 4, at the time of the submission to the Executive Board of its request for a Stand-By Arrangement. The staff is currently reviewing the relevant circulars to confirm that no restrictions remain.

The authorities' draft budget for 2000 was presented to the National Assembly on November 24. The budget proposal is based on an international oil price of US$18 per barrel, with oil production to remain at the current level of 2.13 million barrels per day. The main features of the draft budget are as follows:

The budget envisages an overall deficit equivalent to 2.3 percent of GDP, with a domestic financing requirement equivalent to 0.6 percent of GDP. This compares with a deficit of 10.1 percent of GDP in 1999, with most of the reduction attributable to the increase in revenue.

Outlays targeted at poverty reduction will be increased substantially with domestically financed capital expenditure rising by about 50 billion, or 1 percent of GDP to 4.3 percent of GDP. Moreover, total federal government expenditure is to be reduced by 3.5 percent of GDP, primarily by the elimination of extrabudgetary outlays.

External debt service is set at US$1.5 billion to allow for the substantial increase in poverty reduction expenditure.

A major reduction is to be effected in import duty rates, mostly on raw materials and intermediate inputs.

The domestic petroleum product market will be deregulated and the implicit budget subsidy removed when the budget goes into effect. The Nigerian National Petroleum Corporation will be required to pay export parity price for government crude oil used in local refineries.

The staff's preliminary view is that there may be scope for some savings in the wage bill (an increase of 0.4 percent of GDP to 4.9 percent of GDP has been proposed), outlays for the NNPC priority projects, and other nonpriority expenditures. Therefore the budget deficit should be substantially lower.

Mr. Morais made the following statement:

My Nigerian authorities wish to express their appreciation to staff for their candid report on the country's economic situation and for the broad set of policy recommendations. They found the discussions with management over the last few months quite encouraging and are also very grateful to the Fund for its responsiveness to the country's needs for technical assistance.

As noted in the report, June 1998 was a major turning point for Nigeria. It marked the beginning of a process of political reforms that culminated in the country's return to democratic rule, thus ending an era of military rule characterized by social tensions and political uncertainty. President Olusegun Obasanjo, on assuming office, moved promptly to consolidate the new political order, address key issues of governance and halt the deteriorating economic and financial situation. He has continued to broaden this effort and the government—with the support of the Fund, the World Bank, and other donors—is working to put in place a program of economic reforms aimed at setting the country on a path of high growth and poverty reduction.

Background and Recent Developments

At the outset, let me underline the progress made by Nigeria in recent years in stabilizing the economy. End-period inflation came down from 77 percent in 1994 to 10 percent in 1997 and about 12 percent in 1998. During this period, the exchange rate remained stable, and, reflecting a significant strengthening of the current account, external reserves had increased to fairly comfortable levels. Also, progress was made to introduce greater competition in the economy. Exchange controls on current international transactions were almost fully eliminated, interest rates were deregulated, and restrictions on competition and private-sector participation were removed in most sectors of the economy. In addition, a number of measures were taken to address financial-sector distress, including raising the minimum paid-up capital requirement, liquidating insolvent banks, improving loan recovery, and imposing sanctions for financial malpractice.

However, economic growth continued to be hampered by, among other things, the poor performance of the public utilities—which led to widespread fuel, power, and fertilizer shortages—and by the uncertain political atmosphere. These undermined confidence, deterred productive investment, and slowed the supply response to the reforms implemented. The problem of poor governance and abuses in the management of public resources were recognized by the interim administration, but efforts to address them in the context of the staff-monitored program introduced in January 1999 achieved only modest results. In the event—and against the backdrop of the sharp decline in world oil prices—the macroeconomic situation deteriorated in 1998, and even more so in the five months leading up to the transfer of power to the new government at the end of May 1999.

A lax fiscal stance, reflecting large extrabudgetary expenditures that were accompanied by an accommodative monetary stance—as the Central Bank was compelled to finance the resulting large deficits—created price pressures and pressures on the Naira exchange rate and the country's foreign-exchange reserves. The deficit over the five-month period (January to May) exceeded the target (5.8 percent of GDP) for the year as a whole, and international reserves fell by about US$2 billion to US$5 billion, notwithstanding a 10.5 percent devaluation of the currency and the attempt by the Central Bank to tighten policy by raising interest rates. To reverse the worsening situation, the new government took a number of firm actions to restore fiscal discipline and improve budget implementation. These included a freeze on payments for extrabudgetary outlays, the suspension of all capital spending, and the appointment of a committee to review all contract awards over the five-month period. In addition, the Central Bank adopted strong monetary measures aimed at addressing the large overhang of liquidity in the banking system. These measures proved effective in containing the price pressures and bringing the demand for foreign exchange to a level more consistent with the international reserve target. The revised budget for the period—June to December 1999—introduced by the President and passed by the National Assembly in September, essentially seeks to preserve these gains. In the meantime, some initial steps taken to address the weaknesses of key public utilities have achieved noteworthy results: the protracted shortages of petroleum products have been eliminated, and electric power supply is beginning to show some improvement.

The authorities broadly share the staff's perspective on the country's medium-term prospects. They recognize the difficult challenges that have to be met in diversifying the economy, raising the rate of growth, creating employment, and reducing poverty. They are aware that the external payments position will remain difficult—even given the broadly favorable outlook for oil exports—and that a challenging agenda of reforms lies ahead. It is in this context that they have been discussing with staff a one-year Stand-By Arrangement that they hope the Board could approve early in the new year. This would be an interim step toward the adoption of a medium-term arrangement.

Policy Issues

Over the medium term, my Nigerian authorities are making low inflation, increased growth, and poverty reduction the focus of their strategy. In this regard, staff's suggestions on the priorities for reform are broadly in line with those of the authorities. Indeed, this approach drives the substantial array of measures envisaged in 2000, and my authorities intend to develop these further in the context of a more medium-term reform agenda. They attach importance to sound macroeconomic policies, institution building, and the entrenchment of transparency and accountability in the public sector, and on fostering private-sector-led growth. Against this background, I will comment on some of the specific policies issues raised in the staff report.

Fiscal Policy

The authorities have been firm in implementing the revised budget for the second half of 1999 and expect to achieve their objective of keeping the overall deficit for the six-month period at no more than the target of 1.5 percent of GDP. Expenditures are being watched closely, taking into account actual revenue developments. Accordingly, the central bank's financing of the government has been negative on a net basis since July and well within the target of 0.2 percent of GDP.

The authorities acknowledge that the price at which petroleum is being sold to the Nigerian National Petroleum Company (NNPC) implies a subsidy at the prevailing world oil prices and concur broadly with staff's concerns about its implications for the budget and for resource allocation in general. This issue has, however, remained socially sensitive, and careful handling in the prevailing circumstances is seen as key to ensuring broad support for the changes that are needed to ensure a steady supply of petroleum products. It is in this context that the authorities have proposed full deregulation of the petroleum market and the sale of crude oil to the NNPC for domestic refining at export parity price in the 2000 budget.

As regards domestic debt, the objective in the near term is to keep its level from rising by observing strict limits on fiscal deficits. The issue of arrears is taken seriously by the authorities, as evidenced by the substantial allocation (30 billion) made toward offsetting a portion of such arrears in the revised budget presented to the National Assembly in September. They have proposed an additional allocation (20 billion) for this purpose in the 2000 budget, and as agreed with staff, are working to complete an inventory of all domestic arrears. In addition, an interministerial committee under the chairmanship of the Ministry of Finance has been set up for the purpose. In order to address the problem of domestic arrears at its source, the government has also directed that disciplinary action will, henceforth, by taken against ministries and officers involved in the award of contracts that do not have sufficient funds to back them. This is a particularly important step, as it reflects an early and determined effort to institute and apply administrative sanction to errant public policy behavior.

Furthermore, the authorities have taken a number of steps to improve fiscal transparency as noted in the staff report, and this effort will continue to be given high priority as part of the institution-building process. In this regard, they welcome the suggestions made by staff on ways for further improvements and will continue discussion with them on these ideas over the coming weeks.

Monetary and Exchange Rate Policies

Fiscal restraint by the government in the context of the revised 1999 budget has enabled the central bank to maintain a tight monetary stance, consistent with keeping inflation on a downward course, and meeting the external reserves objective for the year. The Central Bank has also removed the temporary measures adopted to contain the excess liquidity in the banking system. These involved mandatory purchase of Treasury bills by banks. However, as shown in Figure 4, as inflation has come down, real interest rates have climbed sharply, and the authorities are becoming increasingly concerned about the impact these high real rates are having on economic activity. In a cautious effort to address the situation, the central bank, toward the end of November, reduced its minimum rediscount rate by 200 basis points. The bank will be watching the situation closely.

In Appendix VI of the report, the staff present a fair picture of the progress that has been made over the past year to strengthen the banking sector and the financial system more generally. The authorities are close to a full resolution of the problem of distressed banks, with actions being taken on the remaining 16 such banks. Equally important, a number of important measures described in the report have been introduced to strengthen the banks' financial position and the regulatory authorities' capacity to supervise the banking system effectively. The relative adequacy of shareholders' funds to cover classified loans for the system as a whole has strengthened quite considerably since 1995, while the danger posed by distressed banks in terms of their share of loans has diminished considerably. However, the authorities recognize the need to further strengthen supervision and is actively working to that end. Particular attention is being paid to the supervision of the nonbank financial sector, for which a new department has been created in the central bank. The bank, in addition, is considering the possible use of external bodies to carry out on-site and off-site supervision.

Exchange-rate policy has become fully market-based, following the elimination of the official rate (of 22/US dollar) in January. Also, significant further liberation has been implemented including the introduction of a daily interbank market, which has helped to address the segmentation that existed in the foreign-exchange market. They look forward to accepting the obligations of Article VIII over the coming months. While the authorities are committed to a flexible exchange-rate policy consistent with the need to maintain external sector balance and the country's international competitiveness, they believe that the key to strengthening competitiveness essentially lies in addressing structural weaknesses that contribute to the high cost of doing business in Nigeria.

Structural Policy Issues

Staff's views on liberalizing the import tariff regime are in line with the government's own stance. In this regard, tariff reduction across a range of imports is proposed in the 2000 budget. More importantly, a comprehensive review is due next year, and the authorities look forward to further discussion with staff on this issue, with a view to implementing necessary changes due to go into effect in 2001.

On privatization, the authorities note the staff's view on the need to establish a regulatory framework and regulatory body for each of the key sectors, namely, power, telecommunication, and petroleum products. This agrees with the authorities' own views, as the President has made clear in his 2000 budget statement to the National Assembly. The authorities recognize the crucial importance of improvements in these sectors to Nigeria's economic rejuvenation and intend to pursue their interim restructuring and subsequent privatization most expeditiously. They, however, remain open on the specifics of the process in each case, provided care is taken to ensure proper valuation and transparency in all sales in order to maximize the net sale price. The authorities would not exclude possible rehabilitation and injection of new capital at this stage.

The President's commitment to fight corruption and establish good governance more broadly is clearly evident from the initiatives he has taken since coming to office. There is also a clear understanding by the government of the complexity of the task and the need for a multi-faceted approach, involving legislation, judicial reform, and reform of the civil service, to mention the most obvious. Two major initiatives—the Anti-Corruption Bill and efforts to recover stolen public funds—are progressing. The Anti-Corruption Bill is expected to be passed into law before the end of the year, and the President has promised its strict enforcement. However, the government's effort to recover stolen funds being held outside the country, according to the President, are being impeded by complex legal procedures. Recoveries thus far amount to about US$120 million. A number of countries have been most cooperative, and the government wishes to take this opportunity to express its appreciation to them. As regards ongoing investigations, the government is convinced that a cautious approach is necessary for success, preferring to keep such investigations quiet until the full facts are in.

Against the backdrop of the substantial erosion in the standard of and the steep increase in poverty, the government has given top priority to poverty reduction. In November, an interministerial committee concluded a review of the existing antipoverty programs as a first step toward evolving a framework that would be effective in targeting government efforts that hitherto were dispersed in a large number of individual programs. As a follow-up, the President, in his 2000 Budget statement, announced that the Ministry of Finance had been mandated to design a comprehensive medium-term poverty-reduction program which would entail the creation of a fund to support poverty reduction. It is envisaged that the program would, in the context of the Stand-By Arrangement being discussed with staff, elicit financial support for the donor community. The focus of such a program would be on rural electrification, water supply, women and youth development, primary health care, education, and agriculture.

External Financing and Debt

The staff report presents an accurate assessment of the daunting external debt problem of Nigeria. Even ignoring the downsides to the projections—which, in the authorities view, are quite realistic and likely—a Paris Club rescheduling on nonconcessional terms would still present a large financing gap in the medium term and a heavy debt burden over the next several years. Clearly, this makes the task of dealing with the country's pressing problems—reversing the surge in poverty, rebuilding public institutions, and reconstructing major infrastructure vital to the resuscitation of economic activity—more daunting. It is against the backdrop of this desperately difficult situation, which is made even more acute by the huge expectations raised by the successful transition to democracy, that the President has been urging for a substantial amount of debt forgiveness. The country has, meanwhile, continued to do its level best to maintain payments to creditors, despite the pressures presented by these circumstances. The authorities rightly attach high priority to the debt issue, which requires the understanding of its creditors in reaching a solution that would offer the country a real chance to move ahead. For their part, the authorities recognize and are committed to undertaking reforms that will enable the country to grow by 8 to 10 percent and make a meaningful and sustained progress in the fight against poverty.

Statistics

On the issue of statistics, the authorities are grateful to the Fund for the work that has so far been done to develop a program that they expect could lead to an overhaul of the country's statistical system. In the meantime, a number of initiatives are under way to improve the quality and timeliness of monetary and banking, and also balance of payments statistics. In particular, effort has been intensified in the area of computerization aimed at strengthening quality control and speeding up routine data processing. The authorities are looking forward to the next stage in the statistics project, involving broad-based technical assistance to be coordinated by the Fund, and are hopeful that the Fund will continue to provide this much-needed assistance.

Extending his remarks, Mr. Morais noted that this was the first Article IV discussion on Nigeria in 16 years taking place in the context of a civilian government—a government that was seeking a break with the past. The authorities wished to bring to the discussion five key principles marking a new beginning. First, credibility in the overall package of reform measures being pursued by the country. Second, commitment to working closely with the international financial institutions and with all of Nigeria's bilateral partners in development. Third, continuity in those areas of policy that were showing some success. Fourth, a long-term vision for the country rooted in the nation's comparative advantage. Fifth, a strong and vibrant civil society, and a strong and energetic entrepreneurial sector to bolster the crucial regional role of Nigeria. The new administration had achieved some early and favorable results, with the country having made significant progress toward meeting informal monitoring undertakings with the Fund's staff.

Mr. Morais also advised the Board that the authorities had met their target for debt service payments in 1999. He expected that the surveillance discussion would proceed with the following five factors in mind: the enormous challenges the country faced, the diversity of the policy framework that the authorities were seeking to put in place, the need to arrive at a workable balance as regards the competing internal and external demands on the country's resources, the impressive results already achieved since establishment of the democratic government, and the positive signal that could be sent to the government to press ahead with the ambitious reform agenda.

Mr. Yoshimura and Mr. Harada submitted the following statement:

> After a long record of policy reversals, Nigeria has reached an important turning point. I am encouraged by the fact that President Obasanjo, who took office at the end of May 1999, has been promoting a number of strong reforms with substantial ownership. The implementation of these reforms is important not only for the future development of the Nigerian economy and the improvement of living standards but also for the future prosperity of Sub-Saharan Africa.
>
> Still, Nigeria's current economic performance is far from good. Real GDP growth in 1999 is expected to be no more than 0.8 percent and GDP per capita to decrease by 1.9 percent, reflecting the high population growth. Although there has been some improvement in certain areas—for example, the inflation rate has been declining—there are as yet no visible macroeconomic outcomes of these reforms as a whole. Without visible signs of improvement, I am very concerned that the domestic momentum for reform and the credibility of the Nigerian economy with the international community will be lost.
>
> On the whole, my chair is impressed by the authorities' strong resolve to implement reform, and we hope they will continue their efforts and steadily implement further reforms. We support the staff's appraisal, with several additional comments.
>
> First, the Nigerian economy is structurally fragile, depending as it does entirely on the oil sector. This dependence has not only resulted in slow economic development and low living standards, but it has also made it difficult for the people to plan for the future. Also, as the staff pointed out, oil exports, limited by the OPEC quota, are unlikely to keep pace with the high population growth. It is essential to grow nonoil industries in order to reduce economic fluctuations and to realize sustainable economic growth.
>
> In order for the economy to achieve nonoil-sector–led sustainable growth over the long term, the environment for facilitating investment needs to be improved as soon as possible. To this end, various broad-ranged structural problems that have impeded growth should be addressed quickly.

Each time one of these impediments to growth is removed, it will help to sustain the domestic momentum for reform. In addition, restoring credibility with the international community is critical for promoting direct investment. To this end, the authorities should give higher priority to eliminating the external arrears. They also need to improve fiscal transparency and accountability by strengthening policy coordination. I urge them to make further efforts on these fronts.

On the macroeconomic policy side, the authorities' current stance of economic management has been quite prudent. The fiscal deficit has been reduced substantially compared to the huge deficit in the first half of the year, and there is now a small surplus. I am somewhat concerned that next year's budget is projected to have a deficit of 2.2 percent of GDP, and I urge the authorities to make further efforts to prioritize expenditures. We share the staff's concern that petroleum subsidies should be eliminated soon in order to reduce distortion in the petroleum market. We also share their view that the cautious monetary policy and introduction of a market-determined exchange rate are steps in the right direction. I encourage the authorities to make further efforts in these areas.

Unfortunately, the authorities' prudent policies have so far not had beneficial macroeconomic outcomes. The most important task for Nigeria is to rebuild the economic and social system so that the authorities' efforts will result in practical economic outcomes. For example, we are concerned that the financial resources appropriated for social sector investment or high priority infrastructure-building are not being used efficiently to increase social welfare. Without stronger economic and social systems, even though the authorities may be eager to implement reform, it will be difficult for them to achieve a successful outcome.

The indispensable conditions for effective reform are the elimination of corruption and the rebuilding of local institutions to implement social service programs. This will also help boost external credibility. According to the staff report, the authorities took the following steps to combat corruption: the forced retirement of a number of military officers; the investigation of financial malfeasance; the dismissal of 3,000 civil servants, including those at the top levels; and the presentation to the National Assembly of a draft of an Anti-Corruption Bill. We are greatly encouraged by these courageous steps and hope the authorities will continue along this path.

The authorities' efforts to proceed with institution-building are also welcome. Making the civil service more professional and results-oriented, right-sizing the federal civil service, and strengthening economic statistics and other information are steps in the right direction. In particular, I would note the comprehensive IMF and UNDP technical assistance aimed at strengthening Nigeria's economic statistics and other data, and the establishment of a computerized information system, which the Japanese government is strongly supporting through grants and the supplying of experts.

Finally, some comments on Nigeria's external debt. As the staff said, Nigeria has to improve its relations with the Paris Club by establishing a track record of payments. On one hand, the Paris Club has indicated Nigeria's debt should be on nonconcessional terms in the context of a possible SBA; on the other hand, the authorities are requesting debt reduction. Since Nigeria's external debt is so huge and interest payments alone are substantial, this chair realizes the necessity of some debt rescheduling in the future; otherwise, reform cannot be continued, and economic development will not be sustainable. However, Nigeria is at a stage now where the authorities should put their whole effort into establishing a sound track record toward application of an SBA program and into recovering their external credibility, which was badly damaged by the lengthy poor track record. The authorities' request for debt reduction gives external creditors the impression that Nigeria is too quick to depend on external resources and that it might not make prudent use of its resources. This can only hamper the authorities' task of rebuilding external credibility.

With these comments, we strongly hope the authorities will continue to implement the necessary reforms and move toward an SBA program.

Mr. Shaalan and Mr. Bakhache submitted the following statement:

The reform measures implemented on a number of fronts since June 1998 represented a welcome departure from the economic mismanagement of the past years and the consequent severe deterioration in the Nigerian economy. While signs of an economic recovery are yet to emerge, the sharp cuts in spending and the tightening of monetary conditions have led to a sharp deceleration in inflation and have stemmed the precipitous decline in foreign exchange reserves. The government's efforts to restore the rule of law and to rebuild the country's public institutions have hopefully begun to restore public confidence. The steady pursuit of policies that would enhance domestic and international confidence should rank high on the authorities' agenda.

Notwithstanding the progress made to date, Nigeria needs to embark on an ambitious and wide-ranging program of reforms if it is to reverse the economic decline of the past years. For the period immediately ahead, the authorities are expected to implement a number of actions prior to the consideration of a Stand-By Arrangement with the Fund. The establishment of a track record of strong policy performance and the improvement in relations with foreign creditors would demonstrate the authorities' commitment to the new policy direction and pave the way for the implementation of a strong reform program that could be supported by the international community.

We are in broad agreement with the staff appraisal and support the recommended policy priorities, including in particular the need for selectivity and proper sequencing of the reform agenda. In light of the country's weak institutional capacity, such an approach to reform would allow the government to more effectively implement needed reform measures, which would improve the likelihood of program success.

While the medium-term economic prospects of the economy will be affected by developments in the oil sector, we would underscore the staff's point that achieving higher economic growth and reducing poverty in Nigeria hinges more on the government's economic strategy and management geared towards enhancing confidence and expanding market-based activity in the agriculture and manufacturing sectors. We are not in agreement, though, with the staff's characterization, in paragraph 17, that by limiting Nigeria's oil exports, the agreed OPEC oil quota represents a contributing factor to the continuing difficult external payments position. It is well to note in this regard that the production quotas agreed among members of the organization and others are aimed at improving the economic situation of oil-exporting countries and protecting their external and fiscal positions from the record-low real oil prices that characterized most of 1998 and early 1999, and not otherwise.

The immediate priority for the authorities is to establish financial discipline aimed at restoring macro stability and creating a conducive macroeconomic environment for higher private investment. Fiscal prudence is an essential means toward this end, and, like the staff, we believe that a tight fiscal stance for the second half of 1999 and 2000 should be maintained. In this regard, while better revenue performance is expected from higher oil prices, we urge the authorities to exercise restraint on the spending side of the budget and pay close attention to social spending and to clearing arrears to domestic contractors. Furthermore, while we understand the authorities' concern over the social implications of removing the petroleum subsidy, we believe the case made in the staff report for its removal is very compelling. In this regard, we encourage its removal with a view to fully deregulating the petroleum market as soon as possible. Over the medium term, we concur with the general aim and the guiding principle of fiscal policy as described in the staff report. Surpluses generated through improvements in the oil price should be used for debt repayment and to finance an effective poverty-reduction program. Regarding fiscal federalism, we believe that care should taken to ensure that the delegation of activities—especially social spending—to local and state governments should be consistent with their institutional capacity as well as the level and stability of their revenue sources.

Along with the tight fiscal stance, monetary restraint is needed to bring down inflation. The policy actions directed at containing excess liquidity earlier in the year need to be reversed. A credible market-based monetary tightening is certainly superior to these temporary expedients. Further improvement in the management of monetary policy hinges on improving the quality and timeliness of monetary data. In this regard, we are encouraged by the efforts under way to address the data weaknesses. On the exchange-rate system, we welcome the authorities' intention to abolish the Autonomous Foreign Exchange Market in favor of an expanded interbank market that would allow market forces to determine the exchange rate. Furthermore, we encourage the authorities to lift the remaining restrictions on international current transactions.

Given the widespread bottlenecks in the Nigerian economy and the high cost of doing business, the structural reform agenda needs to be deep and broad. In addition to taking competitiveness-enhancing measures and liberalizing international trade, the authorities need to move forward with the privatization program—particularly in the power, telecom, and petroleum products areas. Equally important, as the staff argues, is the need to enhance the regulatory framework for these sectors. Furthermore, a well-functioning and efficient judicial system is essential for enforcing contracts and the rule of law, which is a necessity for fostering the role of the private sector in the economy and improving the investment environment.

With these remarks, we encourage the authorities to implement the prior actions and to spare no effort in advancing what is likely to be a very challenging reform agenda.

Mr. Barro Chambrier made the following statement:

At the outset, we want to thank the staff for its insightful appraisal of the state of the Nigerian economy and the candid description of the constraints that the country has to overcome on its road to economic recovery. As reflected in Mr. Morais's useful preliminary statement, Nigeria is at the crossroads, and the challenges the country faces are economic, as well as political and social. Indeed, Nigeria's recent smooth transition to democracy and the new authorities' determination to improve governance is commendable. The bold and highly publicized steps taken by the civilian administration to fight corruption and restore citizens' confidence are noteworthy. Moreover, we particularly welcome the new government's commitment to liberalizing and opening up the economy, correcting lasting financial imbalances and carrying out structural reforms, especially with regard to the oil sector. Furthermore, as mentioned by the staff, the fiscal outlook hinges upon the evolution of the international oil price; such a heavy dependence on a single product is a factor of vulnerability, and it will be critical to give more attention to the non-oil sector and to increase efforts to diversify the sources of government revenue.

While we broadly adhere to the staff's views, we also want to stress that the new democratic and reformist impetus should not raise unfounded expectations as to the country's economic performance, at least in the short run. It is our view that the election of last May should be the starting point for any new appraisal of Nigeria's economic policy. In that respect, it seems too early to judge the country's achievements, after barely six months. The authorities have to cope with the difficult tasks of meeting opposing and pressing demands. They have to cut a delicate balance between maintaining social peace and political stability on the one hand and implementing economic reforms on the other. Bearing those constraints in mind, we believe that the program of economic and financial reforms should be graduated and paced in such a way that they do not adversely affect reforms in other areas.

On the broad strategy for reform, we share the staff's view that the immediate challenge lies in building institutions; a legal framework for market operations; and capacity for central, state, and local governments to implement policies. We note also that an economic growth rate of 7–8 percent is needed to reduce poverty in a meaningful way, well above the projected 3 to 5 percent in the medium-term outlook. This is not an easy challenge, and we do not see clearly how such a rate can be achieved in the foreseeable future and on a sustainable basis.

With regard to fiscal policy, in the face of mounting social needs, the overall deficit of 8 percent projected for 1999 will not be an easy target to reach. Moreover, subsidies on petroleum consumption are likely to last and burden the budget well beyond 2000. The authorities have indicated clearly their intention to eliminate the subsidy in a gradual way during 2000, and we would also encourage them to deregulate the oil market. Concerning the settlement of domestic arrears by the government in the year 2000, we agree with the staff and the authorities that a comprehensive inventory is an important first step. As regards fiscal transparency, we welcome the staff proposal to strengthen the capacity and independence of the Auditor-General and Accountant-General of the Federation. More generally, we support any initiative aimed at improving treasury and budget management. We view these initiatives as basic preconditions to the strengthening of the budgetary process, and, in that connection, technical assistance from the Fund will be particularly relevant.

The new formula for sharing federation revenues among the three tiers of the government has the potential to improve efficiency. By allocating a bigger share (13 percent instead of the current 4 percent) to natural resource-producing states, the new constitution is framing a new division of labor between central and state governments. We believe that the new formula of fiscal federalism will allow the lower tiers of the government to better cope with basic social needs like health and education. At the same time, we caution about the reliance on local governments to deliver public services; indeed, as the medium-term fiscal outlook shows, the federal government capital expenditure falls from 14 percent of GDP in 1999 to an average 9 percent of GDP for the 2000–05 period, and, in our view, the capacity of lower layers of government to relieve the federal state should be checked. More broadly, we find appropriate the staff's recommendations to target a fiscal surplus when oil prices are above their long-term trend and to allow a deficit only when prices are below that trend.

In the monetary and financial area, we welcome the authorities' plans to end the multiple currency practice and to adopt a market-determined exchange and interest rates, as well as their intention to lift restrictions on international current account transactions. The intention to abolish the AFEM and to allow oil companies to pay taxes and royalties in naira is appropriate and should contribute to the efforts aimed at making the exchange rate market determined. With regard to the banking sector, we concur with the staff that prudential norms should be put into practice and supervision improved. We also agree that the distressed banks should be closed or sold. Furthermore, as pointed out by the staff, a sound financial system will help to restore confidence, mobilize savings, and rationalize the allocation of domestic resources. These are critical objectives and are of fundamental importance to an efficient market system.

On the external front, we note that the high tariffs and import bans give way to smuggling. In that context, we endorse the staff's proposal to remove trade barriers and harmonize tariffs within the ECOWAS. Moreover, with the country's exports overwhelmingly dependent on oil—which accounts for 90 percent of earnings—the need for diversification becomes pressing. As for the country's external indebtedness, with a ratio of outstanding debt and arrears amounting to more than 90 percent of GDP and 280 percent of exports, the burden has become unsustainable. Consequently, we encourage the authorities to initiate a constructive dialogue with creditors—especially those of the Paris Club—in view of a significant debt alleviation.

As for structural reforms, we welcome the authorities' commitment to deregulation and privatization. However, the envisaged 1999–2001 plan to privatize banks, oil firms, holdings in hotels, public industrial companies, power and telecommunications firms, and Nigeria Airways looks rather ambitious. While we commend the authorities for their determination, we would also encourage a properly sequenced privatization program, which will ensure its success. In addition, the traditional dilemma between purely selling distressed public entities or replenishing them before privatizing has to be solved. In any event, the transparency of the privatization process should be guaranteed. Finally, the reform of the civil service towards a better-trained, better-paid, and more result-oriented administration is a good basis for the broader concern of building institutions.

In conclusion, it is our belief that at this critical juncture of its history, Nigeria faces urgent and sometimes conflicting priorities. Indeed, the civilian new administration has to tackle at the same time the challenges of building a nation, a democracy, and a sound economy. In our view, in the case of Nigeria, good governance remains the focal issue. In that context, we believe that expectations about the pace of privatization or the rapid conclusion of the investigation of financial malpractice in the public sector should be realistic. Similarly, we think that the conditions posed by the staff for the contemplated Stand-By Arrangement next January are particularly stringent. The experience that we have gained from other countries in similar situations can prove quite useful here. To enhance Nigeria's success of economic reforms, the support of the international community at this early stage will be critical, and, in this context, we hope that the Board will have the opportunity to consider soon the country's request for a Stand-By-Arrangement. We wish the authorities every success in their challenging endeavors.

Mr. Mori made the following statement:

Nigeria has been experiencing a long period of unsatisfactory macroeconomic performance in terms of growth and inflation, which in turn has held back improvement in social indicators. GDP growth has been slower than population growth. Inflation has remained high, affecting adversely the business environment and taxing the poor. The country has also faced difficulties outside economic management, which have contributed to hampering the macroeconomic performance.

The new government provides Nigeria with its brightest hope in many years of achieving its vast potential. The challenge for the new administration is immense in order to correct the macroeconomic imbalances and economic distortions developed over the years. But we are encouraged by the measures taken by the authorities to correct recent excesses and to seek the establishment of a track record that would allow Nigeria to request a Stand-By Arrangement.

We welcome the new government's resolve and its commitment to ensuring macroeconomic stability. The staff suggests a series of well-focused measures to address the problems. Indeed, macroeconomic stability through fiscal and monetary discipline remains the main objective. But there is also a need to make progress regarding institution-building for economic efficiency and to make the macroeconomic instruments more effective. The authorities are faced with a difficult policy choice, as they need to be appropriately selective and well-sequenced in implementing such a comprehensive agenda in view of the country's limited institutional capacity. The authorities are also faced with the dilemma of having to implement swift and decisive reforms aimed at reducing macroeconomic imbalances while maintaining political stability and avoiding further social unrest.

One key element on the agenda seems to be a well-targeted program to improve the quality of public service by providing appropriate education, health, and essential social services to increase the contingent of qualified human resources and to reduce bottlenecks. In this respect, we support a service-wide reform in the public sector with a strong capacity-building component. We support the view that better remuneration for the civil service is necessary, but wage increases must be accompanied by improvements in the quality of services provided, by close scrutiny of the payroll, and by a major move toward right-sizing the civil service.

Recent favorable prospects for the oil price as well as a good harvest will contribute to the macroeconomic stabilization efforts. Nigeria will continue for some time to rely on oil revenue for its development, as the process of diversification of the economy will take time. Therefore, one cannot downplay the continuing importance of oil revenues in the economic outcome, though we agree with the staff that economic growth and poverty reduction depend as well on the government's economic strategy and management. In this context, it will be essential to maximize the fiscal and foreign exchange gains from oil to attain the medium-term objectives.

In the fiscal area, the budgetary needs and constraints pointed out by the staff in paragraph 30 call for the prudent and well-targeted use of scarce public resources, as well as for additional efforts to seek higher revenues. We share the concerns expressed by the staff on the issue of fiscal federalism. We agree that "the federal government should shift its focus to activities that are truly national in scope, while state and local governments should strengthen the provisions of basic public services." We fully support the recommendation made by the staff on paragraph 39 in this regard.

However, we are concerned by the recommendation made in the appraisal (paragraph 75) that "the federal government's spending on basic social services may have to be increased (until the capacities of the state and local governments are sufficiently enhanced for them to shoulder this responsibility), while other capital outlays will have to be further cut." It is important to avoid revenues being transferred to state and local governments without transferring the corresponding responsibilities. Ideally, the transfer of revenues needs to be simultaneous with the transfer of responsibilities. In the process of establishing fiscal federalism, it is essential to avoid an increase in the consolidated government expenditures.

On the balance of payments, the constraints resulting from the external debt burden should be appropriately addressed to give the necessary relief for the objective of macroeconomic stability. A major concern is that even under favorable conditions, the staff projects a persistent external current account deficit at 8–9 percent of GDP. If not appropriately financed, the objective of much higher growth and lower inflation would be very difficult to achieve.

The staff states that "to achieve a meaningful reduction in poverty, Nigeria needs to achieve economic growth of at least 7–8 percent.' The expansion of small-scale enterprises in both agriculture and manufacturing may allow an effective and rapid creation of new jobs. However, to attain such a rapid pace of growth, it may require initially a considerable increase in imports to modernize the economy and increase its productive capacity. In the short term, it seems unlikely that an increase in imports will be matched by significant improvements in exports despite the authorities' efforts in the trade area. Foreign direct investment could represent an important source of external financing but while privatization may attract foreign resources, to increase considerably its inflows, it seems necessary to achieve further progress in improving the environment for private-sector activity and enhanced investor confidence. Therefore, additional financing by means of transfers, and especially an appropriate debt relief, seem to be necessary in the short run.

On monetary policy, we agree with the staff that a market-based approach is desirable for the efficient functioning of the financial system. But an appropriate and effective prudential framework for the financial system needs to be in place for a healthy market-based system. The staff raises an interesting point that "financial transactions are predominantly in cash." This would imply higher demand for money than otherwise would be in an economy of high inflation, while it would also imply economic inefficiencies. The reliance on such a costly practice may perhaps be reduced once further progress in strengthening the financial system is achieved.

Regarding Box 3, the comparison between Nigeria and Indonesia's economic performance appears to be rather simplistic. Economic policy focused on promoting international competitiveness might have its role in the development process in Indonesia, but many other aspects might have also played a role, such as favorable externalities produced by regional economic developments, or even its initial lower level of the illiteracy rate.

We concur with the emphasis placed by the staff on the importance of the reform and poverty reduction strategy. With a GDP per capita estimated at $271 in 1999 and a population of 120 million people, Nigeria is one of the poorest countries in the world. We look forward to a successful implementation of the prior actions for the consideration of the Stand-By Arrangement, which will provide an appropriate policy framework supported by necessary external financing to promote high and sustainable growth and, therefore, to reduce poverty significantly in Nigeria.

Mr. Ahmed made the following statement:

We thank Mr. Morais for his comprehensive statement and commend the staff for the clear and well-written report. Nigeria's democratic government promises a new beginning. Upon assuming office at end-May 1999, it has moved promptly to avert the risk of macroeconomic instability and establish a system of democratic checks and balances. Yet economic growth and the revival of private-sector confidence remain elusive, and social tensions are high. Given the long history of economic mismanagement, the task faced by the authorities as they attempt to grapple with longstanding problems and turn the economy around is daunting. More importantly, it will take time, perseverance, and unswerving commitment to adjustment and reform before the new-found sense of hope could be translated into tangible gains in the form of social and economic stability and into a visible improvement in the living standards of the Nigerian people.

No matter how difficult the task, it is evident that Nigeria cannot rely on incrementalism. The authorities must commit themselves to decisive, meaningful, and fundamental policy reforms that are comprehensive and well-sequenced but also selective, so as to take account of the country's limited institutional capacity. The broad parameters of the economic restructuring program that the authorities have articulated in their discussions with the staff constitute a formidable agenda. It is anchored on fiscal and monetary prudence; a market-determined exchange rate; a commitment to good governance; and a rebuilding of public institutions; well-targeted social programs; and far-reaching measures to deregulate, privatize, and liberalize the economy so as to foster private sector-led growth.

In the immediate term, it is crucial for Nigeria to establish a solid track record of policy and payments performance so as to set the stage for transition to a one-year Stand-By Arrangement. This will entail a number of prior actions including, inter alia, implementing a satisfactory budget and monetary program, making minimum payments on external debt, and taking a number of steps to address governance issues. We support the thrust of the revised budget for June-December 1999—a stance that is expected to be broadly maintained in 2000—and welcome the close attention given to expenditure control, the issue of arrears, and the steps that are being taken to improve fiscal transparency and treasury and budget management.

A tight fiscal stance is to be supported by a cautious, market-based monetary and exchange-rate system. Mr. Morais notes that the recent fall in inflation means that real interest rates have climbed sharply, and risk has exerted a dampening effect on economic activity. In response to this concern, the CBN has reduced its minimum discount rate by 200 basis points toward end-November 1999. While we support this judicious easing of monetary conditions, it is important to ensure that it does not undermine the authorities' objectives—most importantly, the steady reduction in inflationary pressures. We welcome the authorities' plans to remove the remaining restrictions on international current account transactions and their intention to accept shortly the obligations under Article VIII. On exchange rate policy, it is important to allow market forces to determine the exchange rate so as to reverse the erosion of the competitiveness of the non-oil tradable sector. In this context, we are pleased to note the authorities intention to abolish the AFEM in favor of an expanded interbank foreign exchange market.

Good progress has been made to strengthen the banking sector and the financial system. The authorities have been resolute in addressing the problem of distressed banks, and we encourage them to take further steps to improve bank supervision and reduce the emerging signs of stress in the nonbank sector. The development of a system to provide early warning of bank distress and the establishment of a new department to supervise nonbank financial institutions are important components of the strategy to improve the overall soundness of the financial system.

The authorities' agenda of structural policy reforms is wide-ranging and ambitious. It will be, however, an enormous task that strains implementation capacity, notwithstanding the substantial technical assistance offered. We welcome the top priority assigned to alleviating poverty and the various initiatives that the President has taken recently. The close association of the World Bank with other development partners will be crucial to sustaining this effort. We also strongly endorse the government's firm commitment to deregulation and privatization and to establishing a transparent and fair regulatory framework, as well as the intention to vigorously pursue policies to combat corruption, rebuild institutions, and ensure good governance. It is our hope that specific action plans in these important areas of reform will be designed in consultation with major stakeholders, including, importantly, the poor and disadvantaged.

We agree with Mr. Morais and his authorities that Nigeria's external situation is desperately difficult and needs to be addressed in a decisive and lasting manner through meaningful debt relief. The willingness of the Paris Club to consider only nonconcessional rescheduling of Nigeria's debt in the context of a possible Stand-By Arrangement would still leave large financing gaps and a heavy debt burden, making the task of restoring stability and achieving prosperity in Nigeria an almost impossible one. We join the staff in stressing the critical need for the authorities to improve their relations with the Paris Club by building a solid track record of payments and policy performance. This seems to be an essential prerequisite to establishing the basis for more substantial support from the international community, including the Paris Club.

Mr. Milleron made the following statement:

I would like to commend Staff for their excellent report, which not only describes the recent past as well as the ongoing positive change in Nigeria but, as importantly, well explains the many challenges ahead.

Turning first to the recent past, unsatisfactory performance under the staff-monitored program (SMP) has shown in many areas how difficult it has been to translate intentions into implementations—here, I am notably referring to the persistence of large extrabudgetary expenditures and to the existence of a "petroleum subsidy" in the revised budget.

However, even if their outcome remains to be confirmed, recent efforts made by the authorities in the budgetary and monetary area are encouraging.

Therefore, I am in broad agreement with policies and reforms recommended by staff. I support the seven key elements mentioned in the staff appraisal: fiscal prudence, cautious monetary policy and market-based exchange rate, good governance, rebuilding of public institutions, social programs, deregulation and privatization, trade liberalization. All those key points, as well as their timing and their sequencing, make sense, especially within the framework of a potential Stand-By Arrangement.

Turning now to the prospects of such a potential Stand-By Arrangement, let me strongly insist on the prior actions required by staff: in particular, I strongly support staff's insistence on the need for Nigeria to improve its relations with the Paris Club by establishing a satisfactory track record of payments. Paris Club Creditors have already indicated several times that substantial payments should be made before any financing is agreed by IFIs.

In that regard, let me emphasize that France's favorable position in principle for a potential Stand-By Agreement remains subordinated to a track record of policy performance as well as to substantial payments made to the Paris Club Creditors, before year-end.

Turning now to longer term prospects for Nigeria, I would like to emphasize that medium-term prospects for Nigeria's external payments position, economic growth, and poverty reduction will depend strongly on the government's economic strategy and management—even if a favorable international environment for oil sector activities may also be helpful.

At this stage, it is premature to conclude that, even after a nonconcessional Paris Club rescheduling, a "large" financing gap would persist over the medium term and that the debt would remain "heavy." In fact, I would like to emphasize that the current development level in Nigeria is less a consequence of the debt level in itself than of poor past economic and social policies.

Therefore, in my view, strong economic growth coupled with a resumption of external assistance and improved resource management (including, for instance, the renegotiations of agreements with oil companies) could significantly reduce external financing requirements.

With these comments, I strongly wish the authorities every success in continuing the necessary steps in order to move toward a Stand-By Arrangement.

Mr. Wijnholds made the following statement:

Since May 1999, with the coming to power of the new government, Nigeria's economy is starting to show glimmers of promise after decades of stagnation. Indeed, after unsustainably expansionary fiscal and monetary policies and the dismal performance under the SMP in the first half of the year, control over macroeconomic policy seems to have been regained. At the same time, important initiatives have been taken to address Nigeria's endemic corruption (summed up in paragraph 11), a conditio sine qua non for any further economic progress.

However, while some important first steps have been taken, I am not yet, at this stage, in a position to grant my approval to an SBA for Nigeria.

The overriding reason for my reservation is Nigeria's treatment of its Paris Club creditors, with which, so far, it cannot be said to have acted in good faith. Ninety percent of Nigeria's debt to the Paris Club is in arrears ($18.4 billion out of $20.4 billion) and, in particular, Nigeria has consistently neglected to make payments on pre-cutoff-date debt (i.e., the bulk of the debt owed to the Paris Club that has already been restructured). The Netherlands has not received any payment from Nigeria since 1991, despite repeated bilateral prodding. Moreover, staff has consistently stressed to Nigeria the need to improve its relations with the Paris Club and establish a track record of payments performance but to no avail. Nigeria's failure to do so has led to unequal treatment of official creditors, but more importantly perhaps, to de facto preferred-creditor status of the private sector, to which Nigeria has remained current on its obligations.

Unless significant payments are received on pre-cutoff-date debt, it is highly unlikely that a Paris Club rescheduling will materialize. At the most recent Paris Club meeting on November 16, there was near consensus that the $1.8 billion in payments envisaged for 1999 were grossly insufficient, especially as only $30 million had been set aside, for the first time, for precutoff-date debt. My understanding is that for the year 2000, the budget allocation for total debt-service payments will be even lower, at roughly \$1.5 billion. This is unacceptable, not least because it would seem to be based on a "no adjustment scenario." It is the view of the Netherlands that these debt payments will at least have to be doubled, with significant debt payments (say, \$1 billion) made on pre-cutoff-date debt, in order for it to be able to support a new Paris Club rescheduling.

It would also seem that staff deems such an amount feasible, given that the staff report still mentions an earlier figure of \$3.4 billion for actual debt payments in 2000. Indeed, given the level of current oil prices, efforts to tackle corruption and push back wasteful investments, and efforts to embark on more comprehensive reform, even \$3 billion does not seem very ambitious. Effectively, given that the tables in the paper are all based on the no-adjustment scenario, it is impossible to assess Nigeria's medium-term balance of payments outlook and debt-service capacity (therefore, their tables should not be used as a basis for negotiations with the Paris Club). Interestingly, such a table is included for fiscal adjustment where under a "no-adjustment scenario" the expenditure to GDP ratio falls only from 40.9 percent in 1999 to 39 percent of GDP in 2005. Under the "adjustment scenario," however, the ratio falls to 32.7 percent GDP. It should be noted that this is still substantially above the average on the African continent, which I suspect is closer to 20 percent GDP, but it is an indication of the resources that could be freed up.

Were a similar adjustment effort to be made in the trade sector, Nigeria's external financing outlook would look much less bleak. Again, in the "no-adjustment scenario," nonoil exports are only expected to rise by 1 percentage point between 1999 and 2005 (from 2 to 3 percent of nonoil GDP), while the share of total exports to GDP is even projected to decline (33.7 percent to 32.9 percent). Taking the report's comparison with Indonesia as a yardstick, however, one gets an idea of the promise that Nigeria's nonoil sector potentially has: Indonesia's share of fuel in total merchandise exports fell from 72 percent in 1980 to 25 percent in 1997, while manufactures, for instance, rose from 2 percent in 1980 to 42 percent of total in 1997. All of this points to the importance of rapid deregulation, liberalization (not least of the exchange rate), and reform—along the lines outlined in the staff report.

Finally, a few words on governance and corruption, which the report rightly states as being perhaps the single most important barrier to Nigeria's economic development. Nigeria still ranks second to last (98 out of 99 countries ranked) on the international corruption perception index of Transparency International. Staff is correct in strongly supporting the downsizing of government, judicial reform, and trade liberalization. I have just a few observations.

First, the current high tariffs do not yield the envisaged revenues, nor do they protect industries, due to widespread tax and tariff evasion. A lower tariff and more uniform rates would likely be far more effective on both fronts.

Second, the petroleum subsidy (3.7 percent GDP in 2000) constitutes a massive transfer abroad due to smuggling (petrol is $10 per barrel lower than in neighboring countries; indeed a gallon is almost half price of what it is in the United States, where few taxes are charged). Given that petrol is a bulk product that is not easy to smuggle, this would also seem to point to an inefficient or corrupt customs police/border service. In any event, the latter problem could be circumvented by a rapid phasing out of the subsidy, as staff proposes.

Third, I agree with staff that wages may have to be raised to provide a disincentive for corruption. I would note, however, that the current real "living wages" are likely to be substantially higher due to below-the-counter corruption payments. This raises a timing issue, as one set of payments will have to be raised while the other set will have to be lowered. Put differently, increasing the carrot without strengthening the stick could prove costly to the government. Plans to increase the judiciary and the police force (which will have to be trained) will take time. What will take even more time is bringing about a change in mentality in the country. This will require careful budgeting.

Fourth, I note that only one third of the $2.3 billion withdrawn from the central bank under the Abacha regime was recovered. In other words, roughly $1.5 billion is still missing. Something similar happened in Kenya where, in the Goldenberg case, $100 million was defrauded from the central bank. In Kenya, the slow settlement of this issue was largely responsible for a substantial delay in the Fund program, also because in the Fund's view the central bank's integrity was at stake. A question could be raised to what extent we are measuring with two standards if we are more indulgent in the case of Nigeria (where the amount stolen was much larger and remains unrecovered). My understanding is that those responsible are being prosecuted and that Nigeria is making aggressive efforts to regain the money. This is welcome. However, can staff provide more light and assurances on the institutional safeguards against future "withdrawals?" Safeguarding the Fund's resources and protecting the integrity and credibility of the central bank will be key if we are to move ahead with a Fund program.

Mr. Kelkar made the following statement:

We commend the Nigerian authorities for their efforts in strengthening the institutional framework, improving macroeconomic management, and continuing structural reforms in a very difficult domestic situation. The authorities have correctly given the priority to restore social and economic stability. The economy responded favorably to some extent by decelerating inflation and halting the fall in international reserves. However, signs of economic recovery are yet to be seen, and social tensions remain high.

We are in broad agreement with the staff appraisal and policy recommendations. Nigeria has a long way to go, as many challenges remain to be addressed, such as low growth, high income inequality, low social indicators, high external debt, and vulnerability of the economy to external shocks. Therefore, Nigeria needs a comprehensive economic strategy consisting of a decisive and fundamental reform program in order to achieve broad-based economic growth and to enhance delivery of basic social services essential for improving living standards. In this context, it is encouraging that the authorities have reaffirmed their commitments to market-oriented economic management, privatization, and good governance. They have correctly accorded priority to restoring financial discipline and macroeconomic stability.

On the fiscal front, in the short run it is crucial to contain the deficit by rationalizing expenditure and enhancing revenue efforts in order to strengthen the macroeconomic stability and to prevent further expansion of the already high public debt. As capital expenditure is planned to be brought down sharply, further expenditure rationalization needs to be based more on reduction in recurrent expenditure. In the medium term, the fiscal strategy should aim for an overall balance and, if possible, to generate surplus based on oil prices in order to reduce the high public debt. One of the major challenges on the fiscal front is to develop sound fiscal federalism compatible with the overall macroeconomic framework and the ongoing developments in the political decentralization process. In this context, it is crucial to delegate more responsibilities to state and local governments with increasing their shares in government revenue allocations. However, it is essential to improve the required administrative capacity of state and local governments to undertake such additional responsibilities. Furthermore, encouraging and facilitating private-sector participation in infrastructure development is necessary to improve the infrastructure facilities and to reduce the fiscal burden.

The authorities' determination to pursue cautious market-based monetary policy strategy while moving toward a more market-oriented exchange-rate system is welcome. As the authorities are moving toward a flexible exchange-rate system, it is crucial that the monetary policy should be primarily targeted to achieve the inflationary objective. Present heavy dependency on cash transactions and the existing high intermediation costs in the financial system reflect the necessity of financial deepening in the economy. Further strengthening of financial sector regulatory and supervisory activities are not only crucial to strengthen the financial system but also useful to improve the effectiveness of monetary policy.

We welcome the recent improvements in market orientation in the exchange-rate policy and further liberalization of external-sector activities. It is encouraging that the authorities look forward to accept the obligation of Article VIII over the coming months and to review the tariff structure in the year 2000. We are hopeful that these encouraging developments will improve efficiency in the economy and domestic and foreign investors' confidence. However, Nigeria's external position remains weak and fragile due to the heavy external debt burden and high dependency on oil exports. Therefore, we underscore the necessity of export diversification and improvement in relations with external creditors in order to strengthen the external sector. It seems that the existing oil and gas agreements with investors are less favorable to Nigeria. We are of the view that the review of these agreements should be undertaken as soon as possible, so as to ensure the availability of due benefits to the country will have a positive impact on the external balance as well as on fiscal deficit. It may even improve national savings, which is very low compared with the investment requirements of the country.

We support the staff view of the necessity of a comprehensive well-sequenced reform program to improve a conducive investment environment and to enhance economic growth prospects. We can also see the merits of their arguments for an optimistic comprehensive privatization program. However, we are concerned about the existing institutional capacity limitations and the absorption capacity limitations in the domestic markets to undertake an optimistic privatization program, particularly within a short period. Similarly, we underscore the necessity of building up the required regulatory system before or simultaneously with privatization of utilities such as telecommunication and power. Therefore, we encourage the authorities to take the advantage of available technical assistance from international institutions and donors to strengthen the regulatory framework and improve the institutional capacity required to implement envisaged reforms more effectively.

We welcome the authorities' desire to request for a one-year Stand-By Arrangement (SBA) as an intermediate step in moving towards a medium-term program. However, given the less-satisfactory performance under the SMP, it is crucial to improve the policy implementation and track record to facilitate the arrangement of an SBA and to improve the relationship with external creditors.

With these remarks, we encourage the authorities to implement the prior actions required for an SBA and wish the authorities every success in facing their challenging endeavors.

Extending his remarks, Mr. Kelkar wished to comment on the recommendation made in paragraph 75 of the staff report—which he had endorsed in his preliminary statement—that the terms of the contracts of oil and gas companies should be reviewed. Only future contracts should be reviewed in order not to deter new investors at a time when the legal system was being restructured.

Ms. Lissakers made the following statement:

> In many respects, this discussion marks a sharp departure from previous reviews of Nigeria's economy, and we come to it with quite a different set of assumptions and expectations than was in evidence during our discussion last year.
>
> The election of President Obasanjo and his government's energetic efforts to move the country in a new direction provide a new sense of hope and promise for a genuine break with the damaging economic policies of previous regimes.
>
> If this early promise is realized, we can all look forward to movement toward the policies necessary to secure a more prosperous future for all Nigerians.
>
> At the same time, our hope for better things to come is tempered by the enormity of the tasks ahead, which are well detailed in the documents provided by staff. The staff paper also provides a vision and a framework for advancing quickly on the most critical fronts necessary to achieve macro stability, faster growth, improved living standards, and normalization of relations with foreign creditors and investors.
>
> Rather than reiterate all the elements enumerated in the paper, I will confine my remarks to a few areas which we consider key to establishing the credibility of the reform effort in the eyes of Nigerians and of the world.
>
> At the outset, we want to commend the authorities for their determined first steps to improve governance in Nigeria. The fight against corruption is likely to be long and difficult, but without it, even the best-designed reform program for Nigeria has no hope of success.
>
> Actions taken so far are quite impressive, and we appreciate the complexity and political sensitivity of undertaking this campaign, but clearly much more needs to be done to break away from the legacy of the past few decades. We urge the authorities to persevere in this key area.
>
> It is clear that Nigeria's greatest concern right now is to free up financial resources for its government to implement the necessary reforms and development projects to restore economic prosperity.

We agree with the staff's analysis that a substantial financing gap will remain, even with a Paris Club rescheduling. For that reason, we have informed the Paris Club that we are prepared to grant a more generous rescheduling to Nigeria in the context of a sound economic reform program.

We also agree with the staff's emphasis on the need for Nigeria to improve its relations with the Paris Club by establishing a track record of payments and policy performance. In this regard, it is noteworthy that Nigeria now looks set to repay more than the $1.8 billion envisaged for 1999, as reported in the staff's statement.

Even so, concerns about intercreditor equity remain, and we would urge greater dialogue between Nigeria and its creditors to work toward addressing these concerns.

Going forward, we would like to encourage the staff to develop an external financing plan that addresses not only Nigeria's immediate financing gap but its medium-term viability as well.

This financing plan should include consideration of the role Nigeria's private creditors could play in addressing its financing gap, including an assessment of Nigeria's ability to obtain spontaneous market access on sustainable terms.

In looking at the steps proposed for dealing with the current fiscal situation, the central challenge facing the authorities is to undertake the sharp adjustment and rationalization of fiscal operations necessary to rein in past excesses and reduce domestic debt, while at the same time improve targeted provision of social services to make the benefits of reform quickly palpable to the population.

On the revenue side, we noted the authorities' willingness to move to a new formula for sharing federal revenue among the three tiers of government to take effect in 2000, as well as staff's efforts to think creatively about how to devolve responsibility for providing key social services to the relevant subnational and local government entities.

In particular, increasing the share of natural resource-based revenues going to the producing states, such as those of the Niger Delta, is a step toward alleviating social unrest in these regions. We urge the authorities to increase its efforts to accelerate an inclusive, community-based approach to economic development in the Niger Delta.

On the expenditure side, oil price subsidies are a pivotal consideration. We share staff's concerns over their continuation, and welcome the authorities' plan to eliminate the subsidy over a 12-month period beginning in January 2000.

We fully support the staff's view that these resources could be better used for improving the social sector in ways that more effectively target the poor and support the authorities' priority goal of alleviating poverty. Moreover, taking this step would help to eliminate domestic shortages of petroleum associated with supply pressures in the export market.

We appreciate the sensitivity of this measure but urge the Nigerians to move as quickly as possible on this vital aspect of fiscal sustainability without inciting widespread public unrest.

Clearly, domestic debt is an acute problem, and we note the authorities' efforts to pay down its arrears on National Priority Projects. However, we would like to better understand why Ajaokuta steel complex, which is a financial drain on the government, should receive additional funds.

In this context, we would also like to understand why this firm was not included in the government's comprehensive, three-phase privatization program that was recently announced.

We applaud the high level of engagement by both staff and the authorities on improving fiscal transparency, establishing a timeframe to complete the audit of public accounts, and recommending the inclusion of extrabudgetary expenditures and special funds in the budget.

In particular, we appreciate the authorities' efforts to subject defense spending to the same accountability standards as other ministries, including scrutiny by the Auditor General.

That said, receipts and expenditures that fund military activities are scattered throughout a number of entities—some on-budget, some extrabudgetary, and some commercial. The authorities would be well served by consolidating the various sources on-budget and ensuring they are audited by the Auditor General.

While considerable progress has been made in this regard, work remains on ensuring that audits of all sources are conducted. Further progress by the authorities on these fronts is critical to our ability to support the SBA now under preparation.

The authorities should move quickly to establish the credibility of their monetary stance as well as their commitment to move to a market-based monetary policy, including market-determined exchange and interest rates.

Removal of restrictions on current account transactions and multiple currency practices was viewed as an immediate priority at the time of our last Article IV discussion, and we welcome the authorities' implementation of the steps recommended by staff to facilitate the market-based determination of the exchange rate and allocation of foreign exchange.

We fully support the ambitious agenda for privatization that the authorities have spelled out. This aspect of the undertakings discussed today, combined with initial efforts on governance, provide us with the clearest signal yet that Nigeria is moving in a direction that will materially improve the transparency, efficiency, and effectiveness of resource allocation throughout the economy.

On questions related to the trade regime, we agree with the staff that current policies neither protect the domestic market, nor do they generate much-needed customs revenues in spite of high tariff rates given the extent of evasion observed. Rather, the current regime merely ripens the environment for corruption and smuggling.

The gradual introduction of a reduced and, more importantly, simplified rate system will help alleviate such problems—particularly if this coincides with a crackdown on exemptions and other loopholes in the system.

Mr. Kiekens made the following statement:

This will be another disappointing year for the Nigerian economy, marked by stagnation of real GDP and a current account deficit that is deteriorating in spite of a substantial rise in oil prices. But the strong improvement in the public finances since last May, when the newly elected president began his relentless war against corruption at the highest levels of the government and the army, give reason to hope that there has been a decisive change for the better in the management of Nigeria's economy.

Of course, a great deal more remains to be done to strengthen the effectiveness of economic, financial, and social policies.

Reducing the budget deficit is especially urgent. The budget for 2000, just presented to Parliament, assumes a sizable deficit reduction from nearly 10 percent of GDP in 1999 to 2.2 percent of GDP in 2000, but this is still not as much as the staff thinks necessary to restore macroeconomic stability. There is also much room for improving the transparency of the budget and the quality of public expenditures. Military outlays were mostly financed off budget in 1999 and were twice as high as two years earlier (see Table 9). Another dubious expenditure is the large petroleum subsidy, worth 3.7 percent of GDP. It should be phased out no later than the end of 2000, since it diverts scarce public resources to the well-to-do at a time when the poor have no access to such essential public services as health care and education.

The authorities' plans to reinforce financial discipline with market-based monetary and exchange-rate policy is also welcome. The last restrictions on international current account transactions should be lifted: Nigeria's acceptance of Article VIII obligations will send a strong signal about the authorities' acceptance of market-based policies.

Nigeria's balance of payment needs strengthening. One obvious way of doing this is to develop the economy's nonoil sector, which is still minuscule as a result of the high tariff rates and certain import bans that have fostered corruption instead of promoting domestic development. These high tariffs should be reduced at once to match the levels found in other members of the Community of West African States. Establishing an effective judicial system and an honest, professional civil service will also give a boost to the nonoil economy. None of these remedies strengthen the balance of payments overnight.

A second way of strengthening the balance of payments would be to increase, if possible, the share of petroleum revenues that stays in the Nigerian economy. How does the share of petroleum money remaining in Nigeria compare to the share retained by other petroleum exporters? This crucial bit of information I could not find in the report. I hope the next paper submitted to us will fully answer this question. It may well be corrupt officials have locked Nigeria into oil company contracts that are much less advantageous than those negotiated by other oil-exporting countries. If so, the issue should also be addressed under any program aimed at improving Nigeria's balance-of-payments outlook.

A third way of strengthening Nigeria's external sustainability would be to obtain a new debt rescheduling from its external creditors. This issue is very delicate because Nigeria has such a poor track record of payment to its principal creditors, namely the Paris Club. In view of this very poor performance, the payments that the staff assumes Nigeria will make to its Paris Club creditors in the near future (Table 12) could not possibly suffice to obtain an agreement on further debt rescheduling. Belgium would expect payments of $2 billion to $3.6 billion to Paris Club creditors—rather than the $644 million assumed by the staff—before a new Paris Club debt rescheduling could be considered. My Belgian authorities also think the staff paper underestimates the total amount of debt owed to the Paris Club because it neglects the penalties for late payment of interest. Including these penalty interest charges increases the debt owed to Belgium, for example, by 16 percent.

It also goes without saying that the medium-term balance-of-payments projections presented by the staff paper cannot serve as a basis for debt-rescheduling negotiations with the Paris Club, since they assume the absence of any market-oriented reforms and oil prices substantially lower than those currently observed.

To sum up, the authorities should further strengthen their financial policies and their fight against endemic corruption. Concrete results achieved in these areas and payments to Paris Club creditors that are commensurate with Nigeria's huge debt to them will open the door to substantial financial support by the international community—a support to which all with a stake in the Nigerian economy, not excluding the oil companies, should contribute.

Mr. Chairman, Mr. Morais expected positive signals from this Board meeting, and I am willing to contribute to that. The Fund must play a central and catalytic role in helping the Nigerian authorities succeed with their difficult challenges. I am very eager to see the government able and determined to execute the difficult but necessary policies outlined by the staff. If Nigeria is thus willing and able, it should be supported by a Stand-By Arrangement that can be followed, if it succeeds, by further concessional financing from the Fund.

Mr. Pickford made the following statement:

Let me thank the staff at the outset for the comprehensive analysis contained in the papers, not least in view of the difficulties they faced in collecting an exact picture of the situation at this time and against challenging deadlines. I would also like to welcome the fact that the Fund has now appointed a senior Resident Representative, Mr. Chris Brown.

We can generally support the staff's analysis and recommendations. Specifically, we endorse the view that reform in Nigeria will need to be based on a strong fiscal position to support a monetary policy aimed at maintaining low inflation and that will make room for higher private investment. We also support the staff's call for trade liberalization. These actions and others will assist in creating the right environment for economic growth, which is so vital for poverty reduction.

Reading the preliminary statements that were distributed yesterday, I think it is clear that we all share the same hopes and objectives for Nigeria, namely, that it will use this exceptional window of opportunity to introduce the reforms it needs to generate growth, to reverse the increase in poverty which it has experienced over a long run of years, and to produce a sustainable debt position. The main disagreement I detect is the speed with which that can happen, but I think we all agree on the need for policy reforms that can—and in my view should—lead initially to an SBA, followed by an extended arrangement and lower debt.

But as speakers have said and Mr. Morais has stressed, Nigeria has a big task ahead. Performance under the program has been unsatisfactory, and many of the prior actions remain unmet. This situation does further damage to Nigerian credibility and adds to the difficulties facing the authorities now. Nevertheless, I believe this is an opportunity to look forward.

The United Kingdom has been actively supporting Nigeria's new government, and much of our bilateral assistance ties in with many of the aims and needs identified in the staff report. The staff report notes that well-run social programs will require considerable institution building, particularly at state and local levels. We agree with this analysis, and the United Kingdom, through its aid budget, has been looking at ways to support state and local governments in order to improve their capacity, efficiency, and accountability.

We have also taken an active lead in working with the new Nigerian government, for example, through a number of technical assistance programs that are already up and running. The Treasury has sent a team to share privatization experiences with the Nigerian authorities and will be sending a debt team as well. Many of the bilateral projects focus on weaknesses, such as data collection, identified in the report.

There is clear agreement on the need now for a strong and effective program of economic reform. This is essential to lift the economy, to begin to eradicate poverty, and to provide the track record that could over time build support in the international community for debt relief. Now is a chance for Nigeria to prove its credibility and to press ahead with reform. We urge early completion of all of the prior actions, to be followed by a demanding but deliverable SBA-supported program with strong up-front performance criteria, so that Nigeria can quickly demonstrate commitment to reform through tangible actions.

The 2000 budget is clearly a key factor in setting the future course. Ms. Lissakers rightly stressed the need for improvements, including phasing out the petroleum subsidy. The budget itself is now passing through the national assembly and may be substantially revised. In that context, I note with some concern that the latest reports on the 2000 budget suggest the possibility of a loosening of the fiscal stance. I would welcome the staff's views on those reports and the impact this might have on the authorities' ability to deliver macroeconomic stability. More generally, I would welcome the staff's views on the risks the parliamentary process might present to the completion of prior actions.

One specific area where up-front performance criteria for a possible SBA may be applicable is reform of the oil and gas sectors. Nigeria currently loses tax receipts due to the system of generous concessions. That is something worth looking at.

Nigeria's debt is considerable. It is important that the authorities understand that the SBA and any subsequent Paris Club rescheduling will provide the basis for the longer-term consideration of Nigeria's debt burden. Track records built now will reap dividends in the future, but, in our view, debt relief will be useless without strong economic reform. My authorities have long made it clear that—provided the Nigerian government could build up a satisfactory record and demonstrate that it was devoting efforts to institutional reform and above all to poverty reduction—we would take a generous and understanding approach toward Nigeria at the Paris Club rescheduling, and I welcome Ms. Lissakers' statement in that regard. But, track record is essential.

Part of that track record is the payments record. My authorities have not received payments from Nigeria for some time either, but I believe we have to press ahead and allow space for that track record to develop. I am not sure that it is particularly useful at this stage to set hard payments targets. I think we will all have to be flexible as the circumstances unfold, not least while prices turn out to be higher than the $18 per barrel assumed in the staff report.

Nigeria has private-sector creditors as well as official bilateral ones, and I would ask one question of Mr. Morais and one of the staff. I wonder what consideration has been given by the Nigerian authorities to burden-sharing between respective creditors, and I would also ask the staff for their views on this and possible wider implications for policy and private sector involvement.

My authorities believe that Nigeria now faces a window of opportunity to implement the reforms needed to produce a growing and vital economy, capable of lifting its own population out of poverty and assisting much of the region in reaching its economic potential. Nigeria, in our view, must deliver that performance and record. If it does, we believe the international community must stand ready to provide generous and timely assistance. We wish the authorities every success.

Mr. Faini made the following statement:

Let me commend the staff for writing not only a comprehensive but also an informative report.

Since 1995, growth in GDP per capita in Africa has averaged 1.4 percent, reversing a negative trend that dashed Africa's hopes for more than 15 years. Nigeria, however, has not benefited from the economic recovery. GDP per capita has continued its long downturn. The short run reveals a glimmer of light, though.

We agree with the staff and Mr. Morais that the new administration has drawn attention by implementing some new policies and established renewed hope in Nigeria. Nigeria is, therefore, presented with an historical opportunity to take full advantage of its great human and natural resources. Those opportunities should not be wasted.

Let me focus my comment on one challenge for the Nigerian economy, namely the dependence on a single commodity. We know today that oil represents 93 percent of exports and 27 percent of GDP. Oil revenue similarly accounts for a large part of fiscal revenue. Changes in oil prices, therefore, reverberate throughout the economy, yet, and here is where the challenge lies, oil is unlikely to be the main growth factor.

First, oil prices are unlikely to rise further. Second, oil production cannot be increased substantially except for the unlikely case of a significant change in Nigeria's quota. However, as Mr. Shaalan reminded us, if the quotas of oil-producing countries increase, this immediately has a negative effect on prices. Growth, therefore, will not come from the oil sector but from output and export diversification, and two questions arise in this regard. Is diversification a realistic objective? And how can this objective be achieved?

Mr. Wijnholds is right in applauding Indonesia. Let me stress that a country can successfully diversify—provided it follows sound policies. Consider fiscal policy. First, following an increase in oil prices, governments are typically tempted to spend rather than save the windfall benefits. The increase in both private and public spending boosts the service sector, the nontraded goods sector, and crowds out the nonoil exportable sector—working therefore at cross purposes of the objective of export diversification. Fiscal prudence, therefore, is essential—not only, as the staff rightly says, based on the rule that a budgetary surplus should be targeted when oil prices are above the long-term trend—but fiscal prudence is essential to achieve the objective of economic diversification.

Second, it does make sense to increase social spending and allow an increase in the wages of underpaid civil servants, but this measure must be compensated for by spending cuts on other fronts. Many speakers have mentioned the petroleum subsidy. This represents a regressive subsidy, and a subsidy, paradoxically, to foreign consumers, as Mr. Wijnholds told us. Its abolition could make available resources much needed elsewhere in the economy.

Clearly, however, to achieve the objective of economic diversification, macroeconomic policies must be supplemented by an effort at far-reaching structural reform. If I were asked to single out one reform, I would certainly put trade liberalization at the top of the agenda. Nigeria holds the dubious privilege of imposing one of the most restrictive trade regimes, perhaps the most restrictive one, in Africa. According to the staff, the average tariff is estimated to be 24 percent. That compares with 8.7 percent in South Africa, 14 percent in Zambia, 22 percent in Tanzania.

Nigeria's trade regime is even worse if we focus on tariffs. The reduction and the simplification of the tariff structure are of paramount importance. Nigeria must press ahead with trade liberalization and reduce the anti-export bias of the trade regime if it wants to diversify the economy and reduce the dependence on oil. The fact that the share of petroleum has fallen visibly in terms of GDP since the beginning of the 1990s but not in terms of exports is, I believe, a testimony to the anti-export bias of the trade regime. It also shows that there are resources in the nonoil sector that could be freed for exporting.

In the same vein, adequate exchange rate policies are essential to support export growth and export diversification. We welcome, therefore, the authorities' decision to establish a market-determined exchange rate. Too often in the past, exchange-rate overvaluation has hindered Nigeria's exports.

Many speakers have stressed that Nigeria will need the support of the international economy and, I would add, of investors, if growth is to be promoted and the private sector involved in the process of economic diversification.

Past policies have left the economy burdened with a large stock of external debt. We learned from staff that nonconcessional rescheduling will be insufficient to achieve a sustainable position and eliminate the financing gap. Some Directors in their preliminary statements were not convinced this is the case. Still, it is essential for Nigeria to establish an adequate track record to strengthen its status with the international community. The new government that has taken office in May is committed to pursuing with vigor what is unquestionably a daunting reform agenda. The track record is evidently not long, but it has been good so far.

Nigeria must also make an effort to improve the relationship with external creditors. The pattern of arrears on external debt suggests that creditors have not been treated in an equitable way. This must be corrected. The call for comparative treatment is not new but so far has not elicited an adequate response from the authorities. We believe that the establishment of an adequate policy record must proceed in parallel with an effort to improve Nigeria's relationship with international creditors.

With these remarks, let me once again recall that Nigeria's enormous potential could provide a substantial contribution to Africa's recovery. The new administration provides a fresh hope that this will be used to the best advantage, and I wish the authorities every success.

Mr. Schaad made the following statement:

Given the long period that military regimes were ruling Nigeria, the Nigerians are now looking up to the democratically elected President with great expectations. And I would like to commend the first determined efforts the new government has undertaken to turn things around. The task is daunting, and I agree with the thrust of policies to be implemented as outlined in the staff report. The staff report suggests that neither financial support from multilateral institutions alone nor a substantial debt relief from bilateral donors will be able to fulfill these expectations. Only wide-ranging reform will be able to fulfill them. Besides conducting sound macroeconomic policies, the Nigerian authorities will have to rebuild public institutions and social programs. In so doing, they will have to build a solid foundation for good governance. To unlock the tremendous potential in Nigeria's nonoil sector, as illustrated in the comparison with Indonesia, there will have to be comprehensive privatization, deregulation, and trade liberalization. A legal framework for the different sectors will need to be set up to allow these tools to deliver the intended results. And as new rules are set up to foster economic activity, institutions will have to be built to enforce these new rules.

Given the need for a comprehensive reform program, I welcome the authorities' intention to commit themselves to a Stand-By Arrangement. Unfortunately, however, performance under the Staff Monitored Program (SMP) has been unsatisfactory. Therefore, as Mr. Milleron, I will have to insist on fully meeting the proposed prior actions as a prerequisite for approving a Stand-By Arrangement in the future.

In this respect, I welcome the authorities' move to a market-based exchange rate, the discontinuation of the multiple currency practice, and as recently as yesterday, the elimination of the only remaining exchange restriction. I understand that the last obstacle to the acceptance of Article VIII is now removed.

Unfortunately, important reform projects, such as privatization, have been undertaken just half-heartedly. I also regret that the authorities did not agree to eliminate the highly inefficient subsidy on petroleum consumption without any further delay. As Mr. Wijnholds points out, such a subsidy also provides a tempting opportunity to make a handsome illicit profit. This brings me to the issue of good governance.

On this crucial issue I associate myself with the remarks made by Mr. Yoshimura and Mr. Harada and Mr. Wijnholds. It is truly reassuring that a consensus has now emerged in Nigeria that corruption is responsible for Nigeria's sad economic performance, and I warmly welcome the authorities' efforts to put policies in place to rid Nigeria of this tumor. The extent of the problem calls for a comprehensive approach, ranging from investigating past malfeasance and prosecuting the responsible to civil service reform and institution building and rebuilding.

In the same vein, I welcome that defense spending is now subject to the same accountability standards as spending in other ministries. However, I find it striking that military expenditure in percent of GDP has almost doubled between 1997 and 1999. I would appreciate it if the staff could elaborate on the reliability of this data, also with regard to the remark in paragraph 33. A doubling of military expenditure within the past three years would certainly be very disturbing, particularly given the authorities' call for comprehensive debt forgiveness. I would therefore welcome appropriately stringent conditionality on improvement in treasury and budget management in a future SBA, with particular consideration of military expenditures.

Concerning external financing and debt, the staff notes that even with a Paris Club rescheduling, a large financing gap would persist over a medium term. However, in the staff report it is assumed that commercial debt will be fully paid back despite a Paris Club rescheduling. In the light of our current discussions on involving the private sector in resolving financial crises, I wonder, as Mr. Pickford does, whether these circumstances would not call for some PSI requirement under a potential Stand-By Arrangement. I would appreciate staff comments on this matter.

With these comments, I wish the Nigerian authorities and the Nigerian people success in their comprehensive reform efforts.

Mr. Kioa made the following statement:

The reestablishment of democracy in Nigeria this year has given the country new hopes. The new government has initiated a new departure from the past practices by moving promptly to combat corruption, restore human rights, reintroduce discipline in public services, and avoid macroeconomic instability. This is certainly a welcome development. However, given the depth and pervasiveness of the problems the country has faced, these steps are only a beginning, although a very promising one. Therefore, efforts by the authorities to press ahead and maintain the momentum of the reform process are certainly very critical.

The staff report on Nigeria is comprehensive, and we support the staff appraisal. However, we would like to raise a few points for emphasis.

First, despite the return to democracy and the new corrective measures taken to restore order, it will still take some time and cooperative efforts—both from the authorities and the international communities—to reduce and eradicate deep and pervasive poverty in Nigeria and build a safer living environment for its people. Staff, referring the World Bank report, indicated that economic growth is needed to be pumped up to 7–8 percent per annum, and—given the vast potential resources in Nigeria—there is a good prospect for achieving this seemingly ambitious rate of growth. However, this would call for a comprehensive reform and reconstruction program to be adopted.

Second, since the main resources of the country are oil and gas, a focus on these resources is certainly warranted, on similar lines as Mr. Kiekens's statement. The country's oil production is considerable. An exportable production of around 2 million barrels a day is certainly no small amount. Looking at the balance of payments figure, it is quite intriguing to find how the oil- and gas-related imports have steadily increased from $11.015 billion in 1997 to an estimate of $12.403 billion in 1999. In addition, the country has experienced a sharp rise in the profit transfer from $3.006 billion in 1997 to $4.862 billion for all the oil and gas activities. With the total oil and gas exports only reaching $10.437 billion in 1999, the most precious resources that the country has, in fact, have only contributed to a net resource outflow in no small way. These figures, if my understanding is correct, are compelling for the authorities to make a clear priority of addressing this issue and making a reassessment of how best to proceed with these resources.

Third, the emphasis on institutional building is a step in the right direction. A striking example is the weakness in the treasury and budget management. An improved planning and control mechanism in the budgetary management should form a good basis for the authorities in managing the public flows of resources. Therefore, technical assistance under the IMF/UNDP program for this purpose, scheduled to begin in 2000, has to become an urgent priority.

Fourth, on privatization and deregulation, as the staff rightly recommends, the authorities would have to come up with a clear regulatory framework to ensure fair competition, particularly in the oil, telecommunications, and power sectors. Privatization and deregulation should be carried out as soon as possible and do not have to wait for the completion of the rehabilitation exercise.

Fifth, while Nigeria's productive capability relies heavily on imported goods, as the substitutes are rarely available, its quest for an economic growth of 7 to 8 percent per annum would mean an increased import bill. This means that the external payments will remain weak, as the current export earnings are not sufficient to cover the needed imports. It is, therefore, important for the authorities to explore further nonoil export opportunities in order to supplement the existing oil sector. The persistent overvaluation of exchange rates should be avoided to restore efficiency and improve international competitiveness of domestic exports, particularly the oil products.

Finally, like Mr. Barro Chambrier, at this juncture, Nigeria's need for the support of the international community is critical in enhancing the authorities' resolve in moving to comprehensive reforms. Therefore, we also hope that the Board will have the opportunity to consider soon the country's request for a Stand-By Arrangement.

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

Mr. Cabezas made the following statement:

After the newly elected government of Nigeria took office in May of this year, the country seems to have engaged in a new path of economic reform and political openness. Once in office, the new government took decisive actions towards the improvement of governance and the enhancement of transparency of public affairs. At the same time, the efforts devoted to balancing the damaged fiscal position inherited from the previous administration deserve to be commended. After this good start, we are encouraged and favorably impressed with the commitment of the new Nigerian administration to the implementation of the fundamental reforms suggested in the staff paper.

We welcome the interest shown by the Nigerian authorities to participate with the Fund in an SBA. Nevertheless, we believe that the country still needs to build a minimum track record of sound policy implementation and prudent macroeconomic management in order to consolidate the new direction of policies being proposed by the new government. In this respect, we fully agree with the set of prior actions recommended by staff before an SBA for Nigeria is considered by this Board. In the meantime, we remain confident that the impetus and clear objectives set by the new government will be maintained, and, as a result, the country will be headed towards a path of economic recovery and poverty alleviation.

Regarding poverty alleviation, being aware of the importance of a well-designed governmental social allocation plan, we believe that the benefits that can be drawn from the expansion of the private economy are paramount. In this respect, we welcome the intentions expressed by the government to advancing in the privatization program in conjuncture with the establishment of modern and clear regulatory frameworks for key productive sectors. We believe that these structural measures, coupled with an ample judicial reform directed at ensuring property rights, are the right steps towards setting the appropriate incentives and institutions that will facilitate a more vigorous participation of the private sector in the economy.

We also believe that the diversification of the economy from oil production towards more labor-intensive activities is crucial to allow for a sustainable poverty-reduction process. In this respect, the commitment of the new government to maintaining sound macroeconomic policies and to enhancing transparency and accountability in the public sector will set up the basis for an increase in confidence and a consequential increase in private investment in nonoil activities. In our view, we urge the new democratic government to set up the basis for confidence building in the Nigerian economy. Once confidence is achieved, private-sector involvement will emerge. This process of confidence building requires the participation of the entire Nigerian community, and the authorities should spare no effort to gain public and political support for the bold reform process envisaged for the future. In this respect, we see with concern that the last budget proposal was changed substantially during the National assembly discussions, though we feel somewhat reassured since our staff finally agreed with the authorities on the overall short-term plan.

On exchange rate issues, we welcome the authorities' announcement to establish an expanded interbank market that will allow the exchange rate to be determined by market forces.

On oil-related issues, we concur with staff on the importance of aiming at a balanced budget, bearing in mind a medium-term level for oil price when estimating fiscal income. In this respect, maybe the authorities could be advised to implement a certain type of stabilization fund for oil prices. Such a fund, when governed with clear and transparent rules, can give stability to the country's budget, with the benefit of shielding the budgeting process from pressures to spend the extra income resulting from higher prices. It may also prevent the recurrent fiscal deterioration in periods where oil prices fall to low levels, as expenditure allocations tend to be permanent once incorporated in the budget. This practice allows for heightened stability in fiscal accounts, offering another source of stability to the whole economy. On other oil-related issues, we welcome the announcement made by the government in relation to the elimination of oil subsidies in the economy.

On fiscal revenue sharing, we take note of the new formula that defines federation revenues to be distributed among different government tiers. As presented by staff, the new law requires that a mandatory sharing of at least 13 percent of natural resources-based revenues should go to the producing states. In this respect, I would like to hear staff's views regarding the possible regressive effect of this law, as at a first glance it seems to be detrimental to regions that do not possess an expanded natural resource base—regions that usually concentrate the more extreme cases of poverty.

With this comments, we wish the Nigerian authorities every success in their challenging endeavors.

Mr. Mozhin made the following statement:

As was rightly indicated by staff and previous speakers, Nigeria is at a crucial juncture. The authorities have announced initiatives that, if implemented fully and properly, might lead to a departure from the economic mismanagement of the past, bring the economy back on a sustainable path, and improve domestic and international confidence in the Nigerian economy. Here, I would concur with the proposed sequence of events and would urge the Nigerian authorities first to implement prior actions needed for establishing a track record needed for a one-year Stand-By Arrangement with an objective of moving toward a medium-term Fund-supported program in the coming years. I share staff's assessment of recent economic developments and will comment only on a few issues.

With respect to fiscal policy, we concur with staff that tight fiscal policy is needed for the remainder of this year and in 2000. Petroleum subsidy should be removed as envisaged. While fully understanding the significant social implications of this measure, one can only quote staff that "the government is not only subsidizing the better-off in Nigeria but also in neighboring countries" because of widely spread smuggling activities in the petroleum sector. The authorities should proceed promptly with subsidy removal with an objective to fully deregulate petroleum market as quickly as possible. Equally important is to exercise restraint in budget expenditures and to settle arrears to local contractors. We fully endorse staff's recommendations with regard to the needed course of actions on the fiscal front, including steps to improve fiscal transparency, to strengthen treasury and budget management systems, and to use revenues stemming from higher oil prices for debt repayments. As for the issue of fiscal federalism, we would urge the authorities to ensure the consistency between the delegation of functions to lower levels of government and their implementation capacities so as not to undermine the stability of fiscal revenue flows, in particular.

Efforts on the fiscal side should be complemented by tight monetary policy in 1999 and beyond with an objective of bringing down the level of inflation. Although so far, certain administrative measures aimed at sterilizing excessive liquidity have been successful, they are inconsistent with the market-based monetary policy management and should be phased out in the period immediately ahead. In this regard, we were encouraged by the authorities' decision to abolish Autonomous Foreign Exchange Market (AFEM) in favor of an expanded interbank market with a market-determined exchange rate. Also, announced intentions to remove restrictions on international current transactions and steps to bring banking prudential norms fully in line with Basle Core Principles are encouraging. Finally, further progress in monetary policy management will crucially depend upon improving the timeliness and quality of monetary data, and we would urge the authorities to continue their efforts in this area.

In order for the authorities' reform agenda to bring about tangible results, efforts on the macroeconomic front should be complemented by bold actions in the area of structural reforms aimed at removing existing bottlenecks and impediments to growth. In this regard, I can only echo staff on the need for competition-enhancing measures; deregulation; international trade liberalization; and proceeding promptly with privatization initiatives in such sectors as power, telecommunications, and petroleum. These measures will bear fruit only if accompanied by measures aimed at reducing corruption and fraud, improving governance and institutional capacity, as well as creating the legal environment conducive for the private-sector growth and improving the investment climate.

With these remarks we wish the Nigerian authorities well.

Mr. Kapteijn, noting that many Directors had indicated the need to meet prior actions, pointed out that, while the staff report mentioned that one of the prior actions was the completion of investigations into financial malfeasance by end-1999, the staff's preliminary statement indicated that, according to the Attorney-General, a report could not be expected before end-March 2000. It was not clear whether the progress report would be a sufficient basis on which to proceed or whether it would be necessary to wait for the completion of the investigation, and how this would affect the timing of the Board's discussion on the SBA.

Mr. González-Sánchez made the following statement:

At the outset, we join other directors in commending the staff for the comprehensive and candid set of papers on Nigeria. We also would like to commend the new government of the country for the firm corrective measures that it has introduced on several fronts. Nevertheless, major efforts are still required to achieve sustained growth and stability.

One of the major challenges ahead for the authorities is the development of the nonoil industry. Like other speakers, we believe that the prospects for the country's sustained economic growth and poverty reduction should not depend on the oil industry but, like the staff correctly notes, on economic policy reforms. We consider of particular importance the restoration of effective public institutions, which suffered severe disruptions during the period of military rule. Concerning the promotion of an efficient and competitive nonoil sector, the staff's recommendations about exchange-rate policy, the reduction of high tariffs, and the adoption of a more effective regulatory framework are most appropriate.

We concur with the staff on the need for a comprehensive privatization program, although, like Mr. Kelkar, we believe that it is very important to build up the required regulatory system before or at the same time that the privatization of utilities such as telecommunication and power take place. Experiences in other countries have shown that privatization without an adequate regulatory framework can have undesirable results.

On the question of subsidy to petroleum prices on the domestic market, we are encouraged to learn from Mr. Morais's informative preliminary statement that the Nigerian authorities have proposed full deregulation of the petroleum market and the sale of crude oil to the Nigerian National Petroleum Company for domestic refining at export parity price in the 2000 budget. This is important given the adverse implications of that subsidy for resource allocation and the budget.

We welcome the authorities' approach to monetary and exchange-rate policy. The replacement of the system of central bank allocation of foreign exchange at a predetermined price by an interbank foreign exchange market is a right step in the direction of eliminating price distortions.

We agree on the need of better remuneration for the civil service, and we would like to stress the observation made by Mr. Mori that wage increases must be accompanied by improvements in the quality of the services provided, a close scrutiny of the payroll, and a right-sizing of the civil service.

We learned from the staff representative's preliminary statement that some of the prior actions described in the report have already been met and that some others are expected to be met very soon. This is encouraging, and we support the authorities' intention to request a one-year Stand-By Arrangement, provided that all the prior actions are met. We also join the staff in underscoring the need for the country to improve its relations with the Paris Club.

Finally we welcome the authorities' intention to accept the obligations of Article VIII in the near future and wish them every success in their challenging endeavors.

Mr. Kranen made the following statement:

At the outset, I would like to commend the staff for a well-written and candid report. The current situation in Nigeria is not encouraging. However, Nigeria's economic prospects look somewhat brighter. The new government has taken measures to improve governance and strengthen the fight against corruption, and we welcome the envisaged steps to strengthen the fiscal stance.

In this context, the prompt abolition of subsidies for petroleum prices would be an appropriate measure. I hope the intended careful handling of the social security issue will not cause any delays in implementation. The pace of reforms in the face of privatization should also be accelerated, and there should be a clear connection between privatization and disbursements in the envisaged program with the Fund. In this regard, while we welcome the announcement of a privatization program, we are somewhat disappointed that the monopoly of the national telecommunications company has been extended.

The most important contribution to generate confidence in the reform efforts would be to make substantial payments to the Paris Club creditors in the current and the next few years. I endorse Mr. Milleron's remarks. Mr. Wijnholds and Mr. Kiekens also expressed the views of many Paris Club creditors quite convincingly. I also share Mr. Yoshimura's concerns with regard to Nigeria's request for debt relief. I would like to encourage the authorities to take this concern into consideration and welcome Mr. Morais's announcement in that regard. The rising oil revenues should allow the authorities to fulfill their commitments.

Finally, we wish the authorities success and hope that the new government will adhere to its commitments and undertake all efforts to bolster economic prospects, thereby improving the living conditions of the people of Nigeria.

Mr. Alosaimi made the following statement:

I am heartened by signs that Nigeria is emerging from the difficulties of the past three decades. The authorities' highest priority now is to fully restore the country's policy credibility. Vigilance to avoid a repetition of the shortfalls that have occurred in this year's staff monitored program is, therefore, critical. I find Mr. Morais' helpful statement reassuring in that regard.

That said, let me thank staff for an excellent report. The statement of the problems in hand is frank. I also broadly agree with the report's well-laid-out strategy for the economy. I have only a few brief remarks.

First, given the legacy of policy misdirection, a comprehensive approach to adjustment and reform is clearly appropriate. However, the accumulated problems are simply too formidable to be resolved all at once in a hurry. The step-by-step approach that has been agreed therefore has my full support. What is crucial now is a close staff monitoring of the program's progress to pave the way for the authorities' expected request for a Fund-supported program.

Second, given staff's record on projecting the price of oil, I would urge avoidance of undue speculation as in paragraph 19 in that regard. Furthermore, in recommending overall fiscal balance in the medium term, staff suggests use of an oil price assumption of $2 per barrel below the projections under the WEO. This may indeed be justified as adding an extra margin of safety, given the urgency of debt retirement. However, a more transparent and credible approach would be to make consistent use of the WEO price assumptions with provisions as needed for such urgent goals as debt retirement. Staff comments will be welcome.

Third, and still on the debt problem, paragraph 68 of the report underscores that the external payment outlook would remain very difficult, even on optimistic assumptions on reschedulings by the Paris Club. It is unclear whether this outcome is based on assumption of an oil price at or below that projected for the WEO. I will appreciate a staff clarification in this regard.

Fourth, as staff notes in paragraph 17, the external payment outlook would remain difficult, despite the projected strengthening of the price of oil. Among the contributory factors, staff specifically refers to "the generous terms with oil companies particularly regarding retained profits." An elaboration of this reference will be helpful.

Finally, I welcome the authorities' intent to accept the obligations under the Article VIII shortly.

With these remarks, I wish the authorities success.

Mr. Fenton made the following statement:

With a democratically elected government in power, Nigeria is at an historic crossroads. The challenge is to go forward in earnest with the process of political, economic, and social transition. In particular, early and decisive action to implement sound macroeconomic policies, combat corruption, improve public-sector transparency, and strengthen physical and social infrastructure is necessary to build an enabling environment that will encourage much-needed private-sector investment, both domestic and international. Moreover, widespread poverty, regional inequality, and falling health and education standards need to be addressed through an aggressive economic and social reform effort.

Many of the points that I would like to make have already been covered in the preliminary statements that were circulated and by previous speakers. Like Mr. Milleron, I am in broad agreement with the policies and reforms recommended by the staff and support the seven key elements mentioned in the appraisal. However, given the enormity of the challenge and the limited institutional capacity of Nigeria, I recognize that it will be necessary for the authorities to establish clear priorities for action in the near term. In this regard, like Mr. Yoshimura and Mr. Harada, I urge the authorities to bear in mind that the elimination of corruption and the rebuilding of local institutions to implement social service programs are indispensable conditions for effective reform. In this regard, we welcome the steps enumerated in the staff report that the authorities have already taken to combat corruption.

Prudent fiscal and monetary policies and a more flexible exchange regime are crucial for achieving much-needed macroeconomic stability. On the structural side, privatization and trade liberalization should be priorities.

I would also like to make a point with regard to oil. The proposed budget for 2000 is predicated on oil selling at $18 per barrel. If the price should remain at its current level for the next year, the Nigerian authorities will be the beneficiaries of a windfall gain in revenues. I would urge them to use part of such a windfall to pay down debt and the remainder to build a rainy-day fund that could be drawn upon if oil should fall below $18 in the future.

As for external debt, we understand and sympathize with the concern of the Nigerian authorities about the situation. Nevertheless, we agree with staff that Nigeria must take all possible steps to improve its relations with the Paris Club by establishing a track record in reforms and debt repayment.

Finally, I would like to join other chairs in expressing the hope that the Nigerian authorities will continue to implement the necessary reforms and move to a Stand-By Arrangement in early 2000.

Mr. Wong made the following statement:

Nigeria has finally reached a turning point after decades of economic stagnation. Through a number of initiatives and reforms that have been pursued since President Obasanjo took office, the Nigerian authorities have established an important foundation for future economic growth. While this departure from past policies justifies support, one must also be cautious about the substantial risks that remain.

There are still few signs of a sustained economic recovery. The staff forecast of real GDP growth for 1999 is only 0.8 percent, or a negative 1.9 percent on a per capita basis. Table 7 on the medium-term macroeconomic outlook projects that growth will accelerate to an average of roughly 4 percent a year over the next five to six years. However, given the rapid population growth, this is far from sufficient to address the problems of poverty and unemployment. Between this projected growth path and 7 to 8 percent growth, which is what the staff considers minimal to achieve a meaningful reduction in poverty, there is a huge gap to be filled. It is, therefore, important that the authorities face up to this challenge and take bold and decisive steps to reform the economy. Current levels of oil prices seem to provide a good opportunity to do so.

I broadly agree with the thrust of the staff's reform strategies that encompass seven policy areas. I would like to see them reflected in the medium-term reconstruction program to be developed by the authorities. Also, in designing the program, the lessons from the recent staff-monitored program must be learned. In this regard, I am pleased to learn from the staff's preliminary statement that significant progress has been made towards meeting the undertakings during the period of informal monitoring.

I would join the staff to welcome the authorities' intention to request a one-year Stand-By Arrangement. Provided that prior actions are met, I am prepared to consider Nigeria's request favorably. Having said that, I must stress the very same point made by the staff and by many other speakers, that is, the willingness of the Paris Club to consider only nonconcessional rescheduling of Nigeria's debt in the context of a possible Stand-By Arrangement would still leave a large financing gap. We hope that the international community will increase financial support to Nigeria as the authorities have demonstrated their resolve toward implementing adjustment and reform policies.

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

The staff representative from the African Department assured Directors that, on the question of safeguarding the Fund's resources, the withdrawals amounting to $2.3 billion had been made largely in cash and travelers checks directly to the national security advisor or to the president and had been charged to a special security account against which no payments had been made. That account had been closed about one year ago. Second, following the end of the military regime, the principle had been established that the central bank should not make any payments without the authorization of the Accountant-General. Third, the Auditor-General was now required to submit the audit report within nine months of the end of the fiscal year, and this applied also to the central bank. The Fund was extending technical assistance to the Auditor-General's office so that it could perform this key function adequately.

The staff had also requested an audit of the foreign exchange transactions, which had been completed and was being reviewed, the staff representative reported. The results of the audit report indicated that one of the chief concerns—that reported reserves might not exist—did not appear to be warranted. The staff's intention was to ensure that, if Fund resources were to be drawn, they would be reflected in an increase in reserves and also to monitor each month foreign-exchange transactions of the central bank, with a quarterly review. The central bank had provided the details of individual transactions each month, and the staff had been examining closely whether inflows and outflows matched reserves so an audit could be initiated as quickly as possible if discrepancies were to arise.

With regard to the status of investigations into past financial malfeasance, the staff representative remarked that the fact that they were still ongoing should not be perceived negatively. In light of the importance of the task, the investigations could not be completed quickly and would continue until all the facts had been found. The Attorney-General wished to ensure the confidentiality of the ongoing investigations and was concerned that a public report at the current time could undermine those efforts. The staff's position was not to insist on the completion of the investigations as a prior action and to present a progress report in early 2000, in the context of discussions on a possible SBA for example.

On the question concerning the Ajaokuta steel complex, the staff representative indicated that the authorities were not certain that the complex could be sold at a positive price. They were also concerned that it would be difficult to close the complex, as an entire town depended on its continued existence, and therefore they preferred to continue funding the project. The staff did not share that view and would need to discuss the issue further with the authorities. In that connection, the authorities had indicated that there would be room for further cuts in expenditures in the context of discussions on the budget in 2000, and the Ajaokuta steel complex was one of the items that the staff had in mind.

In response to the request for a comparative analysis of the export revenues of other oil-producing countries, the staff representative said that the staff intended to conduct a study on the subject and to provide a full report in the context of the next Article IV consultation. Over time, the share of joint-venture partners in tax receipts had declined substantially, reflecting the revision of contracts in 1991—which enabled companies to take advantage of significant tax exemptions—and the substantial rise in production costs. Oil companies had also recently been allowed to offset investments costs related to gas projects against tax liabilities. Those projects were developed in response to environmental concerns since 20 percent of the gas flares in the world originated from Nigeria. In addition, companies had been receiving bonuses for the discovery of new oil fields, with tax cuts being determined on the basis of probable reserves and not proven reserves, which was unusual.

In the context of the possible SBA, the authorities wished to renegotiate the existing contracts with the help of the World Bank and the Fund, the staff representative said. They had already prepared a new contract regarding the financial operations and the tax obligations of the oil companies but wished to wait until the completion of the comprehensive review of the fiscal regime before implementing the new provisions during the second half of 2000.

With regard to the staff's use of an oil price projection that was lower than that of the WEO, the staff representative explained that that the authorities had wished to be cautious and to minimize the potential for revenue shortfalls by using a conservative oil price assumption for the preparation of the budget. Theoretically, the reasoning was very simple: by setting expenditures conservatively, even in the event of an oil revenue shortfall, no major problem would occur. However, the situation was slightly more complex in the case of

Nigeria. According to the proposals of the federal government, part of the oil revenue was to be distributed to the state and to local governments, and any excess revenue beyond budgeted levels was to be invested in a special proceeds account instead of being distributed. Therefore, if higher oil prices had been used, state and local governments would automatically have received a larger amount of money, whereas by using a lower price of oil, extra revenue could be sterilized before being committed to other uses. Nevertheless, in order to ensure comparability and transparency, the staff proposed to agree with the authorities ahead of time on how any additional revenue would be used in the event of prices turning out to be higher and to present in a table a column on the budget including both prices.

The decline in oil production had not been a factor in missing the revenue target under the staff-monitored program, the staff representative said. Rather, the lower-than-expected revenue was linked to a shortfall in the collection of taxes and to the inability of national companies to pay fully the government for the oil they were using.

The stock of debt was underestimated, the staff representative confirmed, as the staff had used data provided by the Paris Club in May 1999 and were informed in November 1999 that it did not include interest payments, which amounted to $47 million. Those figures would need to be reconciled with Nigerian data—with the help of bilateral technical assistance—in order to determine the exact amount of the debt.

In response to Mr. Kiekens's statement that $644 million of payments to the Paris Club was insufficient, the staff representative clarified that that figure referred to payments that had been expected in 1999—not in 2000—and that payments to Paris Club creditors in 1999 had in fact already amounted to $925 million. As for 2000, the authorities had provided for payments amounting to $1.5 billion in their budget proposal. The staff had not made any assumptions concerning those payments but were aware that a financing gap would persist even if the debt rescheduling took place. That was an issue to be considered by the creditors.

With regard to the increase in military spending, the staff representative explained that it had not doubled in real terms and this was related to authorities' abolishing two years earlier the official rate at which all foreign-exchange expenditures of the government were valued. The valuation of military spending had consequently increased from 22 naira per dollar to 86 naira per dollar. It was also worth bearing in mind that the staff had obtained more comprehensive coverage of military spending in 1999 than in the past. Nonetheless, the coverage was still incomplete—with a substantial amount of military spending still not properly captured—and the staff was continuing to work with the authorities in that regard.

The revenue-sharing formula was linked to historical considerations and to the debate—at the time of independence—on whether the country should become one federal state or remain divided into separate states, the staff representative noted. The agreement had been that the oil-producing states would retain a certain share of the oil revenue, and this was included in the constitution established at that time. Also, it was not obvious that the nonoil-producing states were poorer than the oil-producing states.

Mr. Faini wondered whether the larger share of revenues going to the natural resource-producing states could be seen as compensation for the damages inflicted to the environment and the disruption of cultural activity.

The staff representative replied that the residents in those states had complained that they had not received a sufficient share of the resources devoted to development and to address environmental degradation—especially of the rivers. Their contention was that, under the military regime, they were neglected by the federal government and government programs were dictated. They wished to have a greater say in how development problems would be addressed and projects determined, with greater control of the resources involved.

With regard to the way in which the parliamentary debate on the budget could influence discussions leading to a possible SBA, the staff representative indicated that, during its last mission, the staff had had a discussion with the leadership of the national assembly, which had expressed its desire to cooperate fully so that a Fund-supported program could start as soon as possible. The leadership had asked the staff to maintain informal contact with them, so that throughout the program negotiations, they would be receiving input and reactions. Indications so far were that they largely shared the staff's views concerning the fiscal stance. The staff did not intend to return to the Board before the national assembly adopted the budget, which would not occur before end-January 2000.

Mr. Kapteijn remarked that, while it appeared that discussions on a possible SBA could take place toward end-January 2000, the first progress report on investigations into past financial malfeasance could not be expected before end-March 2000. He asked how this compared to the Fund's position in the case of Kenya, in which the program was interrupted for a substantial period because the results of a similar investigation were to be made public. Even though he had some sympathy for the points made by the Attorney-General, given that the Board had demanded publicity about malpractice in other countries, he wondered whether the various audits would be made public and, specifically, whether there would be an investigation report on the $2.3 billion that had been withdrawn from the central bank.

With regard to the financing gap that would remain even after a Paris Club rescheduling, Mr. Kapteijn pointed out that the medium-term balance of payments table was not based on a comprehensive adjustment scenario, as indicated by Mr. Kiekens, and wished to know if it was the staff's intention to use that table for Paris Club discussions or whether it would use the table in the upcoming staff report on the request for an SBA, which would presumably be more realistic.

The staff representative responded that, in the context of a Fund-supported program, the staff would develop a scenario fully reflecting adjustment, which would differ significantly from the scenario currently presented. Nevertheless, the financing gap based on WEO oil prices amounted to $2–3 billion, and even if nonoil imports were cut by 10 percent—saving approximately $1 billion—the financing gap would remain.

On the question of malfeasance investigations and the comparison with Kenya, the staff representative indicated that the authorities had completed and publicized one of the investigations (concerning the large contracts in extrabudgetary expenditure awarded during the previous administration). With regard to the $2.3 billion withdrawn from the central bank, the facts were known to the staff and had been broadly disclosed to the public, including the identification of the people who were instrumental in the misappropriation of funds. It was not certain that any new attempt to publicize that case was necessary. Also, the Legal Department had advised the staff, in the context of a program, to refrain from mentioning the publication of such investigation reports because of potential legal implications. Therefore, the staff paper avoided such references, even though the authorities intended to publicize the outcome of the investigations.

Mr. Morais noted that the decision to fight corruption and to launch a series of investigations into past financial malfeasance belonged only to the government and that the role of the Fund was to assist the authorities in dealing with such investigations. It was not appropriate to compare the situation in Nigeria with past events in Kenya, and it would be inappropriate for the Board to delay negotiations on a possible SBA until the completion of all investigations arising from initiatives taken by the former president. While it was clear that the number of cases was substantial, the full extent of malpractice that had occurred in the past was still not known.

The staff representative from the Policy Development and Review Department said that there was one significant difference between the cases of Nigeria and Kenya. In Kenya, the Fund had been dealing with the same government, whereas in Nigeria, it was the government itself that had expressed serious concerns about malfeasance during the previous regime.

An important issue had been raised by Mr. Pickford with regard to potential private-sector involvement, the staff representative noted. Out of $30 billion in total debt, about $22 billion was owed to the Paris Club and $4 billion to multilateral agencies, leaving $3.5–4 billion—about 12 percent of the total—to the private sector. That latter debt was broken into two parts: Brady bonds worth approximately $2 billion and promissory notes worth about $1.6 billion. The promissory notes were essentially unpaid trade accounts that went back several years earlier and that had been converted into promissory notes. They carried an implicit interest rate of about 5 percent. The staff's understanding was that, on a comparability-of-treatment basis, if a nonconcessional Paris Club rescheduling were to take place, official creditors would not be pressing for the Brady bonds to be reopened. With regard to the promissory notes, the staff did not yet have a clear picture of the situation. In any case, the assumption was that if the Paris Club rescheduled the debt, it would not capitalize interest payments during 2000 because, otherwise, the Brady bonds would also have to be reopened for comparability-of-treatment purposes. Also, if there were a concessional debt rescheduling, both Brady bonds and promissory notes would need to be revisited for comparability-of-treatment purposes.

The staff had worked closely with official creditors to better assess the situation and to see what the various options were, the staff representative indicated. The staff had also alerted the authorities that, although they were not being asked to interrupt payments to commercial creditors, the issue of private-sector involvement would be discussed in the near future—before an agreement on the SBA. It was also worth bearing in mind that Paris Club creditors had expressed unhappiness that private creditors had been paid during the previous 12 months, whereas Paris Club creditors had not been paid fully. A likely transition period of a few months would give the staff the opportunity to discuss with the creditors and to identify a solution that would be both workable and acceptable, and that the authorities could realistically implement in order to achieve the expected results.

Mr. Morais made the following concluding statement:

> I would like to thank Directors for their comments and for the Board's support of Nigeria's policy stance, as well as for the timely consideration of the request for an SBA. Directors' views and policy advice will be conveyed faithfully to my authorities.
>
> I will limit myself to a few brief remarks.
>
> Nigeria is trying to build a new and brighter, more prosperous future, based on sound economic policies, sound accountability and transparency, and awareness of the challenges of the new global economic environment. In this regard, the discussions today could not have been more timely. The policy perspectives that have emerged will provide a highly valuable resource from which the authorities will draw as they develop their strategies and priorities for action in the period ahead.
>
> The task facing Nigeria is daunting, and the road ahead is long and difficult. But the authorities have made a start and are approaching the challenges with realism and determination. There is clearly a need for broad and decisive reform to ensure that the objectives of rapid growth and poverty reduction can be achieved. Careful attention also needs to be given to priorities which are necessary in the circumstances of Nigeria.
>
> Nigeria needs the support of the donor community to succeed, and the support the Board has given to an SBA is both crucial and encouraging. I wish on behalf of my Nigerian authorities to express my appreciation for the support of the Board, as provided through a number of ongoing technical assistance programs. My authorities also wish to place on record their gratitude to Japan for its technical assistance through grants and the provision of experts.
>
> I would like to thank Ms. Lissakers for the indication that the United States is prepared to support a Paris Club rescheduling in the context of a sound reform program.

Mr. Yoshimura asked whether the summing up of the Board discussion would be published.

Mr. Morais said that Nigeria had agreed to participate in the pilot project for the publication of the Article IV staff report and all the documents of the consultation.

The staff representative from the African Department noted that the authorities wished to have the staff report published, which was consistent with their policy of openness and transparency. The staff also wished to publish the report in order to enhance the public's awareness of the Fund's work and the Board's views. However, Mr. Morais's memorandum to management indicating the authorities' interest in participating in the pilot project had only been received after the completion of the discussions with the staff. According to the procedures established by the Board, the authorities' interest in participating in the pilot project should have been conveyed to the Fund before the start of the discussions. The publication of the staff report and other documents related to the consultation therefore appeared problematic.

Mr. Yoshimura said that he seemed to recall that there had been one instance in which the publication of the staff report was accepted after the pilot project framework had been agreed.

Mr. Pickford remarked that he had considerable sympathy for the position of Mr. Morais and the authorities, especially considering that the government had been in office for only five months and was eager to stimulate public debate about its economic policies. The Fund should not prevent it from publishing a valuable contribution to the debate, and he hoped that the Board could respond favorably to the authorities' request.

The Acting Chairman observed that it was not up to the staff to decide whether to publish the report. The current policy regarding the publication of staff reports was linked to considerations of the integrity of the evaluation of the pilot project. Nonetheless, the scientific integrity of the evaluation of the pilot project could be maintained by not including the staff report on Nigeria in the evaluation of the experiment. It was therefore up to the Board to consider the matter and to decide.

Mr. Cippà said that he understood the arguments of the staff and agreed that it was important to establish rules so the authorities could not determine how the consultation process was moving forward and then decide whether they should agree to publish the staff report. However, it would be important to know, in reaching a decision, whether the authorities had been fully aware of the possibility of taking part in the pilot project.

The Acting Chairman proposed to ask the staff to prepare a note as background for further Board consideration of the matter.

The Acting Chairman made the following summing up:

> Directors agreed with the thrust of the staff appraisal. They warmly welcomed the policies that had been adopted by the democratically elected government that took office in late May 1999 to restore macroeconomic stability, combat corruption, and liberalize the exchange rate. Directors

believed that an exceptional window of opportunity existed for Nigeria to undertake an ambitious and wide-ranging program of reform to lay the basis for a renewal of domestic and international confidence and sustained economic development. Such a program could unlock Nigeria's great economic potential with a promise of significant benefits not only for Nigeria but also for the region as a whole. It would be essential that the program be based on improved governance, market-oriented policies, strengthened international competitiveness, and poverty reduction. Directors emphasized the need to diversify production and especially exports, over 90 percent of which presently consist of energy products. These reforms would represent a marked reversal from the long period of policy weakness and economic deterioration that occurred under successive military administrations.

Directors commended the authorities' recent efforts to establish a prudent fiscal policy, particularly the strong efforts made during June–December 1999 to reduce the impact on macroeconomic stability of the excessive expenditure of the previous administration. Some Directors expressed concern, however, about the existence of an array of avenues through which military expenditures had apparently been financed and considered that a full accounting for military expenditures was essential.

Directors considered that the fiscal stance in the proposed budget for 2000 should be tightened, while providing for substantially higher expenditures on health, education, and other social services, in view of the country's urgent social needs. They emphasized the importance of strong institutions for the delivery of social services. Directors agreed that the subsidy for petroleum products should be phased out at an early stage, with a view to deregulating fully the petroleum products market as soon as possible. They considered that taxation and fiscal incentives for the oil and gas sector should be revised and appropriate changes incorporated in agreements with oil companies. Directors also attached importance to the early settlement of domestic arrears.

Directors observed that the present cautious monetary stance and the market-determined exchange-rate system were consistent with the medium-term policy framework. They noted that the actions taken since May 1999 by the Central Bank of Nigeria to tighten bank liquidity had helped contain inflation and restore exchange-rate stability. They considered that, with the support of a prudent fiscal policy, there would be scope for gradual reductions in interest rates—which are presently high in real terms. Directors urged that the foreign exchange market be deepened by allowing oil companies to sell foreign exchange for tax payments through the commercial banking system.

Directors stressed the importance of transparency, good governance, a strong judiciary, and institution building for sustained economic recovery and for the success of the overall reform effort. They urged the vigorous pursuit of anticorruption measures, ongoing investigations into financial malfeasance, and prompt finalization of the management audit of the Nigerian National Petroleum Corporation. They stressed that economic inefficiency and the high cost of doing business in Nigeria should be reduced through the pursuit of structural reforms, including actions to strengthen the rule of law. Directors also underscored the importance of an open trade regime, which they saw as desirable on many grounds. They stressed the importance of a far-reaching reform of the tariff structure, following the reduction of some import duty rates in the budget, and strongly urged the removal of ad hoc tax exemptions, including tariff waivers and import bans, both to curtail corruption and to provide for a fair business environment.

While generally supporting the initiative of fiscal federalism, Directors cautioned that the delegation of activities, especially social spending, to lower levels of government should be consistent with their institutional capacity as well as the strength of their revenue sources. To this end, Directors stressed that institutional capacity should be strengthened.

Directors viewed decisive implementation of the privatization program as a key element of the authorities' reform agenda, particularly because the removal of critical bottlenecks, especially in the areas of power and telecommunications, would improve competitiveness. They emphasized that privatization needs to be implemented within a clear, fair, and transparently administered regulatory framework.

Directors observed that Nigeria has to make up for lost ground to achieve reintegration into the world economy. They, therefore, emphasized that a convincing start to the implementation of a strong economic program is essential for the recovery of the Nigerian economy and would pave the way for a one-year Stand-By Arrangement as an interim step toward a medium-term Fund arrangement. They also noted, in this connection, that serious statistical deficiencies presently hamper effective program monitoring and surveillance but that many of these difficulties would be addressed by implementation of the technical assistance program. Directors welcomed the authorities' intention to accept the obligations under Article VIII.

Directors noted that Nigeria's external payments position is weak, and the burden of external debt is heavy. While private capital inflows should respond to strong reforms, a large financing gap is likely to persist over the medium term. Directors acknowledged that Nigeria's debt owed to the Paris Club would likely be rescheduled initially on nonconcessional terms and that the stock of debt could therefore remain high. They urged the authorities to establish quickly a credible track record of payments performance, stressing that this would be a crucial precondition for more substantial support from the international community, donors, the financial markets, and the Paris Club. They also suggested that the appropriate role for private-sector involvement in a sustainable medium-term financing program should be examined. Directors advised the authorities to give priority to the normalization of relations with external and domestic creditors.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The Executive Board adopted the following decisions without meeting in the period between EBM/99/129 (12/6/99) and EBM/99/130 (12/7/99).

5. EXTERNAL AUDIT FUNCTION—SELECTION OF EXTERNAL AUDIT FIRM

Pursuant to Section 20(c) of the Fund's By-Laws, the Managing Director is authorized to appoint PricewaterhouseCoopers as the Fund's external audit firm for a period of five financial years, starting with financial year 2000.
(EBS/99/211, 11/24/99)

Adopted December 3, 1999

6. EXTERNAL AUDIT COMMITTEE, FY 2000—COMPOSITION

Pursuant to Section 20(c) of the Fund's By-Laws, the Managing Director is authorized to appoint the following three persons to serve as members of the external audit committee: Mr. Giorgio Loli for an initial term of three years, Mr. Juan Humud for an initial term of two years, and Mr. K.N. Memani for an initial term of one year.
(EBS/99/211, 11/24/99)

Adopted December 3, 1999

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 97/91 and 97/114 are approved.

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/99/165 (12/3/99) and EBAM/99/166 (12/3/99), by Advisors to Executive Directors as set forth in EBAM/99/165 (12/3/99), and by Assistants to Executive Directors as set forth in EBAM/99/165 (12/3/99) is approved.

APPROVAL: March 15, 2001

SHAILENDRA J. ANJARIA
Secretary