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REPORT AND RECOMMENDATION

OF THE

PRESIDENT OF THE

INTERNATIONAL DEVELOPMENT ASSOCIATION

TO THE EXECUTIVE DIRECTORS

ON A

PROPOSED GRANT OF UP TO US$11 MILLION

FROM THE DEBT REDUCTION FACILITY

FOR IDA-ONLY COUNTRIES TO

THE REPUBLIC OF GUYANA

FOR A DEBT REDUCTION PROGRAM

OCTOBER 2, 1992

CURRENCY EQUIVALENT

Average exchange rates prevailing during recent years, Guyanese dollars (G$) per US$1.00, period average:

1988	10.00
1989	27.16
1990	39.53
1991	111.80
December, 1991	122.00

ABBREVIATIONS

BOG	-	Bank of Guyana
CEM	-	Country Economic Memorandum
CESW	-	Country Economic and Sector Work
CDB	-	Caribbean Development Bank
CGCED	-	Consultative Group for Cooperation in Economic Development
CMCF	-	Caribbean Multilateral Clearing Facility
EEC	-	European Economic Community
EFF	-	Extended Fund Facility
EPDS	-	External Payment Deposit System
ERP	-	Economic Reform Program
ESAF	-	Extended Structural Adjustment Facility
ESW	-	Economic and Sector Work
FY	-	Fiscal Year
GDP	-	Gross Domestic Product
GNP	-	Gross National Product
GOG	-	Republic of Guyana
IBRD	-	International Bank for Reconstruction and Development
IDA	-	International Development Association
IDB	-	Inter-American Development Bank
IFC	-	International Finance Corporation
IMF	-	International Monetary Fund
LSMS	-	Living Standards Measurement Survey
MIGA	-	Multilateral Investment Guarantee Agency
MLT	-	Medium and Long Term
ODA	-	Overseas Development Administration (UK)
OECD	-	Organization of Economic Corporation and Development
OPEC	-	Organization of Petroleum Exporting Countries
PFP	-	Policy Framework Paper
PSIP	-	Public Sector Investment Program
SAC	-	Structural Adjustment Credit
SAL	-	Structural Adjustment Loan
SIMAP	-	Social Impact Amelioration Program
UNDP	-	United Nations Development Program

Fiscal Year

January 1 - December 31

REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE THE INTERNATIONAL DEVELOPMENT ASSOCIATION TO THE EXECUTIVE DIRECTORS ON A PROPOSED GRANT OF UP TO US$11MILION FROM THE DEBT REDUCTION FACILITY FOR IDA-ONLY COUNTRIES TO THE REPUBLIC OF GUYANA FOR A DEBT REDUCTION PROGRAM

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REPUBLIC OF GUYANA

DEBT REDUCTION FACILITY FOR IDA-ONLY COUNTRIES

PROGRAM SUMMARY

Recipient:	Republic of Guyana
Beneficiary:	Republic of Guyana
Amount:	Up to US$11 million
Terms:	Grant

Program Description: The proposed grant would provide up to US$11 million from the Debt Reduction Facility for IDA-Only Countries (the Facility) to the Republic of Guyana (GOG) in support of Guyana's proposed commercial bank debt reduction program. The proposed grant would consist solely of amounts contributed to the Facility from IBRD's FY89 net income.

Under the debt reduction program, GOG will repurchase its outstanding debt owed to certain commercial banks at a price equal to 14.47 cents per dollar of the principal thereof. The implementation of the program will be contingent upon acceptance by creditors holding at least 95 percent of the principal amount of the eligible commercial bank debt of Guyana. According to the financial advisors of GOG, the amount of Eligible Debt is estimated to be about US$93 million which consists of about US$69.1 million in principal and US$23.5 million in past due interest (as of August 1992), evaluated at current exchange rates. At such rates, the financing required to repurchase the total amount of such debt would be just under US$10 million. However, in order to allow for a possible increase in the amount of debt (as a result of additional debt being tendered which has not previously been identified or which was accounted for inaccurately by GOG), and to provide for a possible increase in the US dollar value of the debt because of exchange rate changes between now and the date of the offer, it is proposed that the grant amount be set at US$11 million in order to assure that adequate funding is available to finance fully the operation. It is further proposed that GOG be permitted to use up to US$75,000 of the grant to pay its largest creditor bank for outstanding agency fees and legal expenses which such bank has required be paid as a precondition to its participation in the operation.

Program Benefits: Obtaining significant debt relief is critical for Guyana to attain balance of payments viability in the long term and for the country to achieve sustained per capita income growth as a result of its adjustment efforts. As part of its overall external debt management strategy, Guyana is seeking an orderly settlement of its commercial bank debt obligations and accumulated arrears through the proposed debt reduction operation. While commercial bank debt is only a small part of the total external debt, the proposed operation would reduce the negative effects of the commercial bank debt overhang on the country's relations with commercial banks and facilitate ongoing programs to privatize public enterprises and attract foreign investors to the productive and service sectors of the economy. It should also lead eventually to improved availability and better terms for trade credit and thereby facilitate export growth.

Risks: The principal risk is that the critical mass of participating creditors will not be attained and the operation will not proceed. Due to factors such as the protracted period of default and secondary market trading activity, the precise amount of bank debt which will be tendered will not be known until the expiration date of the offer. However, based on informal discussions with commercial bank creditors, Guyana and its financial advisor for the operation, Scotia McLeod, believe that there will be substantial acceptances from such creditors.

A second risk relates to possible delays due to the general elections scheduled for October 5, 1992, and the possible slippages in the macroeconomic reform program underlying the proposed operation. However, there is broad agreement on the thrust of the Economic Recovery Program (ERP), and the proposed operation provides critical support in keeping the ERP on track.

Disbursement: The grant funds from the Facility would be disbursed upon compliance with the conditions of effectiveness and disbursement in the grant agreement, for the purchase of eligible debt pursuant to the offer and for the payment of incidental transaction and professional services costs incurred by GOG in implementing the program. The proposed grant's closing date is expected to be no later than 180 days after the signing of the grant agreement.

Rate of Return: N.A.

REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE THE INTERNATIONAL DEVELOPMENT ASSOCIATION TO THE EXECUTIVE DIRECTORS ON A PROPOSED GRANT OF UP TO US$11MILION FROM THE DEBT REDUCTION FACILITY FOR IDA-ONLY COUNTRIES TO THE REPUBLIC OF GUYANA FOR A DEBT REDUCTION PROGRAM

1. I submit the following Report and Recommendation for a proposed grant of up to US$11 million from the Debt Reduction Facility for IDA-Only Countries (hereinafter "the Facility") for a proposed commercial debt reduction operation for the Republic of Guyana (GOG). The proposed grant would consist solely of amounts contributed to the Facility from IBRD's FY89 net income. An Information Memorandum on the contemplated operation was previously circulated to the Executive Directors.[1] In the continued absence of any prospects for cofinancing by bilateral donors, the proposed grant has been increased from the US$10 million proposed in the Information Memorandum to US$11 million to provide for any possible increase in the amount of debt finally tendered, and for the payment of incidental transaction costs incurred by GOG in implementing the program.

I. THE ECONOMY

A. Recent Economic Development and Prospects

Background

2. Prior to 1988, Guyana followed a set of economic policies that led to the domination of the public sector in the economy and severely distorted incentives for the private sector. Existing private investments were nationalized, particularly the critical sugar and bauxite sectors, and government control extended to most financial institutions and consumer marketing. While economic performance showed positive growth during the early 1970s, the collapse of sugar and bauxite prices after the boom years of 1974-75 led to a decline in output, large government deficits, accelerating inflation and increased reliance on external borrowing. While new investments were being made by the public sector in the industrial sector, infrastructure was neglected and has gradually deteriorated. The severe decline in real wages and living standards led to a major migration of talented Guyanese to jobs abroad. In 1986, the Government was forced to suspend payments on external debts, both to official and private lenders. By 1988, industrial output was only 68% of the 1976 level. After the devaluation of 1989, total debt was over 600% of GDP. Guyana is today a country with a per capita Gross National Product of US$290 (1991), one of the two lowest in the Western Hemisphere.

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[1] "Guyana: Allocation of Resources of the Debt Reduction Facility for IDA-Only Countries for a Proposed Debt Reduction Operation and Grant from the Facility for Preparation of the Proposed Operation" (IDA/R92-46, April 28, 1992).

The Adjustment Process

3. In mid 1988, the Government launched an Economic Recovery Program (ERP). The main policy objectives of the ERP are to promote economic growth; eliminate internal and external imbalances in the economy; incorporate the parallel economy into the official economy; and normalize Guyana's financial relations with its external creditors. These objectives were set out in the 1989-91 Policy Framework Paper (PFP) prepared by the Government with the assistance of Bank Group and IMF staff. The PFP was reviewed by the Committee of the Whole of the Bank in July 1988 and later approved by the IMF Board during the same month. In April 1989, the IMF endorsed a Fund-monitored program and in June 1990 approved a Standby/ESAF arrangement. Also in June 1990, IDA approved a Structural Adjustment Credit (SAC).

4. The ERP represents a fundamental change in economic policies towards a private sector-led, market oriented economy, and provided a framework for the restoration of international economic relations. Under the ERP, the Government has undertaken far reaching adjustment measures and structural reforms: the fiscal deficit has been reduced considerably, through expenditure restraint and a comprehensive tax reform; the exchange rate and trade regimes have been liberalized; the incentive framework for the private sector has improved dramatically; the Government has made substantial progress in restructuring and reducing the size of the public sector, including the implementation of a major divestment program; and arrears to multilateral and bilateral donors have been cleared. At the same time, the Government has launched a well-designed program to offset the social impact of the adjustment program. Few countries have moved so far so fast in implementing a comprehensive adjustment program.

TABLE 1: GUYANA - BASIC ECONOMIC INDICATORS, 1975-91
(growth rates in constant prices, percent per annum)

	Actual				Prelim.	Est.
	1975-80	1981-87	1988-89	1990	1991	1992
Gross Domestic Product	1.0	-2.3	-2.6	-3.2	6.1	6.5
Total Consumption	2.4	-2.5	9.1	-5.1		
Gross Domestic Investment	9.9	-1.0	-7.3	18.9		
Exports	-3.0	-3.3	-9.1	-2.1	11.7	18.0
Imports	-1.2	-4.4	-9.6	16.2	-1.0	18.0
Inflation (Consumer Prices)	13.2	17.2	50.6	64.9	80.9	15.0
Population	2.3	1.9	1.9	1.5	1.5	1.5

Source: Statistical Bureau of Guyana and IDA staff estimates.

5. With the implementation of the ERP, Guyana's economic performance has improved considerably. In 1991, with most of the economic recovery program reforms in place, the economy grew by about 6% in real terms. Inflation, which remained high during the first half the year, was brought under control and reduced to an average of about 1-2% per month. The outlook for 1992 remains very favorable. Growth is expected to continue at an

impressive rate of about 6.5%. The inflation rate declined further during the first half of 1992 to an estimated annual rate of 15%. The nominal value of the Guyana dollar has remained fairly stable over the past 18 months. The current primary surplus of the public sector increased from 17% in 1988 to 28% in 1991 and is projected to be about 30% in 1992. The balance of payments position also strengthened with gross official reserves projected at about six months of merchandise imports-equivalent.

Constraints on Development

6. Despite the progress attained since the inception of the ERP, the macroeconomic framework is still precarious, given the financial obligations resulting from the country's external debt of about US$1.9 billion. Real wages in the public sector fell drastically in the 1980s and caused an exodus of skilled people, imposing a severe constraint on the provision of public services necessary for economic development. The economy's long-term supply response is also being constrained by the dilapidated state of the country's basic supportive infrastructure. To address these issues will require a sustained effort over a number of years, and strong financial support by the donor community.

Donor Support

7. In June 1990, Guyana settled its arrears to the IMF, the World Bank and the Caribbean Development Bank (CDB) with the assistance of resources mobilized by the Support Group chaired by Canada. In the context of the Support Group's efforts, and in addition to the resources made available under the IMF Standby/ESAF arrangement, the IDA SAC and the CDB, Guyana also received financial assistance from other multilateral and bilateral donors. In June 1992, the Bank chaired a special Sub-Group meeting for Guyana under the auspices of the Consultative Group for Cooperation in Economic Development (CGCED). Participants at the meeting praised the Government's efforts in keeping its adjustment program on track and reiterated their willingness to consider further assistance for Guyana following the successful conduct of the general election scheduled for October 5, 1992.

Economic Prospects and Policies

8. To address the remaining structural problems and financial imbalances, the Government will continue to define its adjustment program within a medium-term context as reflected in an updated 1992-94 PFP, currently under preparation. The 1992-94 PFP assumes real annual growth of about 5% on average for 1992-94, seeks to lower inflation to 8% by 1994, and to maintain gross international reserves at about six months of merchandise imports-equivalent in 1994. To achieve these objectives, the Government will need to continue to pursue fiscal adjustment measures while deepening structural reforms. The program further envisages: an effective implementation of the divestment program that will further the role of the private sector in the economy; infrastructure rehabilitation measures; continued exchange rate and trade liberalization; measures to address the skills shortage in the public sector; the alleviation of poverty; the development of human capital; and the conservation of the ecological balance.

B. Debt Relief and Aid Requirements

9. Guyana's future development will depend heavily on continued access to concessionary external financing, as well as further concessionary debt relief. Overall requirements for official inflows consistent with the 1992-94 PFP are estimated to be about US$550 million during the period 1992-95 (Table 2). Of this amount, about US$150 million

is available from existing loans, and US$400 million would have to come from new loans and grants or additional debt relief. To date, around US$235 million of new loans and grants have been identified. Of the total of US$550 million, about US$160 million (29%) will be required to finance projects under the public sector investment program; the balance would have to be made available in the form of balance of payments assistance and/or debt relief. The large size of these requirements, given the relatively small size of the economy, suggests that additional concessionary debt rescheduling would be the most efficient means of effecting the necessary resource transfer. Therefore, there is a need for additional debt rescheduling on terms even more concessionary than the present Toronto terms in light of Guyana's considerable achievements in structural adjustment and its heavy debt service burden. For example, the rescheduling of all outstanding bilateral debts on the more concessional Trinidad terms would reduce the financing gap from US$400 to about US$220 million, an amount which could be covered by inflows that have been already identified.

TABLE 2: GUYANA - AID REQUIREMENTS
(US$ million)

	1992	1993	1994	1995	1992-95	%
MLT Loans						
existing (pipeline)	**62**	**41**	**26**	**20**	**149**	**27.0**
new MLT	**39**	**65**	**123**	**120**	**347**	**63.0**
identified	*30*	*30*	*51*	*69*	*180*	*32.7*
financing gap	*9*	*35*	*72*	*51*	*167*	*30.3*
Grants, new	**13**	**13**	**14**	**15**	**55**	**10.0**
Total, new	**52**	**78**	**137**	**135**	**402**	**73.0**
Total Aid Requirements	**114**	**119**	**166**	**155**	**551**	**100.0**
Of which: PSIP[2] Finance	38	41	40	42	160	29.0

Source: Bank staff estimates.

II. EXTERNAL DEBT SITUATION

A. Structure of External Debt

10. As of August 1992, Guyana owed its external creditors a total of US$1,908.5 billion (equivalent to 750% of GDP). In 1991, debt service payments were equivalent to 49% of exports of goods and non-factor services. At that time, the interest due to external creditors amounted to over 60% of Government fiscal revenues (excluding aid flows), and with amortization this amounted to just over 200%.

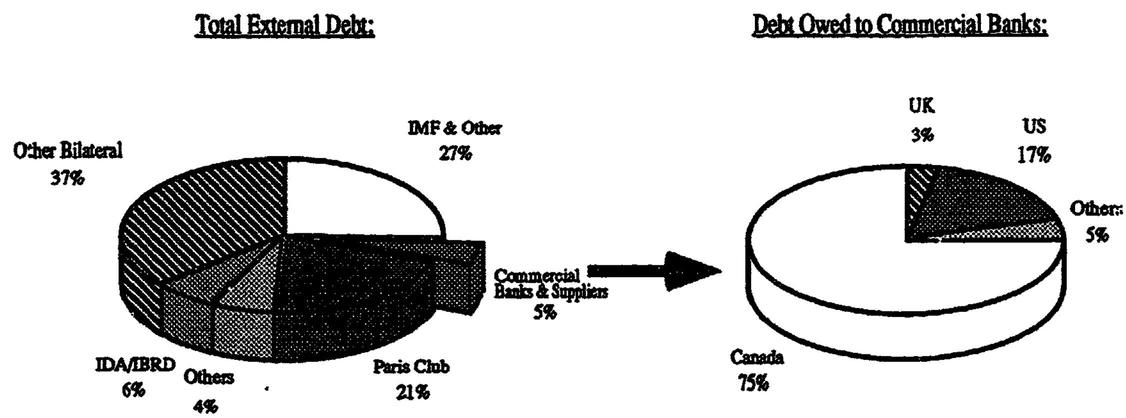
2 PSIP = Public Sector Investment Program.

TABLE 3: Debt Service Payments on Total External Debt, 1991

Debt Service (US$ Mn.)	141
Debt Service/Government Revenues (%)	208
Debt Service/Merchandise Exports & Non-factor Services (%)	49

Source: Bank Staff Estimates.

Figure 1:
Guyana's External Debt
(as of 8/31/92)



*Total Debt: US$1,908.5 Million**

* Does not include EPDS

Debt owed to Banks: US$92.6 Million

Note: "Other" includes Netherlands and Germany

11. As shown in Figure 1 and Table 4, Guyana's external debt is predominantly from official sources. Of the total (US$1,908.5 billion), multilateral institutions account for US$637.5 million (33%), of which US$123.3 million (6%) is from IDA/IBRD credits and loans. Paris Club rescheduled debt is US$391.77 million (20%), and commercial banks' and suppliers' credits account for approximately 5%. Of the total debt of about US$93 million that Guyana owes to commercial banks, approximately US$70 million (75%) is owed to Canadian domiciled banks.

TABLE 4: External Debt By Creditor (as of August 1992)
(US$ Millions)

	Debt Outstanding and Disbursed (Including Arrears)	Arrears Principal	Arrears Interest
Multilateral	637.50	--	--
IDA/IBRD	123.30	--	--
IMF and Other	514.20	--	--
Bilateral	81.70	--	--
Bilateral Rescheduled	1,019.97	--	--
Paris Club Rescheduled	391.70	--	--
Other	628.27	--	--
Commercial Banks	92.60	69.1	25.5
Others	76.69	--	--
Suppliers	47.40		
Nationalization	29.29		
TOTAL	1,908.5	69.1	25.5

Source: Government of Guyana, and Bank Staff Estimates.

12. Guyana's external debt burden is such that the Government will continue to require debt relief and concessional financial assistance from the international community in order to achieve external viability. Despite its sustained adjustment efforts and the relatively rapid export growth expected in the next years, the external position of Guyana will remain precarious over the medium term. The proposed debt reduction operation would support efforts to ameliorate Guyana's debt situation and achieve external viability. Furthermore, the future overall debt burden would be reduced. As Guyana has not paid commercial banks in several years, the immediate effect of a debt reduction operation on cash outflows is zero. However, by eliminating the debt as well as the *scheduled* debt service payments associated with such debt, Guyana will have a smaller overall *contractual* debt burden. The proposed operation would thus be part of Guyana's comprehensive external debt strategy.

B. Debt Strategy

13. An essential element of the Government's effort to attain a position of long-term fiscal and external viability is an external debt strategy which aims at a substantial reduction of its outstanding external obligations to both official and commercial creditors. Guyana's strategy for resolving its external debt obligations seeks to maximize the possibilities for debt relief on concessionary terms. These include efforts to secure the most-favorable Paris Club terms as well as grants and concessionary assistance from the donor community and IDA Facility resources.

Bilateral Creditors

14. In pursuit of the objective of reducing its debt burden, the Government has been successful in renegotiating the terms of its official bilateral debt through the Paris Club and also with Trinidad and Tobago.

15. Rescheduling of Guyana's official bilateral debt (and if the same terms were to apply to Guyana's debt owed to non-Paris Club creditors) on the basis of the terms of the 1990 Paris Club rescheduling agreement (i.e., on Toronto terms) implies US$88 million per year, on average, of debt service relief during the three-year period 1991-93. Details of the debt relief obtained by Guyana from each group of bilateral creditors are provided below:

> Paris Club: The Government of Guyana rescheduled its debt owed to Paris Club members in 1989 and more recently in 1990. On September 12, 1990, the Paris Club creditors[3] of Guyana agreed to reschedule eligible current maturities up to August 31, 1990 and the maturities falling due during the period from September 31, 1990 to July 31, 1993, including all accumulated arrears, in accordance with Toronto Terms.[4] The debt includes commercial credits guaranteed or insured by the governments of creditor countries, long-term loans from the creditor governments which were extended before December 31, 1988, and repayment of principal and interest due as a result of the consolidation agreements concluded or to be concluded according to the Agreed Minutes dated May 23, 1989. Option A of the Toronto terms was chosen by France. Option B was chosen by the Federal Republic of Germany, the Netherlands, and the United States. Option C was chosen by the Governments of Canada, Denmark, Japan, Norway and the United Kingdom.
>
> Other Bilateral Creditors: Guyana is also seeking to initiate negotiations with its non-Paris club creditors to reduce debt service due. It has already renegotiated the terms of its bilateral debt with Trinidad and Tobago. Negotiations with OPEC and other non-OECD bilateral creditors are to be sought with the aim of achieving debt and debt service reduction agreements that are at least as favorable as those reached with the Paris Club.

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[3] Guyana's Paris Club creditors consist of the Governments of Canada, Denmark, the Federal Republic of Germany, France, Japan, the Netherlands, Norway, the United Kingdom, and the United States of America.

[4] The Toronto terms are the following:

- Option A, under which one-third of eligible debt service during the consolidation period is canceled and the remaining is rescheduled at market interest rates over 14 years including eight years of grace.

- Option B, under which eligible debt service is rescheduled at market interest rates over 25 years including 14 years of grace.

- Option C, under which eligible debt service is rescheduled at a lower interest rate (either 3.5 percent or one-half of the market rate, whichever gives the smallest reduction) over 14 years including eight years of grace.

Caribbean Multilateral Clearing Facility

16. As of September 20, 1989, Guyana's arrears under the Caribbean Multilateral Clearing Facility (CMCF) amounted to US$151.3 million, comprising an original principal amount of US$96.5 million and accrued interest of around US$54.9 million. In September 1989, Guyana reached agreement with its CMCF creditors for the rescheduling of its arrears to provide for a twenty year maturity period, including ten years of grace, at an interest rate of 5%, payable on a semi-annual basis.

17. Since November 1990, Guyana has been utilizing its bilateral accrued surpluses, arising from its trade transactions within the Caribbean Region, towards the settlement of its payment obligations under the CMCF. Guyana has paid a total of US$16.6 million to the CMCF over the period November 1990 to July 1992.

Commercial Bank Creditors

18. The Government of Guyana's debt strategy has been to reduce the debt service burden in the short term and also, where possible, to make arrangements to reduce the stock of debt over the long term. Now that Guyana has concluded an ESAF arrangement with the IMF after the repayment of its debt to multilateral financial organizations, and its bilateral debt outstanding to Paris Club members has also been rescheduled, the Government's objective is to address its commercial bank debt problem in a comprehensive manner.

19. Guyana's commercial bank debt has gone through a series of deferrals and restructurings in the past. An agreement was signed on October 31, 1979 between the Government of Guyana and eight commercial banks with the Royal Bank of Canada, as coordinating agent, under which 80% of the principal repayments due during the period November 1, 1979 to October 31, 1981 were deferred and converted into two term loans. Amounts of principal repayments due on these loans were deferred six times thereafter. In terms of the Seventh Deferment Agreement, an amount of US$64.6 million was deferred until November 1, 1988. In addition to the bank debt covered by the Seventh Deferment Agreement, there are three other commercial bank loans in arrears totaling US$4.6 million.

20. Guyana has requested assistance under the IDA Debt Reduction Facility for the purpose of resolving its commercial bank debt arrears in a comprehensive manner. By executing a debt reduction operation, Guyana would attempt to effect an orderly settlement of its commercial bank debt obligations and eliminate the possibility of any further accumulation of arrears relating to such obligations.

Others

21. ***Suppliers Credits.*** In addition to the commercial bank debt, Guyana has some outstanding suppliers credits amounting to about US$47.4 million. These credits are mostly extended to borrowers in the bauxite industry and are subject to separate negotiations, including a recently concluded rescheduling agreement between GOG and some of the suppliers.

22. ***Nationalization.*** This category comprises long-term debts incurred by GOG in the nationalization of certain industries in the 70's and 80's. The total amount outstanding under this category amounts to US$29.29 million. However, GOG has various arrangements in place to deal with this category independently of the proposed operation.

23. *External Payment Deposit Scheme (EPDS).* Under the Bank of Guyana's (BOG) External Payment Deposit Scheme which was implemented in 1978, there is an estimated US$72.03 million of suppliers credit owed to some 2000 suppliers. Between 1978 and 1990, GOB required all private sector importers in Guyana to deposit the remittance value of imports, in Guyanese dollars, in the Bank of Guyana with the understanding that BOG would remit the required foreign exchange payments to the respective suppliers. Although these credits are now in arrears, they are not eligible under the proposed operation since they are not classified as Government guaranteed debt, and are expected to be settled independently of the proposed operation.

III. THE PROPOSED OPERATION

24. The Government has requested a grant of up to US$11 million from the IBRD's FY89 net income contribution to the Facility for a commercial bank debt reduction operation. According to the Government and its financial advisors, the amount of Eligible Debt is estimated to be about US$93 million equivalent (consisting of about US$69.1 million in principal and US$23.5 million in past due interest) as of August, 1992, based on current exchange rates. The President's memorandum notifying the Board of the proposed operation had requested authorization to use up to US$10 million from the IDA Facility, based on the estimated total commercial debt envisaged for the operation at that time. The amount of commercial debt to be retired under the proposed operation, however, could be higher than envisaged due to the possibility of higher amounts being finally tendered for the buy-back and any exchange rate related increase in the US dollar equivalent of the amount of debt designated in currencies other than the US dollar. In addition, it became necessary for the Government to pay its largest creditor bank approximately US$68,000 for legal expenses and outstanding agency fees as a precondition to the bank's willingness to participate in the operation. In the continued absence of any prospects of cofinancing by bilateral donors, it is recommended that the proposed grant be increased from US$10 million to US$11 million as a contingency against an unexpected increase in the principal amount of debt tendered and to reimburse the Government for such expenses and fees. It is anticipated, however, that the actual disbursements from the proposed grant will be around US$10 million, assuming full commercial bank participation. The grant amount is in addition to the grant of US$340,000 previously provided to GOG for legal and financial services to GOG for the preparation of this operation. The objective of the proposed operation will be to discharge the total amount of Eligible Debt at a very substantial discount. The proposed operation is expected to be completed by the end of November of this year.

A. Description of the Operation

25. The proposed Operation is structured as a cash buy-back. GOG will offer to pay its commercial bank creditors 14.47 cents for each dollar of principal of Eligible Debt in satisfaction of all amounts owed with respect to such Eligible Debt, including principal and all unpaid interest, penalties and fees. For the total amount of commercial debt extinguished, including unpaid interest, this would be equivalent to a price of 10.8 cents for each dollar of debt. The buy-back price being proposed to the commercial bank creditors in this operation was established by GOG with the assistance of its financial and legal advisors following discussions with the Royal Bank of Canada, the lead creditor bank (holder of approximately 70% of eligible debt). In the opinion of the financial advisors of GOG, this price should result in substantial acceptance of the offer by the creditors.

26. Creditors will be given until October 19, 1992 to respond to the offer. GOG may extend the expiration period of the offer until October 23, 1992 for creditors initially electing not to participate. The date by which the tenders from the banks must be accepted by

the Government is October 28, 1992 or, if later, ten business days following the expiration date of the offer. Acceptance by GOG is contingent upon at least 95% of the total Eligible Debt being tendered. In addition, any bank that has tendered its debt has the right to rescind its tender no later than two business days prior to the acceptance date if GOG (i) has not received tenders for at least 95% of the Eligible Debt or (ii) such bank reasonably believes itself subject to a potential claim from non-participating banks to share the proceeds received by such bank from the proposed operation. The closing date for the proposed operation is November 24, 1992.

27. Some of the Eligible Debt is outstanding under credit agreements which contain sharing clauses. The effect of such clauses is to require that banks receiving disproportionate payments on the debt subject to such agreements share such payments in some cases with the other banks that are parties to the agreement so that each bank receives its proportionate share of payments made by the borrower with respect to the debt. A waiver of the applicable sharing clauses would have required the consent of banks holding 100% of the principal amount of the relevant debt. GOG and its advisors determined that it would not be practical to obtain such waivers.

28. The offer is structured so that a bank that participates in the operation agrees to waive any claims it may have against either GOG or the Association in the event it is required to share the proceeds of the operation with non-participating banks. Thus, neither GOG nor the Association would have any exposure if a sharing claim were to arise.

29. Furthermore, it is unlikely that any such sharing claim against a bank participating in the operation would be upheld as there are credible legal arguments against giving effect to sharing claims in this situation. However, as there has never been any definitive court decision on this matter, it cannot be said with certainty that this would be the case. Thus, the offer provides a means for participating banks to rescind their acceptance if they believe a sharing claim is likely to arise.

30. It is important to note that a bank can only exercise this recision right no later than two business days prior to the acceptance date. After that date, banks that have tendered their debt are obligated to proceed with the operation even if a sharing claim were to arise. In addition, the Association would provide financing for the operation in any case only if the operation retires 95% of the total amount of Eligible Debt. If this threshold is achieved, any sharing claim would be unlikely to present any practical difficulties.

31. In addition to the resources needed to finance the purchase of Guyana's Eligible Debt, GOG has requested that it be permitted to use up to US$75,000 from the proceeds of the grant from the Facility to finance the incidental costs incurred by it in implementing the operation. Such costs include agency fees paid by GOG to the Royal Bank of Canada as a condition for its participation in the operation. The costs of GOG's financial and legal advisors for the operation are being financed from a separate grant from the Facility of US$340,000,[5] which was funded by the Government of Canada.

32. Actual resources needed for the proposed operation can be determined precisely only following the expiration date of the offer. The resources required will depend on two factors: the reconciled amount of debt tendered and, in the case of debt denominated in currencies other than US dollars, the exchange rate between such debt and US dollars. As no major reconciliation problems are foreseen and only a small amount of the Eligible Debt is denominated in other currencies, it is expected that the proposed grant of US$11 million from

[5] "Guyana: Allocation of Resources of the Debt Reduction Facility for IDA Only Countries for a Proposed Debt Reduction Operation and Grant from the Facility for the Preparation of the Proposed Operation". (IDA/R92-46, April 28th, 1992).

the Facility will be sufficient for the proposed buy-back operation and that actual disbursements will be around US$10 million.

33. The funds to be made available under the Facility will enable Guyana to make payments to creditors that would otherwise not be feasible. It is considered likely, therefore, that the bulk of the existing commercial bank debt will be extinguished under the terms offered. It is possible, however, that some creditors will not tender their claims. As time and resources permit, Guyana will attempt to reach a satisfactory resolution with the remaining commercial creditors for the remaining outstanding debt. However, it is not expected that Guyana would be able to settle any such remaining debt from its own resources in the near future, nor is it anticipated that commercial bank creditors not participating in this operation would be able to obtain more favorable treatment than creditors tendering their claims under the proposed offer.

34. The grant agreement contains inter alia the following conditions of effectiveness:

(a) the details of the offer and related agreements are satisfactory to the Association; and

(b) the Association has received satisfactory legal opinions on the offer and related agreements.

35. The grant funds from the Facility would be disbursed for the purchase of the principal amount of Eligible Debt pursuant to the offer and for incidental costs of up to US$75,000 incurred by GOG in order to complete the proposed operation. No disbursements from the grant account would be made unless the conditions precedent to the purchase set forth in the offer, including the acceptance of the offer by commercial banks holding 95% of the estimated total eligible debt, have been satisfied. The proposed grant's closing date is expected to be no later than 180 days after the signing of the grant agreement.

B. Eligibility

36. The debt retirement program of the GOG meets the conditions specified in the Operational Guidelines and Procedures for the Use of the Resources of the IDA Debt Reduction Facility of IDA-Only Countries (IDA/R89-156, IDA/R89-103, July 19, 1989) and the Review of the Progress Under the Debt Reduction Facility for IDA-Only Countries (IDA/R92-33, IDA/R92-26).

- The Government is currently implementing a comprehensive medium-term adjustment program acceptable to the Association and has succeeded in adhering closely to the policy changes specified in each of the Policy Framework Papers since 1988 (paras. 3-4).

- GOG has an external debt management strategy satisfactory to the Association (paras. 13-23).

- GOG's debt management strategy and the operation to be funded by the proposed grant will materially enhance Guyana's growth and development prospects, as described below.

C. Benefits and Risks

Benefits

37. The low purchase price being offered by GOG should make it possible for the stock of Guyana's commercial debt to be substantially acquired with a relatively small commitment of resources from the Facility. For Guyana, the proposed debt reduction operation is expected to have the following benefits:

(i) Orderly resolution of its commercial debt burden. Guyana has not been able to make any debt service payments to its commercial bank creditors since 1979. Guyana's ability to borrow on commercial terms is severely restricted by its low credit rating and low debt servicing capacity. The proposed debt reduction operation offers the opportunity to help bring about an orderly resolution of Guyana's commercial bank debt burden through the voluntary termination of commercial bank creditor claims on the country. This will help prepare the way for Guyana to eventually resume borrowing, over the long-term, from the international capital markets as the objectives of its ongoing adjustment program are realized. The continued support of the official donor community will be indispensable during the interim period.

(ii) Improved creditor relations. The elimination of Guyana's commercial bank arrears and the strengthening of GOG's balance of payment position should lead to improved creditor relations. GOG is continuing to carry out the policy reforms needed to improve the general climate for private investment in Guyana. With the elimination of Guyana's backlog of external debt obligations, the way would be clear for foreign investors, exporters and importers dependent on foreign suppliers to make investment decisions without being concerned about the risk of disruptions stemming from disputes arising from these external debt obligations. Strengthening the country's balance sheet should also lead eventually to improved availability and better terms for trade finance and other short term banking facilities. How long this process will take and by how much spreads may be reduced are difficult to predict. What is clear is that the continued accumulation of arrears will make it very difficult for Guyana to acquire lines of credit for trade and related activities in an efficient and low-cost manner.

(iii) Facilitate continued compliance with adjustment program. One of the objectives of Guyana's adjustment program is to create a framework for addressing Guyana's arrears with its creditors and for improving the country's relationship with the international financial community. In particular, the funding assurances policy of the IMF requires that in a situation of accumulated arrears to commercial creditors, negotiations take place between the country and its creditors with a view to reaching agreement on a reasonable settlement, consistent with the country's medium-term balance of payments viability. In the case of Guyana, the only scenario that could lead to balance of payments viability is one in which comprehensive debt reduction is achieved. Preliminary estimates suggest that implementation of a debt reduction package similar to the recent Trinidad proposal could lead to balance of payments viability. With the decisions recently announced by most of Guyana's key creditors, implementation of such a debt reduction package has already begun. Several Paris Club creditors have canceled part or all of Guyana's official debt. Similar discussions are proceeding with Guyana's non-OECD official creditors. The availability of the resources of the IDA Debt Reduction Facility will enable Guyana to reduce its commercial bank debt. Without this opportunity, the arrears situation would have to be resolved at some future date when the amount of debt outstanding would be much more substantial. By the year 2005, in the absence of the proposed operation, Guyana's commercial bank debt would be approximately double, in real terms, that of its end-1989 level.

Risks

38. The principal risk is that the critical mass of participating creditors (para. 26) will not be attained and the operation will not proceed. The financial and legal advisors engaged by GOG have had informal discussions with commercial bank creditors and are of the view that the required threshold will be met. The precise amount of the debt which will be tendered, however, will not be known until the expiration date of the offer. A second risk relates to possible delays due to the general elections scheduled for October 5, 1992 and possible slippages in the macroeconomic reform program underlying the proposed operation. However, there is broad agreement on the thrust of the ERP, and the proposed operation provides critical support in keeping the ERP on track.

IV. BANK GROUP STRATEGY AND OPERATIONS

A. Past Assistance

39. Prior to the Structural Adjustment Program approved in June 1990, there had been no new Bank Group lending to Guyana since 1982. Bank Group lending in the past had supported investment operations in a variety of sectors. The Bank Group also provided a Structural Adjustment Loan and Credit, approved in 1981. An IMF Extended Fund Facility (EFF) was also approved in 1981. Guyana's performance under the first year of the EFF fell short of the targets set and the adjustment program was terminated in mid-1982. The improvements envisaged under the Bank Group's program did not materialize because of the slow rate at which planned policies were implemented, and economic performance further deteriorated. An evaluation of Guyana's performance under the 1981 SAL/SAC (OED Report No. 6119 of March 25, 1986) identified two weaknesses: the lack of government commitment to the basic policy thrust of the program and the lack of institutional capacity to implement the program. The lessons were taken into account in the design of the 1990 SAC.

B. The Resumption of Bank Group Assistance

40. The support provided under the 1990 SAC made an important contribution to the success of the Support Group in normalizing Guyana's relations with its multilateral creditors. The Government has responded well to the Support Group's efforts, persevering with the ERP under difficult circumstances, and in spite of the fact that net inflows were small, leaving the program thinly financed. After initial difficulties, the Government took decisive steps and actually surpassed program targets in a number of key policy areas. With the macroeconomic and incentive framework now in place, the next major phase of the Government's effort will need to be directed towards the rehabilitation of basic infrastructure, public institutions, social services and deepening the reform process. Continued progress in these areas will be essential to encourage long-term private sector response to the improved incentive environment and to create confidence in the population at large that opportunities exist for improved living standards. To meet these challenges, however, the Government will need a continuation of substantial amounts of external support in the form of highly concessional loans and grants as well as significant additional debt relief.

C. Country Assistance Strategy

41. The Bank Group country assistance strategy seeks to support the Government's effort to generate sustainable economic growth and alleviate poverty by:

(a) promoting the efficient development of the private sector as the principal engine of economic growth and employment generation. This would involve: (i) support for the Government's divestment and rehabilitation efforts in two of the key productive sectors of the economy (bauxite and sugar), and (ii) support for continued private sector development;

(b) assisting in the rehabilitation of the economic and social infrastructure needed to support the private sector and in institutional strengthening to improve the efficiency of the public administration;

(c) supporting measures to address the short-term impact of the adjustment program on vulnerable groups, to promote economic opportunities for the poor, and to bring about the rehabilitation of the social sectors;

(d) through the Caribbean Group for Cooperation in Economic Development (CGCED), assisting Guyana in its efforts to mobilize the external resources needed for the implementation of the Government's PSIP -- this must come from a combination of concessional loans, grants and additional debt relief;

(e) assisting Guyana in addressing the issue of its commercial bank debts through use of the IDA Debt Reduction Facility through the proposed operation; and

(f) continued monitoring of the ERP, including tax reform and other aspects of fiscal performance through planned Economic and Sector Work (ESW).

42. Poverty Alleviation. In order to understand fully the extent of poverty in Guyana, the recently approved Health and Nutrition project is financing a Living Standards Measurement Survey (LSMS) which will form the basis for the development of a comprehensive strategy for assistance in the area of poverty alleviation. It is also expected that through economic growth and targeted interventions the level of poverty will be reduced. Progress in this area will be crucial to support the viability of the Government's adjustment program.

43. Private Sector Development. The Bank Group's assistance strategy also seeks to promote greater private sector participation in the economy. In two of the traditional productive sectors (bauxite and sugar) where performance has been weak, Bank Group assistance will support the Government's divestment efforts to establish joint ventures as a basis for further assistance in the financing of the rehabilitation needs of both sectors. Efforts will also be made to address related environmental issues, notably in the mining sector. Progress towards the establishment of joint ventures in both sectors has been slow because of the reluctance of potential foreign partners to commit new money in the form of risk capital. These efforts are being closely coordinated with IFC. MIGA recently approved its first guarantee project for Guyana and is considering a number of other guarantee arrangements.

D. Future Country Lending Operations

44. Assuming the continued successful implementation of sound macroeconomic policies and the Government's adjustment measures remain on track, the planned lending for FY93-96 will focus on the following areas:

> Private Sector Development and Public Sector Reform: This will include operations to support the divestment efforts and rehabilitation needs of the bauxite and sugar industries as well as an operation to strengthen the incentive framework for private investments and the financial sector. These operations will be closely coordinated with IFC.
>
> Infrastructure Rehabilitation: Taking into account planned assistance programs by other donors, Bank Group assistance is likely to focus on infrastructure rehabilitation (roads, bridges, sea wall and drainage improvements) and on water supply and sewerage.
>
> Human Resource Development and Poverty Alleviation. A planned human resource development project, to improve the Government's capacity to deliver health, nutrition and education services over the medium term is expected to complement the recently approved Health and Nutrition Project.
>
> Public Sector Restructuring. A key issue in Guyana is the shortage of qualified manpower in the public sector. To address this critical need, a proposed public administration project is currently under preparation to complement the program to restructure and strengthen public administration financed by UK/ODA.
>
> Country Progress Criteria. In view of the tight economic situation, continued strict adherence to the ERP will be essential for the achievement of sustainable growth and poverty alleviation. In particular, the continued implementation of sound macroeconomic policies, including strong fiscal measures, maintenance of a market-determined exchange rate, appropriate pricing policies and divestment of public enterprises, will be essential to support private sector operations and investments as well as the effectiveness of the proposed IDA lending program discussed above.

E. Country Economic and Sector Work (CESW) Program

45. The CESW Program is designed to consolidate the results achieved under the ongoing structural adjustment program and to develop the analytical basis for the proposed lending program. Following the Country Economic Memorandum (CEM) recently completed and presented to the CGCED in June 1992, the CESW program will focus on: (i) a public sector expenditure review, including poverty assessment, and (ii) a private sector review, focusing on the incentive framework for further private sector development.

V. COLLABORATION WITH IMF

46. The Bank Group has worked closely with the IMF in the design and execution of adjustment operations, in formulating the lending strategy, and in economic and sector work. Since the early 1980s, Bank Group and the IMF staff have collaborated closely in the fielding of missions and in providing cross-mission support. Most recently, Bank Group and Fund staff cooperated in the preparation of the Government's updated 1992-94 PFP. Staff of

each institution also comment extensively on each other's work, use a common database, and liaise with each other to ensure consistent conditionality in lending operations.

VI. AID COORDINATION AND COFINANCING

47 Since the inception of the CGCED, the Bank Group has been playing an active role in providing an effective framework for donor coordination and in supporting Guyana's resource mobilization efforts. In this context and in addition to the regular CGCED meetings, the Bank Group has chaired a number of Special Sub-Group Meetings for Guyana and participated in a tour of various donor capitals with government officials to help mobilize support for the ERP. In an effort to provide for a closer and more effective donor coordination in the field, the Bank Group, in collaboration with the UNDP, has recently established a framework for periodic reviews of donor activities and programs on both a monthly and quarterly basis.

48. In view of existing constraints on overall IDA availabilities and Guyana's external resource requirements, Bank Group staff will, as in the past, continue to explore the prospects for cofinancing with other donors for each of the above planned Bank Group operations.

VII. RECOMMENDATION

49. I am satisfied that the proposed grant from the Debt Reduction Facility for IDA-Only Countries would comply with Resolutions No. 89-13 and No. IDA 89-4 of the Executive Directors and recommend that the Executive Directors approve the proposed grant on the terms and conditions proposed herein.

Lewis T. Preston
President

GUYANA - KEY ECONOMIC INDICATORS, 1989-92 a/

	Actual		Est.	Proj.
	1989	1990	1991	1992
GDP Growth Rate	-3.3	-3.2	6.1	6.5
Total DOD (US$ million)	1852	1949	1852	1909
Debt Service (US$ million) b/	297	249	141	151
Debt Service/Exports, Goods	144.9	122.1	59.0	55.0
Public Investment/GDP	25.7	36.8	24.2	25.0
Public Sector Primary Current Account/GDP	18.1	16.9	28.0	30.0
Export Growth Rate (nominal)	-6.5	-0.5	17.2	14.6
Import Growth Rate (nominal)	-1.9	17.9	1.2	23.0
Current Account (US$ million)	-120	-163	-172	-235
Current Account/Exports, Goods	-58.5	-79.9	-72.0	-85.8

a/ 1992-94 Policy Framework Paper, including projections, currently under preparation.
b/ Scheduled.

GUYANA - BALANCE OF PAYMENTS, 1989-91 a/

(US$ million)

	Actual 1989	Actual 1990	Est. 1991
Exports, Goods	205	204	239
Imports, Goods	212	250	253
Resource Balance	-7	-46	-14
Services (net)	-127	-130	-171
Net Transfers (private)	14	13	13
Current Account Balance	-120	-163	-172
Capital Inflows	-62	-32	105
Direct Investment b/	..	7	68
Official Capital Grants	7	15	9
Net LT Loans	-61	-56	-21
Other c/	-8	2	49
Errors and Omissions	1	1	1
Overall Balance	-181	-194	-66
Financing	181	194	66
Bank of Guyana net foreign assets	29	-18	-41
Arrears	-146	-366	0
Exceptional Financing	298	578	107
Memorandum Items:			
Gross Reserves in weeks of imports	3.6	6.0	25.0

a/ 1992-94 Policy Framework Paper, including projections, currently under preparation.
b/ 1989 Direct Investment included in "other".
c/ Includes sales of assets, short-term credits and changes in net foreign assets of commercial banks.

STATUS OF BANK GROUP OPERATIONS IN GUYANA

A. Statement of Bank Loans and IDA Credits as of June 30, 1992

Loan/Cr. Number	Fiscal Year	Borrower	Purpose		US$ Million Amount (Less Cancellation) Bank	IDA	Undisbursed
12 loans and 12 credits have been fully disbursed:					76.2	61.0	
of which SECALs, SALs and Program Loans a/							
1098-GUA	81	Guyana	Structural Adjustment			8.0	
1948-GUA	81	Guyana	Structural Adjustment		14.0		
2168-1-GUA	90	Guyana	Second Structural Adjustment			3.4	
2168-2-GUA	91	Guyana	Second Structural Adjustment			4.3	
2168-3-GUA	91	Guyana	Second Structural Adjustment			18.0	
2168-4-GUA	92	Guyana	Second Structural Adjustment			3.1	
			Subtotal		14.0	36.8	
1729-GUA	87	Guyana	Bauxite Industry Tech. Assist.			7.0	8.2
2168-GUA	91	Guyana	Second Structural Adjustment			74.6	14.2
2168-4-GUA	92	Guyana	Second Structural Adjustment			3.1	3.4
2169-GUA	91	Guyana	Third Technical Assistance			3.0	2.5
2368-GUA	92 b/	Guyana	SIMAP/Health Nutrition and Water			10.3	10.7
			Total (Net of Cancellations)		76.2	159.0	
			of which has been repaid		43.2	2.0	
			Total Held by Bank and IDA c/		33.0	157.0	
			Amount Sold	0.8			
			of which has been repaid	0.8			
			Total Undisbursed d/				39.0

a/ Approved during or after FY80.
b/ Not yet effective.
c/ Book value (IBRD Current Value $50.0m; IDA Current Value $172.8m -- difference due to fluctuation in SDR/US$ exchange rate. Converted at rate prevailing at June 30, 1992)
d/ Current Value converted at SRD/US$ exchange rate prevailing at June 30, 1992.

B. Statement of IFC Investments as of June 30, 1992

Investment Number	Fiscal Year	Borrower	Type of Business	US$ Million Equity	Loan	Total	Total Held by IFC	Total Undisbursed
-	-	-	-	-	-	-	-	-