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Minutes of Executive Board Meeting 84/155

10:00 a.m., October 24, 1984

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	M. K. Bush
	H. C. Schneider
	X. Blandin
	M. A. Weitz, Temporary
M. Finaish	
H. Fujino	T. Yamashita
G. Grosche	B. Goos
	M. Rasyid, Temporary
R. K. Joyce	L. Leonard
A. Kafka	
G. Lovato	N. Coumbis
R. N. Malhotra	
	J. E. Suraisry
	T. de Vries
A. R. G. Prowse	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. A. Ajayi, Temporary
M. A. Senior	J. E. Rodríguez, Temporary
	A. Lindå
N. Wicks	
Zhang Z.	

L. Van Houtven, Secretary
J. C. Corr, Assistant

Also Present

Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; S. Mookerjee, Deputy Director; C. Brachet, H. W. Gerhard, S. Kanesa-Thasan, M. R. Kelly. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman, A. O. Liuksila, S. A. Silard. Middle Eastern Department: J. G. Borpujari. Research Department: N. M. Kaibni. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Western Hemisphere Department: S. T. Beza, Associate Director; M. Caiola, C. M. Loser. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: K. A. Hansen, H.-S. Lee, G. E. L. Nguyen, G. W. K. Pickering, M. Z. M. Qureshi, E. M. Taha, D. C. Templeman, N. Toé, A. Vasudevan. Assistants to Executive Directors: I. Angeloni, W.-R. Bengs, M. B. Chatah, Chen J., G. Ercel, V. Govindarajan, G. D. Hodgson, H. Kobayashi, J. A. K. Munthali, K. Murakami, E. Olsen, J. K. Orleans-Lindsay, T. Ramtoolah, A. A. Scholten, L. Tornetta, A. J. Tregilgas, B. D. White, A. Yasseri.

1. EXTENDED AND STAND-BY ARRANGEMENTS - APPROVAL IN PRINCIPLE

The Executive Directors considered a staff paper on the approval in principle of requests for extended and stand-by arrangements (SM/84/217, 9/25/84; and Cor. 1, 9/28/84).

Mr. Wicks commented that the emergence of the procedure for approval in principle was a symptom of the strains that had characterized international financial markets in recent years. On many occasions, the Fund had had to seek assurances from creditors and donors that sufficient external financing would be forthcoming to support members' adjustment efforts. At the same time, creditors and donors, particularly the Paris Club and the commercial banks, had required assurances from the Fund about an adjustment program before finalizing the external financing arrangements. The situation represented a classic "chicken-and-egg" problem. The best solution by far would be informal consultations between the management of the Fund and the financiers, so that the Executive Board could grant outright approval of an arrangement, followed shortly by, for example, a Paris Club rescheduling. However, there would be cases in which it would not be possible for the Board to give outright approval, such as when Fund management had been unable to obtain sufficiently firm assurances in advance that a financing gap had been closed, or when the circumstances of the case were such that the creditors felt unable to commit themselves, even informally, before a Fund program was in place. In such cases, which ought to be exceptional, the approval-in-principle procedure was proper; in general, the Executive Board had followed that approach.

Experience of the approval-in-principle procedure suggested that it ought to be used cautiously and sparingly, Mr. Wicks continued. Its use was an indication that a program was under some pressure from the outset and emphasized the need for the Board to be as certain as possible, before approval was given, that the adjustment program would indeed be implemented. He agreed, therefore, with the recommendation by the staff that it was preferable to find an alternative procedure to the approval-in-principle approach whenever possible; he also agreed that Executive Board approval should not be sought until there was reasonable certainty about the financing arrangements.

The need for particular caution indicated that the Executive Board ought to take a firm line with regard to prior actions, Mr. Wicks suggested. Whenever prior actions formed part of the understandings on which a program was based, they should be taken before Board approval--whether outright or in principle--was sought. When approval in principle was contemplated, there was even greater need to be certain that all prior actions had been taken because the programs in question were--almost by definition--programs under particular strain. Moreover, it would be unfair to allow breathing space for a few members while their programs had approval-in-principle status, whereas other members were required to fulfill on schedule their undertakings regarding prior actions. Therefore, the approval-in-principle procedure should not be adopted in cases where prior actions remained to be taken, even if financing considerations might justify its use.

With regard to the deadline by which approval in principle would lapse, Mr. Wicks said, he supported the staff's suggestion that the limit should be 30 days, which ought to be an adequate amount of time in which creditors could come to final decisions on the external financing arrangements. A longer delay would increase the risk of the sorts of practical problems described by the staff; for example, the phasing of purchases could become inappropriate, or the policy program could go off track. If a viable program could not be put into effect within the 30 days, it should be withdrawn, and further discussions should take place between the staff and the authorities before a revised program was put forward for approval by the Executive Board.

The staff recommendation that programs for which outright approval was being sought should be brought to the Executive Board in a timely fashion was also welcome, Mr. Wicks remarked. However, the staff did not define "a timely fashion." He assumed that a period of not more than two or, at most, three months was envisaged. If a program were not brought to the Executive Board within that period, the authorities should understand that further discussions would be necessary to bring the program up to date. Finally, he endorsed the broad approach and the guidelines recommended by the staff. The guidelines allowed sufficient flexibility to respond to members' individual circumstances, while preserving important Fund principles, such as uniformity of treatment of members and the revolving character of the Fund's resources. Most important, the approach set out by the staff should help to ensure that all Fund arrangements would be viable from the date of Executive Board approval and thereby safeguard the credibility and the effectiveness of Fund-supported adjustment.

Mr. Grosche stated that he also agreed with the proposed guidelines. It was not advisable to establish guidelines that were too rigid and that could limit the Fund's ability to respond flexibly when needed. However, it was useful to have a general understanding of how the Fund should proceed in cases where approval in principle seemed to be the appropriate solution.

The staff had correctly emphasized that members seeking approval in principle should not be given more favorable treatment than members seeking outright approval of arrangements, Mr. Grosche continued. Approval in principle should be granted only in cases where the adjustment programs were viable; as the staff had stressed, approval should not be sought until management and staff were reasonably certain that financing would be made available in the expected amounts and terms and that all the key elements of the program were in place. In the light of that principle, management and staff should normally propose arrangements for outright approval by the Executive Board. Approval in principle of arrangements in cases where substantial uncertainties with regard to financing remained should be the exception. In that regard, the staff's reference to "substantial uncertainties" on page 19 of SM/84/217 appeared to contradict somewhat the general principle outlined on page 18, where, in paragraph (c), the staff stated that "approval should not be sought, even in principle, until management and staff are reasonably certain that financing will be made available in the expected amounts and terms." He invited the staff to comment on the two statements.

In cases where debt relief was sought through the Paris Club, Mr. Grosche remarked, the proposed procedures should not lead to pressure by the Fund on the creditor countries. Contacts between the Fund, the Paris Club, and the creditor countries ought to retain their purely informal character and should not prejudice the final outcome.

He welcomed the staff's recommendations concerning the adjustment of performance criteria or targets in cases where the external financing arrangements finally concluded were different from the assumptions made at the time of Executive Board approval, Mr. Grosche said. If the outcome turned out to be more favorable than expected, an automatic downward adjustment of the targets would be appropriate. If, however, the external assistance turned out to be less favorable than originally assumed, no adjustment of the target should be made. He also supported the proposed deadline for the lapse of approval in principle. An outer limit of 30 days was appropriate in order to prevent the phasing of purchases from falling out of step with the timing of the performance criteria. The staff had also addressed problems arising from delays between the time of the Board's approval in principle of an arrangement and its coming into effect. Such delays could lead to unintended frontloading as a result of the bunching of drawings. To prevent such a situation, a period should be clearly established by which prior actions would have to be implemented and/or external financing would have to be secured. A failure to meet the deadline would create a need to reopen negotiations.

Mr. Lovato observed that the approval-in-principle procedure provided additional flexibility at a time when the Fund was being called on to intervene in an increasingly difficult and differentiated environment. The financing needs of the countries undertaking adjustment had increased more rapidly than the amount of resources directly controlled by the Fund. Thus, the scope for the Fund's "catalytic" role had widened. Approval in principle was one instrument through which it could perform that role; careful use of the instrument should result in greater benefits than costs. The advantage of enhanced flexibility was one reason why he supported, for the moment, the approval of guidelines rather than the taking of an Executive Board decision. However, if the procedure were applied more regularly in the future, more specific rules of action would have to be established.

The critical issue was when to opt for approval in principle, Mr. Lovato continued. He agreed with the staff's suggestion that it could be considered in cases where it would assist the member in reaching agreement with creditors. However, the approach should be adopted when there was a reasonable certainty that approval in principle would trigger support by creditors or other sources of finance rather than when substantial uncertainty remained with regard to the financing of a program. In a case of real uncertainty, the Fund should be very cautious about putting its credibility at stake; a case in which the Executive Board approved an arrangement in principle and the complementary financing did not materialize would have to be regarded as a serious failure for the Fund. Contingent approval was, therefore, appropriate in cases where a positive signal from the Fund was the last serious condition to be fulfilled for the mobilization of the needed financial resources.

He also agreed with the staff, if he had interpreted its view correctly, that approval in principle should not be made conditional on the adoption of policy measures, Mr. Lovato remarked. A program should come to the Executive Board when prior actions had been implemented. To act differently would be to open the way to unequal treatment of members, some of whom would be allowed to obtain part of the benefit of the arrangement before having demonstrated fully their willingness to take the appropriate policy measures. Furthermore, to make approval conditional on both the availability of additional financing and on the adoption of policy measures would be unwise and could create dangerous confusion. A program that would not be brought to the Executive Board because prior actions had not been taken should not be proposed for approval in principle in order to mobilize external resources, even when such financing was available. Indeed, the Fund should be more cautious when attempting to attract external financing than when its decisions involved only its own resources. In that regard, he invited the staff to assure Directors that the practice described in paragraph (d) on page 17 of SM/84/217 was not being recommended. Finally, he supported the recommendations with regard to deadlines and the procedures to modify the phasing of purchases under an arrangement.

Mr. Fujino stated that it was important to confirm that the basic rule was that approval of arrangements by the Executive Board should take the form of an outright decision. Although there had been cases of approval in principle, that approach had disadvantages, as the staff had mentioned. First, unequal treatment of members could arise, not only because arrangements should not be presented for Board approval before all prior actions had been taken, but also because there could be no clear-cut distinction between cases in which the approval-in-principle procedure was applied and those in which outright approval was sought. Second, under the approval-in-principle procedure, there was always the risk of reinforcing the argument that the Fund attempted to impose specific conditions on its members by making the implementation of certain policies or the granting of debt relief by certain creditors conditions for an arrangement to become effective.

It was, therefore, desirable to avoid the approval-in-principle procedure whenever possible, Mr. Fujino continued. Even under the normal procedure, when outright Board approval was proposed, safeguards could be provided, if necessary, through the use of the review clause and the performance criteria. Closer consultations between the management of the Fund and other creditors on an informal basis would also reduce uncertainties before a program was presented to the Board. Therefore, the circumstances in which the approval-in-principle procedure might be considered should be limited to cases in which only such a procedure could resolve the deadlock created when creditors insisted that debtor countries had in place a program supported by the Fund before they granted debt relief. In that regard, because of the requirement of the Paris Club that an arrangement with the Fund should be in place before it considered a request for rescheduling, he admitted, albeit reluctantly, that the approval-in-principle approach could be considered as a last resort when Paris Club financing on exceptional terms was required.

When exceptional financing was required from private creditors, however, Mr. Fujino added, he had difficulty in accepting the approval-in-principle procedure, even as a last resort. First, it was the responsibility of the commercial banks themselves to decide what kind of debt relief, if any, would be given to debtor countries. While he understood that there were circumstances in which the management and staff of the Fund needed to obtain assurance from commercial banks through informal consultations with regard to the amount of financing to be provided by them, it would not be prudent for the Executive Board to follow the approval-in-principle procedure and to identify, even in general terms, commercial banks as responsible for the financing of the uncovered gap. Second, because the creditor countries of the Paris Club were represented by Executive Directors, their positions on Paris Club financing could be expected to be reflected in the Board's discussion of approval in principle of an arrangement. On the other hand, because Executive Directors were in no position to represent commercial banks, those creditors' views would not be reflected if the approval-in-principle procedure were proposed when exceptional financing was required from private creditors.

He supported the staff's recommendation that, in cases where the approval-in-principle procedure was contemplated, members would be expected to implement all prior actions before an arrangement was submitted for Executive Board approval, Mr. Fujino said. In sum, he welcomed the cautious and sparing approach to the approval-in-principle procedure envisaged by the staff, but he had reservations about the use of such a procedure when exceptional finance was required from private creditors.

Mr. Finaish remarked that, although the different nature of individual cases and the need for flexibility in dealing with them might not permit precise criteria to be laid down on the use of the approval-in-principle procedure, it was, nevertheless, desirable to have a reasonably clear understanding of the main considerations that needed to be taken into account when deciding whether or not to use that procedure. In SM/84/217, the staff provided a useful description of such considerations: the exceptional scale or terms of the financing needed to close an ex ante financing gap, the degree of uncertainty associated with the availability of that financing, and the contribution that an arrangement approved in principle could make to bringing about--and expediting--an agreement between the member and its creditors on the needed financing package. Viewed against those considerations, however, the distinction between some of the arrangements with ex ante financing gaps listed in Table 4 that had been approved outright and the arrangements that had been approved in principle remained somewhat blurred. The situation indicated that the decision to use the approval-in-principle procedure in individual cases, within the broad framework of the foregoing considerations, involved a significant, perhaps inevitable, element of judgment. Therefore, it would be helpful if, in addition to the establishment of a set of general guidelines, the reasons for using the approval-in-principle procedure in individual cases could be explained to the Executive Board in as clear terms as possible when such approval was sought.

The approval-in-principle procedure had provided the Fund with useful additional flexibility in dealing with arrangements involving financing gaps, Mr. Finaish continued, especially at a time of increased uncertainty with regard to external financing for many countries. However, the procedure had certain drawbacks, and problems had been encountered in applying it, particularly in cases where delays had occurred in the coming into effect of an arrangement approved in principle. Therefore, approval in principle should be used only sparingly. In cases of ex ante financing gaps that required financing on an exceptional scale or terms, consideration might first be given to alternative procedures that could make possible outright approval by the Executive Board, such as seeking appropriate assurances from commercial creditors on the needed financing, advance informal consultations with Paris Club creditors, and--where some uncertainties about financing still remained--the provision of an early review under the arrangement. Even in cases where approval in principle might be considered because substantial uncertainties existed about matching financing, an attempt should be made through prior contacts to reduce those uncertainties as far as possible before such approval was sought.

While the approval-in-principle procedure might, therefore, be used in exceptional cases of ex ante financing gaps where it was considered that it would help the member in reaching an agreement with its creditors, Mr. Finaish went on, the staff had argued that that procedure should not be extended to the implementation of specific policy actions by the member. Although he could support that approach as the normal course of action, the option should be retained that some policy actions--in addition to the financing requirement--could be included in certain cases among the conditions to be met for an arrangement to become effective, instead of requiring their implementation before the arrangement was approved in principle. Such cases might arise as a result of unavoidable or unforeseen delays in the implementation of certain measures, or legitimate reservations on the part of the member about a specific prior action unless the financing was substantially assured.

Given the practical problems that could arise as a result of delays in the coming into effect of an arrangement approved in principle, there was a case for setting a deadline after which the approval would lapse, Mr. Finaish considered. A period of up to 30 days appeared reasonable. However, where deemed appropriate, it should be possible to extend the deadline. It was useful to recall that, in half of the cases of approval in principle examined in SM/84/217, the period that had elapsed before the arrangement had come into effect had been longer than 30 days.

There was also merit in the suggestion that in situations where outright approval was sought, the staff might establish with the authorities the time period by which prior actions, if any, would have to be implemented or external financing would have to be secured, Mr. Finaish stated, it being understood that failure to meet the agreed schedule might make it necessary to reopen negotiations. However, due flexibility would need to be exercised in working with any such deadlines. Finally, in some previous cases where delays had occurred in the coming into effect of an arrangement that had been approved in principle, the expiration date of the arrangement had been set with reference to the date of approval in principle, although, in other cases, it had been set with reference to the date on which the arrangement had become effective. He invited the staff to explain the factors that bore on the choice between those alternatives in such a situation.

Mr. Schneider said that, in using the approval-in-principle procedure, the Fund should proceed carefully because there was hardly any request for a Fund arrangement in which external financing was not a problem. In order to exercise flexibility in dealing with the different circumstances of member countries, the Fund should proceed on a case by case basis in deciding whether the procedure should be used. He agreed with the staff that alternative procedures should be applied whenever possible so as to avoid the impression that some members might receive better treatment than others.

The approval-in-principle procedure should be used only in exceptional circumstances, Mr. Schneider continued, which could be said to exist when there was a financing gap that was large in relation to the member's quota; the member had no access to normal commercial market financing; a stabilization program was already in place that demonstrated the member's determination to adjust the existing imbalance, thereby strengthening the confidence of creditors; and a decision to approve in principle was immediately followed by financial arrangements with creditors or groups of creditors that would, it was to be hoped, close the financial gap. He was not convinced that the procedure should be used with reference to prior actions because, as experience had already shown, delays in the implementation of certain policies could easily lead to inappropriate phasing of purchases and inappropriate performance criteria.

Credit ceilings or targets should not be automatically adjusted downward if a country received better than expected rescheduling terms and conditions, Mr. Schneider stated. He agreed with the staff's view expressed in paragraph (f) on page 19 of SM/84/217 that present procedures and assumptions should continue to be applied. It was reasonable to have a deadline by which approval in principle would lapse, and he could support the staff's recommendation that it should normally be not more than 30 days. The staff's understanding that an extension of the deadline would be recommended only if the entire program remained intact deserved emphasis.

Mr. Salehkhou observed that the emergence of, and the subsequent efforts to bridge, external financing gaps among Fund members had become common in recent years as the debt crisis had gradually expanded. In acknowledgement of the severity and importance of such considerations, the Fund's policy had been to assess, as reasonably as practicable, the likely size of the ex ante financing gap and the potential scope for debt relief to be provided by donors and other creditors, both official and private. The staff had indicated on page 16 of SM/84/217 that the rationale for the practice of approval in principle of Fund arrangements was mainly the result of creditors' insistence that debtor countries have in place a program supported by the Fund before they granted debt relief. The situation constituted a clear example of cross-conditionality, under which one condition for a borrower seeking debt relief was to have a Fund arrangement already in place and another condition for the same borrower seeking an effective Fund arrangement was to have prior debt relief from the creditors. Essentially, it was a "chicken-or-egg" argument as to which came first, the Fund or the creditors. Arrangements approved in principle had also, at times, incorporated other specific policy measures that had become preconditions before an approved Fund arrangement could become operative. However, as the staff pointed out, the fact that some such measures had not been implemented prior to the Executive Board's approval had not been the principal reason for selecting the approval-in-principle procedure. The overriding consideration had been to break the deadlock with creditors.

While such a procedure might be flexible and practicable, Mr. Salehkhou continued, it was not necessarily rational, because, as the staff had pointed out, the method did not constitute an unmitigated blessing. Not only was there a risk that different treatment might be accorded to seemingly similar cases, but the phasing of purchases under arrangements and the amount of access provided could also become inappropriate in cases of long delays between approval in principle and the effective date of implementation of the arrangement. However, the important consideration was that the ease or severity of the Fund's program depended on the size of the proposed debt relief. In one important sense, therefore, it was more important for the Fund to be certain of the likely size of the debt relief, before approving the program, than for the Paris Club creditors to require the prior existence of a Fund arrangement before they could agree to debt relief. He invited the staff to say whether there had also been non-Paris Club creditors that had insisted on such a precondition for agreeing to debt relief or whether the approval-in-principle procedure had been intended only to accommodate the demands of Paris Club creditors. If the latter interpretation were correct, the staff might have clarified at several points in SM/84/217 its general references to creditors by specifically referring to Paris Club creditors.

Most of the difficulties that he had mentioned and that stood in the way of the Fund implementing the approval-in-principle procedure would ease or disappear if the Paris Club creditors could be flexible and agree to adopt a similar procedure, Mr. Salehkhou considered. Instead of insisting on an arrangement with the Fund before even considering debt rescheduling, they could insist on such an arrangement prior to approving effective debt relief, thereby giving approval-in-principle treatment to the seekers of such relief before they approached the Fund. In some cases, such an approach could prove beneficial to both borrowers and creditors as it would help the staff--in devising the performance criteria--to assess clearly the magnitude of the potential debt relief with greater certainty and to formulate the adjustment program accordingly. Another advantage was that the Fund would not need to change the ceilings or adjust the stance of the program if Paris Club debt relief turned out to be different from that originally envisaged. He invited the staff to comment on the practicality of his proposal.

The staff had mentioned that informal consultations with the Paris Club secretariat and individual creditors would be held shortly after the Board had approved an arrangement on an outright basis and whenever debt relief on exceptional terms was being sought from the Paris Club, Mr. Salehkhou noted. Again, it would be useful if staff could clarify the point by explaining whether only Paris Club creditors would be approached or whether non-Paris Club bilateral creditors would also be brought into the picture. Other preconditions and criteria that were sometimes embodied in arrangements approved in principle should not be incorporated in decisions as conditions that would activate a program, particularly because those conditions had not been the reason for the emergence of the approval-in-principle procedure. Furthermore, care should be taken not to create further instances of cross-conditionality insofar as World Bank project loans were concerned. In the case studies listed in the Appendix to SM/84/217, the status of World Bank project loans had not been mentioned, nor had there been any reference to the possibility that delays or cross-conditionality were involved in that respect. To take a hypothetical example, if a case incorporating the approval-in-principle procedure coincided with disbursement of a World Bank loan, could the staff confirm that the World Bank disbursement would not be affected by the delay in the Fund program?

Notwithstanding the issues of consistency with the Paris Club and of flexibility, his chair believed that the approval-in-principle procedure should be used only rarely when such an approach would assist the borrower in reaching agreement with all its creditors, Mr. Salehkhou stated, in view of the infrequency of such cases, the more intensive conditionality attached to them, the lack of uniformity of treatment accorded to all creditors, and other procedural difficulties. In such cases, a deadline for the lapse of approval-in-principle, if shortly followed by a staff recommendation to extend that deadline--as had frequently occurred--would not be helpful; perhaps a more flexible approach based on informal consultations between the staff and the borrower would avoid undue rigidity and would prevent unnecessary delay between the date of Board approval and the entry into effect of the arrangement. A predetermined time limit might place pressure on both parties--the borrower and its creditors--to conclude hasty debt relief negotiations in order to meet the Fund's deadline. However, in such circumstances, the borrower stood to lose more because it was the party urgently in need of external financing.

Mr. Kafka said that the approval-in-principle procedure involved exceptional cases; they ought to remain exceptional. He agreed with the staff that flexibility was required, but such flexibility should not prevent the Executive Board from adopting a formal decision. A distinction could be made between flexibility in substance and the language of a decision. The decision could be written very precisely while permitting the Executive Board the required ample flexibility in substance. He would have preferred such an approach.

Approval in principle should not be limited to financing problems, Mr. Kafka continued. It had not been so limited in the past. In that regard, he supported the points made by Mr. Finaish. Nor should there be an invariable rule that approval in principle should lapse after 30 days. There was nothing to be gained by such rigidity. Of course, in each case in which approval in principle was granted, a period should be established after which approval would lapse, but there was nothing to be gained by laying down in advance that the period should be a specific number of days. There had been many cases in which approval in principle had proved helpful, although the arrangement had only gone into effect a month or more after that approval. There ought to be no danger of frontloading purchases, because the first drawing under the arrangement could be set in relation to the date when the arrangement became effective rather than the date of approval.

Similarly, there was no advantage in laying down an exact number of days after negotiations had been completed by which an arrangement should be brought to the Executive Board for a decision, Mr. Kafka considered. Even if such a period were agreed to, what would it mean in practice; for example, at what point did negotiations end? Attempts to establish too much precision only created problems.

Mr. Lindå said that he broadly supported the guidelines recommended by the staff. While they should be applied flexibly, they should be implemented with great caution. In circumstances in which there were substantial uncertainties about the financing of a program, approval in principle, if used sparingly, was an appropriate and necessary procedure. He stressed the catalytic effect of such an approach; it would also provide greater flexibility for the Fund. Moreover, the risk of not adhering to the principle of equal treatment of members should be small if a program were not presented to the Executive Board until the member had taken all actions considered essential for the Board's approval of the program's objectives. Approval in principle might also bring about an improvement in the development of Fund resources since it could reduce the risk that programs might be interrupted, because of a lack of external finance, after drawings had been made.

An effective and balanced exchange of information with other creditors, such as the Paris Club and the banks, was important, Mr. Lindø considered. The exchange of information should be such that it could contribute to a reasonable distribution of the burden of financing. He understood that the Fund's role in that context would be to indicate the financing need in general terms. He agreed with the staff that a decision to approve in principle should include a deadline after which the approval should lapse. After a certain period, the adjustment program could be less appropriate, and the phasing of purchases under the arrangement could fall out of step with the timing of the performance criteria. However, the deadline should be set on a case-by-case basis rather than on the basis of a rigid 30-day limit.

Mr. de Vries said that the guidelines recommended by the staff, which he supported, contained an appropriate combination of order and flexibility. Resort to the exceptional procedure of approval in principle could indicate that the difficulties facing the country were also exceptional. He agreed with other speakers, therefore, that approval in principle should not result in more favorable treatment of a member than would result under the normal procedure of outright approval. He supported Mr. Lovato's point that the Fund would need to receive a signal that approval in principle was likely to bring forth the required additional finance. Of course, there could not be complete certainty in that regard, but the Fund would quickly lose credibility if it approved in principle programs that had no realistic hope of being financed.

The approval-in-principle procedure should be used sparingly, Mr. de Vries continued. Outright approval was far preferable, although care should also be taken to ensure that programs were not brought to the Board for outright approval before they were adequately structured, with too much reliance being placed on review clauses. With regard to the deadline, he believed that the staff's recommendation was less rigid than Mr. Kakfa had suggested. The staff had stressed that a decision to approve in principle should contain a deadline and it had recommended that, in general, 30 days would appear to be "a reasonable outer limit." However, it had not suggested that the deadline should always be 30 days. He could, therefore, support the staff's recommendation.

Outright approval could also involve the issue of delay, Mr. de Vries observed. The longer the delay between the conclusion of negotiations on a program and the Executive Board's approval, the more likely it became that the program was less realistic. Long delays should therefore be avoided, whether approval in principle or outright approval was being sought. More generally, he strongly supported the staff's suggestion that a time limit should be set within which prior actions would be taken in support of the program.

The situation with respect to drawings under the compensatory financing facility had not been discussed in SM/84/217, Mr. de Vries commented. When a drawing in the upper tranche of that facility was being sought, he had no difficulty with resort to the approval-in-principle procedure where appropriate. However, in the case of a drawing in the lower tranche of the facility, a strong case could be made that approval by the Executive Board should be outright because approval would be granted only when the Board was satisfied that the country was pursuing appropriate policies. However, what would happen if the country did not take the necessary measures? It would, nevertheless, have to make repurchases under the facility. He invited the staff to comment.

He supported Mr. Salehkhou's remarks with regard to the avoidance of cross-conditionality in relation to disbursements of World Bank loans, Mr. De Vries added. However, if there were uncertainty about the envisaged finance under a World Bank program, the problem would be the same as that associated with uncertainties about other sources of finance such as commercial banks. Perhaps the staff could clarify what the appropriate course of action should be if the financing of a Fund program were adversely affected by uncertainties with regard to financing from the World Bank.

Mr. Joyce stated that the use of the approval-in-principle procedure should remain exceptional. To date, its use had been judicious. The management and staff had been cautious in proposing resort to the procedure, and the Executive Board had been cautious in agreeing to such proposals. The present discussion was proof of the desire for caution because it reflected the fact that at least some Directors had been concerned, not so much about what had been done in previous cases, but about where the use of the procedure might lead. The thorough examination conducted by the staff and the search for guidelines were, therefore, justified. In the majority of the eight cases described by the staff there had been clear benefits to both the member and the Fund from the use of the approval-in-principle procedure.

He generally agreed with the staff's recommendations, Mr. Joyce continued. The normal practice should continue to be to seek outright Board approval of programs. Indeed, in cases where there were reasonable assurances that the external financing uncertainties were temporary and would be resolved shortly, there appeared to be little need to rely on the approval-in-principle procedure. In most cases, the program could be brought to the Board for final approval. An early performance review would provide a sufficient safeguard in the event that the assumed financing did not in fact materialize and that offsetting adjustments were not taken. However, cases could arise where there remained sufficient doubts about the availability of the necessary financing to make outright approval by the Executive Board difficult to justify. In such instances, it could be argued that approval in principle of an arrangement could be a useful catalyst in generating quick agreement between the country and its creditors because such approval would demonstrate the Board's support of the country's policy direction.

As to the Paris Club, the issue of approval in principle was fairly straightforward, Mr. Joyce suggested. While it was true that the Paris Club required a Fund program to be in place before it approved rescheduling arrangements, all members of the Paris Club were also members of the Fund; through informal discussions with them and with the borrowing member, the Fund should be able to assure itself of the modalities of the likely Paris Club agreement. Even in cases where a Paris Club rescheduling was being sought on so-called exceptional terms and where the use of the approval-in-principle procedure might be considered more appropriate, the likely outcome could be envisaged with reasonable precision.

Similarly, in the case of private debt rescheduling, or where there was a demonstrated need for additional or new financing from the commercial banks, Mr. Joyce remarked, the Fund's practice had been that management should first seek explicit assurances that the required amount of financing--"the critical mass"--would be forthcoming. In those cases, there was no reason not to consider outright approval of the program. If such assurances did not exist, there was equally no reason to consider approval in principle. He did not mean to imply, however, that indications could not be given in advance to private lenders concerning the progress achieved in discussions between the Fund and the member, especially if such indications were likely to help the bankers reach firm conclusions. He assumed that such discussions would take place only with full approval of the member seeking Fund assistance.

He shared the staff's concern about use of the approval-in-principle procedure in cases where, aside from external financing uncertainties, additional policy measures were pending, Mr. Joyce said. As a general rule, the Executive Board should not examine a proposed arrangement unless understandings on key policy actions had been reached and the measures whose immediate implementation was essential to the success of the program had been taken. There were no advantages to be derived from departing from normal procedures in such cases. By definition, prior actions needed to be taken prior to approval. Moreover, if the prior actions had not been taken, creditors would have doubts about the viability of the adjustment program, which could destroy any prospect that the approval-in-principle would serve as a catalyst for raising the necessary financing.

However, it would be a mistake to say categorically that approval in principle should never be given if all the prior actions had not been fully implemented, Mr. Joyce went on. In that regard, he disagreed somewhat with the comments made by Mr. Wicks and Mr. Fujino, and was sympathetic to the views expressed by Mr. Finaish. More flexibility was called for. It was possible to envisage situations in which the range of prior actions was large and in which progress in seeking legislative approval or in implementing some of the less essential actions had been delayed. In such cases, if the use of the approval-in-principle procedure were thought to be appropriate--owing to failure to conclude the external financing arrangements--it might be prudent for the Executive Board to exercise flexibility with regard to the question of prior actions, particularly if the delays were associated with the implementation of some of the less crucial actions.

He supported the staff's recommendation that 30 days should be considered the outer limit when the approval-in-principle procedure was used, Mr. Joyce stated, and that approval would normally lapse--"normally" deserved emphasis--if the financing gap had not been closed within that period. If the limit were much longer, it was likely that major adjustments might be required in the program with respect to its nature and timing. In those circumstances, the appropriate course would be to submit a revised program to the Executive Board rather than to continue to extend the approval in principle for a further period.

Mr. Suraisry said that the adoption in the past two years of the approval-in-principle procedure was a good example of the Fund's flexible response to the difficulties facing some members in securing external financing. The procedure had been a way of helping certain countries in a manner consistent with the Fund's general policies governing the use of its resources. It had, therefore, served a useful purpose in the limited number of cases to which it had been applied. On eight occasions in 1983 and in 1984 to date, seven member countries had been able to obtain debt relief from creditors and to implement appropriate stabilization programs supported by Fund resources. However, the procedure was not without disadvantages. In particular, it had led to problems regarding the phasing of drawings and their linkage to performance criteria because of delays in securing all the necessary financing from other sources. It was, therefore, sensible to establish general guidelines that would help to minimize such problems.

The Fund should be flexible, Mr. Suraisry continued. There was no need for rigid guidelines. Agreement on certain general principles would assist member countries and ensure even-handed treatment of members. In that regard, he agreed with the staff that arrangements should not be presented to the Executive Board for approval in principle unless all prior actions indicated in the arrangement had been taken. Other policy measures essential to the successful implementation of the program would no doubt be adequately covered by review clauses. More generally, it appeared that the guidelines would limit approval in principle to very special cases. While he could support that approach, the Executive Board should continue to rely on the judgment of management to ensure the viability of Fund programs. He expected that approval in principle would include cases where there were substantial uncertainties about the financing of a program and where management believed that such a procedure would assist a debtor country, which had taken all prior actions indicated in the arrangement, to reach agreement with creditors and to implement a viable adjustment program.

He also agreed with the proposed limit of 30 days between the approval in principle and the entry into effect of the arrangement, Mr. Suraisry stated. It was essential to avoid a mismatch between the planned purchases and performance criteria. However, it would be useful to have flexibility in cases where the 30-day limit was exceeded by a very short period and where the program itself was not in danger. In those circumstances, there would be no need to renegotiate the program, because to do so might add unnecessary work to the already too busy staff and hurt the country concerned. However, if the period exceeding the 30-day limit were long or if a program were at risk, he agreed with Mr. Wicks that the program should be renegotiated and a more appropriate one put in place.

Mr. Prowse commented that he agreed with Mr. Suraisry's remark that the development of the approval-in-principle procedure during the debt crisis had provided an example of the flexibility of the Fund and its capacity to develop procedures to meet changing circumstances. Experience had shown the procedure to be appropriate because, on all the occasions on which it had been adopted, the arrangements in question had eventually come into effect despite delays in a small number of cases. In 1983, 4 out of 35 arrangements had been approved in principle and, thus far in 1984, 4 out of 15 arrangements. The latter incidence was as high as would be desirable because, as the staff had made clear, the circumstances in which it would be appropriate to use the procedure should be exceptional. It should be adopted only when there was no effective alternative available.

As other speakers had emphasized, Mr. Prowse continued, approval in principle should not result in more favorable treatment than outright approval. Furthermore, in general, arrangements should not be put forward for approval in principle until the member had taken all prior policy actions considered crucial. He agreed with the need for a deadline in approval-in-principle cases. In that regard, the staff had expressed the position well on page 20 of SM/84/217:

> Thirty days could be a reasonable outer limit for this purpose. It would be understood that a recommendation to extend the deadline would be made only if it was clear that the negotiated program, including for example the phasing and the period covered by the performance criteria and program targets, remained appropriate to the circumstances of the country.

Prior actions should apply to programs presented for approval in principle, as they did to programs presented for outright approval, Mr. Prowse considered. However, he agreed with Mr. Joyce that, in some cases of approval in principle, it should be possible to grant approval before all the prior actions had been taken. If the Executive Board believed the program to be sound, it could grant approval conditional on certain actions' being taken before the program came into effect. In relation to prior actions and the need for equal treatment of members, the staff had made an unusual observation on page 17 of SM/84/217:

> ...the requirement that such policy measures be in place before Board approval of an arrangement--even in principle--avoids the risk of reinforcing the notion that the Fund's conditions are specific, inflexible, and micro-oriented.

It was certainly not clear that insistence on prior actions would avoid the problem that the staff assumed to exist. He invited the staff to comment. More generally, it might be useful at some point to have a discussion of the appropriate use and extent of prior actions, a technique being used with increasing frequency.

One of the alternatives discussed by the staff was the possibility of closer coordination with creditors prior to discussion of the program by the Executive Board, Mr. Prowse went on. The practice was already common and should be continued, but such coordination should not become a negotiation between the Fund and the other creditors in which the Fund adjusted the conditions of its financing in order to persuade nonofficial creditors to participate. The staff also stated that, until all the key elements of a program were in place, "it is desirable for the Fund to retain maximum flexibility to seek adjustment as necessary in policy programs, in financing, or both." However, there were limits to the degree of flexibility and adjustment to program requirements, performance criteria, and the like once discussions with a member were far advanced and the design of the program had more or less been completed. While flexibility was in the interests of both parties, there was also the possibility of excessive flexibility, and the country ought not to be confronted with adjustments to the program and to the performance criteria after the discussions had gone most of the way toward agreement. Such an approach could only lead to confusion and frustration. It was appropriate that management should seek to obtain what the staff referred to as "substantial assurance" about the amount and timing of the commercial financing available during the period of the arrangement. However, it would be useful if the staff could clarify what might be regarded as "substantial assurance," not only in regard to commercial financing but also in regard to other multilateral financing.

The staff's comments about Paris Club rescheduling arrangements and the need to coordinate them with approval by the Fund of its program appeared reasonable, Mr. Prowse said, but the Fund should avoid the impression that the Paris Club could dictate terms to the Fund or that programs of the Fund must be seen as receiving the imprimatur of the Paris Club before the latter would consider rescheduling. A similar point could be made in relation to commercial bank financing.

Mr. Ajayi stated that he agreed with the staff that it was not desirable to establish rigid guidelines on the use of approval in principle. Apart from the different circumstances of members and the need for flexibility on the part of the Fund, which would make rigid guidelines inappropriate, the Executive Board should bear in mind that the members that had been accorded such treatment were few. Only eight members had been granted such approval thus far, and the total amount involved had been relatively small, not exceeding 8 percent of all commitments under stand-by and extended arrangements. He hoped that in future the procedure would be resorted to only in exceptional cases.

Members seeking approval in principle of Fund arrangements should not be given more favorable treatment than those seeking outright approval, Mr. Ajayi continued. At the same time, the former should not be put at a disadvantage. In that regard, the magnitude of prior actions should be made clear to the member. If approval in principle were given by the Executive Board on the basis of already implemented prior actions, the agreement should become effective as soon as agreement was reached with creditors on covering the financing gap, even if the staff, in the meantime, had reason to believe that additional measures were needed. Such measures should be taken up only in the context of the review under the arrangement. That approach would remove uncertainties with regard to the timing of a Paris Club rescheduling meeting and the impression that arrangements approved by the Fund were not necessarily viable, both of which possibilities could have adverse implications for the member and for the Fund.

In paragraph (f) on page 19 of SM/84/217, Mr. Ajayi noted, the staff had pointed out that thus far "there has been no presumption that an upward adjustment of ceilings would be appropriate in the event of less favorable external assistance than assumed, as this would only add to the financing gap." There might be situations in which rigid adherence to that principle could create problems for countries, particularly with regard to meeting certain performance criteria, including those on external arrears. He hoped, therefore, that each case would be treated on its merits with due flexibility on the part of the Fund.

On the deadline for lapse of approval in principle, Mr. Ajayi agreed that the rare cases of recourse to the procedure should be subject to time limits for the reasons put forward by the staff. The recommended 30-day limit appeared reasonable. However, management should be flexible in its approach to extensions of such limits. Arrangements should not be discarded simply because of delays that could make phasing and performance criteria under them slightly inappropriate. So long as the member continued to implement the program effectively, nothing would be lost to the Fund. The member had much at stake, especially if it had to rely on bridging finance pending the coming into effect of the arrangement. Furthermore, as was clear from the Appendix to SM/84/217, the financing gap in each of the eight arrangements involving approval in principle had been large in relation to quota. However, in four of those arrangements, the amount of the Fund's commitment had been relatively small, ranging between

The staff had discussed in the main section of SM/84/217, although not in the proposed guidelines, the circumstances in which the critical uncertainties related to the pledging of official aid, which often involved donor groups, Mr. Dallara observed. Although such cases were often dependent on Paris Club decisions, it would be useful if the staff could indicate how those cases would fit into the guidelines. The guidelines would continue to leave open the possibility of Executive Board approval in principle in a situation in which substantial financing uncertainties existed and where the principal role of the Fund was to lend confidence to the main creditors. He could accept that in rare instances such a situation could arise and that it could be dealt with through the approval-in-principle approach. However, because in almost all cases creditors sought as much assurance as possible regarding the adjustment efforts of the country, it would be useful to have a sense of the type of circumstances that might require greater assurance than usual. With regard to the proposed deadline, he noted that, in the most recent three examples of approval-in-principle, specific deadlines had been established. The practice was appropriate; he could support the proposed 30-day deadline.

Mr. Alfidja said that the approval-in-principle procedure had provided the Fund and members undertaking adjustment the necessary flexibility to meet changing circumstances, particularly because the procedure had been resorted to in cases of uncertainties regarding the availability of critical financial resources in support of the members' adjustment efforts. He agreed with other speakers that the procedure should be avoided as much as possible and should be used only in exceptional cases. However, given the limited experience thus far, he saw no need at present to set rigid guidelines for the use of the approval-in-principle procedure. If, however, the majority of the Executive Board favored the adoption of such guidelines, he would agree with those speakers who had suggested that the setting of a deadline for lapse of approval should be done on a case-by-case basis. The management and staff should be given the necessary flexibility in their discussions with the authorities to establish the time period by which prior action would have to be implemented and/or external financing would have to be secured. In some cases, 30 days might prove too short a period.

Mr. Blandin stressed that approval-in-principle of an arrangement with a member could be justified only when a country was faced with a financing gap that implied extraordinary measures on the part of its creditors. It should, therefore, be an exceptional procedure, although it had become somewhat common recently. In some cases, it had involved increased pressures on the creditor groups because of time constraints and an implied need to produce results. The rule should remain that the Executive Board should examine and approve only complete programs that presented a strong guarantee of success according to the staff's analysis. approval-in-principle of a program constituted a temporary situation not fully in keeping with the confidence usually placed by creditor countries, in particular, in the Fund's work. The procedure should, therefore, remain both flexible and exceptional; standard procedures should prevail whenever possible.

Mr. Ajayi stated that he agreed with the staff that it was not desirable to establish rigid guidelines on the use of approval in principle. Apart from the different circumstances of members and the need for flexibility on the part of the Fund, which would make rigid guidelines inappropriate, the Executive Board should bear in mind that the members that had been accorded such treatment were few. Only eight members had been granted such approval thus far, and the total amount involved had been relatively small, not exceeding 8 percent of all commitments under stand-by and extended arrangements. He hoped that in future the procedure would be resorted to only in exceptional cases.

Members seeking approval in principle of Fund arrangements should not be given more favorable treatment than those seeking outright approval, Mr. Ajayi continued. At the same time, the former should not be put at a disadvantage. In that regard, the magnitude of prior actions should be made clear to the member. If approval in principle were given by the Executive Board on the basis of already implemented prior actions, the agreement should become effective as soon as agreement was reached with creditors on covering the financing gap, even if the staff, in the meantime, had reason to believe that additional measures were needed. Such measures should be taken up only in the context of the review under the arrangement. That approach would remove uncertainties with regard to the timing of a Paris Club rescheduling meeting and the impression that arrangements approved by the Fund were not necessarily viable, both of which possibilities could have adverse implications for the member and for the Fund.

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44 percent and 53 percent of quota. Depending on a member's outstanding use of Fund resources, an increase in the Fund's financial support could have positive effects on the creditors by encouraging them to reach an early decision on rescheduling and/or make new financing available.

Mr. Dallara observed that in the past few years the Fund had been faced with a number of programs in which considerations regarding the financing arrangements needed in support of the adjustment effort had been particularly complex and in which the availability of such financing had been uncertain in varying degrees. The need to resolve those uncertainties had clearly posed important policy and procedural problems for the Fund; in general, they had been resolved in a pragmatic, effective way and had been skillfully handled by the management and the staff.

There had been only a relatively small number of cases in which the Board had resorted to the approval-in-principle approach because of, for the most part, uncertainties concerning financing, Mr. Dallara continued. He agreed with Mr. Prowse that the ratio of approval-in-principle arrangements to total arrangements in 1984 thus far--4 out of 15--was toward the upper end of what could be considered appropriate, although he was not suggesting that in the particular cases put to the Executive Board the use of the procedure had been inappropriate. He agreed with other speakers that approval-in-principle should not become a commonly accepted practice; it should be reserved for exceptional circumstances. In particular, the Executive Board should avoid approval in principle that was contingent upon policy actions.

Problems could arise under the approval-in-principle approach as a result of delays that might be experienced before the program came into effect, Mr. Dallara remarked. In those circumstances, the phasing of drawings and their linkage with the performance criteria and targets could become inappropriate. At a minimum, there could be a bunching of drawings toward the end of the program period, for which no targets or performance criteria had been established. Furthermore, Executive Directors should recognize that there would always be some uncertainties about the financing of a program. It was the task of the Fund's management and the Executive Board to reach a judgment as to what constituted a reasonable degree of assurance when the Board was considering an arrangement. It was thus incumbent on the management, the staff, and the Board to assess the prospects most carefully so as to reduce the degree of uncertainty. He welcomed the extensive efforts that had gone into making such assessments, irrespective of the nature of the financing involved.

With regard to the specific guidelines recommended by the staff, Mr. Dallara said that the Executive Board needed to be flexible, as a number of speakers had suggested. However, recently there had been surprising stress on "flexibility" in the course of the Board's policy discussions. He hoped that Executive Directors would agree that it was possible to be too flexible.

The first guideline recommended by the staff would preclude approval in principle of arrangements in which not all actions within the members' control, considered crucial to the achievement of the program goals, had been taken, Mr. Dallara noted. He supported that proposal. However, one point needed clarification. The staff had stated that:

> In the circumstances where certain policies are to be implemented during the course of an arrangement approved in principle, the implementation of these policies would be monitored, as in the case for other arrangements, through use of a review clause and not by including implementation of such clauses among the conditions for an arrangement to become effective.

He understood that statement to mean that where a program was approved in principle, probably because of financing uncertainties, policy actions should not also be approved in principle. The rationale appeared to be that in cases where immediate policy actions were crucial to the success of the program they would be considered prior actions, and where such actions were not immediately crucial or where they involved implementation of a policy over a period of time, the normal progress of policy and monitoring arrangements under the program would be considered appropriate. He invited the staff to comment.

The second guideline, which concerned uncertainties about financing, provided that management and staff would not submit arrangements to the Executive Board unless there were reasonable certainty that financing would be made available in the expected amount and terms, Mr. Dallara went on. He also supported that proposal. Under that guideline, it should be possible for the staff and management to satisfy themselves and the Executive Board concerning the adequacy of financing by obtaining substantial assurances from banks or other private creditors, when they were the principal sources of assistance, before consideration of the arrangement by the Executive Board. In such cases, the staff noted, uncertainties could remain; it suggested that they could be dealt with through the phasing of drawings and the review procedures. That approach appeared sensible, but it would be helpful if the staff would specify more precisely what kinds of uncertainties might be involved in such circumstances. If official debt rescheduling was the principal financing uncertainty, it should be possible for the Fund's management to ascertain that the needed exceptional rescheduling terms could reasonably be expected to be forthcoming through informal consultations with the Chairman of the creditor club involved and with individual creditors. The procedures that had evolved in recent years in that context were sensible. Although official creditors might be reluctant to make firm or irreversible commitments, the Fund would not be precluded from reaching judgments. The staff suggested that in such cases early reviews and, perhaps, backloaded disbursement schedules would provide further protection to the Fund in relation to the financing uncertainties; he supported the recommendation.

The staff had discussed in the main section of SM/84/217, although not in the proposed guidelines, the circumstances in which the critical uncertainties related to the pledging of official aid, which often involved donor groups, Mr. Dallara observed. Although such cases were often dependent on Paris Club decisions, it would be useful if the staff could indicate how those cases would fit into the guidelines. The guidelines would continue to leave open the possibility of Executive Board approval in principle in a situation in which substantial financing uncertainties existed and where the principal role of the Fund was to lend confidence to the main creditors. He could accept that in rare instances such a situation could arise and that it could be dealt with through the approval-in-principle approach. However, because in almost all cases creditors sought as much assurance as possible regarding the adjustment efforts of the country, it would be useful to have a sense of the type of circumstances that might require greater assurance than usual. With regard to the proposed deadline, he noted that, in the most recent three examples of approval-in-principle, specific deadlines had been established. The practice was appropriate; he could support the proposed 30-day deadline.

Mr. Alfidja said that the approval-in-principle procedure had provided the Fund and members undertaking adjustment the necessary flexibility to meet changing circumstances, particularly because the procedure had been resorted to in cases of uncertainties regarding the availability of critical financial resources in support of the members' adjustment efforts. He agreed with other speakers that the procedure should be avoided as much as possible and should be used only in exceptional cases. However, given the limited experience thus far, he saw no need at present to set rigid guidelines for the use of the approval-in-principle procedure. If, however, the majority of the Executive Board favored the adoption of such guidelines, he would agree with those speakers who had suggested that the setting of a deadline for lapse of approval should be done on a case-by-case basis. The management and staff should be given the necessary flexibility in their discussions with the authorities to establish the time period by which prior action would have to be implemented and/or external financing would have to be secured. In some cases, 30 days might prove too short a period.

Mr. Blandin stressed that approval-in-principle of an arrangement with a member could be justified only when a country was faced with a financing gap that implied extraordinary measures on the part of its creditors. It should, therefore, be an exceptional procedure, although it had become somewhat common recently. In some cases, it had involved increased pressures on the creditor groups because of time constraints and an implied need to produce results. The rule should remain that the Executive Board should examine and approve only complete programs that presented a strong guarantee of success according to the staff's analysis. approval-in-principle of a program constituted a temporary situation not fully in keeping with the confidence usually placed by creditor countries, in particular, in the Fund's work. The procedure should, therefore, remain both flexible and exceptional; standard procedures should prevail whenever possible.

He agreed with the staff that there was no need to establish rigid guidelines on the use of the approval-in-principle procedure, Mr. Blandin continued. Moreover, the guidelines put forward by the staff should be applied with prudent pragmatism. He agreed that there should be closer coordination with creditors prior to Executive Board discussion of an arrangement. However, in the Paris Club, such coordination should not go beyond an informal expression of the willingness of the Paris Club members to consider exceptional measures. It was essential, both for the Fund and for the Paris Club, that the principle that rescheduling could take place only after prior agreement with the Fund should be respected. In that regard, he supported the staff's recommendation in paragraph (d)(1) on page 18 of SM/84/217 that outright approval by the Executive Board could be sought, when some uncertainties remained, if the timing of the review could be appropriately established. In cases where approval in principle was to be considered, precautions should be taken vis-à-vis public creditors and the Paris Club. The creditors should not be locked into too tight or rigid a deadline and thereby suffer from excessive pressure. Consequently, the time limit for lapse of approval should not be the proposed rigid deadline of 30 days, but should instead be left to consideration by the Executive Board on a case-by-case basis.

Mr. Malhotra remarked that he agreed with other Directors that the prudent use thus far of the approval-in-principle procedure had been helpful; therefore, the Fund should continue to avail itself of the procedure, as appropriate. He agreed with the staff that rigid guidelines should be avoided in that regard, although he was not convinced that the staff had fully adhered to that general principle in its recommendations.

The procedure should be used sparingly, Mr. Malhotra continued, and it should normally be confined to cases where approval in principle would enable a member to obtain the necessary financing from other creditors. If prior actions were envisaged, they should normally be taken before approval was granted. However, he agreed with Mr. Joyce and Mr. Prowse that, in certain circumstances, if a country wished to take certain prior actions in the period before an arrangement became effective, it should be allowed to do so. More generally, it was important that the extent of prior actions should be considered carefully. The types of program supported by the Fund varied significantly in nature and length, and there was no special merit in imposing undue conditionality in the early stages of a program.

He did not believe that, as a general rule, a deadline of 30 days should be set as the outer limit in cases of approval-in-principle, Mr. Malhotra stated. He agreed with Mr. Kafka that the Executive Board should consider each case individually. The suggestion by some Directors that the Fund should renegotiate a program when the 30-day deadline was not met was somewhat disturbing. Negotiations on financing arrangements often took time. Moreover, when a case was brought to the Board for approval in principle, it could be assumed that management had taken care to ensure that the authorities and the staff had come to a reasonable agreement on the structure of the program and the conditions that would apply. As Mr. Prowse had pointed out, reopening discussions on agreed programs could be counterproductive. Of course, if the Executive Board believed that a delay of more than 30 days would result in a breakdown of the linkages between drawings and performance criteria, it could take appropriate action in those circumstances, but there was no need to be rigid from the outset.

The staff's recommendations in paragraph (d)(1) and (d)(2) on page 18 of SM/84/217 were worrisome, Mr. Malhotra considered. The staff first suggested that outright approval by the Executive Board should be sought when there was a reasonable expectation that the financing gap would be met, adding that there could be provision for an early review to examine whether the expectations had indeed been met. It went on to suggest in paragraph (d)(1):

> In cases where some uncertainties remain, the timing of the review could be arranged to ensure that the bulk of purchases under the arrangement were available only after its financing has been firmly secured and that early adjustments were made in the program should that be necessary.

The point was repeated in paragraph (d)(2) in relation to Paris Club cases, where the staff appropriately suggested that prior consultations with the Paris Club should take place in order to establish reasonable assurances that the necessary financing would be forthcoming. However, the staff added:

> In these cases also it would be necessary to provide for an early review to ensure that necessary adjustments to the program are made at an early stage. The bulk of purchases would be available only after successful completion of the review.

The meaning of the final sentence was unclear. If the staff intended to suggest that in such circumstances the amount of the first drawing should be reduced, the problem was being approached artificially. Normally, the phasing of drawings would be established on the basis of the member's need over the duration of the program. Artificial curtailment of early drawings might only create difficulties for the member and for the success of the program. He invited the staff to make it clear that that was not the intention.

Paragraph (f) was also in need of clarification, Mr. Malhotra said. He asked whether the staff had in mind domestic or external credit ceilings in stating: "The view has been that an automatic downward adjustment of credit ceilings/targets would be appropriate should more favorable rescheduling or assistance be received." The remainder of the paragraph was also unclear.

Mr. Zhang said that he could support the broad thrust of the guidelines. However, he agreed with Mr. Kafka that the problem should be approached with flexibility and that it would have been preferable to establish the guidelines in the form of a decision. With regard to the deadline for lapse of approval in principle, the 30-day limit would probably be appropriate in general. However, the Executive Board should be flexible in individual cases. More important, when approval in principle was granted and the subsequent negotiations were successfully completed within the deadline, the dates of drawings originally established for the duration of the arrangement should not be affected.

Mr. Weitz commented that he supported the continuation of the approval-in-principle procedure. He noted with satisfaction that all the arrangements that had been approved in principle had come into effect. The procedure was needed in dealing with individual countries. He agreed with the staff that, in view of the different circumstances in member countries, it was not desirable to establish rigid guidelines on the use of the procedure. Approval in principle should be granted in all cases where substantial uncertainties with regard to the financing of the program remained, and where management believed that such an approach would assist the member in reaching agreement with its creditors. Although problems could be caused if there were a substantial delay between the date of the Board's discussion and the date of settlement of pending issues, he opposed the setting of a deadline of only 30 days, after which approval in principle would lapse. Flexibility in that regard was important. It was encouraging that in spite of minor delays the outcome of decisions to approve in principle had been positive thus far.

Mr. de Vries observed that the extent to which approval in principle should be made conditional on the taking of certain policy actions had been a major topic of Directors' interventions. He agreed with the position set out by the staff in that regard. It might be useful to consider a specific case in which it would be appropriate to make final approval of an arrangement conditional on the taking of certain policy measures. For example, a prior condition might be that the country would float its exchange rate. In order to take that action, the country would probably wish to be assured--and to assure the markets--that appropriate financing was in place. Therefore, the necessary action might be taken only after all the financial arrangements had been completed. In those circumstances, it would be appropriate for the Executive Board to approve an arrangement in principle on the condition that such action was taken. However, when no financial gap was involved, a program should not be submitted to the Executive Board until all the agreed prior actions had been taken.

The Director of the Exchange and Trade Relations Department said that the guidelines recommended by the staff were not intended to increase conditionality on members but rather to assist them in putting into place a viable and adequately financed program. While flexibility was important, Fund assistance to a member in obtaining the necessary agreement with its creditors was also important. The setting of a deadline in cases of approval in principle could prove useful in that respect by encouraging the creditors to respond to the Fund's action. It was not in the interests of the member that financing negotiations should drag on indefinitely. In that sense, a significant aspect of the Fund's role during the debt crisis of recent years had been its contribution to sharpening the decisionmaking process, thereby helping members to emerge from their payments difficulties with reasonable speed and to return to a situation in which domestic and foreign sources of capital could be assured that the appropriate adjustment was being undertaken. To be an effective procedure, approval in principle should be rare and limited to cases where it was important to focus the attention of the authorities and of the creditors on decisions that had to be taken. In that context, the staff had suggested a 30-day deadline for lapse of approval in principle in order to encourage early action by creditors to help the member to obtain the necessary financing on a timely basis.

The actions that might have to be implemented by the authorities before approval in principle by the Executive Board were only those deemed critical to the success of the program from the outset, the Director continued. The adoption of other actions, to ensure continuing success for the program, could be monitored through the performance criteria or review clauses. The taking of such measures would be a signal to the Board and to creditors that the political will existed for effective policy implementation.

The staff agreed with the point made by Mr. de Vries concerning the relationship between the procedure of approval in principle of a financial arrangement and a concurrent request for use of resources under the compensatory financing facility, the Director of the Exchange and Trade Relations Department remarked. When the requested compensatory purchase was in the lower tranche of the facility, definite Board approval of the compensatory drawing would be granted simultaneously with the approval in principle of an arrangement. When the requested compensatory purchase was in the upper tranche, however, it would be more appropriate to make the request for a compensatory drawing contingent on the coming into effect of the stand-by or extended arrangement, thus ensuring that all elements of the program, including the necessary financing, were in place. On the question of whether the expiration date of an arrangement should be set with reference to the date of approval in principle or the date of entry into effect of the arrangement, the staff believed that the latter option was preferable because it was more likely to provide for equal treatment of members. Approval in principle was intended to facilitate the financing arrangements necessary to the success of the program, but it should not provide the member seeking such approval with an advantage over a member that had sought outright approval.

The Deputy Director of the Exchange and Trade Relations Department observed that the approval-in-principle procedure was intended to be used in cases where there were uncertainties on the availability of the required financing and where use of the procedure would serve to give creditors reasonable assurance that the member was undertaking adjustment. Prior actions taken before a decision was taken by the Executive Board to approve an arrangement in principle would clearly provide such assurance, thereby helping to resolve the "chicken-and-egg" dilemma that often arose in the process of deciding on the mix between adjustment and financing.

That approach was basically similar to the procedure followed in cases of outright approval, according to which prior actions should be in place before the Executive Board considered the request for an arrangement, the Deputy Director continued. In general, the procedure implied a time limit for the adoption of prior actions equivalent to that prevailing between the date of agreement with the authorities on the program and that of its consideration by the Executive Board, typically of about three months. If delays in implementing prior actions extended much beyond that period, the understandings reached under the arrangement could be endangered. In such circumstances, it might be necessary to reopen discussions on key elements of the program, including the proposed phasing of purchases under the arrangement, as the staff had suggested in SM/84/217. With regard to the point made by Mr. de Vries about the treatment of certain prior actions whose adoption might require that financing arrangements should be in place, the best approach was to proceed flexibly. One way of dealing with that particular issue in the past had been to submit to the Executive Board a request for an arrangement only when firm assurances had been given to the Fund's management that the "critical mass" of financing had been secured.

The Fund's catalytic role raised complex issues, the Deputy Director commented. It contributed to securing additional financing, but, in so doing, it could give rise to perceptions that cross-conditionality was involved. In the particular context of the World Bank, there had been no intention to suggest that cross-conditionality between the two institutions would prevail. On the contrary, in one case of approval in principle, when the issue had arisen, the Fund's Executive Board had decided not to make its approval contingent on disbursement of a structural adjustment loan by the World Bank to the country in question so as to avoid cross-conditionality. Of course, it was possible that certain actions considered necessary by the Fund for it to grant approval might also be considered important by the World Bank. However, each institution would be expected to decide on its assistance according to its own lending criteria. The issue of possible uncertainties surrounding official assistance by donors was covered under paragraph (d)(2) of the recommended guidelines, which provided for an early review of an arrangement to ensure that necessary adjustment to a program could be made at an early stage in the event that financing turned out to be less than expected at the time of approval in principle.

The ceilings referred to in paragraph (f) of the guidelines dealt with domestic credit expansion, the Deputy Director of the Exchange and Trade Relations Department stated. The rationale behind the proposition in that paragraph was that there would be a reduced need for internal financing if more external financing were provided than had been expected. It should be borne in mind that the credit ceilings in many programs represented maxima, not targets to be achieved. Correspondingly, if the external financing turned out to be less than expected, such an outcome did not imply that the domestic credit ceilings should be raised. They had presumably been established on the basis of the best estimate of total resources available domestically; to raise them would amount to counting on resources that were not, in fact, available. With regard to the statement in the staff paper that "the bulk of purchases would be available only after successful completion of the review," the staff had been referring to the desirability of an early timing of the review rather than to the possibility of changing the amounts of the purchases. The statement meant only that an early review affected a larger number of drawings than a later review.

Mr. Malhotra asked whether it had been the practice to reduce domestic credit ceilings agreed in the course of discussions on a program simply because an additional amount of external finance had unexpectedly become available.

The Deputy Director of the Exchange and Trade Relations Department replied that there had been cases in which credit ceilings had been negotiated with the member on the basis of certain explicit assumptions about the availability of capital inflows. In the negotiation, it had been agreed that there would be an appropriate downward adjustment to the ceilings if the inflows turned out to be higher than expected.

Mr. Malhotra commented that, nevertheless, it seemed somewhat unfair to expect a country to intensify its adjustment effort if events moved in one direction, but not to permit it a somewhat easier adjustment if events moved in the other direction.

The Deputy Director of the Exchange and Trade Relations Department noted that the guidelines in SM/84/217 were not intended to modify the Fund's policy with regard to the formulation of credit ceilings and their relationship to capital inflows. Paragraph (f) of the guidelines was a description of an existing practice that allowed for adjustments negotiated with the member to be made to credit ceilings when the assumptions concerning the prospective capital inflows failed to materialize.

Mr. Salehkhou recalled that he had inquired about the process of consultations with non-Paris Club creditors.

The Deputy Director of the Exchange and Trade Relations Department replied that the staff attempted to get as much information as possible from all creditors. Consultation arrangements were well established with the Paris Club, but with other creditors the staff had to proceed pragmatically. The Fund was often able to receive information, with the permission of the member, from the advisory groups established by the commercial banks, and it could also discuss with the main official creditors the prospects for financing. Access to information from other sources of finance was also arranged through the member requesting the arrangement.

Mr. Kafka remarked that, with regard to the question of prior actions in relation to approval in principle, he would prefer not to have a rigid rule that all actions would have to be taken prior to such approval. There should be sufficient flexibility to allow some actions to be taken between the time of approval in principle and the coming into effect of the arrangement. That approach had been used in the past and should continue. He reiterated his view that it was unfortunate that the Executive Board was not being asked to take a decision on the issue before it. A decision was preferable to guidelines and, properly written, could allow for as much, if not more, flexibility.

Mr. Joyce said that he agreed with Mr. Kafka on the question of prior actions. There could be many reasons why it might be advantageous for the Executive Board to take a decision approving an arrangement in principle at a certain time, which might not, nevertheless, be the time by which all the desired actions could be taken. Therefore, in line with the general principle stated by the staff that the guidelines should not be rigid, it would be desirable to proceed somewhat pragmatically in relation to the question of prior actions.

Mr. Wicks commented that paragraph (e) of the recommended guideline allowed for the appropriate degree of flexibility. The paragraph concluded "...members would be expected to implement prior policy actions before an arrangement was submitted for Board approval." An expectation, not an obligation, was thus being established, which was entirely appropriate, given that the Board was being asked to approve guidelines, not rules.

Mr. Malhotra said that, with regard to the adjustment of credit ceilings, he remained disturbed by the implied automaticity in the sentence: "The view has been that an automatic downward adjustment of credit ceilings/targets would be appropriate should favorable rescheduling or assistance be received."

The Chairman commented that the sentence was not meant to change the Fund's existing policies. It was clear, however, that when a program was discussed with a member, it was designed on the basis of certain assumptions, which included the prospects for capital inflows. If those assumptions and financing arrangements did not materialize as expected, it would obviously be necessary to make adjustments to the program.

The Director of the Exchange and Trade Relations Department added that the sentence had been intended to reflect a particular aspect of Fund policy, namely, that in order to preserve the revolving character of its resources the Fund approved only a fully financed program. If the assumptions about foreign financing turned out to be invalid, there was a danger that the member might fall into arrears. To avoid such a situation, it would be necessary for the member to make a stronger domestic adjustment effort.

Mr. Malhotra remarked that his concern was not so much with cases in which the financing turned out to be less than expected, but with the assumption that, if financing turned out to be greater than expected, an automatic downward adjustment of domestic credit ceilings would be appropriate.

The Chairman stated that the staff would examine in due course the issue raised by Mr. Malhotra.

Mr. Kafka asked whether Mr. Wicks's position would allow him to consider for approval in principle cases in which not all prior actions had been taken.

Mr. Wicks replied that the Executive Board could proceed as it wished, subject to the Articles of Agreement and to the Rules and Regulations of the Fund. If the Fund's management recommended that in a particular case a decision should be taken to approve an arrangement in principle although not all prior actions had been taken, the Executive Board was free to consider such a recommendation. The recommended guidelines did not preclude such an approach. However, under the guidelines provided for, the normal expectation was that arrangements would not be presented to the Board until all the necessary prior actions had been taken.

The Chairman made the following concluding remarks:

> Executive Directors generally endorsed the thrust of the staff paper, noting that resort to the procedure for the approval in principle of requests for extended and stand-by arrangements had thus far been cautious and had proved useful. Directors approved, therefore, the flexible guideline approach suggested by the staff. The main points that Directors stressed were:
>
> (1) The Fund should resort to approval in principle in a sparing fashion for exceptional cases in which alternative methods were not available or had been exhausted. The normal procedure was and should remain outright approval.
>
> (2) In order to minimize the use of approval in principle, management and staff should undertake in each case intensive consultations with all creditors so as to seek reasonable assurances on the financing of the program. Where such reasonable assurance had been reached, outright approval would continue to be the normal procedure.
>
> (3) The resort to approval in principle should not result in more favorable treatment of some members relative to the treatment granted to those members who sought outright approval.

(4) If substantial uncertainties remain with regard to the financing of a program and if management believed that in such exceptional circumstances approval in principle would assist the member in reaching agreement with its creditors, the procedure would be used.

(5) That procedure would only be used if the problem to be solved was a financing problem.

(6) It was expected that prior actions related to policy measures should normally be taken by the country in question before the Executive Board considered approval in principle.

(7) Whenever approval in principle was sought, the proposed decision should include a deadline. As the staff pointed out, such an approach was in the interests of the member country and of the attainment of financing agreements. The deadline would be decided on a case-by-case basis, but, normally, a 30-day period would seem reasonable.

I would like to add two personal thoughts. First, I believe that Directors have been cautious and sufficiently flexible. Of course, approval in principle should not be overutilized. However, it has proved to be a very effective procedure, particularly in the case of smaller countries. In some of those cases, discussions with the creditors, especially with the banks, are protracted; the Executive Board's decision in principle--for a specified period--can stimulate action. Therefore, we should not discard that sort of approach.

Second, when prior actions are crucial to the validity of a program, they have to be taken before the Board approves the arrangement. That is absolutely clear and equality of treatment demands it. But the type of situation indicated by Mr. de Vries can arise, namely, a specific action can be linked to the attainment of the financing. In such a case, it could be appropriate to approve an arrangement in principle before the action is taken. Policy measures to be embodied in the program at a later stage might also become contemporaneous with the entry into effect of an arrangement approved in principle. In such circumstances, establishing prior conditions would involve no laxity; rather, the implementation of policy measures under the program would be reinforced. Such a procedure would have to be used selectively and with subtlety. I also agree completely with Mr. Wicks that the prior actions needed to make a program valid and credible must be taken at the outset, and especially if there is doubt about the financeability of the program, because it is in those circumstances that prior actions can be crucial in resolving a difficult situation and eliciting adequate financial support.

The Executive Directors took note of the Chairman's remarks.

2. EXECUTIVE DIRECTOR

The Chairman bade farewell on behalf of Executive Directors to Mr. Lovato at the conclusion of his term of office as Executive Director.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/154 (10/19/84) and EBM/84/155 (10/24/84).

3. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment of an Assistant to an Executive Director as set forth in EBAP/84/221 (10/17/84).

Adopted October 19, 1984

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/222 (10/18/84) and EBAP/84/224 (10/19/84) is approved.

5. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/84/223 (10/19/84) is approved.

APPROVED: July 25, 1985

LEO VAN HOUTVEN
Secretary