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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/177

3:00 p.m., December 6, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	M. K. Bush
J. de Groote	H. G. Schneider
	G. E. L. Nguyen, Temporary
	M. Z. M. Qureshi, Temporary
	T. Yamashita
	B. Goos
J. E. Ismael	Jaafar A.
	L. Leonard
	H. A. Arias, Temporary
R. N. Malhotra	
	E. A. Ajayi, Temporary
F. L. Nebbia	B. Jensen
	J. E. Suraisry
	G. Ortiz
J. J. Polak	
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
J. Tvedt	
	T. A. Clark
	N. Coumbis
Zhang Z.	Wang E.

L. Van Houtven, Secretary
S. J. Fennell, Assistant

<u>Also Present</u>

African Department: A. D. Ouattara, Director. European Department: G. F. Kopits. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; G. Belanger, J. Berengaut, E. H. Brau, H. W. Gerhard, S. Kanesa-Thasan, P. Neuhaus. External Relations Department: J. E. McEuen, H. P. Puentes. Fiscal Affairs Department: C. A. Yandle. IMF Institute: O. B. Makalou. Legal Department: G. P. Nicoletopoulos, Director, P. L. Francotte, W. E. Holder, Ph. Lachman, A. O. Liuksila, S. A. Silard. Treasurer's Department: Q. M. Hafiz. Western Hemisphere Department: C. M. Loser, L. M. Valdivieso. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, S. M. Hassan, P. Péterfalvy, G. W. K. Pickering, A. Steinberg, E. M. Taha, A. Vasudevan. Assistants to Executive Directors: H. Alaoui-Abdallaoui, W.-R. Bengs, J. Bulloch, J. de la Herrán, G. Ercel, V. Govindarajan, N. Haque, G. D. Hodgson, Z. b. Ismail, A. K. Juusela, S. Kolb, K. Murakami, M. Rasyid, J. E. Rodríguez, A. A. Scholten, A. J. Tregilgas, E. L. Walker, Wang C. Y.

1. RELATIONSHIP BETWEEN PERFORMANCE CRITERIA AND PHASING OF PURCHASES UNDER FUND ARRANGEMENTS

The Executive Directors considered a staff paper on the relationship between performance criteria and phasing of purchases under Fund arrangements (SM/84/259, 11/20/84; and Cor. 1, 11/30/84).

Mr. Ismael said that while the Fund should, in principle, refrain from restricting its flexibility by modifying any of its operational procedures, a modification of existing practices might be necessary in some instances to avoid misunderstandings and ambiguities. If guidelines on the relationship between performance criteria and phasing of purchases under Fund arrangements were necessary, the Executive Board should adopt a formal decision on the issue rather than rely on the Chairman's concluding remarks.

Although he had no difficulty with the general thrust of the paper, Mr. Ismael went on, he was concerned about a number of points raised by the staff in its conclusion. He agreed fully with guideline (1) that every effort should be made to limit to a minimum the delay between the Executive Board discussion of an arrangement and the beginning of the program. Nevertheless, the Executive Board should recognize that delays arising from technical factors might be unavoidable and beyond the authorities' control. Two Fund procedures resulting in delays could be avoided. First, the practice of approving an arrangement in principle, pending a satisfactory conclusion of financing arrangements, should be resorted to sparingly and only in exceptional cases. Second, he was opposed to the requirement of prior actions, which often caused delays between the beginning of an annual program period and the date of discussion of that program by the Executive Board. Any proposal for prior actions should be subject to Executive Board discussion and approval. The staff had not adequately addressed the question of how purchases and performance criteria would be phased if there were unavoidable delays between the beginning of a program period and the date of discussion by the Executive Board.

The amount of a purchase should be related to the magnitude of adjustment by the member throughout the program period, Mr. Ismael considered. When a substantial amount of adjustment was warranted at the initial phase of the program, the size of the purchase should be on the same scale. The Fund's financing should be seen more as a form of assistance than as a reward, as it seemed to be at present. Should undue delays render the adjustment program obsolete, either partly or completely, it should be renegotiated in order to re-establish the viability of the premises underlying the program.

He supported guideline (2), regarding lags in reporting of data, Mr. Ismael remarked. It was reasonable for the Fund to expect reporting lags to be limited to two months, with the qualification that special circumstances should be accommodated. He agreed that the staff should explain the reason for the lags and the efforts to reduce them in those cases where reporting lags exceeded two months. The Fund should provide technical assistance to countries experiencing difficulties in complying with the guideline.

As for guideline (3), the Fund should make every effort to limit the delay between the date of approval of an adjustment program by management and the date of discussion of the supporting arrangement by the Executive Board, Mr. Ismael suggested. The outer limit of three months for that period was long, particularly in those countries experiencing substantial maladjustment and whose economies were extremely fragile. The renegotiation of a program in cases where the delay indicated significant slippages in its implementation would not only burden the staff unduly, but also impose unnecessary pressure on member countries.

The current practice regarding the frequency of purchases was generally satisfactory, and the number of purchases in a 12-month period should be limited to four, Mr. Ismael remarked. He saw no problem with bunching the first two purchases in some cases, as the best way to provide assistance was to match the size of the adjustment effort with an appropriate amount of financing. He did not favor the two-month guideline separating the initial and the second purchase under an arrangement, unless the amount of the purchase could vary to match the extent of the adjustment effort. He had difficulty with the suggestion that the date of the last purchase should not be earlier than two months before the end of the arrangement. Although the staff had noted one possible exception--the case where initial Executive Board approval had been only in principle--there were other exceptions, and the Executive Board should apply guideline (4) particularly flexibly.

He could go along with guidelines (5), (6), and (7), Mr. Ismael stated. He was uncertain why the staff was opposed to establishing performance criteria for a six-month period, as had been overwhelmingly the practice in the past, particularly given the substantial uncertainties surrounding adjustment programs. Uncertainty was more the norm than the exception, especially in countries experiencing substantial economic imbalances. Guideline (7) should not prevent the setting of indicative targets or performance criteria at the quarterly or midterm reviews, if necessary.

He had difficulty in supporting guidelines (8) and (9) regarding the linking of the final purchase to the conclusion of satisfactory understandings on the following year's program, within the context of either a multiyear arrangement or a succession of one-year arrangements, Mr. Ismael said. While he appreciated that it was in both the Fund's and members' interest to persevere with adjustment policies, he failed to understand the need to include an additional requirement making the last purchase under an arrangement conditional on the member's reaching understandings with the Fund on a new program. The final two guidelines would paralyze a member by insisting, first, that it meet performance criteria and, second, that it reach understandings with the Fund on the following year's program.

Mr. Tvedt indicated broad agreement with the guidelines proposed in SM/84/259. While evenhanded treatment of members was important, he had no difficulty in agreeing with the staff that the general guidelines must be applied flexibly in special cases, which should be appropriately explained by the staff.

In general, adherence to program targets by members tended to weaken significantly toward the end of the program year, Mr. Tvedt observed. He therefore supported the inclusion of a performance criterion as close to the end of the program period as practicable and of indicative targets for the end of the program year, which would serve as a monitoring mechanism and would provide a basis for discussions on possible subsequent Fund arrangements. Performance tests should be tied more closely to the satisfactory completion of program reviews, but he was concerned that the proposal to link the final purchase under an arrangement to the successful completion of negotiations on a possible follow-up program might delay the final purchase until well beyond the original program period.

Mr. Yamashita remarked that the linkage of purchases under an arrangement with the Fund to implementation of an adjustment program was a basic element of Fund conditionality. The main objective of the proposed guidelines was to ensure that the program period did not differ significantly from the duration of the arrangement, allowing the performance criteria to cover as much of the program as possible.

He supported guideline (5), aimed at minimizing the period between the last performance criteria and the end of the arrangement, Mr. Yamashita stated. The transition between annual programs would generally be strengthened if performance criteria were specified for the end of each annual program period. In the case of multiyear arrangements, year-end performance criteria should normally be established. If they were not observed, the next year's program should include necessary corrective measures, together with recommended modifications or waivers of the performance criteria where appropriate. Furthermore, it was reasonable to make the final purchase conditional on the member's reaching understandings with the Fund on the next year's program.

In the case of a succession of annual arrangements, indicative targets, rather than year-end performance criteria, should be set for the end of each arrangement period, Mr. Yamashita said. When formulating the new program, the staff and the authorities should take those indicative targets into account. For countries that were likely to make prolonged use of the Fund's resources, the last purchase under an arrangement should be conditional on the member's reaching understandings with the Fund on a new program. In conclusion, he endorsed the thrust of the staff paper and could support the operational guidelines.

Mr. Nebbia observed that the staff paper dealt extensively with the relationship between the distribution of purchases and performance criteria under Fund arrangements in support of adjustment programs. The staff had not fully evaluated all aspects of the issue, particularly how the timing and amounts of disbursements could be adapted to best fit the needs of the particular country undergoing adjustment.

The staff paper included no formal definition of the purpose of using Fund resources in support of adjustment programs, Mr. Nebbia noted. The closest explanation was that "the Fund's normal practice has been to provide resources fairly evenly throughout the period of the arrangement to ensure that adequate support to the adjustment effort was available at all points of the implementation of the program" (page 3, SM/84/259). If that statement meant that resources should be evenly distributed throughout the program period, its underlying assumption was that the imbalances of the economy were also distributed evenly; in other words, that balance of payments, financial, and fiscal needs were evenly distributed, as were external debt flows. The Executive Board should reconsider the guideline requiring even distribution of purchases throughout the program period, because the symmetry that it induced would not benefit all sectors of an economy, particularly as the phasing of purchases affected the timing of other flows into the economy. The timing of disbursements by commercial banks under all recent refinancing arrangements with countries undergoing Fund-supported adjustment programs was closely related to the phasing of purchases from the Fund by those countries. It seemed unfair that the proposed guidelines would influence the distribution of inflows of financial resources other than those from the Fund.

When setting quantitative performance criteria, the staff should take into account any relevant exogenous factors, Mr. Nebbia suggested. The nature of quantitative targets was such that abrupt absolute changes in the variables covered by the targets could have significantly harmful effects. A member country might well experience capital flight or a loss of foreign exchange and respond by introducing exchange controls. Such imbalances should indicate the need for bridging finance rather than for restrictive quantitative targets.

Perhaps the proposed guidelines were attempting to relate the use of Fund resources to the period during which a member country was in compliance with the adjustment program, Mr. Nebbia commented. For example, if, under a one-year program, a country complied with the performance criteria only during the first six months, it should be permitted to draw only 50 percent of the resources made available under the arrangement with the Fund. If that were the purpose of the guidelines, they should be reassessed.

More specifically, he could go along with most of the guidelines proposed by the staff, especially those oriented toward decreasing the lag between the beginning of the program period and the date of discussion of the supportive arrangement by the Executive Board as well as lags in the reporting of data, Mr. Nebbia stated. In addition, the period between the approval of an adjustment program by management and the date when the supporting arrangement was discussed by the Executive Board should be limited to no more than three months.

On guidelines (8) and (9), he did not accept the proposal to make the last purchase under an arrangement conditional on the member's reaching an understanding with the Fund on a new program, in the case of either a multiyear program or a succession of one-year programs, Mr. Nebbia remarked. The impact of the changing international environment on a member's view of future programs with the Fund was difficult to ascertain, and it seemed unfair to subject members to the conditionality proposed in those guidelines.

He also had difficulty in supporting guideline (4), partly because of its rigidity and partly because he was not clear about its scope, Mr. Nebbia continued. In the past, the quarterly phasing of performance criteria had been convenient for a variety of reasons relating to data collection, the design and implementation of policy, and the schedule of promissory notes and interest payments. However, the calendric disbursement of resources was clearly divorced from the realities of developments in an economy. Furthermore, the even distribution of purchases throughout the period of the arrangement would have an impact on the distribution of financial flows from commercial banks, thereby affecting such crucial aspects of the adjustment program as the financing of the current account deficit. The Fund had shown flexibility by taking account of exogenous factors in the setting of quantitative targets. Flexibility with respect to financial flows and international reserves was also essential for the successful completion of an adjustment program. The Executive Board should not give the impression that it wished to link the distribution of purchases to the distribution of performance criteria.

Mr. Romuâldez expressed support for the first seven guidelines proposed by the staff, which merely reflected current practice. The Fund should apply the guidelines flexibly, particularly guideline (4).

He had strong reservations concerning guideline (8) and the last sentence of guideline (9), which proposed delaying the final purchase of an annual arrangement until understandings were reached with the Fund on the following year's program, Mr. Romuâldez said. They represented a tightening of conditionality that was inconsistent with the flexibility with which the Fund management and staff had approached the issue of linkages between performance criteria and the phasing of purchases under Fund arrangements. Purchases were more useful to a country in the context of the adjustment program being implemented than at the end of the program, as the financial resources were used to support the adjustment efforts. An annual program, whether or not it was part of a multiyear arrangement, possessed an internal consistency that was designed to achieve the established objectives and was supported by a financial package structured to match the adjustment effort. The integrity of an annual program would be violated by the proposed guidelines (8) and (9).

Mr. Goos remarked that it was important to establish a set of generally agreed rules regarding performance criteria and phasing of purchases, in order to avoid misunderstandings and to ensure equal treatment of members and the effective implementation of adjustment programs. In general, the test dates for performance criteria and for purchases should be spread evenly throughout the period of an arrangement, and the lags between them should be minimized. The staff paper clearly indicated that the application of that principle required a complex set of guidelines to accommodate specific circumstances.

He was in broad agreement with the staff recommendations, Mr. Goos noted. On the frequency of purchases, the current practice of allowing four or five purchases a year had worked satisfactorily so far and should therefore be maintained. He was concerned that the testing of performance criteria and hence, the timing of purchases had been increasingly affected by delays in reporting relevant statistical data. Technical assistance from the Fund could considerably improve the situation. In any event, the staff's suggestion to restrict reporting lags to a maximum of two months as a general rule, without unduly impairing the reliability of data, appeared appropriate.

He also agreed with the staff's proposal with respect to the distribution of purchases, Mr. Goos commented. He welcomed the recent trend toward a more equal distribution of the total amounts of purchases with a decline in the average proportion of financing made available upon approval of an arrangement. An even distribution of financial support throughout the arrangement period should encourage a member to maintain the adjustment effort until the end of the program. He could also go along with the proposal in guideline (4) concerning the timing of the second and last purchases of an arrangement. The suggestion made by some Directors that the quantitative distribution of purchases should be related to the strength of the adjustment effort and the country's need was difficult to reconcile with the catalytic role of the Fund, a role that it could perform best by ensuring continuity of the adjustment effort.

As for the test dates for performance criteria, Mr. Goos continued, he attached particular importance to an effective linkage between purchases and performance. However, such a linkage could not always be assured, and the staff's suggestions in guidelines (1), (3), and (5) to minimize unavoidable deviations from such an ideal distribution were appropriate.

Regarding guideline (6), it was unsatisfactory that in a considerable number of programs the period covered by performance criteria had been significantly shorter than 12 months, Mr. Goos considered. As a result, an important function of performance criteria--to provide a guide for the formulation and implementation of adjustment measures--had been weakened. Furthermore, the frequent use of reviews for setting short-run performance criteria had greatly contributed to the increasing work load of the staff and the Executive Board. He therefore supported the effort to lengthen the horizon of performance criteria to as much of the regular program period as possible and, under normal circumstances, to at least six months. He also agreed with the proposal to include indicative targets at the outset for that part of the 12-month period for which performance criteria had not been established. Purchases linked to a performance test immediately preceding a review should be made conditional on the satisfactory completion of the review whenever performance criteria were set for periods shorter than 12 months, so as to ensure equal treatment with those members whose performance criteria had been set for a 12-month period.

He strongly endorsed guideline (8), which, by linking the final purchase under an annual program to understandings on a subsequent program, would both promote the maintenance of the adjustment effort and demonstrate that multiyear arrangements were an integrated undertaking, Mr. Goos remarked. Guideline (9), while strengthening the continuity of the adjustment effort under a succession of one-year programs, would indicate at an early stage that the Fund stood ready to provide additional financial assistance. His authorities were concerned that the proposed guideline might add to the tendency toward the prolonged use of Fund resources. The use of performance criteria proposed in guideline (9) should be restricted to those cases where prolonged use of Fund resources seemed appropriate. An example might be where both the extent of the imbalances and the authorities' commitment to adjustment would generally justify a two-year or three-year arrangement, but where certain circumstances--lack of reliable statistical data, strongly fluctuating export prices, or uncertainty about the outcome of far-reaching economic reforms--would make it difficult to formulate objectives and adjustment policies with a sufficient degree of accuracy for more than one year. Finally, with the aforementioned reservation, he could support the proposed guidelines. It would be useful if the staff, in its future work, could explain the reasons for any major deviation from the guidelines.

Mr. Suraisry observed that, as the proposals in the staff paper raised important policy issues, it would be necessary to study some of them further before the Board could take a final decision. There was merit in establishing clear guidelines covering the link between adjustment and financing under Fund arrangements, a link that was central to Fund conditionality and was vital to ensuring that members would be treated uniformly. In clarifying existing procedures, however, the Fund should not impose new burdens on borrowing members. Guidelines should not be a means of increasing conditionality, nor should they be regarded as rigid rules; they should be interpreted flexibly, taking account of circumstances in individual cases.

He broadly endorsed the first five guidelines, which were in line with present practice and were designed to be helpful to members using Fund resources, Mr. Suraisry commented. Guideline (3), proposing to minimize the delay between the date when a program was agreed to by management and the date when the supporting arrangement was approved by the Executive Board, should help members to obtain Fund financing more promptly. Minimizing such delays would reduce the risk of slippages in an agreed program before it came to the Board. Consequently, there would be less need to renegotiate key elements of a program, thereby relieving the burden on members and staff.

Perhaps the staff, in its papers concerning requests for stand-by or other arrangements, should provide more information on the relationship between performance criteria and phasing, Mr. Leonard commented. Rather than include a new section, the staff should add a few sentences that would indicate the program period, the relationship between the adjustment period and the program period, the reporting delays, and their linkage to phasing of purchases.

In the real world, numerous exceptions to the ideal case would inevitably occur, Mr. Leonard noted. Special cases should be approached in the same spirit of flexibility as in the past. It would be useful for the Board to be informed of the reasons for any deviations from the norm. He would address three types of special cases.

First, in guideline (6), the staff noted that every effort should be made to include performance criteria for a 12-month period, and, at a minimum, they should be set for at least six months, Mr. Leonard commented. If that minimum period of six months were not met, the staff report should include a full explanation of the underlying reasons. It would perhaps be equally appropriate to provide an explanation in all cases where the performance criteria were not set for a 12-month period. By strengthening the role of performance criteria as guideposts, the Fund would reduce the frequency of reviews and would strengthen the forward-looking nature of adjustment programs. In about one third of the arrangements approved in 1983 and 1984, the horizon for performance criteria was less than three months.

Second, he supported the staff proposal to include indicative targets for that part of a program where it was impossible for performance criteria to be set, Mr. Leonard stated. In order to maintain the continuity of a program, provision should be made for reviews, at which time the indicative targets could be replaced with performance criteria. He agreed with the proposal to restrict purchases until the completion of such reviews. Furthermore, indicative targets should be included for the last month of an arrangement period, particularly in cases where that period ended some months after the program period.

Third, Mr. Leonard went on, in cases where Fund resources might be used for a number of years, the operational guidelines should be strengthened. As a first step, performance criteria or indicative targets should be set for the end or near the end of annual arrangements, as was normal practice. When it appeared likely that a member would require further Fund resources after the expiration of an annual program, the overall performance under the program and the successful completion thereof would be important criteria in establishing future arrangements. The staff should inform the Board how the member had performed under the previous arrangement, particularly with respect to the final performance criteria or indicative targets. Members should be discouraged from allowing major slippages toward the end of a program period before seeking follow-on assistance from the Fund.

satisfactory completion of the review whenever performance criteria were set for periods shorter than 12 months, so as to ensure equal treatment with those members whose performance criteria had been set for a 12-month period.

He strongly endorsed guideline (8), which, by linking the final purchase under an annual program to understandings on a subsequent program, would both promote the maintenance of the adjustment effort and demonstrate that multiyear arrangements were an integrated undertaking, Mr. Goos remarked. Guideline (9), while strengthening the continuity of the adjustment effort under a succession of one-year programs, would indicate at an early stage that the Fund stood ready to provide additional financial assistance. His authorities were concerned that the proposed guideline might add to the tendency toward the prolonged use of Fund resources. The use of performance criteria proposed in guideline (9) should be restricted to those cases where prolonged use of Fund resources seemed appropriate. An example might be where both the extent of the imbalances and the authorities' commitment to adjustment would generally justify a two-year or three-year arrangement, but where certain circumstances--lack of reliable statistical data, strongly fluctuating export prices, or uncertainty about the outcome of far-reaching economic reforms--would make it difficult to formulate objectives and adjustment policies with a sufficient degree of accuracy for more than one year. Finally, with the aforementioned reservation, he could support the proposed guidelines. It would be useful if the staff, in its future work, could explain the reasons for any major deviation from the guidelines.

Mr. Suraisry observed that, as the proposals in the staff paper raised important policy issues, it would be necessary to study some of them further before the Board could take a final decision. There was merit in establishing clear guidelines covering the link between adjustment and financing under Fund arrangements, a link that was central to Fund conditionality and was vital to ensuring that members would be treated uniformly. In clarifying existing procedures, however, the Fund should not impose new burdens on borrowing members. Guidelines should not be a means of increasing conditionality, nor should they be regarded as rigid rules; they should be interpreted flexibly, taking account of circumstances in individual cases.

He broadly endorsed the first five guidelines, which were in line with present practice and were designed to be helpful to members using Fund resources, Mr. Suraisry commented. Guideline (3), proposing to minimize the delay between the date when a program was agreed to by management and the date when the supporting arrangement was approved by the Executive Board, should help members to obtain Fund financing more promptly. Minimizing such delays would reduce the risk of slippages in an agreed program before it came to the Board. Consequently, there would be less need to renegotiate key elements of a program, thereby relieving the burden on members and staff.

Similarly, the proposal to minimize lags in the reporting of data relating to performance criteria should benefit countries by enabling them to draw under an arrangement in accordance with the agreed schedule of purchases, Mr. Suraisry noted. Guideline (2) provided for the necessary flexibility in those cases where it was impossible to limit reporting lags to two months. When appropriate, the Fund should provide technical assistance to help members to improve their reporting procedures. Members would also benefit from guidelines (4) and (5), which were intended to ensure that adjustment and financing would proceed smoothly throughout the program period. Those guidelines were flexible enough to take account of members' different circumstances.

The remaining guidelines had broader policy implications and departed somewhat from present practices, Mr. Suraisry considered. He agreed with the staff that it was normally appropriate to establish, at the outset, performance criteria for at least six months of an annual arrangement. Experience had shown however, that it was not always possible or desirable to set performance criteria so far in advance, given the economic uncertainties in some member countries. It might be appropriate to rely on review clauses in those cases where it was unrealistic to establish performance criteria six months ahead. In any event, guideline (6) should be interpreted with considerable flexibility.

Indicative targets covering the period of an arrangement for which performance criteria were not established could be useful to both the Fund and borrowing members, Mr. Suraisry remarked. Such targets would help a member to plan ahead and would provide a basis for future policymaking but should not be used as performance criteria, nor should they be linked to purchases in any way, imposing an extra burden on borrowing countries. There was no need to set indicative targets for the last month of a Fund arrangement in every case; guidelines (4) and (5) provided adequate safeguards to ensure that an arrangement would be carefully monitored throughout.

With regard to guideline (8), he agreed with the staff that it was normally appropriate to include performance criteria up to the end of each annual segment of a multiyear arrangement, Mr. Suraisry stated. In multiyear arrangements, the purchase linked to end-year performance criteria should usually be conditional on the member's reaching understandings on the next year's program. That guideline was justified in most cases because a member adopting a multiyear program had to address deep-rooted structural imbalances, which required continuous and sustained adjustment efforts over the full period of an arrangement.

He had serious doubts about guideline (9), Mr. Suraisry concluded. The last purchase under an annual arrangement should not be conditional on a member's reaching understandings with the Fund on a follow-on program; such a requirement would blur the distinction between two separate programs and could deter countries from requesting a follow-on arrangement, even when it was fully justified. The Fund should rely on the other safeguards included in the previous guidelines to ensure continuity between successive annual arrangements.

Mr. Arias noted that the staff intended to streamline some operational guidelines in order to ensure uniformity of treatment of member countries. Nevertheless, the Fund should retain its flexibility in establishing performance criteria and determining the phasing of purchases under Fund arrangements.

He agreed with the first three guidelines, but he had reservations regarding guidelines (4), (5), and (6), Mr. Arias remarked. In embarking on an adjustment program, a member indicated its willingness to implement comprehensive economic policies and improve its balance of payments position. Fund resources were necessary to support those adjustment efforts. The staff should not be concerned about the bunching problems of the first two purchases under an arrangement or about a last purchase occurring unduly early before the end of the arrangement. On the contrary, the staff should be concerned with the assistance that a member required to support its adjustment efforts aimed at solving the country's internal and external difficulties. Guideline (4) represented an increase in conditionality rather than an increase in support for member countries and did not therefore reflect the true role of the Fund.

He was not clear about the meaning of the indicative targets proposed in guideline (7), Mr. Arias said. Was an indicative target some kind of objective with particular flexibility?

Some member countries experiencing serious economic difficulties had found it painful to implement an economic adjustment program, Mr. Arias noted. Exogenous external developments could render an adjustment program inappropriate in the short term, in which event, corrections in the program should be made at the time of the reviews. Performance criteria should not always be established for the 12-month period of an arrangement. The frequent use of reviews to determine performance criteria was a more consistent and appropriate way to assist member countries undergoing adjustment.

He rejected guidelines (8) and (9), proposing that the last purchase under a program should be made conditional on the member reaching understandings with the Fund on the following year's program, Mr. Arias stated. Annual programs were independent and should be treated as such.

Mr. Leonard noted that the staff paper referred to the ideal or, at least, to normally desirable procedures. He supported virtually all of the conclusions that the staff drew from the hypothetical model. He would add only two points of emphasis and one suggestion.

First, as a general rule, performance criteria should be spread over the entire period of an adjustment program, even for adjustment periods slightly longer than 12 months, Mr. Leonard remarked. Indicative targets should be established for that part of the program where it was not possible to specify performance criteria. Second, there should be a high degree of congruence between the program period and the period of the Fund arrangement. He welcomed the undertaking by management to try to bring programs to the Board within three months of their approval by management.

Perhaps the staff, in its papers concerning requests for stand-by or other arrangements, should provide more information on the relationship between performance criteria and phasing, Mr. Leonard commented. Rather than include a new section, the staff should add a few sentences that would indicate the program period, the relationship between the adjustment period and the program period, the reporting delays, and their linkage to phasing of purchases.

In the real world, numerous exceptions to the ideal case would inevitably occur, Mr. Leonard noted. Special cases should be approached in the same spirit of flexibility as in the past. It would be useful for the Board to be informed of the reasons for any deviations from the norm. He would address three types of special cases.

First, in guideline (6), the staff noted that every effort should be made to include performance criteria for a 12-month period, and, at a minimum, they should be set for at least six months, Mr. Leonard commented. If that minimum period of six months were not met, the staff report should include a full explanation of the underlying reasons. It would perhaps be equally appropriate to provide an explanation in all cases where the performance criteria were not set for a 12-month period. By strengthening the role of performance criteria as guideposts, the Fund would reduce the frequency of reviews and would strengthen the forward-looking nature of adjustment programs. In about one third of the arrangements approved in 1983 and 1984, the horizon for performance criteria was less than three months.

Second, he supported the staff proposal to include indicative targets for that part of a program where it was impossible for performance criteria to be set, Mr. Leonard stated. In order to maintain the continuity of a program, provision should be made for reviews, at which time the indicative targets could be replaced with performance criteria. He agreed with the proposal to restrict purchases until the completion of such reviews. Furthermore, indicative targets should be included for the last month of an arrangement period, particularly in cases where that period ended some months after the program period.

Third, Mr. Leonard went on, in cases where Fund resources might be used for a number of years, the operational guidelines should be strengthened. As a first step, performance criteria or indicative targets should be set for the end or near the end of annual arrangements, as was normal practice. When it appeared likely that a member would require further Fund resources after the expiration of an annual program, the overall performance under the program and the successful completion thereof would be important criteria in establishing future arrangements. The staff should inform the Board how the member had performed under the previous arrangement, particularly with respect to the final performance criteria or indicative targets. Members should be discouraged from allowing major slippages toward the end of a program period before seeking follow-on assistance from the Fund.

He did not favor guideline (9), whereby the last purchase of a program would be made conditional upon the member's reaching understandings with the Fund on a new program, Mr. Leonard remarked. It was not to the advantage of either the member or the Fund to make a purchase under a current program conditional on understandings' being reached on a future program. There should, however, be as smooth a transition as possible between two programs; for countries adopting a follow-on program, the management and staff of the Fund should carefully evaluate and take into consideration performance under previous arrangements in establishing the degree of adjustment required and the amount of Fund resources to be made available under the later program.

Mr. Schneider indicated broad agreement with the proposed guidelines, which were in effect a verification of current practice. However, he had some reservations about the last sentence in guideline (9). While he agreed that the establishment of indicative targets was in the interest of both the Fund and the member country, he had great difficulty in accepting the proposal to make the last purchase under an arrangement conditional on the member's reaching understandings with the Fund on a new program. Guideline (9) could encourage the prolonged use of Fund resources.

Mr. Coumbis stated that he agreed with the two objectives of the guidelines, to ensure uniformity of treatment of members and to strengthen the link between performance and purchases under Fund arrangements. He also agreed with most of the conclusions reached by the staff. The proposals were operational guidelines based on experience, but they should be applied flexibly. It would be unwise to increase the problems of members by adopting unnecessarily rigid rules.

He could go along with all but guidelines (4), (8), and (9), Mr. Coumbis concluded. Although guideline (4), regarding the distribution of purchases, was too rigid, he could support it if it were applied with particular flexibility. He did not agree with the last sentence of guideline (9), proposing to make the last purchase of an arrangement conditional on the member's reaching understandings with the Fund on a new program.

Mr. Ortiz said that he agreed with guideline (1), which stated that every effort should be made to minimize the lag between the beginning of an annual program period and the date of discussion by the Executive Board of supporting annual arrangements. Unnecessary delays could cause complications and might necessitate a revision of the program objectives. Additionally, he supported guidelines (2) and (3), aimed at minimizing lags in reporting of data related to performance criteria and at limiting the period between the approval of an adjustment program by management and the date when the supporting arrangement was discussed by the Executive Board to no more than three months.

As for guideline (4), although a case could be made for having as many purchases as possible in order to link more precisely drawings and performance, there was a practical limit to the number of purchases under an arrangement, Mr. Ortiz stated. Furthermore, it was highly unlikely that estimates of economic variables, such as monetary aggregates and public sector deficits, could be obtained more frequently than on a quarterly basis. There should, therefore, be no more than four purchases during a 12-month period. On a related point, purchases should be distributed according to the specific needs of a country and should not be determined mechanically by inflexible rules. Flexibility in that area was especially important because disbursement of commercial bank credit to members was often linked to the timing of purchases under Fund arrangements.

He agreed with guidelines (5), (6), and (7), Mr. Ortiz said. Every effort should be made to include performance criteria for as much of the 12-month period of the Fund arrangement as possible. When it was not possible to fix in advance performance criteria for the entire period, they should be established for at least six months and indicative targets set for the rest of the period.

As for guidelines (8) and (9), it would be difficult to establish performance criteria up to the end of each annual segment of a multiyear arrangement, Mr. Ortiz considered. While medium-term scenarios served a useful purpose for policy analysis, they were not forecasts. Finally, he did not support the proposal that the last purchase under an annual program that was considered likely to be one of a succession of one-year programs should be made conditional on the member's reaching understandings with the Fund on a new program. A member should not be required to agree on conditions for a second arrangement before being able to draw all the resources to which it was entitled under the first arrangement.

Mr. Polak stated that he hoped that the proposed guidelines were intended to ensure equality of treatment of members and not to introduce further rigidities. He agreed with all of the guidelines, with the exception of the last sentence of guideline (9).

Mr. Zhang observed that the staff had codified the current practice on phasing of purchases. A country should not be made to suffer because of rigid, mechanical application of the guidelines, should they be approved by the Executive Board. Executive Directors should consider three factors. First, the phasing of purchases should be flexible enough to meet the special circumstances and needs of a borrowing country without sacrificing the principle of uniformity of treatment. Second, the phasing of purchases should coincide with the degree of adjustment under a program. In the past, adjustment under Fund-supported programs had tended to be front-loaded, while the release of resources had been back-loaded. That practice was undesirable and should be changed. Third, the last purchase of an annual program should not be made conditional. He could not accept guidelines (8) and (9).

Mr. Qureshi remarked that the adoption of a clear set of guidelines on the relationship between performance criteria and purchases under Fund arrangements would be useful. However, due flexibility in the application of such guidelines was necessary in view of the different circumstances of individual countries. Although the need for flexibility had been mentioned in the paper, it would be appropriate to mention it in the guidelines as well, should they be adopted in the form of a decision, as suggested by Mr. Ismael.

While he agreed that every effort should be made to align the period of an annual program with that of the supporting annual arrangement, a significant lag between the two periods might be unavoidable in some cases, Mr. Qureshi suggested. The number and the amounts of purchases under an arrangement were two distinct issues that should be considered separately. He supported guideline (4) proposing that purchase dates should be distributed as evenly as possible over the period of an arrangement. Whether there should be four or five purchases during a 12-month period depended on the particular circumstances of the member in question, and five purchases might not always be the preferred course of action. Furthermore, there was no obvious merit in seeking an even distribution of purchase amounts over the arrangement. The distribution of amounts could be influenced by a concentration of the needed financing and adjustment at the start of the arrangement. The data reported in the paper indicated a significant reduction over the past three years in the average proportion of financing made available upon approval of an arrangement, even though the front-loading of adjustment had increased significantly.

He agreed with guideline (6), which recognized the advantages of establishing performance criteria initially for as much of the 12-month period of the Fund arrangement as possible, while recognizing the existence of uncertainties and constraints in some cases, Mr. Qureshi commented. He had reservations about the proposal to make the purchase linked to end-year performance criteria conditional on understandings' being reached with the Fund on the next year's program within a multiyear arrangement. It was still more difficult to support the staff's suggestion that, even in cases where there was only an expectation--not a formal commitment or understanding--that an annual program would be part of a succession of one-year programs, the last purchase under an arrangement should be made conditional on the country's reaching agreement with the Fund on a new program. While he appreciated the importance of sustaining the adjustment effort, the linking of purchases to understandings on future action would undermine the integrity of the relationship between the achievement of performance criteria and the right to make the associated purchase.

He did not favor the establishment of performance criteria at the end of a program period in annual programs that were not part of multiyear arrangements, because, given normal reporting lags, the last purchase could not be made until well after the expiration of the arrangement, Mr. Qureshi noted. Such a requirement was unnecessary. Guideline (5), regarding the earliest date of the last performance test and the inclusion of year-end indicative targets, should be sufficient to ensure that slippages in performance did not occur toward the end of the program period.

Mr. Malhotra indicated his agreement with guidelines (1), (2), and the first part of (3). Every effort should be made to limit to less than three months the period between the approval of an adjustment program by management and the date when the supporting arrangement was discussed by the Executive Board. A renegotiation of the program, necessitated by a significant delay in implementing the agreed program, represented an additional burden, on both the staff and the member. He hoped that such action would be necessary only in truly exceptional cases.

As for guideline (4), he would prefer that the number of purchases in a 12-month period be limited to four, Mr. Malhotra said. He saw no problem with regard to the bunching of the first two purchases under an arrangement if adjustment were stronger at the beginning of the program.

He agreed with guideline (5) and the thrust of guideline (6), Mr. Malhotra stated. The objective of establishing performance criteria over a minimum period of six months was appropriate. On guideline (7), indicative targets were merely guideposts for the member and should not be equated with performance criteria. What did the staff consider to be the purpose of indicative targets?

He had serious objections to the proposal that the last purchase of an annual program should be made conditional on understandings' being reached with the Fund on the next year's program within the multiyear arrangement or on a new program where there was a clear prospect of prolonged use by the member, Mr. Malhotra stated. Guidelines (8) and (9) were retrograde steps, which could not be distinguished from one another and were based on mistrust of member countries. If a member met the last performance criteria of an annual program, it would be wrong to withhold the purchase associated with them.

Mr. Nguyen remarked that several cases in the past had raised questions about the rationale behind the phasing of purchases and about the principle of equality of treatment of members. He held strong reservations about the last sentence of guideline (9), but he agreed with the rest of the proposed guidelines, which should be interpreted with some flexibility.

Mr. Ajayi noted that while a number of the proposed guidelines were a codification of existing practice, some of them contained elements of additional conditionality. He supported guidelines (1), (2), (3), and (5), and urged the staff to apply guideline (4), regarding the distribution of purchases, particularly flexibly. Purchases should be phased according to the strength of adjustment measures adopted. A front-loading of purchases might be appropriate in some instances, for example, if significant amounts of resources were necessary as a result of the lifting of restrictions and controls. The lack of sufficient financial support at the initial stage of an adjustment program might jeopardize the program's success. Management and the staff should take full account of the special circumstances of each country when applying guideline (4). The staff's suggestion that the second purchase under an arrangement should occur no earlier than two months from the initial purchase was unnecessarily rigid; bunching of purchases was appropriate if the relevant performance criteria had been met.

While he agreed that every effort should be made to include performance criteria initially for as much of the program period as possible, he was not clear on the need for the proposal in guideline (7) to establish indicative targets for the part of the program for which performance criteria had to be set later, Mr. Ajayi commented. The requirement that indicative targets should be included introduced additional complications into negotiations, which were already difficult.

He had no objections to the first part of guideline (8), Mr. Ajayi continued, but he was opposed to the second part requiring that the purchase linked to end-year peformance criteria also be conditional on a country's reaching understandings with the Fund on the next year's program within the multiyear arrangement. Furthermore, he did not agree with the last sentence of guideline (9), proposing that the last purchase under a program should be made conditional on the member's reaching understandings with the Fund on a new program.

Mr. Clark indicated his general support for the staff proposals; he would look forward to reviewing the experience under the guidelines in due course. He had two specific points. First, his chair had registered concern on a number of occasions about programs in which the last performance test had been scheduled well in advance of the end of the arrangement. He hoped that guideline (5) would serve to avoid such situations arising in the future.

Second, his chair had also raised questions about the continuity of performance monitoring of members that adopted a multiyear arrangement or a sequence of arrangements, Mr. Clark recalled. Guidelines (8) and (9) were aimed at addressing that problem, but he was concerned that the proposed conditionality was, in fact, back to front. Would it not be more appropriate for the new program to be made dependent on performance under the previous program? On a practical level, what could be written into an adjustment program that would be consistent with guideline (9)? What would happen if a country chose not to adopt a follow-on program?

Mr. Tshishimbi stated that he agreed with most of the proposed guidelines, which were largely a codification of existing practice. He urged the Executive Board, however, to apply the guidelines flexibly.

Every effort should certainly be made to limit the lag between the beginning of a program period and the date on which the arrangement became effective in order to strengthen the link between financing and adjustment, Mr. Tshishimbi remarked. As for the phasing of purchases, the length of the intervals between the first two purchases of an arrangement had been growing, and the Executive Board should not exaggerate its fears in that regard.

With respect to guidelines (8) and (9), Mr. Tshishimbi commented, he was concerned about the proposal to make the last purchase of an annual program conditional on the member's reaching understandings with the Fund on a new program or within a multiyear arrangement, on the following year's program. If negotiations on the new program were protracted, the last purchase of the previous program might be unduly delayed.

Ms. Bush noted that, while no substantial changes in Fund policy were implied in the staff paper, the guidelines were flexible and could usefully be adopted. The Fund's record to date on performance criteria and phasing of purchases under Fund arrangements had been mixed, and specific guidelines might help to standardize the Fund's practice to the extent possible to ensure uniformity of treatment and the success of adjustment programs. She basically agreed with eight of the nine guidelines proposed by the staff and would comment briefly only where an observation was needed.

Guideline (1) addressed the need to minimize the lag between the beginning of an annual program period and the date of discussion by the Executive Board of the supporting annual arrangement in order to facilitate the establishment and monitoring of quarterly performance criteria, Ms. Bush observed. Differences between program and arrangement periods had caused some difficulties, and any procedural changes that could be made to smooth out those differences were welcome. She also agreed with guideline (2), that data should be reported on a timely and accurate basis to facilitate the assessment of compliance with a Fund arrangement and to ensure the rapid disbursement of resources.

She supported guideline (3), which proposed that every effort should be made to limit the period between the approval of an adjustment program by management and the date when the supporting arrangement was discussed by the Executive Board, Mr. Bush stated, but she wondered whether the proposed maximum of three months was too long. If the delay were longer than three months, the staff should give strong assurances that the program as originally proposed remained appropriate. If there were significant slippages, the staff should renegotiate the program.

In the past, her chair had indicated its opposition to the bunching of purchases at the beginning of a program and the dead period toward the end of an arrangement when performance criteria were not tied to purchases, Mr. Bush recalled. She supported guideline (4) on the number and timing of purchases, particularly regarding the date of the last purchase, and guideline (5), which was consistent with the previous four guidelines.

She strongly urged that efforts be made to include performance criteria initially for as much of the 12-month period, of a Fund arrangement as possible and, at a minimum, for six months, Ms. Bush stated. Where the minimum period was not met, the staff should explain fully the underlying reasons. Guideline (7), related to the setting of indicative targets for any part of the 12-month period for which performance criteria could not be established, was appropriate.

Regarding guideline (8), she supported the inclusion of performance criteria up to the end of each annual segment of an arrangement and the linkage of the final purchase to understandings' being reached on the next year's program under a multiyear arrangement, Ms. Bush noted. While she appreciated the need for continuity in the adjustment effort as embodied in guideline (9), however, she had some misgivings about the implicit assumption that there would be a follow-on program before it had been requested by the member concerned and before the Executive Board had taken a decision. The even distribution of purchases and related performance criteria should generally be sufficient to encourage continuous adjustment and facilitate the negotiation of a new program should it be requested.

Mr. Salehkhou remarked that the staff paper addressed two concerns raised previously by some Executive Directors, about the relationship between performance criteria and purchases under Fund arrangements applied in individual cases and how best to ensure uniform treatment of all members. However, the staff was proposing a number of operational guidelines that it presented as a mere "codification and clarification of current practice." If endorsed by the Board, those guidelines would change present procedures substantially, increasing rigidity and further tightening conditionality. Furthermore, the issue of equal treatment of members was hardly being addressed by the guidelines, which provided for exceptions in countries facing extraordinary circumstances.

The proposed guidelines were somewhat mechanistic in their approach to the timing and frequency of performance criteria and the regulation of drawings, Mr. Salehkhou noted. Account was not taken of a member's actual needs, its financial commitments to other Governments and multilateral institutions, or the impact of delays in the observance of performance criteria. The guidelines would also reduce the ability of the staff, management, and Executive Board to address members' problems, particularly the small members' with flexibility.

The first three guidelines were reasonable and would undoubtedly improve current procedures by strengthening the link between financing and adjustment, Mr. Salehkhou considered. In particular, the proposal to minimize the period between the beginning of an annual program, or its approval by management, and the approval of the arrangement by the Executive Board was appropriate. Furthermore, efforts should be made to minimize lags in reporting data, as long as adequate provisions were made for those members who had problems gathering data. However, the suggestion that a program should be renegotiated when the delay between the approval of an adjustment program by management and the date when the supporting arrangement was discussed by the Board exceeded three months was unfair to member countries, which were not usually responsible for the delays. Moreover, such a provision would put excessive pressure on the member to expedite multilateral financing agreements with its creditors even when the terms were harsh.

Guideline (4) was particularly mechanistic, Mr. Salehkhou considered. Drawings under Fund arrangements should conform mainly to members' financing needs, which might not be evenly distributed throughout the program period. Furthermore, provided that appropriate performance criteria were adopted, bunching or front-loading of the first two drawings under an arrangement would generally enhance the implementation of adjustment measures, the harshest of which generally had to be put into effect at the beginning of Fund-supported programs. The current practice of having four purchases linked to the observance of quarterly performance criteria during a 12-month period was appropriate, and any increase in the number of purchases would be an unacceptable tightening of conditionality.

Guideline (5) also represented a mechanistic approach to the setting of test dates for performance criteria and would, in effect, penalize those members that did report data on a timely basis, Mr. Salehkhou observed. He was particularly opposed to the suggestion that the date of the last performance test should not be earlier than three months from the end of the arrangement.

Guidelines (6) and (7), regarding the period covered by performance criteria, allowed for the flexibility required to deal with the circumstances of each country, particularly the uncertainties associated with economic developments and with the real impact of the adjustment measures implemented, Mr. Salehkhou noted. While he agreed that indicative targets should be set for the period not covered by performance criteria, they should not be replaced automatically by formal performance criteria, which should be based on the experience of the previous period and the overall targets of the program.

The final two guidelines relating to the transition between successive annual programs represented an unwarranted tightening of Fund conditionality, Mr. Salehkhou commented. The legality of those guidelines was questionable. Satisfactory safeguards to ensure continued performance by the member up to the end of the arrangement already existed--multiple reviews and limits on the earliest date for the last performance criteria and corresponding drawing. Furthermore, a member's performance after the end of an adjustment program was generally taken into account by the staff in negotiations on any follow-up arrangement. The proposal to make the last purchase under a program conditional on understandings being reached on a follow-on program would deter some members from seeking further support from the Fund or might force them to accept terms that might be unrealistic or unsustainable.

The proposed guidelines were clearly much more than a codification of current practice, Mr. Salehkhou remarked. Their adoption by the Executive Board would deprive management and staff of the flexibility needed to ensure the successful formulation of Fund programs and an adequate response to members' needs. The concerns of Directors that had prompted the present discussion hardly warranted the introduction of further rigidity and additional conditionality.

The Director of the Exchange and Trade Relations Department stated that guideline (8) was not intended to represent a tightening of current practice. The staff was merely codifying the present practice of linking the final purchase to the review at the end of the year of the following year's program. The guidelines were intended to help the Executive Board ensure that members were treated uniformly, while maintaining a degree of flexibility.

The staff representative from the Exchange and Trade Relations Department commented, with respect to the distribution of purchases through the period of an arrangment, that the staff had been referring to the time distribution of purchases rather than the phasing of amounts. On page 3 of SM/84/259, the staff had explicitly stated that "on occasion, there are substantial reasons in favor of front-loading" of amounts. That issue had been discussed in detail in EBS/80/262 (12/4/80). In the current paper, the staff was not arguing against front-loading of purchases when it was justified on the basis of the degree of adjustment or the balance of payments need of the member. Rather the staff was suggesting that the first performance test date should not precede the date of approval of the arrangement and that, given the normal reporting lag, the date of the second purchase should not be within two months of the date of approval of the arrangement.

Directors generally supported guideline (6), which proposed that performance criteria should normally be included for at least six months, the staff representative noted. He had no difficulties with Mr. Leonard's suggestion that the staff should provide a detailed explanation in the event that the performance criteria were not specified for the entire 12-month period. However, in most cases, performance criteria would probably be specified for shorter periods than 12 months.

Indicative targets were intended as some kind of guidepost to the member and the Fund, the staff representative explained. There was a basic difference between indicative targets and performance criteria; indicative targets would not govern purchases under a Fund-supported arrangement. The staff had mentioned in passing that, where a review had been delayed to a time near the end of the arrangement, it might be useful to have indicative targets that extended beyond the arrangement period. Such indicative targets would represent a kind of rolling horizon of six months, whereby the member and the Fund would have some agreed benchmarks that would guide the member in the management of economic policy. The concept of a six-month rolling horizon could not apply to performance criteria, which by definition were related to purchases during the period of the arrangement.

The staff considered that guidelines (8) and (9) would strengthen the effective and continuous implementation of adjustment policies and would provide for a smooth and even transition of purchases from one program to the next, the staff representative from the Exchange and Trade Relations Department indicated. While the requirement that members must reach undertandings on the next year's program could result in undue

The staff representative from the Exchange and Trade Relations Department explained that the first purchase would be made available at the time of Executive Board approval of the Fund-supported arrangement. The remaining four purchases would be made available on a quarterly basis, following the observance of the performance criteria.

The Director of the Exchange and Trade Relations Department remarked that the staff was proposing that the first drawing of the second year's program should be related not only to the last performance criteria of the previous program, but also to acceptance of the program for the second year.

Mr. Malhotra suggested that the annual segment of a multiyear arrangement should coincide as closely as possible to the fiscal year of the country undergoing adjustment. Furthermore, he agreed with Mr. Qureshi that two types of conditionality were being proposed, the performance criteria and the midyear and end-year reviews.

The Chairman invited other Directors to indicate whether a country should be allowed to make the last purchase at the end of an annual program, even if there were no chance that negotiations on the second year of the arrangement would be successful.

Ms. Bush stated that, in a multiyear arrangement, the meeting of the performance criteria at the end of the first year did not imply that the broader objectives of the arrangement were being met. A 12-month program was not the analytical unit of an arrangement; adjustment measures and performance criteria in the first year of an arrangement were set with the overall objectives of the arrangement in mind.

Mr. Goos expressed agreement with Ms. Bush. Guideline (8) was more or less a logical extension of existing practices with respect to one-year stand-by arrangements in which performance criteria were set for only six months. Both six-month units of the 12-month arrangement would be interlinked. Annual segments of a multiyear arrangement should also be regarded as units, which should also be interlinked.

The staff representative from the Exchange and Trade Relations Department, responding to a question from the Chairman, remarked that the review at the end of the first year of a multiyear arrangement should relate to negotiations on a second-year program and would represent a performance criterion in itself.

Mr. Qureshi observed that most Directors had opposed the staff proposal, contained in guideline (9), to link the last purchase under an annual program to an agreement being reached on a new program, even though the initial program had been conceived in a medium-term context as part of a succession of one-year programs. While holding to that position, he would consider it logically difficult to prescribe a different policy for annual programs that were part of a multiyear arrangement.

Regarding guideline (8), she supported the inclusion of performance criteria up to the end of each annual segment of an arrangement and the linkage of the final purchase to understandings' being reached on the next year's program under a multiyear arrangement, Ms. Bush noted. While she appreciated the need for continuity in the adjustment effort as embodied in guideline (9), however, she had some misgivings about the implicit assumption that there would be a follow-on program before it had been requested by the member concerned and before the Executive Board had taken a decision. The even distribution of purchases and related performance criteria should generally be sufficient to encourage continuous adjustment and facilitate the negotiation of a new program should it be requested.

Mr. Salehkhou remarked that the staff paper addressed two concerns raised previously by some Executive Directors, about the relationship between performance criteria and purchases under Fund arrangements applied in individual cases and how best to ensure uniform treatment of all members. However, the staff was proposing a number of operational guidelines that it presented as a mere "codification and clarification of current practice." If endorsed by the Board, those guidelines would change present procedures substantially, increasing rigidity and further tightening conditionality. Furthermore, the issue of equal treatment of members was hardly being addressed by the guidelines, which provided for exceptions in countries facing extraordinary circumstances.

The proposed guidelines were somewhat mechanistic in their approach to the timing and frequency of performance criteria and the regulation of drawings, Mr. Salehkhou noted. Account was not taken of a member's actual needs, its financial commitments to other Governments and multilateral institutions, or the impact of delays in the observance of performance criteria. The guidelines would also reduce the ability of the staff, management, and Executive Board to address members' problems, particularly the small members' with flexibility.

The first three guidelines were reasonable and would undoubtedly improve current procedures by strengthening the link between financing and adjustment, Mr. Salehkhou considered. In particular, the proposal to minimize the period between the beginning of an annual program, or its approval by management, and the approval of the arrangement by the Executive Board was appropriate. Furthermore, efforts should be made to minimize lags in reporting data, as long as adequate provisions were made for those members who had problems gathering data. However, the suggestion that a program should be renegotiated when the delay between the approval of an adjustment program by management and the date when the supporting arrangement was discussed by the Board exceeded three months was unfair to member countries, which were not usually responsible for the delays. Moreover, such a provision would put excessive pressure on the member to expedite multilateral financing agreements with its creditors even when the terms were harsh.

Guideline (4) was particularly mechanistic, Mr. Salehkhou considered. Drawings under Fund arrangements should conform mainly to members' financing needs, which might not be evenly distributed throughout the program period. Furthermore, provided that appropriate performance criteria were adopted, bunching or front-loading of the first two drawings under an arrangement would generally enhance the implementation of adjustment measures, the harshest of which generally had to be put into effect at the beginning of Fund-supported programs. The current practice of having four purchases linked to the observance of quarterly performance criteria during a 12-month period was appropriate, and any increase in the number of purchases would be an unacceptable tightening of conditionality.

Guideline (5) also represented a mechanistic approach to the setting of test dates for performance criteria and would, in effect, penalize those members that did report data on a timely basis, Mr. Salehkhou observed. He was particularly opposed to the suggestion that the date of the last performance test should not be earlier than three months from the end of the arrangement.

Guidelines (6) and (7), regarding the period covered by performance criteria, allowed for the flexibility required to deal with the circumstances of each country, particularly the uncertainties associated with economic developments and with the real impact of the adjustment measures implemented, Mr. Salehkhou noted. While he agreed that indicative targets should be set for the period not covered by performance criteria, they should not be replaced automatically by formal performance criteria, which should be based on the experience of the previous period and the overall targets of the program.

The final two guidelines relating to the transition between successive annual programs represented an unwarranted tightening of Fund conditionality, Mr. Salehkhou commented. The legality of those guidelines was questionable. Satisfactory safeguards to ensure continued performance by the member up to the end of the arrangement already existed--multiple reviews and limits on the earliest date for the last performance criteria and corresponding drawing. Furthermore, a member's performance after the end of an adjustment program was generally taken into account by the staff in negotiations on any follow-up arrangement. The proposal to make the last purchase under a program conditional on understandings being reached on a follow-on program would deter some members from seeking further support from the Fund or might force them to accept terms that might be unrealistic or unsustainable.

The proposed guidelines were clearly much more than a codification of current practice, Mr. Salehkhou remarked. Their adoption by the Executive Board would deprive management and staff of the flexibility needed to ensure the successful formulation of Fund programs and an adequate response to members' needs. The concerns of Directors that had prompted the present discussion hardly warranted the introduction of further rigidity and additional conditionality.

The Director of the Exchange and Trade Relations Department stated that guideline (8) was not intended to represent a tightening of current practice. The staff was merely codifying the present practice of linking the final purchase to the review at the end of the year of the following year's program. The guidelines were intended to help the Executive Board ensure that members were treated uniformly, while maintaining a degree of flexibility.

The staff representative from the Exchange and Trade Relations Department commented, with respect to the distribution of purchases through the period of an arrangment, that the staff had been referring to the time distribution of purchases rather than the phasing of amounts. On page 3 of SM/84/259, the staff had explicitly stated that "on occasion, there are substantial reasons in favor of front-loading" of amounts. That issue had been discussed in detail in EBS/80/262 (12/4/80). In the current paper, the staff was not arguing against front-loading of purchases when it was justified on the basis of the degree of adjustment or the balance of payments need of the member. Rather the staff was suggesting that the first performance test date should not precede the date of approval of the arrangement and that, given the normal reporting lag, the date of the second purchase should not be within two months of the date of approval of the arrangement.

Directors generally supported guideline (6), which proposed that performance criteria should normally be included for at least six months, the staff representative noted. He had no difficulties with Mr. Leonard's suggestion that the staff should provide a detailed explanation in the event that the performance criteria were not specified for the entire 12-month period. However, in most cases, performance criteria would probably be specified for shorter periods than 12 months.

Indicative targets were intended as some kind of guidepost to the member and the Fund, the staff representative explained. There was a basic difference between indicative targets and performance criteria; indicative targets would not govern purchases under a Fund-supported arrangement. The staff had mentioned in passing that, where a review had been delayed to a time near the end of the arrangement, it might be useful to have indicative targets that extended beyond the arrangement period. Such indicative targets would represent a kind of rolling horizon of six months, whereby the member and the Fund would have some agreed benchmarks that would guide the member in the management of economic policy. The concept of a six-month rolling horizon could not apply to performance criteria, which by definition were related to purchases during the period of the arrangement.

The staff considered that guidelines (8) and (9) would strengthen the effective and continuous implementation of adjustment policies and would provide for a smooth and even transition of purchases from one program to the next, the staff representative from the Exchange and Trade Relations Department indicated. While the requirement that members must reach undertandings on the next year's program could result in undue delays in making the final purchase, such delays would not result in a permanent loss of the purchase if the program were on track. The purchase would immediately become available upon adoption of the next year's program. The staff realized that the linkage of the last purchase under one annual arrangement to agreement on a successive arrangement, as outlined in the second part of guideline (9), had received only limited support from Executive Directors. Some Directors were opposed to that part of the guideline because they felt that each arrangement should be independent and that a purchase under one arrangement should not be conditional on agreement on future programs, while others were concerned that the guideline would imply continued commitment by the Fund to provide resources to the member. In fact, the staff had not pressed for such a linkage, noting that the preceding guidelines should normally reduce the risk of a slippage in performance toward the end of an annual arrangement.

The Director of the Legal Department remarked that while, formally, the last sentence of guideline (8) would represent a new Fund rule, it would be legally consistent with the multiyear nature of such an arrangement. Under a multiyear arrangement, a member undertook to agree on performance criteria relating to all years of the arrangement, not just to the first year.

Mr. Malhotra stated that he was concerned about the practical, rather than the legal, aspects of guideline (8). In practice, financing of a multiyear arrangement was broken up into annual periods. If agreement between the Fund and the authorities could not be reached on the second or third annual program of the arrangement, the member would not be able to purchase the Fund resources available under the multiyear arrangement.

The Chairman commented that a member accepted a multiyear arrangement with the understanding that there would be important changes in economic policies over a period of time. Those policy measures would be defined and implemented in successive annual segments. The last purchase under one segment should logically be dependent on understandings being reached on the program for the next annual segment since the whole multiyear arrangement should be marked by continuity and consistency.

Mr. Malhotra said that if a member was meeting the performance criteria of a multiyear arrangement, there should be a continuum of adjustment and purchases. Guideline (8) would result in the interruption of that continuum even if the performance criteria were being met.

The staff representative from the Exchange and Trade Relations Department stated that although interruptions in purchases had resulted in some cases when there had been delays in reaching agreement on the second year's program, such delays should not necessarily occur. If the program was on track, negotiations on the second year's program could be initiated early enough such that there would be no interruption in purchases.

The Director of the Exchange and Trade Relations Department remarked that while the staff regarded performance clauses as important, it had also provided for review clauses to enable additional contributions by the Executive Board at certain stages. Guideline (8) was one application of that principle; the review at the end of the annual segment of a multiyear arrangement would represent a checkpoint, at which time the Executive Board could ensure the continuity of the adjustment program.

The Chairman observed that if negotiations on the program for the second year of a multiyear arrangement were initiated three or four months prior to the end of the first year and were completed satisfactorily, there would be no cause for an interruption in purchases by the member. Guideline (8) called for a review at the end of each annual segment of a multiyear arrangement to determine whether an understanding had been reached on the next year's program and to decide on the release of the last purchase.

The staff representative from the Exchange and Trade Relations Department noted that if a member failed to meet the performance criteria at the end of an annual program but had reached agreement with the staff on the next year's program, a waiver of the performance criteria would usually be called for, thereby providing a continuum of adjustment.

Mr. Malhotra stated that a member entering into an extended arrangement was clearly concerned with economic adjustment and with receiving financial resources from the Fund. Increasing pressure on a member through the introduction of more conditions was inappropriate. He wondered if a member would be denied the last purchase under the first annual program if it did not wish to pursue a follow-on program.

Mr. Qureshi remarked that if guideline (8) were adopted, roughly one half of the drawings under a multiyear arrangement would be subject to two sets of performance clauses, the review--midterm or end-year--and the original set of performance criteria. It was appropriate to treat midterm reviews as performance criteria, but he did not agree that end-year reviews should be regarded as such. The operational unit of Fund arrangements was an annual program, even in a multiyear arrangement. Neither performance criteria nor a clear set of policies were laid down initially for the entire period of the arrangement.

Mr. Kabbaj recalled that the present discussion had arisen out of the former Deputy Managing Director's concern that a member pursuing a three-year extended arrangement would not be obliged to observe the performance criteria at the end of the final year, but could still make the drawing. Perhaps the staff had intended to link the final purchase in the final year of an extended arrangement to a set of performance criteria. Finally, given that performance criteria were established quarterly, how did the staff propose to distribute five purchases throughout a 12-month period?

The staff representative from the Exchange and Trade Relations Department explained that the first purchase would be made available at the time of Executive Board approval of the Fund-supported arrangement. The remaining four purchases would be made available on a quarterly basis, following the observance of the performance criteria.

The Director of the Exchange and Trade Relations Department remarked that the staff was proposing that the first drawing of the second year's program should be related not only to the last performance criteria of the previous program, but also to acceptance of the program for the second year.

Mr. Malhotra suggested that the annual segment of a multiyear arrangement should coincide as closely as possible to the fiscal year of the country undergoing adjustment. Furthermore, he agreed with Mr. Qureshi that two types of conditionality were being proposed, the performance criteria and the midyear and end-year reviews.

The Chairman invited other Directors to indicate whether a country should be allowed to make the last purchase at the end of an annual program, even if there were no chance that negotiations on the second year of the arrangement would be successful.

Ms. Bush stated that, in a multiyear arrangement, the meeting of the performance criteria at the end of the first year did not imply that the broader objectives of the arrangement were being met. A 12-month program was not the analytical unit of an arrangement; adjustment measures and performance criteria in the first year of an arrangement were set with the overall objectives of the arrangement in mind.

Mr. Goos expressed agreement with Ms. Bush. Guideline (8) was more or less a logical extension of existing practices with respect to one-year stand-by arrangements in which performance criteria were set for only six months. Both six-month units of the 12-month arrangement would be interlinked. Annual segments of a multiyear arrangement should also be regarded as units, which should also be interlinked.

The staff representative from the Exchange and Trade Relations Department, responding to a question from the Chairman, remarked that the review at the end of the first year of a multiyear arrangement should relate to negotiations on a second-year program and would represent a performance criterion in itself.

Mr. Qureshi observed that most Directors had opposed the staff proposal, contained in guideline (9), to link the last purchase under an annual program to an agreement being reached on a new program, even though the initial program had been conceived in a medium-term context as part of a succession of one-year programs. While holding to that position, he would consider it logically difficult to prescribe a different policy for annual programs that were part of a multiyear arrangement.

The Director of the Exchange and Trade Relations Department stated that resources were made available under the extended Fund facility for longer periods and in amounts larger in relation to quotas than under stand-by arrangements. Furthermore, a member must present a broad program for the whole period of the arrangement at the time that it requested access to the facility. In addition, the repurchase period for an extended arrangement was longer than for a stand-by arrangement.

The Chairman remarked that Mr. Goos had made a relevant point. In the case of an annual program in which performance criteria were set for only six months, the staff and member would expect to negotiate further on the performance criteria for the second six months of the program. The second half of the annual program would be presented to the Executive Board at the time of the midyear review. A logical extension of that practice in the case of a multiyear arrangement would be to link the first and second annual programs with a review clause.

In response to a question from Mr. Qureshi, the Chairman indicated that guideline (8) would also apply to a multiyear stand-by arrangement.

Mr. Qureshi noted that if that were the case, the differences cited by the Director of the Exchange and Trade Relations Department between an extended and a stand-by arrangement could not be used as justification for treating the last purchase under an annual program forming part of a multiyear arrangement differently from one relating to an annual program that was not part of a multiyear arrangement but was considered part of a succession of one-year arrangements, when both the multiyear arrangement and the successive one-year arrangements were stand-by arrangements.

Mr. Malhotra asked the staff to provide information on the number of cases where extended arrangements had been interrupted at the end of the first or second year. The proposal to make the last purchase under an annual program conditional on the member's reaching understandings on the next year's program of a multiyear arrangement would put excessive pressure on the member. If a member were experiencing a financing need, pressure already existed to formulate the program for the second year of an extended arrangement.

The Director of the Exchange and Trade Relations Department stated that the staff would examine the experience of members under extended arrangements to determine whether guideline (8) would, in fact, represent a change of existing practice.

Mr. Clark remarked that, while he was in favor of the idea of continuity of performance monitoring, it could perhaps be expressed more clearly than in guideline (8).

The Chairman noted that Directors were in broad agreement with guidelines (1) and (2). Most Directors agreed with guideline (3), which suggested limiting to three months the period between the approval of an adjustment program by management and the date when the supporting arrangement was discussed by the Executive Board; a number of speakers considered that the Fund should make every effort to limit that period to less than three months. Guideline (4) did not represent a change of practice, and reassured Directors that the staff would apply it flexibly. There was broad agreement on guideline (5), regarding the need to distribute test dates for performance criteria as evenly as possible throughout the period of the arrangement. Guidelines (6) and (7) were also broadly supported by Directors. The staff would reformulate guideline (8) for further consideration by the Executive Board. Most Directors were opposed to the last sentence in guideline (9), proposing that the last purchase under an arrangement should be made conditional on the member's reaching understandings with the Fund on a new program.

Mr. Clark remarked that Directors had objected more to the idea of making the last drawing of a program conditional on the member's reaching understandings with the Fund on a new program than to the idea of linking programs as such. Perhaps guideline (9) could be reformulated to make the first drawing under a second program conditional on the observance of the performance criteria at the end of the previous program.

The Chairman asked Directors for their views on whether the guidelines should be formally adopted.

After a brief discussion, it was decided that the Chairman's summary of Directors' views on guidelines (1)-(7) would provide appropriate guidance for the staff and would ensure broad uniformity of treatment of members. Directors considered that formal adoption of the guidelines would not give the staff sufficient flexibility to deal with exceptional circumstances. They agreed that guidelines (8) and (9) would be reformulated by the staff for consideration at a later date. 1/

1/ See SM/85/39, 2/4/85, and Cor. 1, 2/13/85; see also EBM/85/38, 3/8/85.

2. ITALY - EXCHANGE SYSTEM

Mr. Zecchini informed the Executive Board that his Italian authorities had taken a number of measures to liberalize the foreign exchange system. (EBD/84/322, 12/17/84)

APPROVED: September 6, 1985

LEO VAN HOUTVEN
Secretary