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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/131

3:00 p.m., September 6, 1983

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
	H. G. Schneider
	X. Blandin
A. Donoso	
R. D. Erb	
	T. Alhaimus
	T. Yamashita
	J. Reddy, Temporary
R. K. Joyce	
A. Kafka	C. Robalino
G. Laske	G. Grosche
G. Lovato	
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	S. E. Conrado, Temporary
	A. Lindø
	C. Taylor
Zhang Z.	Wang E.

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

1. Compensatory Financing Facility - Requirement of Cooperation . . . . Page 3

Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; F. d'A. Collings. Asian Department: H. O. Roden. European Department: L. A. Whittome, Counsellor and Director. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; H. Ghesquiere. External Relations Department: C. S. Gardner, Deputy Director; D. Cheney. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; G. F. Rea, Deputy General Counsel; S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director; R. R. Rhomberg, Deputy Director; K.-Y. Chu, N. M. Kaibni, E. A. Milne, T. K. Morrison. Secretary's Department: A. P. Bhagwat, J. A. Kay. Treasurer's Department: G. Wittich. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: T. A. Connors, S. El-Khouri, S. M. Hassan, H.-S. Lee, Y. Okubo, P. D. Péroz. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, H. A. Arias, J. Bulloch, M. Camara, M. B. Chatah, R. J. J. Costa, G. Ercel, I. Fridriksson, G. Gomel, V. Govindarajan, N. U. Haque, H. Kobayashi, M. J. Kooymans, W. Moerke, V. K. S. Nair, J. K. Orleans-Lindsay, G. W. K. Pickering, J. Schuijer, D. I. S. Shaw.

1. COMPENSATORY FINANCING FACILITY - REQUIREMENT OF COOPERATION

The Executive Directors resumed from the previous meeting (EBM/83/130, 9/6/83) their consideration of a text put forward by the staff, interpreting the requirement of cooperation under the compensatory financing facility for drawings above and below 50 percent of quota (EBS/83/171, 8/12/83).

The Chairman stated that there were three questions to consider regarding the text proposed by the staff. First, should the word "seriously" be included in the text? Second, should an alternative to the word "seriously" be formulated? Mr. Polak had suggested that a country should be required to take prior action when the balance of payments problems extended beyond those of the export shortfall. Third, how should the notion of "reasonable assurance" be clarified? Mr. Polak had preferred "reasonable assurance" to be replaced by "the adoption by the country of a significant first step toward the correction of the balance of payments." What were Executive Directors' views on those questions?

Mr. Malhotra commented that he had some difficulty in considering the staff paper further. After its circulation, he had referred the gist of the paper to his authorities. It was the reaction of his authorities that the paper was not interpreting the existing guidelines but that it sought to change the nature of the facility. He would be grateful if discussion of the paper could be postponed to a later date so that he could discuss in greater detail the new formulation with his authorities.

Mr. Robalino, Mr. Zhang, Mr. Alfidja, and Mr. Alhaimus remarked that they too would favor a postponement and that no decision should be taken at the present time.

Mr. Polak said that he would be in favor of a few days' delay.

Mr. Malhotra suggested that the issue should be discussed in October, after the Annual Meeting.

Mr. Erb considered that as the issue had been discussed previously, the Executive Board should try and agree on a revised text at the present meeting. A final decision could be made in the following week.

Mr. Taylor stated that he would not be opposed to a delay of a few days, but the changes in wording were not so radical that a long delay was required.

Mr. Joyce, Mr. Morrell, and Mr. Laske supported the views expressed by Mr. Taylor and Mr. Erb.

Mr. Malhotra recalled that at the previous discussion of the requirement of cooperation under the compensatory financing facility (EBM/82/39 and EBM/82/40, 4/2/82), the Executive Board had decided to maintain the existing policy. He realized that some Directors were concerned about some countries in which the balance of payments problem was embedded in a larger imbalance. However, the text being considered by the Executive Board at the present meeting was not an interpretation of existing policy, but a formulation of a new policy. He wished to consult his authorities on the broad thrust of the proposed text before discussing the matter in the Executive Board. One Director had suggested that a revised text should be agreed on at the present meeting and that if, after consulting their authorities, some Directors received instructions that differed from the text, the policy could always be changed. However, that procedure was not fair to his authorities. He was only requesting a delay of about one month.

Mr. Salehkhou remarked that the new interpretation of the requirement of cooperation did introduce an implicit element of conditionality that changed the nature of the compensatory financing facility. Like Mr. Malhotra, he believed that such a change would require new instructions from his authorities.

Mr. Reddy stated that he fully agreed with Mr. Taylor that there was nothing radical in either the staff's or Mr. Polak's proposals. For precisely that reason, there was no operational urgency in taking a decision within the following few days, and he would prefer a postponement until October.

Mr. Conrado commented that he had considerable difficulties with the staff's proposal. Perhaps the issue should be considered by the Interim Committee or by the Executive Board after the Annual Meeting.

Mr. Erb said that one of the reasons that the Executive Board had decided to refine the interpretation of the requirement of cooperation for drawings both below and above 50 percent of quota was because some Executive Directors considered that conditionality for drawings in the lower 50 percent of quota was being applied in a discriminatory manner. The staff paper (EBS/81/251, 12/30/81) prepared for the earlier Executive Board discussion of the requirement of cooperation (EBM/82/39 and EBM/82/40) had indicated that, in a number of cases of drawings of less than 50 percent of quota, the staff had had serious doubts about whether the countries would cooperate with the Fund in an effort to find appropriate solutions for their balance of payments difficulties. The issue that they were discussing was not a new one, but, because some Executive Directors were concerned that a new policy was being applied in a discriminatory way, it was essential to define clearly the requirement of cooperation sooner rather than later.

A more precise definition of the requirement of cooperation should indicate that conditionality would be greater when the export shortfall was part of a larger balance of payments problem, Mr. Erb considered. Conditionality would not be applied to all drawings in the lower or upper 50 percent of quota, but only in those circumstances where the imbalance was large and where there were serious questions about whether the policies were appropriate to deal with the problem.

Mr. Joyce said that he could sympathize with those Directors who had expressed concern about the need to proceed cautiously and only after consulting with their authorities. If the policy on the requirement of cooperation were being changed, the matter would merit ministerial consideration. However, he did not think that a change of policy was involved.

The problem was to try to define what, in fact, the Fund's policy regarding the requirement of cooperation had been, Mr. Joyce went on. He was not sure that the positions taken by some Executive Directors and some members of the staff completely reflected Fund policy. Given that confusion, he welcomed the intention to define more precisely the policy on the requirement of cooperation under the compensatory financing facility. Although there was obviously a divergence of opinion with respect to the precise definition of the requirement of cooperation, there was not a disagreement with respect to the basic policy. A compromise on the wording that would reflect the concerns on both sides of the argument should be reached. There were those Directors who were concerned that, if the wording was not restrictive enough, access to the facility would be easier than it had been in the past. Other Directors considered that wording that was too restrictive would represent a change of policy.

Perhaps the Executive Board could find language that would express the considered judgment of both sides of the argument, Mr. Joyce continued. Executive Directors could then consult with their authorities on the new wording. He would prefer to try to draft a revised text at the present meeting, provided that other Directors agreed that the Executive Board was not developing a new policy on the compensatory financing facility.

The Chairman remarked that the policies described in the staff paper were being and would continue to be applied. Those policies were in accordance with the language of the decision on the compensatory financing facility. When there was a balance of payments problem that exceeded the amount of the shortfall, the staff would assess the policies and the intentions of the authorities. If the staff considered that a member's policies would not solve the balance of payments problem and if the authorities had no intention of adopting policies that would enable them to repurchase at the required time, the requirement of cooperation would not have been met. In a number of recent cases, countries had shown no indication that they would cooperate in the future and, therefore, the Fund had not even approved a drawing in the lower 50 percent of quota. The Executive Board should try to reach a compromise solution on the wording of the text, with the understanding that it was not establishing a new policy.

Requests for compensatory financing from countries experiencing a balance of payments problem that was larger than the export shortfall were becoming more frequent, and were complicating the application of the requirement of cooperation under the facility, the Chairman observed. Prior action by the authorities would not be required in cases where the Fund was convinced that the country would address the problem in an appropriate way. The staff had expressed that policy in a skillful way in the text. However, in view of the remarks made by Executive Directors, he would be happy to change the wording.

He favored the deletion of the words "demonstrated good faith by," the Chairman indicated. In addition, he had no difficulty with the inclusion of the word "seriously" before "deficient," if Mr. Polak intended that wording to mean that, if the set of policies pursued by the authorities of a country were broadly appropriate but not exactly along the lines preferred by the staff, there would be no reason to bar that country from access to the compensatory financing facility.

Mr. Polak said that the alternative wording suggested by him at the end of the previous meeting (EBM/83/130) was weaker in meaning than "seriously deficient." He would therefore prefer to include the word "seriously."

The Chairman stated that there were two options to consider regarding the notion of prior action. First, the staff's proposal suggested that the Fund should be convinced that the member had given a reasonable assurance that the policies needed for the correction of the balance of payments would be adopted. That statement was vague because it did not define what would be considered a reasonable assurance. The staff proposal did not imply that a country's authorities should have taken all the action necessary to solve the problem prior to making a request.

Mr. Polak's proposal was more precise since it stated that the Fund would have to be satisfied that a significant first step had been taken toward the correction of the balance of payments, the Chairman observed. The staff definitely preferred its original version, however, because it was not clear what was implied by a "significant first step." For example, suppose a country requesting compensatory financing were pursuing a totally inadequate fiscal policy and had a totally unrealistic exchange rate. If the overall balance of payments problem were much larger than the export shortfall, the Fund would require the member to take a significant first step toward the correction of the balance of payments problem before requesting financing. It would be inappropriate for the authorities to adjust the exchange rate while totally ignoring their domestic demand management policy. The authorities might not follow the first step by taking the most reasonable second step.

Mr. Taylor remarked that he did not think that the various forms of wording put forward by the staff and other Executive Directors had been very different. Although he would prefer to leave out "seriously," he could still agree to the proposal if it were included. With regard to the issue of a "reasonable assurance" versus a "significant first step," it was best to maintain a degree of flexibility, and for that reason he supported the staff's version.

Mr. Erb commented that he could agree to the inclusion of the word "seriously," especially in light of the discussion at the previous meeting and the staff's explanation of its interpretation of that word. He preferred the staff proposal regarding "reasonable assurance," as Mr. Polak's suggestion of "a significant first step" could create problems if the country did not anticipate taking additional steps in other areas that might be needed. The wording by the staff provided more flexibility.

Mr. Morrell remarked that although the staff formulation gave some flexibility to the staff and management, it put Directors in a difficult position in advising their authorities on how to proceed with respect to a purchase under the compensatory financing facility. As Mr. Joyce had said, one of the main reasons for the present discussion was to clarify the requirement of cooperation; it was not to implement a policy change.

Perhaps Mr. Polak's suggestion could be clarified further by including "a first step in the major areas of policy deficiency," Mr. Morrell considered, as that would indicate that a broad set of actions was necessary.

Mr. Laske stated that he could support the staff text either with or without the inclusion of the word "seriously." He would prefer to retain the staff's formulation of the last sentence of the text on drawings below 50 percent of quota. However, he would be willing to look at any other wording suggested by Executive Directors so that a consensus could be reached at the present meeting, which was certainly preferable to any postponement.

Mr. Joyce reminded Executive Directors that he favored Mr. Nimatallah's proposal. However, he had a slight preference for some variation of the staff text over Mr. Polak's text. Regarding the last sentence of the staff text on drawings below 50 percent of quota, he would prefer to drop the word "the" and say instead "...that policies needed for correction of balance of payments will be adopted." By including the word "the," the staff implied that the country should adopt the policies prescribed by the management of the Fund, as if it were entering a stand-by or extended arrangement. In his interpretation of the present policy, the member was not required to give assurance that it would adopt the policies specified by the Executive Board, but rather that it would adopt policies necessary for the correction of its balance of payments problem.

He would object strongly to any suggestion that the member should implement policies equivalent to those required under a stand-by arrangement before making a drawing of less than 50 percent of quota, Mr. Joyce went on. At the other extreme, the country should not adopt policies without discussing with the Fund whether they were appropriate to solve the balance of payments problem. The policy on the requirement of cooperation was somewhere between those two extremes.

Mr. Zhang inquired whether a country with an unsatisfactory record of cooperation would be required to take prior action when making a request to the Fund for financing of its balance of payments problem resulting from rising costs of imports. If a country that already had a stand-by arrangement in operation experienced an export shortfall, would the staff require the authorities to take further action prior to making a request for compensatory financing?

The Deputy Director of the Exchange and Trade Relations Department responded that in the past when the staff had had serious doubts as to whether a member would cooperate with the Fund, it had discouraged requests from the country until the authorities provided assurances that they would cooperate. The prior action that would be required depended on the particular case.

If the balance of payments problem were caused only by rising import costs of cereals, the staff would require no change of policy, the Deputy Director from the Exchange and Trade Relations Department commented. The Fund had to ensure the revolving nature of its resources. The staff, therefore, had to be sure that the balance of payments problems of a country would be solved in the medium term so that it would be in a position to make repurchases. The requirement of cooperation was intended to serve that purpose.

Mr. Joyce inquired whether, in fact, the requirements for drawings of less than 50 percent of quota under the compensatory financing facility were more demanding than for drawings in the lower credit tranches.

The Deputy Director of the Exchange and Trade Relations Department responded that that was not so. To make a drawing in the first credit tranche, a member country had to adopt a Fund-supported program that outlined all the policies to be introduced for the following 12 months. For compensatory financing of less than 50 percent of quota, the country was only required to assure the Fund that it would take action in the future to address its balance of payments problems.

Mr. Joyce commented that some member countries were concerned that the requirements for drawings of less than 50 percent of quota under the compensatory financing facility were more demanding than for first credit tranche drawings. The conditions attached to the first credit tranche were rarely onerous. For drawings of less than 50 percent of quota under the compensatory financing facility, however, the staff was concerned whether the authorities had met the test of cooperation. It was worrying that a country experiencing serious balance of payments difficulties as a result of poor policies pursued in the past would be required to take more extensive action to meet the test of cooperation under the compensatory financing facility than might be required for a regular drawing in the first credit tranche.

The Deputy Director of the Exchange and Trade Relations Department commented that in the case suggested by Mr. Joyce, the test of cooperation would require that the country should take some action that assured the Fund that it would tackle its problems in the future. The conditions for drawing in the first credit tranche might require the member, in addition to agreeing on a detailed program of action for the following 12 months, to take some measures prior to making the request, which would generally be more demanding than for compensatory financing of less than 50 percent of quota.

Mr. Polak remarked that although a stand-by arrangement was normally required for a drawing in the first credit tranche, the authorities only had to make a reasonable effort to follow the program without necessarily taking all the actions necessary to solve the problem. In his wording of the text on the requirement of cooperation, he was trying to distinguish between those countries that were willing merely to give assurance without necessarily taking action, and those countries that were prepared to address their problems by taking some action, even if they were not in a position to adjust all the shortcomings in their policies.

Responding to a request by Mr. Malhotra, the Deputy Director of the Exchange and Trade Relations Department said that there would not be much difference in substance between an adjustment program for a drawing in the first credit tranche and a program for drawings in the upper credit tranches: the objective of the program in either case would be to ensure that the member would be in a position to make repurchases within three-five years. However, for arrangements in the upper tranches, disbursements were phased, and performance criteria would have to be met. In the first credit tranche, there was no phasing, and there were no performance criteria.

Mr. Erb recalled that drawings in the lower credit tranche had been made only in circumstances where the overall balance of payments problem was not a major one. At the present meeting, the Executive Board was considering those countries that had serious balance of payments problems. Mr. Joyce had commented that as countries made purchases in higher credit tranches, the degree of conditionality would increase. However, in his view, the more severe the problems, the more likely that a country would need to make drawings in the upper level of the credit tranches and, simultaneously, to take more significant action to deal with its balance of payments problems. Drawings of a large amount were not a reward for taking more adjustment measures, but were a reflection of the larger balance of payments problems facing the country.

For drawings of less than 50 percent of quota under the compensatory financing facility, the Fund was not requesting that a country, in effect, adopt an upper credit tranche program, Mr. Erb explained. The Fund was requesting merely that the authorities should be prepared to address the overall balance of payments problem during the following year by introducing appropriate policies, if necessary.

Mr. Taylor, in response to Mr. Zhang's question regarding a country with a stand-by arrangement with the Fund that experienced an import price increase or an export shortfall, considered that action would be required only if the problem were not inherently reversible. The balance of payments should be restored to a position that would enable the authorities to make the repurchases on time.

The Chairman agreed with Mr. Taylor; in general, the export shortfall had to be reversible for a country to have access to the compensatory financing facility. However, when the balance of payments problems were larger than the export shortfall, the country would be required to indicate that it would take action to address the larger balance of payments problem.

Mr. Joyce inquired whether the requirement of cooperation applied to the buffer stock financing facility.

The Director of the Legal Department responded that the requirement of cooperation was the same for the compensatory and buffer stock financing facilities.

Mr. Malhotra observed that a number of Directors had stressed that the policy on the requirement of cooperation was intended to ensure that the revolving nature of the Fund's resources was maintained. How many countries making a drawing under the compensatory financing facility had been unable to make repayments in the required period?

The Economic Counsellor said that only a very few countries had been unable to make repurchases on schedule. However, he would provide the exact information for Mr. Malhotra later.

As to the question of what constituted a reasonable assurance, the Economic Counsellor went on, it seemed that the Executive Board had been trying to establish whether the actions required in order to provide that assurance would be more or less under the compensatory financing facility than under credit tranche drawings. That question was unanswerable in a unidimensional sense, as circumstances causing the balance of payments problem varied widely. Furthermore, the history of cooperation with the Fund would differ from one country to another. It was therefore not possible to define what would provide a reasonable assurance in all cases.

If the balance of payments problem were limited to the export shortfall, no action by the authorities would be required to provide reasonable assurance to the staff, the Economic Counsellor continued. If, however, a country experiencing a very large balance of payments problem, for which it had taken no action, requested compensatory financing for an export shortfall, the staff would require quite a substantial demonstration by the member of its intention to cooperate. It was difficult to define precisely actions that would provide reasonable assurance, since it would depend on two factors: the extent of the balance of payments difficulty apart from the export shortfall, and the member's record of cooperation.

Mr. Erb commented that any use of Fund resources had to be consistent with the Articles of Agreement. One of the provisions of the Articles was that the Fund should not provide resources in circumstances where a country might take action that was detrimental to the international financial system. It was not a question of whether a country could or could not repay the Fund, but whether it would be able to repay the Fund without having to introduce measures that might be contrary to the Articles of Agreement. Furthermore, the Fund should not provide resources when a country would need to adopt another Fund-supported adjustment program so that it could make the repurchases on time.

Mr. Donoso remarked that, as he understood it, Mr. Erb was saying that prior action would be required when policies were deficient to deal with balance of payments difficulties and when a country's record of cooperation in the recent past had been unsatisfactory. Only when both, rather than either one or the other, of those circumstances prevailed would the authorities be required to take prior action. In that case, the word "and" should perhaps replace the word "or" in line 9 in the text for drawings of less than 50 percent of quota.

The Economic Counsellor explained that he did not intend his statement to imply that both of those conditions had to prevail; both factors would have to be considered when trying to assess whether the country would adopt the policies needed to correct its balance of payments.

The Director of the Legal Department said that the existing decision clearly stated that the Fund had to satisfied that a member would cooperate. The reasons why the Fund might not be satisfied could vary considerably. Furthermore, the Fund could not provide resources unconditionally, because it had to maintain the revolving character of its resources. Therefore, the Fund must be satisfied that the use of resources was temporary and that the member would take action that was not detrimental to itself or the international community. In light of the provisions of the Articles of Agreement, the Fund had the right under the existing decisions on the compensatory and buffer stock financing facilities to require that prior action be taken before it could be reasonably assured that the member would cooperate with the Fund.

Mr. Alhaimus indicated that, like Mr. Donoso, he had also suggested in his earlier statement that "or" should be replaced by "and" in the paragraph on drawings below 50 percent of quota. Otherwise, prior action would be required of members whose existing policies to deal with balance of payments difficulties had been excellent although cooperation might not have been as expected, and of members whose record of cooperation had been fully satisfactory although their policies had been inadequate. Prior actions should be required only if both shortcomings arose.

The Chairman noted Mr. Alhaimus's point but indicated that it was not consistent with the basic concept that the Executive Board was discussing.

Mr. Zhang stated that he wanted clarification on another point. Suppose a country whose policies were deficient experienced an export shortfall totaling 50 percent of quota; should the country request the use of resources under the compensatory financing facility or in the credit tranches? Which would be better for the member in terms of conditionality?

The Deputy Director of the Exchange and Trade Relations Department indicated that it was difficult to answer that question in general terms; the gravity of the overall balance of payments problem and the policy adjustments that would be called for needed to be taken into consideration.

The Economic Counsellor explained that a member in the circumstances described by Mr. Zhang would not have to undertake an adjustment program in order to have access to the compensatory financing facility. It was a matter of policy rather than an adjustment program that would provide assurance.

The Chairman, responding to a question by Mr. Zhang, stated that the prior action required by the staff depended on the circumstances of the member making the request. There might be cases in which the degree of prior action would be very close to a Fund-supported adjustment program. In other cases, where the balance of payments problems were not great and the previous record of cooperation had been good, the degree of prior action would be slight. He was a little concerned about Mr. Polak's formulation of a "significant first step" as it indicated precisely that one step should be taken. In a country where the balance of payments problem was severe and where the record of cooperation was poor, the staff might require more in terms of prior action than merely a significant first step.

Mr. Malhotra, responding to Mr. Erb's comment that a member might take actions not in accordance with the Articles of Agreement or that a member might request further assistance from the Fund in order to make repurchases on time, noted that there were a number of countries that had been under Fund-supported programs for several years. Some problems could not be resolved within three to five years. He would be interested in examining statistics that provided evidence for the points made by Mr. Erb. It was possible that the Executive Board was trying to formulate a policy for an issue that was not as great a problem as some Directors imagined.

The Chairman assured Mr. Malhotra that it was not the intention of the staff to formulate a new policy. The number of countries requesting compensatory financing in which the balance of payments problem was larger than the export shortfall was unfortunately increasing. When the larger balance of payments problems were not addressed by the authorities--for reasons that varied from country to country--the Fund would not approve the request for resources under the compensatory financing facility until the member provided reasonable assurance that it would take action. The exact degree of prior action required depended on the gravity of the balance of payments problem and on the authorities' record of cooperation. At the present meeting, the Executive Board was trying to describe that practice clearly in the text of the requirement of cooperation.

Mr. Erb indicated that he could agree with Mr. Joyce's suggestion to eliminate the word "the."

Mr. Lovato said that, having heard the Chairman's remarks, he would support the comments made by Mr. Joyce and accept the staff proposal regarding "reasonable assurance."

Mr. Polak remarked that to delete the article in front of "policies" would not solve the problem, though it might eliminate the idea that the set of policies should be those proposed by the Fund. He would say, instead, "reasonable assurance that corrective policies will be adopted."

Mr. Lovato, Mr. Erb, Mr. Joyce, Mr. Laske, and Mr. Schneider indicated their agreement with Mr. Polak's suggestion.

The Chairman remarked that Mr. Polak's suggestion had a number of advantages over other proposals: it was better in terms of language and substance, and it maintained the flexible application of the requirement of cooperation.

Mr. Malhotra said that he was concerned that there was little differentiation between drawings below or above 50 percent of quota.

The Chairman responded that for a drawing of less than 50 percent of quota under the compensatory financing facility, the Fund would have to be satisfied that appropriate policies would be taken, and for drawings of more than 50 percent of quota the Fund had to be satisfied that appropriate policies had been taken. When the balance of payments problems were not severe, the test of cooperation would be mild. However, if a country were experiencing severe balance of payments problems and were not taking appropriate action or not cooperating with the Fund, the staff would have to be satisfied that some action had already been taken before a request for compensatory financing would be considered.

The Economic Counsellor suggested that Mr. Polak's recent formulation should include a reference to the balance of payments; perhaps it could read "but give reasonable assurance that policies to correct the balance of payments will be adopted."

After further discussion, Executive Directors agreed that the wording should be "that measures corrective of the balance of payments should be adopted."

Mr. Zhang considered that, in view of the speed with which compensatory financing was often required, it might be better to state that simultaneous rather than prior action was necessary to provide reasonable assurance.

Mr. Polak said that the words "prior to the submission of its request" were redundant, and could usefully be deleted.

The Economic Counsellor stated that he could accept Mr. Polak's suggestion if it were understood that reasonable assurance was provided before the decision was taken.

Mr. Taylor said that he preferred the inclusion of the words "prior to submission." Perhaps it would be better stated as "prior to submission of the request."

Mr. Erb remarked that it was important to specify precisely when prior action should be taken. Was the final request for a drawing under the compensatory financing facility submitted a few days before the Board meeting?

The Director of the Legal Department confirmed that the legal request for a drawing was made immediately before the Executive Board considered the matter. It would be most logical to indicate that prior action should be taken before consideration by the Board of the request.

Mr. Joyce inquired whether the staff would interpret the issue of prior action with some flexibility. For example, the authorities of a country, although indicating that they would take action, might have to delay implementation for a variety of reasons. If that country's record of cooperation were good and the staff had no doubts that the action would be taken, would the Fund be willing to approve the request?

The Director of the Legal Department indicated that it was Fund practice to be flexible with respect to all requests for resources. In many cases, an announcement by the government that it would take a certain action was considered an acceptable assurance for the approval of the use of resources.

Following a short discussion, the Executive Board agreed on a revised text of the requirement of cooperation under the compensatory financing facility, which read as follows:

<u>Lower tranche</u>

The criterion--namely, that the Fund is satisfied that the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties--implies a willingness to receive Fund missions and to discuss, in good faith, the appropriateness of the member's policies and whether changes in the member's policies are necessary to deal with its balance of payments difficulties. Where the Fund considers that the existing policies of the member in dealing with its balance of payments difficulties are seriously deficient or where the country's record of cooperation in the recent past has been unsatisfactory, the Fund will expect the member to take action that gives, prior to submission of the request for the purchase, a reasonable assurance that policies corrective of the member's balance of payments problem will be adopted.

<u>Upper tranche</u>

The additional criterion of the upper tranche--namely, that the Fund is satisfied that a member has been cooperating with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties--means that, in the light of the action taken by the member and the balance of payments policies being pursued, the Fund is satisfied with the member's record of cooperation. The existence of a satisfactory balance of payments position (apart from the effects of the shortfall) or the existence of and broadly satisfactory performance under an arrangement with the Fund, or the adoption of such an arrangement at the time the request for a purchase under the compensatory financing facility is made, will be considered to provide evidence of cooperation. However, the existence or the adoption of an arrangement is not a prerequisite. If a member's current and prospective policies were such as would, in the Fund's view, meet the criteria of the use of resources in the credit tranches, the member would be deemed to have been satisfactorily cooperating with the Fund, even though such use was not contemplated at the time of the request for compensatory financing.

The Executive Board agreed to consider the revised text again at a meeting to be held on September 14, 1983. 1/

APPROVED: March 2, 1984

LEO VAN HOUTVEN
Secretary

1/ See EBM/83/140 (9/14/83).