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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 99/24

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**Executive Board Attendance**

M. Camdessus, Chairman  
S. Fischer, Acting Chairman  
S. Sugisaki, Deputy Managing Director

**Executive Directors**

A. Barro Chambrier  
T.A. Bernes  
R.F. Cippà  
B. Esdar  
N. Eyzaguirre  
R. Faini  
J. Guzmán-Calafell  
K.A. Hansen  
K.-T. Hettrakul  
W. Kiekens  
K. Lissakers  
  
A. Mirakhor  
  
  
S. Pickford  
M. Portugal  
A.S. Shaalan  
M.R. Sivaraman  
G.F. Taylor  
Wei Benhua  
J. de Beaufort Wijnholds

**Alternate Executive Directors**

S.M. Al-Turki  
D. Ondo Mañe  
P. Charleton  
W. Szczuka  
W.-D. Donecker  
  
J. Spraos  
  
O.-P. Lehmussaari  
C. Harinowo  
  
B.S. Newman  
R. Fernandez  
  
P.A. Akatu, Temporary  
A. Lushin  
L. Palei, Temporary  
S. Collins  
  
  
M. Takeda

R.H. Munzberg, Secretary  
A. Linde, Acting Secretary  
N. Hairfield, Assistant  
S. Soromenho-Ramos, Assistant

**Also Present**

IBRD/Other: R. Raymond, European Central Bank. European II Department: T. Catsambas. External Relations Department: S.J. Anjaria, Director; L. Aylward, M. Bell, J. Mark, R.W. Russell. Legal Department: W.E. Holder, Deputy General Counsel; R.B. Leckow, I. Mouysset. Middle Eastern Department: Z. Iqbal. Monetary and Exchange Affairs Department: J.S. McCarthy. Policy Development and Review Department: J.T. Boorman, Director; T. Leddy, Deputy Director; A.G.G. Bennett, J. Gold, J. Hicklin, I. Kapur, G.R. Kincaid, T. Van der Willigen. Research Department: P.R. Masson. Secretary's Department: J.M. Boughton, S. Bhatia, P. Gotur, A. Mountford, M.J. Papin, B.A. Sarr. Treasurer's Department: D. Williams, Director; B.V. Christensen, J.C. Corr, M.M. Cuc, L.U. Ecevit, M.G. Kuhn, T. Mast, A. McGuirk, A.B. Westphal. Western Hemisphere Department: Z. Bogetic, R.K. Rennhack, J.G. Stotsky. Office of the Managing Director: D.A. Citrin; Office of Budget and Planning: E.-A. Conrad, Director; P.J. McClellan, N. Sachdev; Office of Internal Audit: E. Brau. Advisors to Executive Directors: W.F. Abdelati, M. Askari-Rankouhi, B. Couillault, M.H. Elhage, S.S. Farid, A. Giustiniani, N. Jadhav, Luo Y., M.F. Melhem, H. Mori, S. N'guiamba, J. Ntamatungiro, H. Ogushi, E. Rodriguez, O. Schmalzriedt, F. Zurbrugg. Assistants to Executive Directors: A.S. Alosaimi, S.A. Bakhache, T. Belay, N.R.F. Blancher, R. Burgess, J. Chelsky, I.-K. Cho, H.W. Cocker, R. Djaafara, N.K. Gueorguiev, I.C. Ioannou, C. Josz, S.K. Keshava, D. Nardelli, J. Nelmes, K. Ongley, Peh K.H., Qi J., J.N. Santos, J. Schaad, C.-P. Schollmeier, R.J. Singh, Siti Mariam Mohd. Yusof, Sugeng, M. Vismantas, Vongthieres O., M. Walsh, R.P. Watal, P. Winje, I. Zakharchenkov.



## **1. STRENGTHENING AND/OR TRANSFORMING INTERIM COMMITTEE**

The Executive Directors considered a paper on strengthening and/or transforming the Interim Committee (EBD/99/31, 2/12/99).

Mr. Milleron made the following statement:

In October 1998, the Executive Board was mandated by the Interim Committee to study its strengthening and/or transformation. Therefore, I welcome today's meeting, which provides us with a first opportunity for a full-fledged discussion on an important part of our Architecture discussions. The Fund plays a prominent role in the international monetary system and in world cooperation on economic and monetary affairs, as stated in Article 1 of its Articles of Agreement: reinforcing its functioning and accountability is a key element of our agenda. The Board has a special responsibility to propose next steps to be considered by the Ministers at the Interim Committee in April, so that they may give further guidance on the ways to proceed.

I will give some views on the proposals to strengthen the Interim Committee explored in the staff's paper, and elaborate on the reasons why my authorities propose to transform the Interim Committee into a Council. I will attempt to answer three questions:

- what are the objectives of the strengthening/transformation of the Interim Committee?
- can these objectives be fully attained within the current institutional framework?
- what could be the role and main attributes of the Council ?

### **I. What are the objectives of strengthening/transforming the Interim Committee?**

The central objective is to give full legitimacy to a universally representative and operational body. More accountable to its members, it would be mandated at the political level to give strategic orientations for international monetary and financial affairs.

The IMF must remain at the center of the international monetary architecture. The IMF, whose membership is universal, is the legitimate body for dealing with international economic and monetary affairs, as stated in its Articles of Agreement. Informal groups, comprising a limited number of countries, can prove useful for consultation and political impetus where necessary, but cannot decide on behalf of legitimate bodies.

The Fund must be adapted to its new missions. The world has changed dramatically. Fund missions have changed accordingly. A first attempt took place, at the beginning of the seventies, to take into account major shifts in the international monetary system. This was partly successful through, among other

things, the creation of the Interim Committee. We are now facing renewed challenges: for instance, structural reforms (with sometimes far-reaching political consequences), governance issues, or prevention of crises play an increasingly important role for the Fund. But the institutional framework is lagging behind. Several important issues currently at stake should now be dealt with at the political level to reach a satisfactory consensus. There is in my view a real need for ex ante political impetus, that only a decision-making body would be able to initiate.

There should be stronger appropriation of policies promoted by the Fund in order to make them more effective. The IMF has been sharply criticized in recent months for the very central policy principles guiding its programs. To some extent, this is unavoidable, and some criticism was justified. But there is a point (especially when criticism comes from its own members) where this could undermine the credibility of the institution and therefore its ability to support its members. Promoting ownership starts within the Fund's organization.

In order to attain these objectives, the IMF's political governance, accountability, and legitimacy must be increased by vesting larger direct powers in the political representatives of the member countries. The IMF Board and Management needs the support of the Governments of its members, all of them. Enhanced legitimacy would match the universality of the IMF's membership, and one has to make sure that all points of view are accurately reflected and taken into account. For this, one has to ensure that decisions have a political legitimacy. I will come back to this point when looking at the Council's role in this matter.

## II. Can these objectives be fully attained within the current institutional framework?

Some progress can indeed be achieved within the current framework. As proposed by the staff, we can improve the way we conduct Interim Committee meetings, hold ad hoc meetings, involve when necessary officials from capitals in our work, improve the communiqué process, be flexible regarding arrangements within constituencies and grant a more active role to some observers, the World Bank in particular. In a nutshell, we can support all options explored in the paper. We also share the view that a more fundamental restructuring of constituencies can be considered in the future, but it should not delay more urgent decisions.

All these improvements, though significant in themselves, will not address the fundamental issue of making the Fund more accountable to its members. This requires direct involvement of political representatives, and decision-making power is a means to foster this involvement.

In addition, we have recently observed that the current legal framework rendered quite difficult to implement some innovative suggestions aimed at improving consultation and collaboration within the IFIs. I will only give three examples :

- the organization of a preparatory meeting at the Deputy/Alternate level recently led to different views regarding the respective roles of the Board and of the Interim Committee's "deputies". It is a fact that the relevant Resolution provides for specific procedures as concerns the preparation of Interim Committee meetings, but the preparatory process does not allow sufficient room for the implication of governments' representatives where necessary;
- in the same manner, increasing the number of participants (additional Alternates for "wide" constituencies, new international bodies, etc.) requires amending the Resolution ;
- lastly, allocating a real speaking right to main observers, such as the World Bank, also calls for institutional changes. As the status of observer may be insufficient, a new concept of "consultative member" could be set up.

All in all, if we really want to strengthen the Interim Committee, we have to transform it. Let me now address the content of these changes, i.e. the nature of the body that we want to bring into existence.

### III. What could be the role and the main attributes of the Council ?

Division of powers between the Executive Board and the Council:

Most of the objections to the Council that I have heard to date are related to the issue of bypassing the Executive Board and paralyzing the decision-making process. This concern had already been raised with the creation of the Interim Committee, and it is interesting to note that it did not materialize. Nevertheless, I agree it is a serious issue we have to address. A clear definition of the powers at each level is important in order to make sure that an orderly decision-making process is maintained. Since the Council's creation would have no impact on the powers of the Board of Governors, this question would mainly arise between the Executive Board and the Council. One point is central here: I want to make clear that the Board has to remain the place where programs are decided. But the guidelines underpinning those programs should clearly become the prerogative of the Council when appropriate. The general scope of the Council's mandate (Schedule D, Article 2a : it "shall supervise the management and adaptation of the international monetary system, including the continuing operation of the adjustment process and developments in global liquidity, and in this connection shall review developments in the transfer of real resources to developing countries") shows implicitly that individual decisions regarding country programs are not part of its powers. This should be clear in the decision of the Board of Governors establishing the Council.

Representativity of the Council :

The Council structure has a critical advantage when it comes to representativity: each member of the Council could split his vote to reflect the

diversity of views within his constituency, which is not possible at the Executive Board. This feature would ensure a more representative balance of voting powers, giving more room to emerging and developing countries (to give an illustration, the weight of these countries would reach approximately 40 percent of voting rights, against approximately 30 percent at the Executive Board due to its constituency-based voting structure). Even if only 24 Governors sit at the table, all of them could meet during preparatory constituency meetings to prepare strategic decisions. I cannot see a better trade-off between the operational capacity that we seek for the Council, by limiting the number of participants, and the universality of its representation, which implies the involvement and decision of all members.

#### Coordination with the other international institutions involved:

The transformation of the Interim Committee into a Council naturally raises the question of coordination with other bodies, including the World Bank. The creation of the Council would in my view provide an appropriate impetus to closer coordination between the two institutions. The Development Committee could be similarly strengthened for development issues. The mandate of each Committee would be focused more precisely on their core areas of responsibility, with a pragmatic handling of areas that overlap. Eventually, both transformations would lead to the creation of two reaffirmed political bodies, each clearly focussed on, albeit inter-related, different issues. The representative of the World Bank at the Council could be granted a status of "consultative member" that would allow him to speak freely in the Council. Other relevant bodies could be offered the same treatment (such as IOSCO, BIS...), and a symmetrical treatment should be granted to the IMF representative at the Development Committee (as it is the case today).

#### Practical features of the Council :

The number of meetings would be flexible, depending on the international agenda. It would be desirable to keep the current system, with two meetings per year ; nonetheless, when needed, this frequency could be increased. Ministers would be invited to focus their attention on fewer topics of strategic importance. The preparatory process could be achieved through meetings, possibly at the level of Executive Directors and Deputies, and may include a large participation if necessary (several alternates for wide constituencies). The main advantage of these meetings would lay in common work of governments' representatives and Executive Directors, which would facilitate and improve efficiency of our own work. These preparatory meetings would also provide the occasion to gather the recommendations and orientations given by other relevant groups. Finally, the Secretary of the Fund would serve as the Secretary of the Council.

Any change of the Interim Committee which would really make a difference would have to entail actual transformation of its role. Bringing into existence the Council would not only respond to the intent of the Articles of the Fund, but help to achieve this goal.

Mr. Shaalan made the following statement:

I will have to admit that after several careful re-readings of the staff paper with an open mind, I find myself bewildered as to what the problem is that we are trying to solve by creating a Council. Of all the criticism, and there have been many, that have been leveled at the Fund regarding the latest global financial crisis, I have not heard any that have pointed an accusing finger at the functioning of the Interim Committee. Far from it. The public questions have been directed at the Fund's professional competence in the fulfillment of its core mandate of surveillance over its member's economic policies and the global monetary system. Was the Fund sufficiently vigilant in its surveillance over its members? Did the Fund provide good advice to its members before and after the crisis? These were legitimate questions posed and they need answers.

It is the Management and the Executive Board that should be held accountable for providing the answers. The work we have done in analyzing the crisis was a major step in this process. Indeed our ongoing work on improving the international monetary system to reduce the incidence and severity of future financial crises must be our over-arching concern in the immediate period ahead. The well-being of millions of people all over the globe depends upon it. Which is why I find it distressing that our attention is increasingly being diverted to the organizational non-issue of transforming the Interim Committee to a Council. Leaving aside for the time being the way this topic was placed into the Communiqué of the last Interim committee, it is incumbent upon us to focus our attention on the real global economic and financial problems for which we need to find solutions for. I believe, however, that it is legitimate to continue to seek to improve the functioning of the Interim Committee. I shall cover the proposals in Sections II and III in the order they are presented.

II. Has the Interim Committee performed the role envisaged for it? How can its role be strengthened?

A. Procedures:

Conduct of meetings:

We assume the proposal here is against having more restricted meetings of the Interim committee, given the desirability of broad participation by the membership at large. We agree. We favor keeping the discussions open to the maximum extent possible. In fact, we would call for a reconsideration of the format of the most restricted meeting of all, namely the lunch discussion, and would propose that Executive Directors, who are responsible for full reporting to their constituencies, be included. In our view the present situation constitutes a major shortcoming in the procedures of the Interim Committee, which also adversely impacts the Communiqué process, which I shall address later.

Frequency of Meetings:

We have no problem with the present system. Ad hoc Interim Committee meetings can be held on an as needed basis.

#### Preparatory Work of the Committee:

As noted in the paper, the preeminent role of the Executive Board in the preparatory work of the Interim Committee meeting was considered critical at the time of the creation of the Interim Committee. In my view the Board has very successfully fulfilled this role over the past years. Nevertheless, we are told "it has been suggested that the Committee's work would be enhanced through a broadening of the preparatory process." We have difficulty accepting this proposal. Adding layers of bureaucracy is well known to delay deliberations and to dilute responsibility. We therefore strongly favor keeping the present system as is. In any case, the suggestion of establishing by the Executive Board of working groups to focus "in particular on those issues that go beyond the scope of the Fund's activities and responsibilities" is unnecessary. Such issues should be left out of our agenda, period. How many times has the Board said that we must focus on our core responsibilities?

#### Views of other Groups/Bodies:

As noted in the paper, the Resolution provides that "the Committee shall take account of the views of other bodies having specialized responsibilities in related fields." In our view, the underlined phrase must be emphasized here, if we truly want to benefit from the expertise of other bodies. At the same time, we would also caution here, as we have on other occasions, against having the agenda for the Interim Committee meeting dictated by decisions taken in other "political" fora.

#### Communiqué Process:

While we are dissatisfied with the present drafting process, the suggestion put forward of meeting ahead of the Interim Committee Meeting to discuss the draft communiqué strengthens the worst aspect of the process, which leads to the fact that the communiqué does not altogether reflect the proceedings of the meetings. This is an area where real reform is needed, but the proposal put forward is certainly not the answer.

Here I would also note that, as we have seen in the last Interim Committee meeting, problems arise with regard to the proper recording of the discussion in the restricted lunch session. Since it is generally Executive Directors who are sitting at the table at the end of the day to approve the Communiqué, the streamlining of the process would be significantly enhanced if they had first-hand knowledge of what went on in the restricted lunch session. This is another extremely important reason to include Executive Directors in the lunch session. It would greatly facilitate and improve the credibility of the Communiqué process.

## B. Composition:

### Membership:

We see some merit to the proposal to introduce more flexibility in arrangements within constituencies to ensure that ministers and governors with particular interest on specific items on the agenda, are seated at the table during the discussion of that particular item. Other proposals would need to be more carefully thought out before we take action on them.

### Observers:

Tremendous discretion and restraint would need to be exercised in allowing observers to address the Committee. Time is already a major constraint. We would, however, agree that the President of the World Bank should be given privileged treatment.

## C. Terms of Reference:

We agree that we should focus the agenda on fewer topics and only on those issues that require ministerial attention.

The question of the overlap of the issue of transfer of real resources, which is also included in the terms of reference of the Development Committee is, in our view, of little relevance.

## III. The Council:

I take issue with the statement that the Fund "is increasingly perceived as lacking political accountability." I do not know what this means. We have not heard any complaints from the membership with regard to "Ministers'/Governors' sense of participation" in the Fund's key decisions." I am sorry to say that brandishing such vague statements in the public domain is giving the impression that we are trying to dilute our accountability for the professional advice we are giving. Management and the Executive Board, being a resident full time elected or appointed Board members, should be held accountable to the Fund's shareholders and should not be allowed to shirk their responsibilities through the creation of another decision-making body. Let me add that the single example being suggested in the paper for the proposed Council's deliberations, namely "to make standards more acceptable to the membership", is far from justification for establishing a Council. Finally, the fact that the proposed Councillor could split his vote to reflect the different views of his constituents only means that the Council would in fact act like the Board of Governors. So why not let the members of the Board of governors cast their votes directly, as they do now, on issues that require decisions at that level?

Mr. Bernes made the following statement:

#### We Need a More Systematic Approach

While the paper for today's discussion contains some interesting facts and insights, it suffers from the shortcoming of trying to advance remedies for the Fund's perceived lack of political "accountability" or "legitimacy" without first, a clear understanding of what it means to be politically "accountable/legitimate" and second, why the current structure is considered by some to be lacking in this regard. A better sense of the answer to the second question, in particular, is essential to any effort to improve management and oversight of the international monetary and financial system.

At the outset, let me be clear about one thing. While I would in no way want to undermine the significance of, and wisdom behind, the efforts expended by the founders of the Bretton Woods Institutions or its "renovators" in the early 1970s, we must remember that the world has since evolved in ways that could not have been foreseen by even the most visionary among the architects. As such, while there is much to learn from earlier intentions to enhance the Bretton Woods system as described in Section I of the paper, I would not give these suggestions undue weight. They are but one possible way forward.

#### Objectives of the Exercise

What we should be seeking to articulate at this point is the most appropriate response to the demands of a more modern international financial world. Any such effort must also take into account the political realities of today, both between and within member countries. What we are talking about is, after all, defining global economic governance which, as we well know, is rarely separable in practice from political governance.

As noted, the problem under consideration is a perceived lack of political accountability/legitimacy for the Fund. In reading between the lines of the staff paper, I take this to mean two distinct things -- first, that Ministers are not adequately engaged in policy making at the Fund and second, that the public does not see the IMF as being adequately accountable to member governments and their citizenry.

#### Fostering Greater Participation by Governors

With respect to the first problem, the paper focuses on the Interim Committee since it -- along with the Annual Meetings -- is when Governors gather to discuss Fund issues. I accept the conclusion that the conduct of IC meetings can be improved to foster greater participation and interactive discussion among Governors. I do not believe that more frequent meetings would contribute to greater engagement of Governors. Rather, given the plethora of demands on our Governors -- both domestic and international -- more frequent meetings might actually result in a diminished ministerial presence.



At the same time, I believe it is deceptive to assess the productivity of the Interim Committee based only on what transpires at the meetings. Interim Committee meetings are more appropriately viewed as part of a process rather than as a single event. Their occurrence provides impetus to their representatives to resolve key issues in a timely manner. Were they not to occur, our incentives to come to clear and easily-communicated solutions would be diminished. As such, conclusions about their effectiveness require an assessment of the full period leading up to the meetings -- from the formation of the Executive Boards' Work Program, to the relevant policy discussions, to the drafting of the agenda and preparation of reports by the Board.

On the question of how to bolster ministerial interest and involvement in the Interim Committee process, the key resides on two fronts. First, the Executive Board -- the functional representatives of Governors -- must be proactively involved in setting the agenda for the meetings. This will clearly require systematic consultation of Executive Directors prior to formation of a draft agenda and in the scheduling of Board policy discussions, particularly in the period immediately prior to the meetings. The recent establishment of a Committee on the Agenda and Board Procedures is a welcome first step in this regard. It should go without saying that, before we consider substantive restructuring of the overall framework, we need to pay attention to enhancing the effectiveness of existing structures. It is heartening that the process of improving the corporate governance of the Fund is now underway and I would encourage us to more explicitly integrate that initiative into our considerations of architectural reform.

This is not to downplay the need to improve the way Interim Committee meetings are conducted to facilitate a more productive exchange of views. The recent G-22 meetings provide examples of how this can be done effectively. To a significant degree, the success of the meetings in promoting an open dialogue was a function of their minimalist bureaucratic structure. In this case members' participation was maximized by having the agenda and related documents drafted by the representatives themselves. We should also realize that it is not necessary that ministers and governors participate in all meetings themselves in order to move discussions along. Deputies' meetings could fulfil the same function, particularly on more technical or detailed issues.

The second leg of a strategy to increase Ministers' "sense of participation in the Fund's key decisions" may require greater efforts in capitals. Perhaps the engagement of some Governors is less than would be hoped for because the demands of their domestic responsibilities. They may only be able to focus on the issues for discussion just before the Meetings, not in the earlier period when policies are being formed and decisions taken with input from officials in capitals. We need to accept and adapt to this limitation since, for the most part, the primary responsibilities of the individuals involved are domestic. To the extent possible, and on issues deemed to be of particular interest to Governors -- officials should attempt to provide briefings and seek direction earlier on in this process. But the scope here is finite and the presence of Governors in any global forum will always be partly symbolic.

On a related point, I was pleased to see attention being drawn to perceived inadequacies of the communique process. From past experience, the problem with the exercise is not who is, or is not, present or whether or not Ministers are actively engaged. The problem is that officials have very little time to consult and respond to the text presented to them prior to the actual drafting session. A more fruitful process would entail making a draft of the communique available to Executive Directors and capitals in advance of the IC and providing an opportunity for Executive Directors -- after consulting with their authorities -- to respond to the draft a few days prior to the meeting. I would urge us to apply this model on an experimental basis and then assess the results.

### Political Accountability and Legitimacy?

The more substantive criticism that the staff paper seeks to address is that the Fund is "increasingly perceived as lacking political accountability." I believe the problem needs to be looked at more closely before expounding the perceived virtues of a "Council" as the appropriate answer.

Are we, for example, talking about "legal" accountability or accountability in the sense of "political legitimacy?" I do not believe that we suffer from significant shortcomings with respect to the former. The ultimate accountability is to the Board of Governors which delegates some of its authority to the Executive Board. The combination of these two bodies encompasses the relevant universe of legal authority. Therefore, any effort to "strengthen" the position of the Interim Committee—which, it was agreed, was to serve as a forum for policy discussions—would simply imply a redistribution of power. (The paper itself notes that "most of the powers that are or may be conferred on the Council are presently allocated to other organs.") Therefore, before we consider forming a Council, I would want stronger evidence that the existing bodies were incapable of exercising their authority in an effective manner. I would also welcome a stronger argument as to why a Council would fulfill the functions any better. At present, these lines of thought are lacking.

If we mean "political legitimacy," we need to be very clear to whom the Fund's legitimacy is deemed inadequate. If it is the public writ large, the first response should be greater transparency with respect to the operations of, and deliberations within, this institution. Publication of details on our Work Program is key here. With respect to the Interim Committee specifically, our accountability and legitimacy would be greatly enhanced if we were to make more transparent the operations of the existing body by making public—prior to the IC—the agenda and reports to the IC. Actions designed to increase public awareness and understanding of this institution's work would go farther in enhancing its "accountability" than any redistribution or enhancement of its power.

### Recognizing Domestic Political Realities

Regrettably, these lines of thought are not well covered in the paper under consideration. Instead, the reader is led quickly to the notion of a

“Council.” Here, I have many questions. It was envisaged that the Council would be a “decision-making” body. I am not sure what sort of decisions the Council would—or indeed could—take. The ultimate authority to commit our members to specific actions resides with national legislatures. Increasingly, the Fund is dealing with complex issues that are of relevance, not only to Ministers of Finance, but to a variety of constituencies within the executive branch of government including Ministers of Trade, Foreign Affairs, Development and Industry. Add to this the need to involve other international institutions like the World Bank, where accountabilities to members may be through different Ministers than at the Fund, and I seriously question the realism of expecting Finance Ministers, Central Bank Governors and their officials to arrive with the “flexibility and authority to negotiate on international economic matters.” Indeed, I question the extent to which efforts to concentrate more power in a Council—at the expense of domestic decision-making process—is anything but a diminishment of political “legitimacy.”

The current situation, which allows for discussion of these issues over time and positions to be developed in capitals, is more pragmatic and politically realistic. It is true—in a general sense—that “countries might be more willing to accept the decisions of a political body in which their own representatives had participated.” However, in pluralistic societies, this requires an open and transparent consultative process, the timetable for which varies from country to country. Failure to acknowledge this point puts this institution increasingly in the undesirable position of agreeing to things that its Governors are not able to deliver on. Rather, the same “political legitimacy” can be achieved -- on an ongoing basis -- through a combination of Executive Board discussions and decisions and through votes by Governors after consultation with the appropriate interests within their countries.

As a side note, one way we can -- albeit in a small way -- bridge the “political” gap between the World Bank and the IMF in discussing issues of mutual interest at the Interim Committee was suggested by Mr. Milleron in his Gray. Granting the representative of the World Bank the status of “consultative member,” which would allow him or her to speak freely at the Interim Committee meeting, would be a welcome innovation.

As I have argued, it is highly questionable if a “Council” would really enhance the “political legitimacy” of the Fund. It is worth recalling that more than one third of Fund Governors are central bankers -- not Ministers of their Governments (elected or otherwise). The ratio is similar in the Interim Committee, where Governors who are not members of their respective governments hold just less than one third of the voting power. Despite the clear competency of the central bankers involved -- many of whom have legal independence from their Governments -- I question the extent to which the citizenry of the countries involved would consider such representation more politically “appropriate,” particularly if “decision making power” is involved. Perhaps the advocates of the Council are suggesting that all governorships be in the hands of members of governments rather than Central Bankers? If so, I believe we need to be explicit about this since it could have a significant impact on the culture of this institution. Personally, I would prefer not to go down that

route. However, it is inescapable if we are sincere about wanting to create a more "political" entity.

On political legitimacy and the issue of constituency structure, I am much less sanguine than are the authors of the staff paper about its ability to adequately reflect the diverse views of member countries. It is fine to say, as a general principle, that members who have a particular interest in specific items on the agenda would be seated at the table during the discussion of those items. In practice, however, there are likely to be a number of members in a constituency that find an item of particular importance and views may be in conflict. The fact that the diversity of views is accommodated under current circumstances may be a function of the informal nature of the Interim Committee. If it were to be converted into a Council with "decision-making" power, these conflicts may not be so easily managed, likely to the detriment of smaller countries. The proposed approach also seems to reinforce a representational status quo that -- for reasons of historical inertia -- may not give adequate voice to many important emerging-market and transition economies.

#### The Bottom Line

To summarize, I am troubled by the manner in which our deliberations are proceeding. I do not believe we have a clear enough understanding of the source of the problems we are trying to address. Yes, we need to enhance the value of discussions at Interim Committee meetings and yes, we need to enhance the "political accountability" of the institution and its responsiveness to its members. However, I do not believe the creation of a Council responds to these concerns. Rather, we need to first strengthen our own corporate governance to better reflect the interests and priorities of our membership. We need to provide room to allow the political decision-making process within members' countries to operate. We need to open up the Interim Committees deliberations to the public to enable them to better communicate their views to their governments. We need to structure IC discussions in such a way as to facilitate a free flow of ideas among Governors. I would argue that increasing the political stakes of those discussions by bestowing "decision-making" power on the Interim Committee will have the opposite effect.

I would urge us to step back and rethink our approach here. We are going to have to live with the results of our deliberations for a long, long time.

Mr. Hansen made the following statement:

I welcome this opportunity to reflect on some of the issues well ahead of the Spring Meetings. The Executive Board needs to have a voice in how to proceed with the idea of strengthening and/or transforming the Interim Committee, not the least because the working environment of the Board might be affected. Although the staff paper offers some insight into this and other issues, I would have preferred a somewhat different layout of the staff paper focusing on alternative courses of action. My comments focus on issues where

consensus has started to emerge among my constituents, but I emphasize that more discussion is required before one can come to any final conclusions.

Regarding establishment of a Council, my authorities attach great importance to the issue of strengthening the Interim Committee and making its work more efficient. While the Fund's membership is already involved at the political level in the decision making process, a strengthening of the Interim Committee would make the Fund more accountable, and would also enhance the political legitimacy of its decisions. Unlike informal ad hoc groupings, membership of the Interim Committee rests on agreed principles.

The discussions in the time ahead should focus on developing the substance of new proposals in more detail. It is important to find the right means to achieve the goals we believe are common to this exercise, i.e., to improve the conduct of Interim Committee meetings so that they become meaningful events where true debate over issues is conducted. The idea of transforming the Interim Committee into a Council should be further examined. Before, however, proceeding with recommending any establishment of a Council, I consider it important to define in more detail the relationship between such a Council and the Executive Board.

There is also a need for further discussions about the implications for such an institutional change on the mandate and the terms of reference of both the Interim Committee and the Development Committee, particularly taking into account any institutional overlap.

Establishment of a Council is only one among a range of possibilities. My authorities find it especially important to examine to what extent the Board of Governors could play a more direct role in giving political credibility to Fund decisions.

On the proposed meetings of Alternates, I can support the suggestion on page 5 to experiment with a meeting of Alternates in April in preparation for the Interim Committee meeting. In that context, any preparation of Ministerial meetings should be based on the Interim Committee constituency structure and should respect the Board's areas of responsibility. In considering a broadening of the preparatory process for Interim Committee meetings, consideration should be given to the fact that the establishment of working groups of the Board does not require an amendment, while working groups of the Interim Committee would require an amendment of the Resolution.

Regarding flexible representation, my authorities support the introduction of more flexibility concerning representation. This must, however, be a decision for each constituency to take.

I do not, at this point, find that it is necessary to increase the number of associates that individual Interim Committee members are allowed to bring to the table. Increasing the number of participants may lead to less interactive and less meaningful discussions.

My authorities strongly support the notion that any discussions about a more fundamental restructuring of the Executive Board and of the Interim Committee should wait for the results of the presently launched work on the review of the quota formulae.

Regarding observers, I support the idea of delegating to the Chairman the power to allocate time according to the issues on the agenda for selected observers' statements. In addition, extending the present list of observers to include the Chairman of the Basle Committee and the IOSCO could be considered. Many of the subjects now coming up for discussion also seem to require a more active participation by the World Bank. Moreover, I also support the recommendation to give the President of the World Bank "privileged treatment."

On the relationship between the Interim Committee and the Development Committee, I favor the idea to sharpen the focus on their respective mandates, and that this avenue should be explored further, along with other ideas on how to address the institutional overlap.

Mr. Sivaraman made the following statement:

I see that there is no logical basis for a Committee of Ministers to continue on an ad hoc basis beyond the 25 years they have functioned as the Interim Committee. It cannot be ignored that Article XII recognizes a Council as a part of the structure of the Fund. It would, therefore, require strong reasons to contest any move to operationalize Section 1 of Article XII containing provision for setting up a Council. A question now to consider is whether we have reached an opportune moment in the history of the Fund to set up the Council.

One apparent but not a functional reason would be that this century is ending and the Interim Committee has functioned for about 25 years and therefore, it would be appropriate for the Fund to have its structure as is conceived in its Article XII. The second reason could be that it is anachronistic to continue a Committee of Ministers as an Interim Committee when it has been in existence for 25 years and all important policy matters on which the Board has taken a decision are reported to the Committee and the latter has pre-eminently discharged its responsibility in giving directions and guidelines to the Board on crucial issues. In other words, the Interim Committee has more or less been functioning as a Council in respect of policy matters without it being designated as such. The third reason could be that the Executive Board has been found to be deficient or been slow in taking decisions particularly during the crises period. This could be countered as there is little evidence to establish this. The fourth reason may be the feeling that the IMF decision making is bureaucratized and mostly taken by the staff and endorsed by the Board without much change particularly in the case of program countries. This may not be entirely true as in many cases, the Board has given specific directions to the staff and management. In any case, these procedures can always be improved. On policy matters, the members of the Board take decisions on the basis of political directions of their authorities. Therefore, the perceived need for a

decision-making process at the political level could also be questioned. The fifth reason is that with a political decision making body in the structure of the Fund, the Executive Board and the management can pass on responsibilities for decisions that may be otherwise difficult to take.

However, on a logical basis, I still find no substantial reason to oppose a proposal to implement Article XII, Section 1 of the Articles of Agreement in setting up the Council.

In the staff paper, I find a comment which is somewhat disturbing to at least developing countries:

“It must also be noted that a more fundamental restructuring of the Executive Board and of the Interim Committee can always be considered. In the present circumstances, it would be appropriate, nevertheless, to wait for the results of the presently launched work on the review of the quota formulae.”

My enquiries with the Secretary's office have revealed that there has been no major work yet done on the review of the quota formulae and the phrase means no more than that there is a decision to review the quota formulae. There appears no need for a fundamental restructuring of the Board as there is reasonable balance between developing and developed countries in the Board. Over the years, in spite of the fact that the rate of growth in output in developing economies has been increasing faster than that of industrialized economies, the quota share of the former has come down. In terms of purchasing power parity, the advanced economies, in 1997, accounted for only 55.3 percent of the global GDP. Any review of quota formulae will have to keep in view this incongruity and restore the balance between industrialized and developing economies in the matter of quota shares and voting strength. It is advisable not to talk of a fundamental restructuring of the Board as it could mark the beginning of a needless controversy.

Now, I would like to offer a few comments on the Council.

- (a) Even when the Council is constituted, it is going to reflect only the voting strength of the Executive Board and in this respect it is not going to be an improvement over the present situation.
- (b) Schedule D of the Articles permits the appointment of not more than 7 Associates by each member. In other words, there can be theoretically 168 Associates in addition to 24 Councillors and 24 Executive Directors and a meeting of the Council could become unwieldy.
- (c) The other significant issue that merits consideration is that the Council as per Section 2(a) of Schedule D is also charged with the responsibility of reviewing developments in the transfer of real resources to developing countries which is now done in the meeting of the Development Committee. We have to find ways

of reconciling the responsibility of the Development Committee and the Council in this regard.

- (d) Specific powers that are exercisable by the Executive Board under Schedule D, 5(a) have also been given to the Council. Under 2(b) of Schedule D, the Council has to consider any proposal for an amendment to the Articles of Agreement. Beyond these, there are no substantial powers of the Council. However, its main task is stated in clause 2(a) of Schedule D, i.e., the supervision and adaptation of the international monetary system. In other words, the Council can propose changes in the architecture of the international monetary system. Here, there could be an overlap of functions between the Executive Board and the Council. There has to be a proper division of responsibilities. In this context, the delegation of powers as it stands now between the Executive Board and the Board of Governors requires to be looked into.
- (e) Section 3(c) of Schedule D stipulates that the Council shall not take any action that is inconsistent with any action taken by the Board of Governors and the Executive Board cannot take any action inconsistent with what has been taken by the Council or the Governors. Does it mean that the Council can override the decisions of the Board?
- (f) Is there a way of strengthening the present Committee so that it becomes a decision making body without setting up a formal Council? Perhaps, it is feasible if discussions are interactive and specific issues are put up to the Committee for a decision. The decisions of the Committee then can be implemented unless required to be ratified by the Board of Governors. This may, however, require a change in the Articles of Agreement as well as Schedule D if the Committee is to become a formal decision making body.

If a Ministerial Council has to be active in the decision making process, then it has to meet more often and for longer intervals than at present. Decisions which will have enduring consequences on the economies of the member countries have to be taken only after careful thought and discussions and not in a peremptory manner. As members are unlikely to be in a position to spend several days away from their main responsibilities, the operational responsibility to discuss issues and formulate changes in policies or evolve new policies will have to continue with the Executive Board. In the circumstances, we have to properly recognize the functions and responsibilities of the Council and the Executive Board.

On the whole, I think there are a number of issues relating to the setting up of the Council which have to be settled before a final decision is taken on the matter.



Mr. O'Brien made the following statement:

We welcome this opportunity to continue our discussion on strengthening and/or transforming the Interim Committee. We share fully the view that the Fund has a central, pivotal role to play in the development and management of the international financial system, as we move into the new millennium. Certainly, a more flexible, transparent, and accountable Fund must be a centerpiece of the new architecture of the international financial system. However, we must be very careful not to underestimate the challenges and pitfalls that face us in this exercise, and be particularly careful that we do not unnecessarily act against the interests of the smaller, most vulnerable of our members.

#### Procedures

We agree that one of the more pressing challenges in the conduct of meetings of the Committee is resolving the dilemma of promoting the broadest possible participation while making the meetings more inter-active and productive. This issue has to be addressed in part by resolving the question of membership and rotating participation in meetings, as well as greater participation of members of large constituencies through improved systems of briefings and feed-back. In addition, efforts should be continued to provide a more focussed agenda with the prior circulation of prepared statements by Ministers, and a limited list of topics for discussion by Ministers. We agree, further, that the present frequency of meetings, twice per year, is adequate, with the provision for ad-hoc meetings to deal with truly urgent, critical issues.

With regard to the preparatory work for the Interim Committee Meetings, we are of the view that the Executive Board should remain principally responsible for all such work. In addition, the work done by other committees or agencies should be channeled to the Committee through the Executive Board. However, it would certainly be useful and advisable for the Executive Board to seek to actively incorporate a wider range of views and opinions in its preparatory work for the Interim Committee Meetings. We therefore support fully the recommendation for the Executive Board to establish working groups rather than having those groups appointed by the Interim Committee. The composition of the working groups need not be limited to officials or "deputies" but could include selected representatives of other international organizations and academia. However, for the 1999 Spring Meeting, participation in the working groups should be limited to officials or deputies nominated by members of the Committee.

On the issue of the communiqué process, we have no objections. This would certainly reduce the burden this effort has imposed in the past and allow more time for Ministers to discuss policy issues.

We believe that, at least for the time being, the constituency composition of the Committee should remain the same as that of the Board. Constituencies should have the flexibility to appoint to the Committee, a Minister from a country other than that of the Executive Director. Any more

fundamental changes should indeed wait, not only on the results of the review of the quota formulae, but on much more intense and broad-based discussion of the issues. Consequently, we believe that the best short-term approach is for the constituencies to exercise greater flexibility in allowing their members to sit at the table. In addition, we have no objections to the exercise of discretion by the Chairman of the Committee in allowing observers to speak, and a preferred status for the President of the Bank.

### The Council

On the more substantive issue of transformation of the Interim Committee into the Council, we see the need for a great deal of caution and very careful consideration. We believe that the reservations and concerns of the Executive Board at the time when the Interim Committee was established and the Council was postponed may be even more relevant today. Indeed, we share the sentiment of the Managing Director, expressed at the recent retreat, that it may be more prudent to strengthen the operations and effectiveness of the Interim Committee before proceeding with the establishment of the Council. (I do hope that my memory serves me right, and I have not misquoted the Managing Director.) The mere fact that the Articles make provision for the Council should not constitute sufficient cause for its implementation. That decision must be made on a very careful assessment of its present relevance and potential effectiveness.

Two of the more compelling arguments put forward by proponents of the Council are that it would provide for better decision-making and greater public accountability. We are not really convinced by these arguments, and do not see clearly how the Council will improve on the effectiveness and accountability of the Committee. Under the present arrangement, policy recommendations of the Executive Board which require the approval of the Board of Governors are "approved" or endorsed by the Interim Committee before going to the Board of Governors. I would be interested to find out if there was ever any instance in which a matter which went to the Interim Committee and did not receive its endorsement was sent to the Board of Governors for a decision or where a proposal endorsed by the Committee was not approved by the Board of Governors. The real value then may be the time saved in having the decision made by the Council rather than the entire Board of Governors. This, however, could exclude the active participation of many governors of the Fund and would perhaps undermine the cooperative nature of the organization.

With regard to public accountability, the work of the Interim Committee receives wide publicity and critical scrutiny. Members of the Committee are held responsible for the policies they endorse or recommend. We must presume that their positions represent those of their authorities and governments. The question is will decision-making powers really increase this accountability or "political endorsement" or make Ministers more responsible than they are?

On the other hand, one of the very real concerns of those who advocate caution in establishing the Council is the implication for the role of the

Executive Board. Here, perhaps I am grateful to Mr. Milleron, who in his very helpful statement, inadvertently points to the issue. He points out that the Board will continue to decide on programs but the guidelines underpinning these programs should clearly become the prerogative of the Council. The results of our recent Executive Directors' retreat clearly indicate the concerns of many Directors, that while they should not become involved in negotiating programs, when such programs come to the Board, there was little or no scope for dissention. Instead their relevance rested primarily on setting the policy guidelines and the operational framework in which programs are negotiated. If I understand Mr. Milleron correctly, the existence of the Council would seriously undermine the role and effectiveness of the Executive Board.

Additionally, some questions arise. Will the Council be constrained to act on the advice of the Executive Board only? Or can it act on its own advice or that of other bodies or agencies? In other words, would the Council be able to take decisions on matters not placed before it by the Executive Board or without reference to the Executive Board? Would the Council have the prerogative of establishing its own advisory body? We believe that the answers to these questions should be carefully considered before we proceed further along the road of the Council.

Mrs. Hetrakul and Mr. Peh submitted the following statement:

We welcome the opportunity to review the role of the Interim Committee and its working procedures, with the view of making them more efficient. As the only forum where finance ministers and central bank governors representing the entire membership of the IMF periodically meet to discuss on issues of systemic importance, the Interim Committee has a significant role to play in providing leadership to the international community. Efforts to enhance the effectiveness of the Interim Committee are obviously critical.

#### Procedures and Composition

The importance of broad participation and representation at the Interim Committee meetings should not be compromised by attempts to promote greater interactive discussion. We therefore would not encourage the conduct of restricted meetings though they may generate more interactive discussion. Ways that would facilitate greater interaction, not just in terms of the breadth of participation but also the depth of issues discussed should be explored. While the suggestion of allowing interested Ministers and Governors to be seated at the table during the discussion of certain items could help in this regard, this arrangement should not dilute the commitment of a multi-member constituency to arrive at a common stance on issues.

While we welcome the idea of strengthening the preparatory work of the Interim Committee through the establishment of working groups of the Executive Board, the agenda of these working groups should be well thought out and focused. The reason for examining areas that fall outside the scope of the Fund's responsibilities, as suggested by the staff, is not clear. There are,

however, merits in giving due consideration to recommendations of other groups.

We support the suggestion of increasing the number of Associates such that each chair would have as many Associates as members in the constituency. Compared to the current arrangement, such a representation is arguably more consistent with Fund's universal membership.

### The Council

The Interim Committee currently possesses no formal powers of decision making and was intended solely to provide political guidance to the work of the Executive Board. It is suggested that the Committee be transformed into a Council in order to increase Fund's accountability and enhance the legitimacy of its decisions, and thereby facilitating more effective functioning of the Fund. While we support in principle the establishment of the Council, the following are some concerns that would have to be addressed:

- The Interim Committee has fostered a strong and mutually reinforcing process of collaboration with the Executive Board, a result that is partly attributable to the advisory role of the former. The advisory function of the Interim Committee has also prevented the problem of bypassing the Executive Board from arising. This however is likely to be an issue if a decision-making power Council is to take the place of the Interim Committee. An unambiguous definition of the role of the Council, including its powers, is necessary to ensure beneficial collaboration between the Council and the Executive Board. We should be explicit on the role and powers of the Council rather than implicit on decisions that fall within or outside its mandate. In this regard, a clearer definition on the "decisions of a strategic nature" (p.10) to be taken by the Council is warranted. While we agree that decisions regarding country programmes should not be part of the Council's powers, the matter becomes complicated if the country concerned is systemically significant and decisions taken could have systemic consequences.
- Notwithstanding the fact that developing countries may be better represented in terms of voting powers than that in the Executive Board, we need to address the fear that the Council might take decisions that bore more heavily on the developing and emerging market economies than on developed countries. Universal membership and participation would only be in name if the Council is perceived, rightly or wrongly in the case of Interim Committee, a "rubber stamp" of the G7. Ways of involving developing member countries in the agenda-setting process of the Council should be explored in order to increase their sense of ownership.

- The decision-making Council will presumably meet more frequently than the Interim Committee as discussions on systemic issues are unlikely to be concluded in one session. Would that be feasible in light of the already demanding schedules of Ministers and Governors? While the Council could also vote by mail, such a practice could impede efforts of encouraging more active interaction among members.
- While the splitting of votes by Councillors is to be welcomed, it puts at risk the strong record of consensus building achieved by the Interim Committee. The Council should facilitate rather than hinder the process of consensus building among members. Moreover, a serious division on some systemic issues, if disclosed to the public, could have adverse impact on market confidence.

Mr. Cippà made the following statement:

In the broader context of the discussion to strengthen the international financial architecture, the Interim Committee called for a review of the various institutional components of the international financial system “including the possibility for strengthening and/or transforming the Interim Committee” itself. I wish to thank the staff for the proposals they have put on the table, which represent a very good base for discussing the future of the IC. This discussion must be viewed as preliminary, as a number of issues need further thinking within my constituency. Before commenting on the various proposals, I would like to make three general remarks.

First of all, the IMF must remain the center of the international financial architecture and the IC is the appropriate political forum for discussing its reform. A number of other ad hoc high-level bodies are competing with the IC in this respect. However, unlike the IC they do not operate within a universally agreed institutional framework.

Second, the need for the Fund to acquire greater legitimacy and increased accountability is well founded. The principal objective to strengthen and/or transform the role of the IC should therefore be to obtain a greater political backing from the capitals for the strategic decisions taken by the Fund.

And third, my authorities are not convinced that in order to strengthen the IMF's legitimacy we need to go all the way of transforming the IC into a decision-making body, like the proposed Council. Some less comprehensive reforms might do the job. After all, since its creation in 1974, the IC has served as a body providing political guidance on all important questions concerning the functioning of the international monetary system. While reporting formally to the Board of Governors, it has at several occasions in the past paved the way for important decisions to be taken by the Executive Board.

Let me turn now to the specific proposals concerning the modalities of preparing and conducting IC Meetings :

Concerning the meeting agenda, we favor a greater focus on those matters that require ministerial attention. The IC should be an opportunity to provide advice and guidance on important strategic issues such as the involvement of the private sector in the resolution of financial crises, on institutional reforms such as the one we discuss right now, or the creation of the contingent credit line.

We consider the idea of preparing ministerial IC meetings by deputies very interesting. Next month's scheduled deputies meeting will provide lessons for how to proceed in the future. My authorities favor a preparation of meetings on the deputies' level along the constituency structure. Deputies have proved to fulfill essential roles in preparing meetings of other bodies. We are convinced that they would do a good linking job between the IMF and capitals, therefore improving the accountability of our institution. Deputies need not meet formally, but the presumption would be that deliberations of deputies at their meetings should be taken into account by the Executive Board, the body that would continue to be formally responsible for the preparation of IC meetings.

It is often argued that the IC does not adequately reflect the economic weight of emerging economies. This is not a problem only for the IC. The same representation exists in the Executive Board, which is only the reflection of the quota structure. This is an issue that should be addressed by itself and my authorities encourage management to advance in the review of quota formulas. In the meantime, there are other possibilities to allow emerging markets voice their concerns. We consider the idea to let other ministers of the constituencies sit at the IC table for selected issues very interesting.

We are in favor of the creation of working groups. This can be another opportunity for members of the constituencies to participate more actively in specific policy dialogues. Obviously, such working groups could also benefit from contributions from other multilateral institutions.

Under normal circumstances, the IC should not meet more frequently than twice a year. We should be ready, however, to consider special meetings if such a need emerges. The same frequency should apply to the meetings at the deputy levels, at least in the beginning. As we gather experience with this new instrument, more frequent meetings could be envisaged.

Finally, the terms of reference give rise to some areas of overlap between the IC and the Development Committee (DC). I personally would favor the staff's approach. However, my authorities have not yet reached a final position on this issue.

Mr. Eyzaguirre and Zoccali submitted the following statement:

The Fund's universal membership and the requirements of an increasingly integrated and virtually "on line" world economy underscore the

importance of facilitating a smooth process of global adjustment. It is not surprising, therefore, that the Fund should be at the center of the debate on the architecture of the international monetary system and that major aspects impinging on the effective discharge of its mandate, including the mechanisms to strengthen world cooperation and consensus-building, would be under review.

Indeed, the Executive Board has the responsibility to distill those substantive and institutional issues, to ensure the fullest involvement of the membership over all the strategic decisions of the Fund. It does not necessarily follow, however, that the search for multilateral consensus over the complex and evolving issues entrusted to the Fund would gain in effectiveness or even, what Mr. Bernes in his grey terms "legal" accountability by acting, some 16 years after the Second Amendment of the Articles, on the institutional provision in Schedule D. The mere establishment of a Council would not obviate the need for delegated representation in the case of multi-country constituencies or ensure the degree of political attention from capitals that more direct decision-making powers over the Fund's wide agenda would imply.

Moreover, it is not clear to us that lack of formal decision-making powers of the Interim Committee has deterred it from agreeing on strategic decisions, or from bringing its political leverage to bear on the rest of the membership, once ideas were sufficiently distilled. The incremental political legitimacy to be derived from the Council over that of the Interim Committee would seem to us to be less compelling than focusing on the conditions for improved political consensus-building. At this stage, we see more merit, in pragmatically exploring options for strengthening the preparatory work of the Interim Committee. Preparatory meetings between officials from capitals and the Executive Board offer a promising a starting point to improve the flow of ideas and the identification of issues where progress is necessary and political consensus possible, in the areas which most closely correspond to the Fund's core mandate.

In this context, a few brief comments on the modalities to strengthen the Interim Committee's role are warranted. First, on the conduct of meetings our preference remains for maximum openness, within the structure of limited high-level attendance. Second, with respect to the frequency of meetings, we feel that this has not constituted a binding restriction for their effectiveness and that in any event the possibility of an extraordinary, or ad hoc meeting allows sufficient flexibility to accommodate unforeseen developments. Third, on taking into account the views of other bodies having specialized, but related responsibilities, it is important to strike a balance between the requirements of an interconnected agenda and the multiplication of discussion fora which ultimately serve to devalue participation and outcomes. Fourth, with respect to the Communique Process, suffice it to express agreement with the views advanced by Mr. Shaalan. Fifth, on the composition of the membership, we would be amenable to introducing some flexibility in arrangements to enrich the debate with the participation of those Ministers, Governors or persons of comparable rank from a constituency with a particular interest on a specific agenda item. Sixth, on the question of broader attendance and observers,

common sense suggests a narrow interpretation of common interest. We would be amenable, however, to permanent observer status being granted to the president of the World Bank.

Finally, Mr. Chairman, the terms of reference constitute in our view a crucial aspect for the effectiveness of the outcome, and we would agree with those that urge a focused agenda and one or very few, well-defined topics requiring ministerial attention.

Mr. Pickford made the following statement:

I welcome the opportunity to discuss this paper again. But let me say at the outset that, like Mr Hansen, I think we will need considerably more discussion on these issues before we can start to draw any firm conclusions on the way forward. I also think the paper could have been a little clearer in its approach had it first identified the problems we are trying to address, and then suggested a range of alternative possible solutions.

Like Mr Bernes, I also think the paper is written very much within the limits imposed by the thinking of our predecessors as international financial architects. It therefore attaches too much weight to earlier blueprints for reform of the Bretton Woods system. I think we need a little more thinking "outside the box" on these issues, since present circumstances are rather different from those envisaged by the founders of the Interim Committee, and present problems rather different from those they were trying to address.

I do not doubt that the Interim Committee is in need of reform. In terms of representation alone, it is hampered by the absence of, for example, international financial regulators, and by the fact that the World Bank attends only as an observer - revised proposals for privileged treatment notwithstanding. This limits its ability to discuss policy on a raft of issues which fall outside the IMF's remit but which nonetheless greatly affect or are greatly affected by the operation of the international financial system. Such issues include, for example, financial regulation, corporate and financial sector restructuring, and economic development.

The IMF Council would, I think, suffer from the same problems as the Interim Committee in terms of being too narrowly focussed to deal with the full range of international financial issues.

One solution is to rely on ad hoc arrangements, which can provide the flexibility to bring together representative and relevant countries to deal with specific problems, and which have shown they can produce useful ideas and recommendations for reform. But they lack the means to convert their conclusions into action in the relevant countries and international institutions. The G10 recommendations on the inclusion of collective action clauses in sovereign bond contracts are a good example of this failure to turn good ideas into concrete policy action - at least to date.



Our key objective in my view should be to find a way to bring together all the key organizations and interests involved in the management of the international financial system. Clearly, the mechanics of how to do this, the role of the Interim Committee within this framework, and the interaction of the IMF with other institutions, are all issues which need to be considered carefully. I would encourage us to follow Mr Bernes' advice and take a step back and rethink our approach to these issues.

The Secretary noted that several Directors had stated that there was a need for further analysis of the issues related to the establishment of the Council, particularly with regard to the legal structure envisaged in Schedule D of the Articles of Agreement for the respective roles of, and the relationship between, the Council and the Executive Board. The paper before the Board did not contain a detailed discussion of those legal issues but rather focused on the exploration of the reasons why it might be justified to establish the Council. However, as acknowledged in the paper, it would be necessary to return to those specific legal issues.

Directors had also raised questions about the meaning of legitimacy, the Secretary remarked. In that regard, it should be noted that the institutional legitimacy of the Fund—or for that matter of the Interim Committee or the Executive Board—was not in question. The Committee of Twenty had considered the question of legitimacy in its 1972 discussions on the Council and, as stressed in the staff paper, under Article I of the Articles of Agreement, the Fund was the central “machinery for consultation and collaboration on international monetary problems.” Therefore, the issue was merely whether there was a need for *enhanced* legitimacy, and whether it would be enhanced by establishing an organ with decision-making power. In that connection, Mr. Bernes and other Directors had also mentioned the need to consider the extent of the Fund's accountability vis-à-vis its members and the public at large, the role of transparency of the Fund's activities in enhancing that accountability, and the relevance of different domestic aspects of legitimacy, including differences in the political status of members—elected versus appointed officials—of the Committee. Those were all issues that could be explored further, within the central context of enhancing legitimacy.

Mr. Mirakhor remarked that he had been pleased to hear that the Secretary believed that the institutional legitimacy of the Fund itself was not in question, because it was an institution set up by international treaty and with universal membership. However, if that was the case, it was difficult to see how the legitimacy of any of its organs might be lacking. As Mr. Shaalan had noted, even the most vociferous critics of the Fund never questioned the legitimacy of the Fund or of the Interim Committee. Instead, most of their criticism related to whether the Fund's prescriptions were appropriate; whether or not the Fund was overly politicized; and whether or not there was enough transparency, corporate governance, and accountability. Those issues, rather than the question of legitimacy, were what needed to be addressed. Moreover, if the aim was to strengthen or transform the Interim Committee, it would be counterproductive, as well as bad politics for the Executive Board, to question the legitimacy of the Fund itself or of any of its organs. The best argument in favor of strengthening and/or transforming the Interim Committee was that Article XII of the Articles of Agreement provided for the establishment of a Council, and that a decision needed to be taken on whether and when to implement its provisions.

The Chairman replied that the political legitimacy of the Fund was more frequently questioned in Europe than in the United States, where the political culture was different. It appeared to some observers that the Fund was an institution ruled by technocrats, where

directly elected representatives were only allowed an advisory role through the Interim Committee. A decision to enact the Council could allay that concern somewhat. Moreover, while it was true that the Fund's legitimacy was embodied in an international treaty, that treaty made a provision for a permanent body, the Council, which had never been brought into existence. The question was to decide whether the interim period had ended, and if so, to establish the Council.

Mr. Bernes reiterated that he was not convinced that the Council would respond to the questions that were being raised. In fact, it could raise even new questions about political legitimacy, and the issue therefore needed to be explored in some detail.

The Chairman asked whether Mr. Bernes was suggesting that the Articles should be amended to remove the option of establishing the Council.

Mr. Bernes confirmed that he was not.

Mr. Shaalan wondered whether the word "Interim" in Interim Committee meant that the Committee was temporary, and would exist only until the Council was created, or whether it had another meaning altogether.

The Secretary explained, in response, that the word "interim" referred only to the interval period pending the establishment of the Council, and had no specific time limitation. The Committee of Twenty had originally contemplated that the Council be established immediately. Thereafter, it had been assumed that it would come into existence shortly after the effectiveness of the Second Amendment of the Articles of Agreement, which included a provision whereby the Board of Governors could establish the Council by an 85 percent majority of the total voting power. Pending that time, the Interim Committee was created to advise and report to the Board of Governors in specified areas. No specific time limit was set for its existence, as it had been expected that it would be replaced by the Council in relatively short course. However, at the time of the effectiveness of the Second Amendment, the required majority for the establishment of the Council could not be mustered. As the Interim Committee had begun to show vitality, it was then suggested that more experience with it would be helpful before proceeding on the question of establishing the Council.

Mr. Takeda made the following statement:

Strengthening the function of the Interim Committee is paramount among our tasks to better structure the international financial architecture. In view of the magnitude of the impact of the crisis in Asian countries and elsewhere in the world, it is very important to enhance the contribution of the Interim Committee to the stability of the world economy by making sure that it functions properly.

The staff paper is a useful summary of various points relevant for strengthening the Interim Committee, but when discussing these points, we should keep in mind another issue; namely, the role of the Development Committee, which constitutes the other wing of the international financial community. How to deal with the relationship between these two committees is not a straightforward issue, and we cannot, and should not, come to a

conclusion hastily. Therefore, my comments today on the Interim Committee are of a preliminary nature.

On the frequency of the Interim Committee meetings, I agree with maintaining the practice of meeting twice a year, with possible ad hoc meetings if necessary.

On the composition of its membership, we should take into consideration the fact that the role played by emerging economies in the world economy has grown rapidly and that the impact of their economic performance on the rest of the world is quite substantial. In view of this development, we should continue to explore what representation structure in the Committee might be most appropriate to reflect better the voices of those emerging economies. This is not something that can be addressed in a very short period of time. Rather, we should tackle this issue from a long-term perspective.

In view of the fact that the potential agendas of the Interim Committee are getting broader, it makes sense to consider expanding the role of observers to the Committee. Due consideration, however, should be paid to not diluting the substance of the Committee's discussions by having too many observers. My impression is that the time allotment in the past Interim Committee meetings was rather tight

On the terms of reference of the Committee and the possible transformation to the Council, I agree that it is important to increase political accountability for decision-making on important matters related to the stability of the international financial system, but this issue, as I said earlier in my statement, is closely related to issues of the role and function of the Development Committee; namely, how to strengthen its function and accountability and how to arrange better the division of labor between the two committees. We presently have various proposals on these issues, including consolidating the two committees in some way, and we would have to further examine carefully the pros and cons of these proposals before reaching a conclusion.

On the meeting of deputies, I am not fully convinced by the argument put forward in the staff paper that having preparatory work done at such a meeting is not appropriate because it is not written in the resolution. We are in a transitional period of change in the international financial system, and I am of the view that a flexible approach in terms of the fora for discussion will help create flexible ideas for improvement. I support holding a meeting of deputies before the coming spring meeting.

Mr. Guzmán-Calafell made the following statement:

The search for means to strengthen the Interim Committee is a crucial element in our efforts to improve the architecture of the international monetary system, and therefore today's discussion is most welcome. The staff paper contains a number of interesting ideas in this respect, both procedural and

substantive. I would like to comment briefly on them in the order in which they are presented in the report.

The staff is right to point out that notwithstanding the efforts made to foster greater participation and interactive discussion during Interim Committee meetings, progress in this respect has been modest. I do not believe that moving toward more restrictive meetings would represent an adequate solution to this problem, since the result is uncertain and it would have undesirable implications for chairs with large constituencies. In my view, a more convenient way to move in this direction is to focus more adequately the issues to be discussed at these meetings. In the past, we have presented Interim Committee members with extremely ambitious agendas covering a long list of topics within a very limited time frame. Naturally, this has been detrimental to the depth of the discussions and the interest of participating countries. For this reason, I fully endorse the staff's recommendation to focus future agendas on fewer topics and only on those issues that require ministerial attention.

With respect to the preparatory work for the Committee, I am open minded to the proposal to more actively involve officials from capitals. It is too early to say what is the best way to achieve this objective, and at this stage the most reasonable thing to do is to proceed with the meeting of Deputies which is scheduled for mid-April and, after a careful evaluation of the results, decide whether the continuation of this approach or of a revised one is worthwhile. In this process, we must consider to what extent a mechanism like this can allow us to concentrate at the Fund the consideration of issues that are under study in other fora. I am convinced that both a wide participation of member countries and the involvement of the Executive Board are essential for a successful outcome of the Deputies meeting.

I can go along with the staff's suggestions regarding the reports of other groups or bodies during Interim Committee meetings, and to the proposed modifications to the drafting process. The issue of the composition of the Interim Committee is far more complicated. I fully agree with the staff that emerging market countries are not adequately represented as members, and we can also find representation problems among industrial countries. There is no easy way out of this problem, and in my view the option of introducing more flexibility in arrangements within constituencies, while helpful, does not provide a satisfactory solution. One possible way to move in the direction of achieving a more adequate representation is to try new approaches in meetings at the Deputy level, if we decide to preserve them. This would allow us to test different courses of action without altering the present composition of the Interim Committee.

On the issue of observers I agree that it is mainly for the Chairman to determine whether their participation is convenient or not, and clearly the President of the World Bank should be given privileged treatment in this regard. I am somehow confused on the "constitutional" overlap between the Interim and Development Committees. The staff notes that this matter has been handled pragmatically in the past, and proposes that we could continue to proceed in the same manner. This suggests to me that pragmatism has provided

an adequate response to the overlap, and therefore I fail to see why we want to consider a different approach. On the other hand, if due to reasons that the staff should clearly explain to the Board this is a course of action which is no longer desirable, I would have no objection to making the Development Committee a Bank-only committee.

Let me comment now on the Council. This is a very important issue on which we need to reflect carefully. According to the report, there are two main arguments in favor of the creation of a Council. First, involving elected officials more directly in the Fund's decision making would make the Fund more accountable and would also enhance the legitimacy of its decisions. Second, by having decision-making powers, the Council would have greater authority than the Interim Committee and would increase Ministers/Governors' sense of participation in the Fund's key decisions.

I have some doubts on these arguments. In the first place, it is not evident to me why we need to enhance the legitimacy of decision making at the Fund, since the decision-making process is clearly explained in the Articles of Agreement, which have in turn been endorsed at the highest political level in all the member countries. The importance of making the Fund more accountable is not apparent either. If we have a clear structure of decision making, and I think no one doubts that we do, accountability should not be a major issue. I am also skeptical of the need to increase Ministers/Governors sense of participation in the Fund's key decisions. The views of Executive Directors during Board meetings, and especially when considering key items, are not the result of personal positions, but rather a reflection of the instructions received from their capitals.

On the other hand, the creation of the Council is not free of costs. The main among these has been pointed out repeatedly by other Directors: the establishment of the Council would seriously undermine the role of the Executive Board. In fact, the final paragraph of the staff's paper is revealing in this respect: according to Schedule D of the Articles of Agreement, whenever there is overlap in decision making, the actions of the Executive Board in the exercise of its delegated powers shall not contradict the actions of the Council.

Taking into account all these elements, although the substitution of the Interim Committee with a Council with decision-making powers has some positive elements, I am not convinced that this would be an adequate means of achieving our objective of strengthening the architecture of the international monetary system.

Mr. Wei Benhua made the following statement:

At the outset, we welcome this opportunity to discuss the issue of strengthening and/or transforming the Interim Committee, as part of our efforts in searching for appropriate ways and priorities to reform the architecture of the international monetary system. This chair generally agrees with the idea of strengthening the IC through reforming IC meeting procedures and increasing its diversity and flexibility through arrangements within each constituency. As

for the drafting of the IC Communique, like Mr. Shaalan, we believe this process can be facilitated by the participation of Executive Directors in the restricted lunch session of the IC meetings. Turning to the issue of Observers, we agree that Observers might be allowed to address the IC members, but should be limited on issues within the mandates of the institutions they represent. In this regard, the President of the World Bank should be granted privileged treatment meaning he is entitled to participate fully in the discussions. We also agree with Interim Committee chairman's proposal to call an IC Deputies meeting for the forthcoming Spring Meeting.

It is true that the fundamental restructuring of the Executive Board and the IC can always be considered, but we would like to emphasize that the restructuring should improve the representativeness of the developing countries. We hope the review of the quota formulas can make expeditious progress in this regard.

As for transforming the Interim Committee, different views expressed during our informal discussions have reflected its important and controversial nature. While we find some merit in the arguments supporting the idea of transforming the Interim Committee, this chair has some concerns on this proposal.

First, as explained by Mr. Milleron, the central objective of transforming the IC into the Council is to give full legitimacy to the Fund. I have to admit that I am not quite clear what the full legitimacy refers to, and it is also difficult to convince ourselves that the lack of legitimacy on the part of the Fund has been the major reason contributing to the current international financial disorder and the deficiency of the existing international monetary architecture. Therefore we have some doubts on the urgency of this issue.

Second, transforming the IC into the Council requires a redistribution of power among different organs of the Fund, especially between the Executive Board and the Council. We can say that the Council should focus on those issues that require political support, particularly on decisions of a strategic nature. However, the concept of "strategic nature" is ambiguous, and it seems to us that the line is not easy to draw. In addition, it seems that it is too complicated for one institution to make two kinds of decisions by different organs of the institution based on different voting structures. I think it might be difficult to tell the difference between these two kinds of decision given the fact that the Executive Directors vote on the instruction of their authorities, which, in most cases, involves the participation of Ministers and Governors.

Like others, it is also our view that the Fund must remain at the center of the international monetary architecture. We appreciate all the efforts made by the Fund and the national authorities in reforming the international monetary architecture; however, it seems that more substantial issues need to be addressed before changes to the organizational structure. Therefore, this chair has serious reservations on transforming the IC into a Council. There is some argument that the word "Interim" is no longer suitable for an institution which

has been in place for more than two decades. In this connection, we can support the pure change of the name of the IC.

Finally, a few words about the “constitutional” overlap between the Interim and Development Committees on issues of the transfer of real resources to developing countries. We agree to continue the practice of handling this issue in a pragmatic way as we have done in the past.

Mr. Esdar made the following statement:

Mr. Chairman, first of all I would like to commend the Secretary for the comprehensive and well-organized paper for discussion today.

Before coming to the more detailed suggestions, let me start with the most general and—as the discussion has illustrated today—also the most controversial issue, i.e. the question whether we should transform the Interim Committee into a Council.

Mr. Chairman, I am afraid we need more discussions on these issues also on the political level. Obviously, there is not yet sufficient support for that idea. Also my authorities have not come to a final assessment. Against this background I would suggest to leave this question open for further consideration and concentrate our immediate future work on the objective to further improve the efficiency of the IC as it exists.

Here, I very much appreciate the concrete proposals in the paper and I can go along with most of them. I would like to take them step by step:

#### Conduct of meetings

The main objective should be, to have a broad and effective discussion. I have some sympathy for complaints from our colleagues from multi-country constituencies, that some of their members cannot participate in restricted meetings. While we should not exclude in general restricted meetings, I would suggest to regard those restrictions as exemptions, also in light of making IC meetings more lively and more open to observers.

#### Frequency of meetings

I agree that the IC should typically meet twice a year with the presumption to have ad hoc meetings - if necessary.

#### Preparatory work of the Committee

The paper correctly states that the preparatory work for IC meetings would be done by the Executive Board. However, as we all are aware, Mr. Campi - not at least in order to reintegrate the work which has been done outside this institution back into the IC - has suggested to have an extraordinary meeting of the deputies for the preparation of this Spring meeting. In light of the particular circumstances, my authorities support Mr. Ciampi's suggestion.

### Use of other groups and bodies

In light of the overall objective to reconcentrate the discussion on items which are clearly at the responsibility of the Fund, I support the suggestion to use the work of other institutions with relevance to the Fund's work as an input for the IC

### Communiqué process

Given the problems and hardships we experienced in this area, I really appreciate any improvements. Insofar, it might be a good idea to do some drafting before the meetings, based on written statements, and to leave for the members of the IC only those areas where still open questions and brackets exist.

### Membership

Again, with the objective to assure broad participation, we have no problems to introduce more flexibility in arrangements within constituencies, also with regard to the questions of who will sit at the table at particular agenda items. I could also go along with the suggestion to increase the number of associates, but certainly not in a framework which would provide less room for one-country constituencies.

### Observers

As already mentioned, it would be a good idea--if suggested by the Agenda--to invite observers to speak.

My authorities have also no problem to provide the President of the World Bank full speaking rights at Interim Committee meetings.

Mr. Al-Turki made the following statement:

I welcome this important paper on strengthening and/or transforming the Interim Committee. Coming in the midst of the ongoing global financial crises, the paper provides a timely opportunity to ponder future management of the Fund's international economic and financial surveillance role. The basic choice is twofold. One option is to build on the present flexible set up, which provides that the Interim Committee's recommendations, although non-binding in principle, are in practice routinely endorsed by the Board of Governors. The alternative is to give effect to the Second Amendment provision for the Council as a more high profile political body with the power to provide mandatory advice for the Fund.

The choice between the status quo and the Council idea clearly is a basic issue that requires careful prior reflection. Here, let me remark on the issues that I consider critical.



First, I share the long-standing concerns that the paper notes regarding possible dilution of the powers of the Executive Board. It is crucial that any modification of existing arrangements allays such concerns. In particular, with or without participation of official from capitals, the Executive Board's preeminent role in the preparatory process should be kept intact. In that context, I could go along with the management's idea of an experimental meeting of the Executive Board to prepare for the next meeting of the Interim Committee.

Second, I remain of the opinion that continued focus on well-defined and high priority issues is critical for future effectiveness of the Interim Committee. That said, in very exceptional circumstances, an ad hoc meeting can be considered.

Third, while I appreciate the case for incorporating views of groups other than the G-10 and the G-24, it is also important to ward off dangers of an unduly expansive process. Let me add here that I believe current practices on allowing observers at the meetings has been useful and should be continued.

Fourth, regarding the composition, it is important to first recognize that the balance reflected in the current position represents a consensus that the membership achieved after considerable deliberation. Here, let me reiterate my conviction that a measure of stability in such basic aspects is critical for the Fund. I therefore see no need for any restructuring at present of the Fund's membership representation practices.

Finally, on the Council, the Interim Committee has already evolved into the effective means for the membership's engagement in the Fund's decisions at the political level. As the staff underscores, the Council would essentially amount to an explicit reconciliation of that reality in the form provided for in the Second Amendment. However, the formal change has important implications. Here, the first priority clearly is to ensure that consequences on the allocation of authority between the Executive Board and the Council are fully understood. This highlights the importance of adequate reflection and exchange of views toward an informed approach the Council idea.

Mr. Wijnholds made the following statement:

I generally agree with what Mr. Esdar said.

First, as regards improving the quality of debate within the Interim Committee, I agree that we should try to focus the discussions of our Ministers on several key policy issues, for which the Board requires guidance. This is, of course, in large part what the Interim Committee is already doing and the key question is therefore: which aspects do we no longer discuss?

This in itself is something we should perhaps ask our Ministers at the next Spring Meeting. For the WEO discussion, for instance, I am not entirely convinced that it constitutes the highpoint of my Minister's day. This is a pity, as discussing each other's economic policies, strengthening monetary cooperation, and exchanging views on which policies are most appropriate is

clearly at the core of the Fund's mandate. Currently, however, the discussion on the WEO does not seem to be a real dialogue. It seems more aimed at reaching agreement on a text for the communique than on having a frank exchange of views. Similarly, policy discussions also seem to some extent obligatory, again with a view to eventually being able to make some kind of public statement through the communique. In this regard, I would certainly be open to experimenting with having the drafting session take place prior to the actual Interim Committee meeting itself, possibly with the involvement of the Board and the capitals.

In the same experimental vein, my authorities can support the one-time preparatory meeting proposed by Mr. Ciampi. The details of this meeting remain rather vague, however, and I would certainly welcome it if we could be provided with a bit more information about the format and the content of that meeting, perhaps by Mr. Faini. I would note, however, that my authorities attach great value to preserving the role of the Executive Board in preparing the Interim Committee meetings. Therefore, any preparatory meeting should be closely coordinated with the Fund staff and management, even if a heightened role for capitals is envisaged.

If this were to help in the preparation of the Interim Committee, and perhaps stimulate more ownership of IMF-issues on the part of capitals, I could also support the establishment of working groups, which could report either to the Board or to the Interim Committee. Again, to preserve much of the institutional knowledge present in the Board and to avoid overlap and repetitive discussions, I would, in any case, expect the Board to be closely involved with such working groups.

Finally, on the issue of the respective roles of the Interim and Development Committee, I favor a clear split between the two. The Development Committee should be mainly a Bank Committee in which the MD would be a permanent observer. The World Bank president would then receive reciprocal treatment in the Interim Committee. I believe both committees will be perfectly able to deal with areas of overlap in a pragmatic way.

The Chairman remarked that he agreed with Mr. Wijnholds that the Interim Committee's discussion of the WEO was not satisfactory. That was of particular concern in the present year when the major issue of how to distribute the responsibility for maintaining enough growth in the international system—and of which instruments should be used to that end in each group of countries—was being faced. Given the paramount importance of the questions at stake, it would be regrettable if the discussion did not involve the Ministers or Governors personally. Therefore, it would be crucial to take great care to put the proper questions to the Ministers, and to work with the Chairman of the Committee to ensure that the key actors, in particular, were encouraged to participate actively. In light of the substantial agenda, the Ministers might also be encouraged to consider whether it might be possible in the future to devote one and a half days to the Interim Committee meeting, instead of only one day. It might be useful to discuss that issue at one of management's lunches with Executive Directors.

Ms. Lissakers observed, in response to the Chairman's comments, that the amount of time which Ministers were willing to devote to meetings was a function of how useful they found them. At present, the Interim Committee had fallen into a somewhat formalistic format, and there was little incentive for Ministers to dedicate a large amount of time to it. That should be contrasted with the experience at the recent ad hoc meeting of Western Hemisphere Finance Ministers, which had produced an intense engagement from participants. The G-22 meeting, at which the Managing Director and President Clinton had both been present, had also been a free-flowing, intense, and quite long discussion. Ministers had clearly felt that the discussion was in their interest, not because the G-22 was a decision-making body, but because the format of the discussion, and the preparation for it, had been such that they had brought to the fore the issues that were uppermost in Minister's minds. It was possible to replicate that experience with the Interim Committee, but not by merely lengthening the meeting.

The Chairman agreed that the experience in those fora should be kept in mind in preparing for the September meeting of the Committee.

Mr. Sivaraman remarked that one reason why Ministers felt little incentive to participate actively in the Interim Committee was that the outcome of the meeting was defined beforehand in the draft text of the communiqué. In that context, the meeting itself was reduced to an academic level discussion. Moreover, even for those issues on which the Managing Director prepared a report, no problems requiring decisions were posed to the Ministers, except in cases such as the quota review or SDR allocations. Even in those cases, however, the Board generally came to a unanimous conclusion before taking the issue to the Committee. To encourage greater participation, it would be important to identify issues that needed to be brought to Minister's attention, and on which their guidance was being sought. A preparatory meeting of Deputies ahead of the meeting of the Committee could be useful in that regard. Those steps needed to be taken whether the Interim Committee was transformed into the Council or merely strengthened. While granting decision-making powers to Ministers by establishing the Council might also strengthen the incentives for participation, it should be noted in that regard that the Interim Committee's communiqués were already generally treated like decisions.

The Chairman noted the points made by Mr. Sivaraman, but stressed that Ministers should not be given the impression that the views that they might choose to express at the Interim Committee meetings would not be reflected in the communiqué.

Mr. Bernes agreed with Ms. Lissakers that the G-22 process should be emulated. He also supported the proposal to allow more observers in the meeting room to ease the constraints on multi-country constituencies. However, with respect to the latter, he expressed concern that a large increase might have the undesired effect of inhibiting the discussion. He wondered whether it might be feasible to set up a "listening" or "overflow" room where the proceedings of the meeting could be televised, and followed by those members who were interested in witnessing, but not participating in, the discussion.

The Chairman replied that that possibility would be looked into, and that the technical arrangements would be made. Nevertheless, he was skeptical that many delegates from capitals, and particularly Ministers themselves, would be willing to be relegated to a listening room.

Mr. Taylor made the following statement:

I agree with Mr. Esdar and a number of other Directors that there is insufficient support at the moment for bringing the Council into existence. Therefore, I will concentrate on enhancing the efficiency of the Interim Committee.

On the conduct of the meeting and the problem of allowing a greater number of observers in the room without inhibiting the discussion, the solution should not be to hold a full meeting in the morning and a restricted meeting in the afternoon. The experience with this procedure has shown that it is difficult to distribute the topics on the agenda in an appropriate manner, and meetings with restricted attendance adversely affect chairs with large constituencies. I am pleased that Mr. Bernes has raised the idea of a listening room, an idea which I had already raised at the Board's retreat, and which I wanted to table again. It is an intermediate position that would ease a number of pressures for multi-country chairs. I certainly agree that we could never put a Minister in a listening room, but relegating a group of lesser officials to a listening room could improve the sense of immediacy among those Ministers who are at the table, and also facilitate the task of distinguishing between those observers—notably the President of the World Bank—who should be more involved in the discussion, and others who would more appropriately be in a listening room.

On the communiqué process, a number of Directors have suggested that a draft of the communiqué should be discussed the day before the meeting. This is an idea worth trying as long as it is only one day before, so that the relevant officials from capitals can be involved. On the other hand, I wonder whether discussing a draft beforehand is consistent with the need to engender some genuine debate among Ministers. In this connection, I note Mr. Shaalan's suggestion of allowing Executive Directors to attend the lunch discussions of the Committee. Important issues are often deliberately left to the luncheon discussion, and it is difficult for us to ensure that Minister's views are accurately reflected in the communiqué without having been present for that portion of the meeting.

On the terms of reference of the Interim Committee and the organization of the agenda, I was going to raise more or less the same issues that have already been raised. I agree that a longer meeting might be useful, but I also agree with the observations made by Ms. Lissakers in this regard. Moreover, before trying one-and-a-half days, we should try a full day. One way to organize the agenda would be to put the architecture issues in the morning, and a well organized WEO discussion in the afternoon. We certainly have to make sure that there is an appropriate and full discussion of architecture that draws in all the interests of those who should be expressing views.

On the preparatory work for the Committee, I agree with the points made by Mr. Wijnholds. Moreover, one way to take account of the views of other groups and bodies would be to establish working groups of experts to examine specific issue, and to send their reports to the Chairman of the

Committee. This process seems to have worked in relation to the G-22 meeting.

The membership structure of the Committee is a difficult issue. Without precluding the possibility of more extensive changes at a later time, we should concentrate on what could be done right now to improve the representation of members. As far as I know, the existing arrangements permit whatever flexibility is needed within constituencies, and I am not sure that anything else needs to be done except in quite exceptional situations, which have been identified once or twice before, where the appropriate solution is to bring a second or third Ministers to the table and an additional chair for that item.

Mr. Barro Chambrier made the following statement:

There are two main prerequisites from this chair: It is very important for us to have full representation in the Interim Committee, and appropriate decision-making authority on politically sensitive issues. It would also be important to ensure that, if a new organ is put in place, the role of the Executive Board in the normal activities of the Fund is preserved. The various suggestions that have been made in this regard in recent months deserve to be examined carefully, but I would like to underscore that our views at this stage are preliminary.

We support the suggestion to establish working groups to examine selected issues, and in particular those that go beyond the scope of Fund activities and responsibilities. We are of the view that these groups should be established on an experimental basis for the upcoming Spring Meeting and that we should learn from the experience.

We agree that the process for the communiqué can be improved; and we understand that more flexibility may be provided in the meeting for the participation of multi-constituency chairs by allowing Ministers and Governors who have a particular interest on a specific item in the agenda to sit at the table during the discussion. Such provision would certainly give the Interim Committee the desirable diversity and flexibility.

Concerning the possibility of allowing observers to attend meetings of the Interim Committee, I believe that the Chairman should have the responsibility to allocate a given period of time to each selected statement on specific issues on the agenda. In that context, it is our view that the President of the World Bank should be given privileged treatment.

A large majority of this chair's countries considers that it would be important to set up a new body that would have decision-making authority. In this regard, the suggestion to bring the Council into existence, as provided under Schedule D of the Articles of Agreement, should be given serious consideration. One advantage would be that we would be building on our foundation. The Council would give greater authority than the Interim Committee and would enable the direct participation of Ministers and

Governors in the Fund's decisions. At the same time, and this is not a minor argument, the acceptance by the membership as a whole of decisions on politically sensitive issues would be facilitated. Nevertheless, it would be important to preserve the role of the Executive Board, and the responsibilities of the Council should be restrained to issues that require political backing by the membership. Finally, the Council would allow members to better reflect the views of their respective constituents by casting split votes. Let me also add that, as a multi-constituency chair, I would be in favor of allowing more associates in the meeting room.

I would like to stress that we remain open to other ideas that would strengthen the efficiency and the effectiveness of the Interim Committee.

Mr. Morais made the following statement:

I would like to thank the staff for the useful paper, which contributes to further developing our discussion on ways to strengthen and possibly transform the Interim Committee. As many Directors have made comments on most of the important points, I will be brief.

While I support the principle of the formation of a Council, I have a number of concerns which would need to be addressed:

Firstly, it is not clear, as Mr Bernes, Mr Shaalan and others have mentioned, precisely how the Council will expand political legitimacy. I would also want to understand more clearly why it is felt that a Council would perform more optimally than the existing Interim Committee, if the work of the Interim Committee were to be strengthened.

Secondly, as a representative of a number of small members in this Board, I can see the enticement of having a greater capacity for smaller members to voice their views in a political Council. But it is not clear in the paper exactly how this would improve the position of developing countries. In this sense, I strongly share the concerns raised on this point by Mrs Hetrakul in her grey.

Thirdly, I have a particular concern about the possibility of vote-splitting in any new Council. One of strengths of the Interim Committee can be argued to be precisely its capacity to build consensus, by virtue of its informality. This has not prevented the Interim Committee adopting far-reaching decisions in the past and, by virtue of the Committee's importance, in seeing these decisions carried through into practice. In my view, a consensus-building mechanism will be a vital ingredient in developing a new global financial architecture which is built on international consensus. Before moving to a Council, I would argue strongly that such a consensus-building mechanism needs to be in place. I do not see this mechanism fully elaborated on in the staff paper. In this context, I also think it would be important to await the outcome of the review of quota formulate.

Fourthly, I am concerned about the status of the Executive Board, should a new Council come into being. Again this has been commented on by some earlier speakers. There are a host of practical considerations, which go to the core of the issue of the effectiveness of member representation, which are not treated in the paper. It would be important, in my view, for any further paper on the issue of transforming the Interim Committee, to consider in much greater detail, the impact of a new Council, not only on the status of the Executive Board, but on what the development of a Council means for the day-to-day management of any member's relationship with the Fund.

Finally, two very brief comments on the issue of strengthening the Interim Committee:

Firstly, I support the proposal to assign the President of the World Bank privileged treatment.

Secondly, on the issue of the frequency of meetings, I do not see major shortcomings with the current system. I concur, in this respect, with a number of Directors who argue that we should be cautious about our expectations of the likelihood of attracting a more frequent attendance of political heads to meetings.

Mr. Lushin made the following statement:

I will touch upon some issues regarding strengthening the Interim Committee in the order they have been presented in the staff paper.

#### Interim Committee

The frequency of meetings, in our view, should not be changed from the present system, that is, two meetings in a year. If necessary, ad hoc meetings can be held.

We also have no major problems with the preparatory work of the Committee as it is being undertaken now within the Executive Board. We think that much could be done by the Board, in cooperation with the Management and the staff in improving the preparation for the Interim Committee (IC) meetings, say, by avoiding rush work in the run-up to these meetings and devoting more time to preparation and discussion of important policy issues. However, we remain skeptical with regard to the possibility of improving the preparation process by calling a separate Deputies' meeting or creating working groups of the Executive Board, which would include officials from capitals. We are afraid that the attempts to build more sophisticated bureaucratic frameworks could replace the greater emphasis that should be placed on the substantive content of the meetings and which could be made within the already existing procedures.

The views of other groups/bodies can serve as useful input to the IC meetings, especially if they incorporate specialized expertise in appropriate

areas. However, we join Mr. Shaalan in cautioning against the IC agenda being strongly influenced by decisions and views taken in other fora.

We join those speakers who call for discretion in allowing the observers to address the IC meetings. This said, we support granting the President of the World Bank privileged treatment with respect to participation in the discussions.

Regarding the terms of reference, we think that:

- first, the necessity to focus the agenda of the IC on fewer topics and only those that require ministerial attention can hardly be disputed;
- second, the overlap between the terms of reference of the Fund and the World Bank with regard to the transfer of real resources to developing countries has not been an obstacle so far. We favor an approach that maintains the pragmatic treatment of this issue in the future.

#### The Council

If a decision to transform the IC is firmly taken, we agree that the most logical way to proceed in this case will be to implement Article XII, Section 1 in setting up the Council. And if there were to be a broad consensus on this issue, we would be prepared to join it. However, we are not fully convinced that the time has now come to say good-bye to the IC, which so far has served the IMF well. It seems that at this particular moment the balance of arguments is in favor of strengthening the IC rather than dismantling it and replacing it with a Council. Apart from other reasons for maintaining the status quo, we think that trying “to swap horses when crossing a stream”, that is, trying to launch major institutional reorganizations during this current uneasy time, could make our decision making less, rather than more effective, at least for a while.

Mr. Mirakhor made the following statement:

On the issue of the Council, as I said earlier, I am persuaded by Mr. Sivaraman’s constitutional argument. But, he also raises the question of whether this is the right time to move in that direction. A move forward will depend on how strongly and how convincingly a case can be made in favor of the implementation of Section I of Article XII. We have a lot of homework to do on that score. As to accountability, Mr. Bernes makes a strong case that much could be done to improve transparency and corporate governance, to which I agree.

On the question of the Interim Committee restructuring, I am not sure that this is the most opportune time to raise this issue. Mr. Sivaraman is perhaps justified to see a threat to developing country representation. Any proposal for strengthening or transforming the Interim Committee that carries with it the implication of disenfranchising developing countries contradicts the



spirit of universalism that has been a source of pride for this institution. I support the suggestion that any thoughts on restructuring be left until after the quota formula review has been completed. I find Mr. Sivaraman's argument as well as those of Mr. Wei in this regard compelling.

As to the agenda of the Interim Committee, we favor greater focus on matters that require attention of the Ministers. We have not been careful enough in putting issues to the Interim Committee and, therefore, limiting the number of items on the agenda to allow them to focus on very few issues that are vital in terms of political decision-making will be helpful. We believe that the Executive Board should continue to be responsible for the preparation of the Interim Committee meetings. We can support the involvement of working groups as we would the involvement of Deputies, at least for this upcoming meeting. We believe that two meetings of the Interim Committee will be enough under normal circumstances, but we could support extraordinary meetings as the need arises.

I support Mr. Esdar and Mr. Taylor that restricted meetings should be kept to an exceptional minimum. In this regard, I support Mr. Shaalan's suggestion that Executive Directors should be present in all meetings of the Interim Committee, in particular the luncheon session. I also agree with Mr. Wijnholds's and others' suggestion for prior circulation of the communiqué. I think it would be helpful, although Mr. Taylor has a good point that if the communiqué is in fact circulated ahead of time, it may limit the discussion of the Interim Committee. I do not think that is a worry. In fact, it may focus the debate if some version of the communiqué is circulated ahead of time.

We also support greater representation of multi-country constituencies as associates in the Interim Committee discussions. We support the active participation of the World Bank in the deliberations of the Interim Committee, in particular granting the President of the World Bank privileged treatment, provided we functionally define what that means. In that regard, I was concerned with the content of the World Bank's letter to the Deputy Managing Director. We should try to address the concerns raised in that letter. If more active participation by the President of the World Bank in the discussion of the Interim Committee would alleviate those concerns, I am all for it.

Ms. Lissakers made the following statement:

Several Directors, and particularly Mr. Eyzaguirre and Mr. Bernes, have already made quite eloquently in their grays most of the points that I wanted to raise. There is little, if any, divergence in our views, and I will only highlight a couple of points.

On the efforts to revitalize the Interim Committee, the instructive experience of the G-22 should be emulated.

On the communiqué process, Mr. Wijnholds makes a valid point that the communiqué can become a trap for the discussion, because Ministers feel

compelled to touch on every issue that might be in the communiqué in order to have their views on the record. This is something that we should think about improving.

We favor the active participation of the World Bank in the Interim Committee, as more and more of the issues that we are facing cut across the responsibilities of our two institutions. The question is how best to do that, and that goes to a larger, and as yet unsettled issue, which is the division of labor between the Interim and Development Committees, which in turn is a function of the expected division of labor between the Bank and the Fund. That is a subject of debate, at least indirectly, in the larger architecture discussion. It seems premature to make decisions about organizing in detail the operations of the Interim and Development Committees until there is greater clarity about the division of roles of the two institutions.

I would just make one comment on the letter from Mr. Sandstrom to Mr. Fischer that was circulated to the Board, where Bank management argues that being able to speak for a few moments in the Interim Committee is not a substitute for "being fully involved in the discussion, as well as in the preparation of the agenda papers and issues for ministerial consideration." I am not sure what is meant by this sentence precisely, but if it means that the Bank Board, as well as the Fund Board, would have to discuss all of the papers that will be sent to the members, as well as of the agenda items and policy decisions, then in effect we would have two boards governing the Fund. Both Boards have been involved in the HIPC process, but this reflects the way that the Initiative had to be designed, and we have seen how complicated it is to keep the two institutions moving in tandem. I do not see how it would be workable for this to become the model for most of the substantive issues. My authorities have not thought this proposal through in detail, and this is my preliminary, personal reaction to this formulation of what the Bank management appears to have in mind.

On the Council, I agree with the concerns expressed by Mr. Bernes and others that its establishment would weaken the Board as an effective executive body, particularly if we were to go as far as Mr. Milleron seems to suggest. His description of the division of responsibilities between the two bodies seems to imply that the Board would be left with very little to deal with, and that its authority would be undermined without creating an effective substitute, because Ministers simply cannot perform that executive role. Mr. Bernes raises in his gray more profound questions about the meaning of political legitimacy that have not really been articulated in this debate until now, but questions that should be addressed before moving in the direction of the Council.

Mr. Pickford agreed with Ms. Lissakers that it would be important to try to define more clearly the respective roles of the Bank and the Fund, and noted that he was in favor of clarity of responsibilities and accountability. However, a discussion aimed at specifying a clearer division of responsibilities between the Interim and Development Committees might merely highlight the fact that there were an increasing number of issues that cut across the mandates of various institutions—including the Fund, the World Bank, the BIS, and others—and that the existing fora to discuss them lacked sufficient breath. One example was the financial sector,

with regard to which it had been necessary to set up mechanisms to coordinate the actions and responsibilities of the Bank, the Fund, and the BIS. Therefore, such a discussion would also have to address the questions of governance and political accountability for those broad issues. That should be done, however, in an overarching forum capable of providing advice on, discussing, and supervising the role and actions of the various financial institutions.

The Chairman replied that it should not be forgotten that Article I of the Articles of Agreement of the Fund stated that the Fund provided the machinery for consultation and collaboration on international monetary problems. Nevertheless, it was true that there were issues which were relevant for the proper economic development of the world that were beyond the reach of the Ministers of Finance. Those included trade issues, which in many countries were in the hands of trade ministers, or social issues that might be under the purview of ministers of labor. It would be difficult to ensure the adequate representation of all those interests in an overarching forum in a way that enabled it to address broad issues in the encompassing way suggested by Mr. Pickford. The only solution would be for the heads of government themselves to meet from time to time, to define strategies and distribute tasks among the institutions. That was an issue beyond the scope of that day's discussion.

Mr. Kiekens made the following statement:

What protects countries against contagion is not so much the conditional country-specific availability of Fund financing, but rather the credible assurance given by the Fund that the country's policies are sound, and its economy, particularly the financial sector, strong enough to absorb shocks to its external position.

Such assurance by the Fund should be given primarily on the occasion of Article IV consultations. Those evaluations of a country's macroeconomic policies will progressively be complemented by assessments of the country's compliance with international standards for data disclosure, financial sector supervision, fiscal and monetary policies, and other structural features relevant for the well functioning of the economy. Obviously, one of the strongest assurances the Fund can give about the soundness of a country's policies is a precautionary stand-by arrangement.

I still see little need to create a new facility under which the Fund would commit itself to provide balance of payments financing in excess of normal access limits to countries that are following sound policies but could be threatened by contagion. Such countries already have access to precautionary stand-by arrangements with normal access limits. If exceptional balance of payments difficulties emerge due to sudden loss of market confidence, these countries are additionally entitled to financing above access limits through the Supplemental Reserve Facility, provided they can agree on additional adjustment policies if needed. In the rationale of the proposals before us, the mere existence of the SRF policy provides protection against contagion for countries receiving a good assessment by the Fund.

That being said, creating a new Contingent Credit Line or "precautionary window" within the Supplemental Reserve Facility is, in my view, only a relatively minor and acceptable change in present Fund policies,

provided access to CCLs or precautionary SRFs is subject to the same strong conditionality as present upper credit tranche arrangements, including regular performance reviews. Failure to complete a review should suspend access to the CCL or precautionary SRF. In addition, it is essential that if a crisis occurs, actual drawings of exceptionally large amounts should be subject to the completion of a comprehensive review of the country's policies and of its ability to repay the Fund. However, we should be aware of some possible negative side effects of CCLs and precautionary SRFs. The first such side effect is that at the moment of crisis, the Fund may be in a difficult position to require needed policy adjustments for countries whose economic policies it previously assessed as sound. A second possible side effect is that market participants could erroneously believe the CCL is a firm commitment by the Fund to provide large sums of financial assistance, while in reality it is little more than a commitment to negotiate, when a crisis strikes, about a program that could justify such a large financial assistance. This brings me to the issue of moral hazard.

As under the SRF, the country should seek to maintain or regain private sector credit to complement the Fund's exceptional financing. Effective burden sharing with the private sector in cases of crisis is essential to limit moral hazard. For this reason, we should consider postponing the adoption of a CCL instrument or amending the SRF decision until we have made progress on the issue of the private sector's role in forestalling or resolving financial crises.

I agree that a country will only be able to obtain a CCL or precautionary SRF for one year at a time, of course with the possibility of renewal.

Let me repeat my opposition to the suggestion that access to the CCL or the precautionary SRF must in principle be complemented by official bilateral credits. Official financial balance of payments support should in principle come exclusively from the Fund, through its general resources, supplemented if necessary by resources the Fund borrows under the NAB and GAB. A new quota increase should be considered if the Fund's liquidity position requires it.

In sum, I see no urgent need to add new lending instruments to the Fund's existing policies with respect to precautionary SBAs and the SRF. But at the same time, I view the introduction of a contingent credit line or a precautionary window under the SRF as relatively small and acceptable adjustments to the Fund's present policies, provided that access conditions to such credit lines remain as strict as under present SBA policies, and that any actual drawing above normal access limits is made conditional on a comprehensive review of the adequacy of the member's policies and its ability to repay the Fund. Between those two options, I prefer amending the SRF decision to make precautionary SRFs possible.

Mr. Faini made the following statement:

The discussion so far has shown that we share many objectives, some of which were already at the heart of the founding fathers at Bretton Woods, and some of which are probably relatively new.

One of these objectives is the strengthening of the political legitimacy of this institution. Here we had a lively exchange between Mr. Bernes and Mr. Mirakhor, and I do not need to reiterate the very good points that were made. Let me just observe that the Interim Committee has in its history fulfilled much more than a simple advisory role. It has provided substantial guidance to this Board during the debt crisis in the 1980s, during the process of transition of the previously planned economies into a market-based system, and during the most recent events. Can we further enhance this political role? This is the question that we are faced with, and to which we will have to find an answer.

The second objective that I believe we all share, and which was perhaps was not a concern years ago, is greater coordination with other bodies. In the last 20 years, the Fund has moved into new policy areas, and other institutions have had to address some issues that are well within the purview of the IMF. While we agree on the objective, the discussion has shown that there is, unfortunately, little agreement on the way to proceed. No broad consensus has been reached on either the Council, an overarching committee which would oversee both the Development and the Interim Committees, or the proposal to give the Interim Committee a two-hat structure, whereby it would not only advise the Fund but would be in charge of coordinating its activities with other bodies. The Chairman of the Interim Committee, Mr. Ciampi, is trying to make a devoted and strong effort to build a consensus, and in light of his efforts, it would not be appropriate for this chair to come up with any specific proposals.

The short-run objective of Mr. Ciampi and of this chair is to make sure that the Spring Meetings will be fully successful, and I welcome many of the proposals which have been put forward here in that regard. I believe that this Board has a major responsibility in the next few weeks to work toward resolving in a constructive and productive way those issues that will play a critical role in the discussions of the Interim Committee which are still unresolved. Again, in the spirit of ensuring that the Spring Meetings will be successful, Mr. Ciampi has proposed that a special informal meeting be held at the deputy level to take stock of the work of the Executive Board on the agenda of the Interim Committee—which by then should have been largely completed—iron out differences, resolve misunderstandings if possible, and strengthen the political involvement of ministers and their deputies. We have been encouraged by the support that this proposal has received. Mr. Ciampi has received letters from about half of the members strongly supporting this suggestion, and I could see that there was broad support for this idea today as well. Therefore, a new letter will be sent to the members of the Interim Committee, to propose a date for the preparatory meeting. Two people from each constituency will be invited to attend. Here, we face a delicate tradeoff. Mr. Guzmán-Calafell said in his statement that larger meetings are welcome, and clearly, the tradeoff is that small meetings are more productive, but larger meetings are more inclusive. We have decided to compromise and invite two people per constituency. The meeting, as many people have said, is of an extraordinary nature. It is a response to a set of circumstances which we will all agree are quite unusual. Its agenda will closely reflect the work program and agenda of this Board, with a view to ensuring the successful conclusion of the Spring Meeting.

The Chairman thanked Mr. Faini for his clarification of the views of the Chairman of the Interim Committee, but suggested that the Executive Board would need to return to some of the organizational details related to the envisaged exceptional preparatory meeting, perhaps after it agreed on the agenda for the Interim Committee. In particular, it would be essential to clarify the extent of participation of the members of the Board. They should, preferably, be the spokespersons, but if that was not possible, then they should at least be present. Moreover, it would be important for the preparatory meeting to be held toward the end of the work of the Board, but soon enough to allow it to meet at least once afterwards to wrap up the preparations for the Interim Committee discussions themselves. The latter should, of course, be based on documents or principles approved by the Board, as the preparation of that work was part of the constitutional role of the Executive Board.

In addition, he did not agree with Mr. Faini's suggestion that, because there was a lack of consensus on any of the diverse suggestions to strengthen or transform the Interim Committee that had been mentioned that day, some of them for the first time, decisions on those matters should be taken elsewhere, the Chairman stated. The Board should not be allowed to put aside such important deliberations, particularly at a time when the objective was to strengthen the Fund and its organs.

Mr. Milleron made the following additional remarks, in response to comments from Executive Directors on his initial statement:

At the end of this discussion, I am both pleased and a little frustrated. I am pleased because the paper presented by the staff fostered an interesting discussion, and because valuable suggestions have been made to improve the functioning of the Interim Committee. I am a little frustrated, however, because our conclusions have fallen short of what is necessary. It seems to me that we remain with something that I would call a black hole, which we do not want to look at.

Let me try to explain. There is no question that the responsibility for the operational work of the Fund should remain with this Board. There should not be any ambiguity about that. On the other hand, the Board of Governors has no operational responsibilities at all, and very limited scope to supervise the evolution of the international monetary. Between these two levels, there are political issues—in the deep sense of the term—that have to be addressed, and that have not been addressed up to now. Moreover, I would not hesitate to say that there are also questions related to ethics and democracy. Transparency, for instance, is related to ethics. As a well-known French politician said, “clarifier, c’est moraliser.” (A rough translation into English would be that, “to clarify is to edify.”) Moreover, many issues related to the consequences in terms of equity of the decision that we are preparing need to be considered, particularly in the context of the discussions that we have with our colleagues in the Bank.

Other issues are related to democracy because they raise questions about the role of the state and the limits of that role, as well as about the meaning of the real involvement of the private sector. Moreover, better ways must be found to ensure that the views and concerns of emerging market and small economies are presented adequately in deliberations on the international monetary system, and that the latter are not appropriated and controlled by ad

hoc groups with limited representation and accountability. That is certainly one question that we should have addressed today in one way or another, and which we did not. I do not agree with those who thought that it would be sufficient to introduce some additional flexibility into the current arrangements for representation and that further steps could be considered later. I would say that it is urgent and that we should not wait. One reason is that it is paradoxical for the most accountable group of representatives to an organ of this organization—those Ministers that are elected—to have a merely consultative or advisory role through the Interim Committee. This is difficult to explain and justify to outside observers, who perceive as a result that the Fund is ruled by technocrats.

In this spirit, I hope that the Secretary might be able to provide us with a little more analysis on the issues related to the Council, with respect to which the discussion in the paper was a little brief. In particular, it would be useful to consider further the difficult question on the articulation of the respective roles of the Executive Board and the Council.

Ms. Lissakers remarked that she did not feel that she herself lacked legitimacy, as she was appointed by the President of the United States and confirmed by the legislature. Moreover, her chair was certainly concerned with fostering a broader participation of the Fund's membership in all of the discussions on major architectural and international financial issues. That was one of the reasons why the G-22 meeting had been convened, and she considered that the proliferation of fora that other chairs had commented on with alarm had been extremely useful and constructive in that regard. It had helped to establish a broader basis of consensus on some critical issues, and to move the debate on architecture forward. Moreover, the Council might not resolve the constituency and representation issue in the way imagined; nor was it precluded that more creative approaches could be taken to the organization of Interim Committee.

Mr. Milleron agreed that Ms. Lissakers' legitimacy was not in question, but noted that it was an indirect legitimacy. He should have specified that he was referring to those that had direct elected legitimacy.

Ms. Lissakers remarked in this connection that, as Mr. Bernes had pointed out, one-third of the Council would consist of independent central bankers who were not elected.

Mr. Milleron replied that the objective should be to find ways to enhance ownership by involving those that did have direct elected legitimacy more deeply in the work of the Fund. The question of how to strive for the same objective through central bank governors also needed to be considered.

Mr. Bernes observed that many of the questions that were being posed, and for which answers were being proposed, were not well defined. It would be important to clarify them before proceeding. In particular, before proposing ways to enhance legitimacy or ownership, one should examine why they were perceived to be lacking. A paper on the possible relationship between the Board and the Council would be premature as long as some of those fundamental questions remained.

Mr. Milleron agreed that questions on broad fundamental issues such as transparency and governance remained. However, it might be easier to address them by identifying limited, specific elements for which solutions could be identified.

The Chairman observed that Directors had raised issues that touched the core of the Fund's institutional foundations. Therefore, he agreed that it would be useful if the staff could return to the Board with a more elaborate analysis of the issue of legitimacy, with regard to which Mr. Bernes had shared some very thought-provoking reflections; as well as of the legal issue of the relationship between the Executive Board and the Council. Directors would be informed of when and how they would be provided with the necessary elements to discuss those two issues further.

The Secretary remarked that, while some issues needed further elaboration and would have to be returned to, the meeting had not been inconclusive. It had focussed well on the central issue raised in the paper, which was how the constitutional structure of the Fund, and the relationship between its different organs, could be improved. In that regard, three main topics had been addressed: how to make the Interim Committee more inclusive and dynamic; how to enhance legitimacy and ownership within the Fund's mandate; and how to administer the relationship with the World Bank.

With regard to the first topic, the question was how to ensure that the Fund could play the central role that had been envisaged for it in a changing international system, the Secretary explained. The Committee of Twenty had felt that a body with decision-making power at the political level like the Council would best ensure that the Fund could adapt effectively to any changes and challenges that might arise. Since then, however, there had been a broadening of the participants in the global economy—with a proliferation of small and emerging economies, as well as with the greater role of private actors—which made it more difficult to ensure that all views were adequately included in deliberations on the international monetary system. There had also been a broadening of the issues that were relevant to the global economy, which required greater coordination with other institutions. As the Interim Committee appeared to be having some difficulty in responding to those two challenges, it was relevant to consider whether the Council might be better suited to address them, or whether other solutions were available that would preserve the central role of the Fund.

To that end, it was crucial that the Fund be perceived as being able to credibly administer the system, and follow through on political decisions, the Secretary continued. It was in that context that the concept of legitimacy became important. It had been noted that legitimacy could be defined in many ways; what seemed to be in question where the Fund was concerned was not its institutional mandate, but rather whether there was sufficient political backing to the decision-making process of the Fund, and a resulting sense of ownership by members of its decisions. In that connection, Directors had raised the interesting issue of the difference between those representative to the Executive Board or the Interim Committee that were directly elected, and those that were appointed. Those complex issues could be examined more closely in a separate discussion, as requested.

On the relationship of the Fund and the World Bank, Ms. Lissakers had expressed concern about the proposals for full participation of the Bank in the Interim Committee process, the Secretary noted. The Bank had suggested that its role in the Interim Committee should parallel the Fund's role in the Development Committee. It should be noted, however, that that analogy was somewhat inappropriate because the Development Committee was a



joint committee of the two institutions which had been established by separate resolutions of the two Boards of Governors, while the Interim Committee was a Fund's only organ. Moreover, it would not be possible to make the Bank a "member" of the Interim Committee, as suggested by Mr. Milleron, because an institution could not be a member of the committee, and the members of the Interim Committee are drawn from the Fund's membership. Nevertheless, broad support had been expressed for giving the president of the World Bank privileged treatment with respect to participation in the Committee's discussion, and many Directors considered that he should be given the right to speak. It had been noted that the issue of the overlap in the mandate of the two institutions needed to be handled pragmatically.

Finally, a paper would be prepared on the issue of the relationship between the Council and the Executive Board, the Secretary confirmed. Many of the questions that had been asked in that regard were of a legal nature. Those legal aspects were spelled out in the Articles. The paper would particularly focus on general issues raised by the envisaged legal structure, including how to clearly define operational versus strategic issues.

The Acting Chairman made the following summing up:

Directors welcomed the discussion on issues relating to the governance of the Fund. In particular, it was stressed that the Fund—as an organization with universal membership—must remain at the center of the architecture of the international monetary system. Indeed, as stated in Article I of the Articles of Agreement, the Fund provides "the machinery for consultation and collaboration on international monetary problems." Noting the significant role that the Interim Committee has to play in providing leadership to the international community, Directors welcomed the efforts to enhance the Committee's effectiveness.

In view of the importance of the forthcoming Interim Committee meeting—and, in particular, the need to move forward on the efforts under way on the reform of the international monetary system—Directors saw merit in the proposal to have a preparatory meeting at the Deputy level prior to the April Interim Committee meeting. Such a preparatory meeting would, in particular, take stock of the progress in the work on the issues on the agenda. At the same time, several Directors stressed the central role of the Executive Board, and that the preparatory work for the Interim Committee must proceed in accordance with the Board's Work Program. In conclusion, the Executive Board noted the proposal that there be a meeting of officials from capitals a few weeks prior to the ministerial meeting; following that preparatory meeting, the Executive Board would meet to wrap up the preparations.

Looking beyond the forthcoming meeting, there was broad support for maintaining the present practice of holding meetings semi-annually. Ad hoc meetings might be considered, but only if they were needed. In line with the efforts to enhance participation and representation at the Interim Committee meetings, Directors generally did not favor holding meetings with restricted attendance.

In general, Directors felt that, while procedural changes could help to improve the quality of the meetings, the scope for real change lay elsewhere. In

particular, the strength and success of the meetings depended on their substantive content. To that end, a streamlined agenda, focusing on a few key issues that required ministerial attention, would be essential. At the same time, it was noted that the assessment of the effectiveness of the Interim Committee should not focus only on the meetings per se, but should include the entire process whereby the Executive Board reports to, and seeks guidance from, the Interim Committee.

On the membership of the Interim Committee, Directors agreed that it was important to maintain the constituency-based structure of the Committee, which was a reflection of the constituency structure of the Board. They noted that the Committee's constituency structure provided sufficient flexibility to allow for greater participation by the membership at large. One possibility that could be explored further is to make arrangements within constituencies so that countries that are not members of the Committee can also actively participate in its deliberations, but it would be up to the individual constituencies to decide the nature of these arrangements. Several Directors thought that revisiting the issue of representation and the composition of the constituency structure should await the outcome of the review of the quota formulae.

Directors generally welcomed the suggested changes that were aimed at making the meetings more participatory by including a larger number of officials. In that context, they noted that, as the Fund was addressing issues that required cooperation and coordination with other organizations, it was useful to have representatives of relevant organizations attend the meetings. It was noted that the Chairman of the Interim Committee could use his discretion to allocate, depending on the issues on the agenda, a specified period of time to statements by selected observers. Directors agreed with my suggestion that, in view of the unique relationship between the Fund and the World Bank, it was appropriate to give the President of the Bank privileged treatment with respect to participation in the Interim Committee's discussions, and to hear from other observers, including from the Chairman of the newly-created Financial Stability Forum, who—as the General Manager of the Bank for International Settlements—already attends as an observer.

Furthermore, as some of the architecture issues require input from and close cooperation with others in their fields of expertise, the suggestion was made to create some mechanism that would facilitate work between the Fund and experts on these issues. This could be achieved by establishing working groups of the Board, which could include officials from capitals and/or experts.

Some Directors expressed dissatisfaction with the communiqué process, and offered suggestions to improve it: while a few Directors felt that the drafting could be done prior to the meeting, others thought that efforts should be made to make the communiqué more reflective of the actual discussions at the meeting itself.

Directors took note of the various proposals put forward on the relationship and division of labor between the Interim and Development Committees. A few Directors supported the idea to make the Development

Committee a Bank-only Committee. In general, Directors felt that the constitutional overlap between the Interim Committee and the Development Committee had been handled pragmatically thus far, and should be continued. They considered that it was up to the respective Committees to suggest ways to improve their own work. In that context, it was important to focus first on the appropriate division of tasks.

Directors held diverse views on the Council:

The majority of Directors was still unconvinced at this stage of the merits of establishing a Council, noting that the Interim Committee, despite the absence of decision making powers, in effect already discharged the responsibilities envisaged for the Council. Several felt that the present institutional structures did provide the necessary legitimacy and accountability, and that emphasis should be placed on enhancing these structures, as well as, more broadly, on the pressing issue of reform of the international monetary system. Some Directors thought that further analysis was needed to come to a judgement on the establishment of a Council, and noted in particular the need to explore the impact of the Council on the work and responsibilities of the Executive Board.

A few other Directors, however, felt that it was important to have the involvement of Fund members at a political level to take decisions on key strategic issues. In particular, this would strongly underline legitimacy and ownership in the Fund's decisions and the accountability of the institution. These Directors were in favor of moving ahead on the decision to establish the Council, as provided for in Article XII, Section I of the Articles of Agreement. In their opinion, this would respond to the calls for strengthening the institutional structures of the international monetary system, and send a strong signal of progress in this area.

I would suggest that we proceed with the following:

- the preparation and discussion of the agenda for the Interim Committee;
- a report to the Interim Committee on the state of our discussions on strengthening and/or transforming the Interim Committee;
- and, that we return with an analysis of the issue of "legitimacy", and the relationship between the Executive Board and the Council.

## **2. CONTINGENT CREDIT LINE—FURTHER CONSIDERATIONS**

The Executive Directors considered a paper on further considerations toward a contingent credit line (SM/99/54, 2/24/99; Sup. 1, 3/9/99).

Mr. Faini made the following statement:

We welcome the opportunity to further discuss the Contingent Credit Line. In our earlier discussion, this Chair argued that the design of a

precautionary facility faces a virtually insurmountable challenge, namely to reconcile the objective of preventing financial panic from spreading across markets with the need to prevent excessive risk-taking by private agents. There is no perfect solution to this problem. Whatever the proposed solution, it will not satisfy all needs. Yet, exactly because of this “intrinsic impossibility,” we need to take a constructive approach and work toward a feasible albeit imperfect solution that will strike a delicate balance between conflicting but equally valuable objectives.

This Chair was quite critical of the early paper on the CCL. We still believe that the January proposal was strongly unbalanced on many accounts. We would argue, however, that the new revised proposal addresses many of the concerns expressed by the Board at that time with regard to the definition:

- a) of the eligibility criteria (thereby limiting possible adverse selection effects);
- b) of the conditionality attached to the facility (thereby addressing the concern about borrowers’ moral hazard); and
- c) of the private sector involvement (thereby limiting moral hazard problems on the creditors’ side).

#### Eligibility

Currency crises may be caused by weak fundamentals or by a self-fulfilling shift in expectations. The CCL should be designed to help countries with sound fundamentals vulnerable nonetheless to a speculative attack. Consequently, eligibility criteria must be based on an adequate analysis of fundamentals.

As imperfect as it might be, the literature on currency crises and “early warning indicators” shows that a broad range of variables must be monitored to assess the soundness of economic fundamentals. In our view, both the eligibility to the CCL and its size should then be determined by a set of sustainability checks that would include: a) the evolution of the real exchange rate, b) the level and the composition of public debt (both domestic and foreign), c) the level and the composition of external debt (allowing for the presence of collective action clauses in the case of securitized debt), d) the share of short-term external debt unmatched by private contingent credit lines, e) commercial banks net foreign asset position (and, whenever feasible, their position in derivative markets), and f) the evolution of domestic credit over GDP. The list is only suggestive. Additional variables may be introduced. Also, in forming their judgement, the staff and the Board would be expected to consider not only the “level” but also the recent development of these variables.

#### Involving the private sector

Appropriate private sector involvement should be a key feature of the CCL, as restated by a number of groups including the G-7. In this spirit, we

would argue that private sector involvement should not be seen simply as a separate or an additional issue in the design of the CCL. On the contrary, how the private sector will be involved must be an intrinsic part of the structure of the CCL.

We agree with the staff that at this stage “we cannot be definite on how the private sector might best be involved in this context” (emphasis added). Nonetheless, we can be more specific. The staff paper states, on p. 6, that “the size of the CCL would depend on whether or not the member seeking the CCL has succeeded in obtaining additional or contingent financing from other private creditors.” This sentence is open to interpretation. Does the staff imply a positive or a negative relationship between private and official contingent financing? In the latter case, with a negative link, the size of the CCL would be larger in the absence of private contingent financing. Accordingly, there would be little or no incentive for countries to seek private contingent lines of credit or for private creditors to grant such financing. Moral hazard problems would be greatly exacerbated. Admittedly, as the staff states, “it would not be reasonable to require that a member availing itself of a CCL secure contingent financing from private creditors” (emphasis added). It would be extremely reasonable however to include the existence of private contingent financing among those criteria that would enhance the eligibility of countries to the CCL. The availability of a private contingent credit line would then be seen as an improvement in the country’s fundamentals, thereby reducing its vulnerability to a speculative attack.

In our view, the CCL should also stipulate that: i) members with large stock of short-term foreign debt would not in general be eligible unless they have secured private contingent financing and ii) members seeking contingent financing from the Fund should make a good faith effort to secure private contingent financing.

As a whole, these provisions would give members an incentive to seek an agreement with private creditors. Conversely, private sectors would be more willing to provide private contingent financing, under the expectation that their investment would then be protected by IMF conditionality. All parties would have an incentive to enter into such an agreement. Also, moral hazard problems would be less severe compared to the case where the private sector is not involved. Other forms of private sector involvement (collective action clauses, call options) in addition to private contingent credit lines could also be considered in assessing the eligibility of a member to the CCL.

#### Conditionality

We welcome the acknowledgment that the first phase of the CCL should envisage a process of close monitoring of the member’s policies and economic conditions through quantitative and possibly structural benchmarks. We also support the notion that the activation of the CCL will require a Board review and, if necessary, the review of conditionality. The need for additional conditionality will arise for instance when “contagion” comes, as it often does,

with a loss of competitiveness. Such pressures must be met through an appropriate mix of external financing and adjustment.

#### Augmentation or Commitment Options

The staff's preference has somewhat changed compared to January when either the Augmentation or Commitment Options were retained. Contrary to the staff's view, we favor the Augmentation Option. We believe that the Commitment Option leaves little room for flexibility in response to changes in external conditions and in countries' policies. Yet, flexibility is needed mostly in a context where the Fund signs a contract with a country without having full control over the actions of the agents and without knowing all the information that the agents may have. The adoption of the commitment option would, in our view, severely weaken the design of the CCL.

#### New facility or precautionary SRF

We remain unconvinced of the legal arguments in favor of the creation of a new facility. Even in the case of policy failures, the Fund would still retain the option to demand the adoption of a strong program before granting access to the SRF component of the CCL.

The establishment of the CCL responds to the twin objective of avoiding financial panic and preventing countries from responding to balance of payment crises with measures that restrict trade and capital flows and that would ultimately be detrimental to their economic welfare. The international community must show its readiness to support its members in a turbulent economic environment. At the same time, the design of the CCL must solve a delicate trade-off, to the extent that the prevention of financial panic may exacerbate moral hazard problems. There is no perfect solution to this trade-off. The perfect, however, should not be the enemy of the good. The revised paper makes substantial progress on a number of crucial issues. We must continue work on this area as a matter of great urgency.

Mr. Shaalan and Ms. Abdelati submitted the following statement:

We welcome this second discussion of a mechanism that would provide assurances to members pursuing sound economic management, yet facing possible external shocks, that resources would be available in a timely manner and in appropriate amounts in the form of a contingent credit line. The availability of a properly designed mechanism or facility could prevent or reduce the adverse contagion effects stemming from volatile market reactions. But future crises in all likelihood will occur. There are of course risks, and we should be aware and take account of these risks when framing the structure of such a credit line and in its presentation. First, care must be taken to ensure that private market players do not see the approval of a CCL as foreshadowing an imminent crisis. Second, and as we pointed out in the preliminary discussion last January, approval of a CCL could become a destabilizing factor if it leads to higher inflows than otherwise, thereby setting the stage for sudden massive

outflows. Is there a need for a new facility or can contingent credit lines be accommodated within existing facilities?

In the last discussion on the subject, we favored the FMP option over the Commitment or Augmentation options and in that regard, we noted that the negotiation of a formal arrangement involving access to financing might give a perverse signal to the market -- namely that a potential crisis is looming. We find the arguments presented in paragraph 4 and 5 against the FMP option not very convincing. The staff believes that an FMP program could be perceived as weak and not as strong as programs with upper credit tranche conditionality, and the endorsement would be weaker because of the absence of an up-front purchase. We see no reason why such programs and endorsements should not be maintained at the required strength. Furthermore, we do not see why "there is a risk that the standards applied to Fund endorsement of FMPs could, over time, be eroded and fall below those that would be expected to apply in the context of an arrangement". Equally important to ensuring the strength of the program and of our endorsement, we would note that timeliness of response is an equally critical element to consider in comparing options. Activation of the Credit Line under the Commitment Option would entail a review of policies and elaboration of additional measures with related conditionality, and therefore the time needed in preparation for Board consideration would probably be about the same as that entailed in either switching from an FMP to access through a Credit Line, or augmenting an existing arrangement. Therefore, we see no reason to favor one option over another on the basis of strength of the program or timeliness of response and we still find considerable merit in the FMP Option. If, however, the staff still finds difficulty with this option, we would have no problem in going along with the Commitment Option.

While the eligibility criteria described in paragraphs 7 and 8 are somewhat more explicit than in the last paper, they still seem operationally difficult to apply and so restrictive that few, if any, members would unequivocally satisfy them. For one thing, it is not clear what is meant under (c) by "the member..has maintained constructive relations with private creditors". This phrase would seem to require further clarification. Second, in elaborating the eligibility criteria, the paper attempts to make a clearer distinction than the earlier paper between countries that are experiencing a balance of payments crisis due to policy shortcomings and those who only need a precautionary line of credit. We believe that this distinction will always be a difficult one to make and we need not go too far to find an example to illustrate this point. If we had this facility in place two years ago, it is most likely that a country like Korea would have been eligible particularly on the basis of the assessment in the most recent Article IV Consultation. In retrospect, however, after the onset of the crisis, we have learned of the pre-existence of shortcomings in policies and structural weaknesses that weakened the country's resilience to contagion effects. This experience would call for caution against providing a positive a priori endorsement of a member's overall policy stance. A positive endorsement that soon proves incorrect would endanger the credibility of the CCL and of Fund endorsement more generally. Indeed, we think it would be very difficult to provide such a priori endorsement to the vast majority of the membership. In this connection, we would be interested in

knowing the countries which the staff consider to be “potentially eligible” based on the proposed criteria referred to in Section IV.

We see three essential characteristics that a CCL must have at the time of activation. The first is that speed must be of the essence even though a thorough re-assessment of developments since approval of the credit line will be necessary. The second is that appropriate conditionality must be identified. The third is that involvement of the private sector involvement. The latter is a very complicated matter. Unless we have a workable system to which banks and other creditors can agree to, we would have reservations on providing a facility that may amount to bailing out the private sector. This issue does not seem to be adequately addressed in the staff paper, perhaps because it was intended for a separate discussion. We would have liked to see reference to the suggestions we made during the preliminary discussion in January with respect to exploring the options of a voluntary or mandatory roll-over or standstill as a regular feature of such a credit line, or an evaluation of the still ongoing Brazilian experience.

As to whether we should establish a new facility, we maintain our previous position that existing facilities can accommodate the objectives at hand here. As noted earlier, from the perspective of substance, we do not find a convincing justification for staff's position. The possibly compelling reason for a new facility is psychological in nature, namely to distinguish the role of a new facility from that of an SRF, where crises arise out of problems that are not beyond the member's control including policy failures. Presumably, this objective could also be achieved through a precautionary credit line provided under existing facilities. Let us remind ourselves that the first item under the eligibility criteria mentioned in paragraph 7 refers to the precautionary nature of the member's request for use of Fund resources based on the fact that there is no immediate balance of payments need. Therefore, the fact that there is no immediate balance of payments need would in itself be seen as a sufficient distinguishing factor to differentiate the situation of such countries from that where the member requests an emergency SBA or EFF supplemented by an SRF after the onset of a crisis. Argentina is a good case in point of a precautionary arrangement which could be speedily augmented by SRF funds if the dangers of contagion materialize. We would appreciate staff views on the viability of this approach.

Mr. Bernes made the following statement:

Events in financial markets over the past year have demonstrated the inadequacies of the international financial architecture to deal with the potential damage that sudden and substantial reversal of capital flows can inflict on the global economy. The challenge is to reform the system in such a way that would preserve the tremendous benefits of globalization and the free flow of capital, while reducing the likelihood and severity of financial crises.

A prominent cause of financial distress, as was evidenced in Asia and Latin America over the past twelve months, is the loss of confidence in the ability of countries to service their external obligations. In most cases, the loss



of confidence is caused by inappropriate domestic macroeconomic policies and structural weaknesses which should be addressed by policy adjustments supported by some financial assistance if necessary. But, in a globalized capital market where necessary information is not always available and herd behavior is prevalent, countries that pursue sound policies can also be sideswiped by a general loss of confidence by international investors. The proposal to establish an IMF contingent credit line (CCL) intends to help these countries and prevent contagion.

Countries that qualify for the CCL receive, in effect, a seal of approval for their policies from the international community. This implicit expression of confidence in an economy that is subject to contagion together with the availability of a large amount of funds might reassure international investors and prevent a financial crisis from spreading. I share the concerns of those who point to the potential moral hazard that the CCL entails and the tremendous strain that it could potentially bring on the Fund's financial resources. These concerns can be addressed, however, by designing the CCL in a way that would limit its use. To achieve this, the CCL should be based on strong and well-defined eligibility criteria.

#### Modalities of the CCL

While in principle the FMP, the Augmentation Option and the Commitment Option can all provide a contingent credit line if they are designed well, I agree with the staff that the Commitment Option would potentially have the largest impact on markets through a firm commitment of a large amount of resources up front.

#### Eligibility criteria

I fully agree with the staff that adverse selection must be avoided to ensure that the CCL is used for the purpose that it is designed. Approval of CCLs for countries that are subsequently found to have serious policy weaknesses will quickly undermine the ability of the CCL to boost market confidence. The usefulness of the CCL will suffer if it is used in circumstances other than those in which a very high degree of certainty exists regarding the underlying economic health of the borrower. However, the staff's proposed eligibility criteria do not provide an effective blue print for screening the applicants for this facility. It is true that it is ultimately up to the Executive Board to decide whether a country is eligible or not, but before a proposal comes to the Board the staff should be able to make its own judgement and screen the applicants on the basis of objective criteria.

In my view, it is absolutely critical that a CCL candidate, in addition to having sound economic policies, adheres to agreed international standards (e.g., SDDS, fiscal and monetary policies, and banking standards). The standards help ensure that the member's sound economic policies are sustainable, which is a precondition for the CCL. I recognize that the standards are evolving and more progress is needed. However, one can assemble a set of minimum

standards for the CCL, which could be augmented in the context of an adjustment program if the member decided to activate the CCL.

Moral hazard risks of establishing the CCL are evident. To reduce these risks and the potential burden on Fund resources, access to the CCL should be made contingent upon the member taking measures that would ensure the involvement of private sector creditors. While many of the proposals that have been put forward and being discussed in various fora are complex and may require lengthy negotiations and, in some cases, legislative actions, the proposal to establish private lines of credit is relatively simple. This, in principle, would reduce the need for official assistance and directly involve the private sector in the prevention and the resolution of financial crises. Knowing that they have promised to provide more financing in the event of a crisis, private creditors might be expected to monitor the activities of borrowers in a more scrupulous and continuous manner, and be less inclined to race for the exits at the first sign of trouble. I recognize that the banks may offset their exposure associated with the credit line through various means, but this would not leave the country any worse off than in the absence of these credit lines.

#### Activation

Activation should be based on clear evidence that the member has lost access to capital markets, and that it has taken the necessary policy steps. The activation should be accompanied by an adjustment program, the content of which can be determined on a case-by-case basis.

Footnote 6 in the staff paper states that members can request access to the credit tranche resources committed under the CCL without activating the CCL. There is an inherent inconsistency in allowing members to use credit tranche resources and have access to the CCL. A request to use only the credit tranche resources is an indication that contagion is not the cause of the member's difficulties, and that it requires an adjustment program under a stand-by or an extended arrangement. In this case, the access to the CCL should be canceled.

#### Amount, phasing and terms

I agree with the staff that the terms and the phasing of the CCL should be the same as those under the SRF. More stringent terms, while desirable, may not be feasible as members in need of financial assistance can cancel their access to the CCL and request an arrangement under the SRF. I also agree that access to the CCL should be available for one year. If conditions warrant, the access could be renewed. When the CCL is activated, the resources should be made available over a year from the date of activation.

Given that the CCL is designed to deal with a loss of confidence and not an identifiable balance of payments gap, it is difficult to determine the size of a CCL for a specific member. However, Fund resources are limited and the staff's illustrative analysis of the impact of the CCL on the Fund's liquidity reveals the potential difficulties that the Fund may face if a number of CCLs

are activated at the same time. In this context, I would like the staff to explore the possibility of setting a ceiling for access under the CCL, as well as under the SRF.

#### Establishing the CCL

While establishing the CCL by creating a window within the SRF is a simpler approach, I would agree with the staff that a separate facility would be more appropriate. The SRF is designed for countries that are in need of policy adjustment whereas the CCL is an insurance against possible disruptions in the future. The success of the CCL depends in part on markets' understanding of this distinction. As I noted earlier, the CCL should be looked at as a seal of approval for the member's policies, which cannot be done if we use the SRF as the vehicle to provide contingent credit lines.

Mr. Guzmán-Calafell made the following statement:

I would like to start by commending the staff for the speed with which they are moving in delineating the features of a new contingent credit line at the Fund. I am convinced that the design of a mechanism aimed at providing additional protection to those countries with fundamentally sound economies but which are concerned by the potential effects of contagion, can represent an important stabilizing element in the world economy. The establishment of a contingent credit line at the Fund would foster market confidence and macroeconomic stability by encouraging member countries to negotiate programs with the Fund, and by signaling the availability of substantial amounts of resources to face speculative attacks arising from contagion. Therefore, the CCL can represent a central component of our efforts of crisis prevention.

I fully agree with the staff that the Commitment Option is the preferable model for a credible CCL. I mentioned during our previous discussion of this issue that in my view any window of this nature must be accompanied by a strong economic policy stance, the full commitment of the Fund to the member's program, and the availability of large scale external financing. Among the alternatives included in the paper, the Commitment option is the only one that meets all these criteria, thus implying the safest way to strengthen confidence and prevent contagion.

The specification of the particular characteristics of the CCL presents different degrees of difficulty. In some areas, for instance the definition of amounts and terms, the most reasonable route to follow is to adhere to the approach implemented with the SRF and to adjust it as needed in light of the experience. In other cases the issue is not as clear. I have some concerns in particular regarding the issue of eligibility. Here a delicate balance must be achieved between the need to limit access to the facility to those countries whose economies are fundamentally sound, on the one hand, and to set these criteria realistically to avoid excluding unfairly some possible candidates, on the other. While I can see the rationale for most of the criteria in this respect included in section III of the paper, I have serious doubts regarding the merits

of incorporating as a condition for access to the CCL the expectation that the member will not need to use Fund resources under prevailing circumstances and policies. This would automatically exclude from the CCL all countries under traditional Fund programs that are using Fund resources. According to the paper, "for a member seeking the CCL there must be evidence that its economy and policy stance are in good order." It is not clear to me that the use of Fund resources automatically implies the opposite. For this reason, I think this should not be an element for determining eligibility under the CCL. At the very least, this condition should be interpreted flexibly.

The staff suggests that those countries not satisfying the eligibility criteria for the CCL should be given the option of negotiating precautionary SRF's. I fully support this proposal. I have stressed on several occasions that the fact that the SRF cannot be used under present circumstances for preventive purposes represents a major limitation of this facility. In this respect, it will be important to make very clear to markets that the use of the SRF is not restricted only to countries in crisis.

The staff argues that members should have access to the CCL for only relatively short periods of time, and no more than one year, as in the SRF, is proposed. Since this period seems too short, the provision for extension for up to one year as suggested in the paper is essential, and a similar feature should be incorporated to precautionary SRF's.

The search for means for an adequate involvement of the private sector in the context of Fund supported CCL's is very important, and I look forward to our upcoming discussion of this subject. At this stage, I would only like to emphasize that this is an issue where easy solutions are not available and where discussions are likely to continue for a long time. For this reason, I concur with the staff that it would be unreasonable to require member countries requesting a CCL to secure contingent financing from private creditors. The alternative proposed, i.e., to enter into good faith negotiations to this end, represents a far more sensible option. It is difficult to imagine the activation of a CCL without official bilateral support, and the staff is right to point out that this is an area where further work is needed.

The problems in estimating the implications of the CCL for Fund liquidity are clear. In view of the uncertainties that surround this issue, it is very difficult to evaluate the extent to which the Fund will be able to provide support to member countries through the CCL. I agree with the staff that the current methodology for assessing liquidity under precautionary arrangements is not appropriate for CCL's, and there is no doubt that we have to be ready to support Fund resources both with the GAB and the NAB, and that alternative sources of finance, namely private and official bilateral financing, will also need to be tapped. However, it is important not to exaggerate the implications of the new facility for Fund's liquidity. In particular, given the strict eligibility requirements delineated in the report, it is to be expected that the number of countries that will actually be in the possibility of using the CCL will be very small.

Regarding the establishment of the CCL, I agree with the staff that the SRF covers a broader range of situations than those intended for the CCL, and therefore I support the creation of a new special facility. Obviously, following this course of action faces a number of uncertainties, since it requires 85 percent of the voting power. As I said before, I am convinced that the availability of some sort of contingent financing at the Fund is fundamental in today's world economy. Therefore, if the support needed to set in motion a new facility is not there yet, we should at least agree to introduce a preventive element to the SRF, and thus to allow its use by those countries which are not in a crisis but which are concerned by the possibility of contagion.

Mr. Sivaraman made the following statement:

Our chair would like to commend the staff for a useful paper on an important subject. A detailed review of the options, possible modalities and implications is undoubtedly helpful in placing the notion of a Contingent Credit Line (CCL) in a proper perspective.

While the idea of a CCL is intuitively appealing - especially in view of the latest financial crisis in South East Asia, it is beset with several operational difficulties. Even the noblest of intentions could turn out to be counterproductive, if not operationalized properly in terms of formulation, logistics and timing. It is our considered view that establishment of a CCL is seriously fraught with such risks.

Our chair would like to voice our concerns and reservations through a series of questions which have not been fully addressed in the staff paper and which, in our view, call for discussion in the Board:

- (i) What is the target group of the member countries that the proposed CCL is intended to help? If the target group is very narrow, the impact of the CCL would be only marginal whereas if the target group is too wide (i.e., systemic phenomenon), then the CCL would certainly run into resource constraints. More broadly, is it appropriate to go in search of a problem with a solution in hand, especially with the given liquidity situation of the Fund?
- (ii) Are we sure that the proposed CCL would be decidedly useful? One way to address this question is to ask - what impact it would have made had it been in existence, say, before the onset of the Asian crisis? The way the proposal has been formulated does not offer a clear cut answer, which reflects poorly on the proposal. Under the eligibility criteria, probably none of the countries would have qualified. Even today, probably none would qualify with the exception of one or two industrialized countries. Countries may be made to qualify, but then it will be too late for CCL to be of any use.

- (iii) The proposed CCL, essentially, attempts to go a step beyond the SRF not only in terms of adding a "precautionary phase" as implied in para 16 (p.7), but also in seeking to pre-empt capital outflows threatened by contagion. This raises at least three basic questions:
- (a) Is it feasible to predict with reasonable accuracy the incidence and the extent of potential outflows triggered by a contagion?

By its very nature, contagions are innately unpredictable. Before the onset of the Asian financial crisis, the conventional wisdom maintained that a contagion runs from a large country to smaller ones. The Asian financial crisis demonstrated that a contagion could run both ways between large and small countries and that it could be transmitted through common causes effects, spillover effects or even wake-up call effects. But it is still open to question as to whether contagion can affect a country which fulfils the eligibility criteria. If it does, then what belief people will have in following right policies? Could staff clarify? It may be recalled that the extent as well as severity of the Asian financial crisis was grossly underestimated and that the international financial community is still on a learning curve in respect of contagion. Under these circumstances, it is unrealistic to assume not only that contagion could be predicted but also that the amount of contingent financing needed for stemming the possibility of outflows in the wake of the contagion could be foretold. Experience in this regard does not augur well for the establishment of a CCL.

- (b) How are we going to ensure that a CCL, if established, would pre-empt the potential outflows rather than financing them?

The staff paper has recognized in para 20 (p.9) the possibility that in the event of triggering a contingent financial arrangement, creditors may be induced to offset their exposure to the country by withdrawing from other credit markets or from other countries in the region, which may serve to exacerbate the spread of the contagion, rather than reduce it. Our chair would like to underscore the perilous possibility of a serious moral hazard situation wherein a CCL only assists the speculators and other fund operators who want to make an exit from the country in question.

The possibility of such an occurrence is not as remote as one would hope to be. In this regard, we would like to recall the Heisenberg's Uncertainty Principle from Experimental Physics which demonstrated that the observer of an experiment has an effect on the outcome. This principle could easily be extended to crisis prevention and management. What the Fund would do - as a result of the view it takes on the possibility of contagion, may

itself make the contagion possible. In other words, the very act of entering into a CCL may induce or exacerbate the capital flight from the country in question. Needless to say, in such cases, the medicine would turn out to be worse than the disease itself.

- (c) Apart from the undesirability of the substitution mentioned above, would it also not violate Article IV, Section 1(a) of the Fund's Articles of Agreement which clearly states that "a member may not use the Fund's general resources to meet a large or sustained outflow of capital"?
- (iv) Will the proposed CCL be a step forward in the direction of creating a lender of last resort? If so, should it not be automatic - rather than requiring a detail and time consuming assessment? Why is the access under the proposed CCL restricted to one year only? Does the experience with the recent Asian financial crisis not suggest a longer duration to be effective?
- (v) Given the liquidity constraints for the Fund, would the proposed CCL not crowd out the normal access of resources for the members in need? At the very least, would it not lead to a further tightening of the Fund conditionality? In this context, the larger question of additional resources for the Fund and for the new international financial architecture needs to be addressed simultaneously.
- (vi) Is it possible to make a clear distinction between the proposed CCL and the existing SRF even though we may say the latter is designed to meet a crisis situation and the former a pre-crisis situation?
- (vii) Is it also right to commit vast sums of Fund resources to countries which do not immediately require it when we have discussed need to advance repurchases when a borrower is in a position to do so?

In our view, these fundamental questions must be fully addressed before any meaningful progress could be made on the subject.

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

We would first like to say that we agree with the thrust of the staff's proposal on the modality of the contingent credit line. As we stated in the previous meeting, we think that the prequalifying option based on the regular "health check" is the best option, and therefore some of the proposed requirements in the pre-activation stage, such as the monitoring requirement, are not entirely in line with what we envisaged in the prequalifying options. But as an important first step to equip the Fund with the means to provide sufficient liquidity in a timely manner to countries affected by contagion that have good

policies and performance, we can go along with the proposed modality. Having said that, in order to make the CCL most effective, we would like to offer the following suggestions.

While it is proposed to monitor developments in the pre-activation stage through monthly benchmarks, it is not clear how strictly these benchmarks would be applied. In our view, the application of the benchmarks should not be excessively strict, in view of the fact that the countries that will benefit from this facility will basically be those with good policies and performance. It should also be noted that, if we place too high a bar at the pre-activation stage in terms of program implementation, there will be a risk that not many countries will be interested in utilizing the facility. We would appreciate knowing the staff's thoughts on this point. Moreover, while it is proposed to include structural reform in the conditionality at the pre-activation stage, we think that benchmarks on structural reform should be kept to a minimum as this facility is basically intended to provide liquidity support for a very short time and, again, is intended for countries with good policies. Our line of thinking in this regard is not limited to the pre-activation stage; in the post-activation stage also we should carefully avoid overloading the policy program with excessive structural reforms.

We would like to reiterate that the adherence to internationally accepted standards, one of the eligibility criteria, should be checked with due consideration to country-specific conditions, including stage of development.

In checking whether the Fund has sufficient financial resources to implement the CCL, the GAB/NAB are considered important arrangements to provide additional resources to the Fund, if necessary. It seems to us, however, that the paper's examination of the resource requirements of the CCL is not conclusive and there is therefore considerable risk remaining in the financing of the facility. If the market is not convinced there is sufficient financing available when needed, the facility will become ineffective and, in a worse case scenario, the crisis would be aggravated. I would therefore like once again to stress the need to seriously examine ways to finance the facility sufficiently, including the Fund's raising funds in the market.

Needless to say we should make our utmost effort to involve the private sector in order to minimize the potential risk of moral hazard which the establishment of this facility could increase. In this respect, I am not sure whether it is sufficient to require a country to have entered into good faith negotiations with private creditors to maintain their exposure and to be committed to not increasing its short-term external indebtedness unduly. These are certainly measures that we should require. But we could do more. For example, we would suggest considering that a country requesting the CCL should be required to modify the contracts of its future foreign bonds to include collective action and sharing clauses and to make a commitment to better external debt management through the comprehensive reduction of both short- and long-term external debts as necessary.



Finally, on the issue of the way to establish the CCL, taking into consideration the pros and cons of each of the two alternatives presented in the staff paper, we have an open mind and are willing to join the consensus.

Mr. Milleron made the following statement:

I was glad to see that the staff was able to incorporate into the proposal many of the concerns raised by Directors during our first discussion on a contingent credit line, and I will refrain from saying once more why I think the creation of such an instrument is desirable. The paper before us provides a good understanding of the major features of such an instrument: it makes it very clear that eligibility will have to be earned and that conditionality will remain at the center of Fund financing. These two points are essential if we want to deal with the legitimate concerns of those who fear that we would increase moral hazard by creating such an instrument. The attempt which has been made largely answers these concerns, and the paragraphs on eligibility, activation and conditionality provide important safeguards.

Nevertheless, I think the proposal before us should be improved or modified on three important points: private sector involvement should be reinforced, the Augmentation option should not be prematurely excluded, and the proposal to simultaneously create a precautionary SRF and a CCL is not satisfactory. I will focus on these points, since I am in broad agreement with staff's analysis.

#### Involvement of private creditors

First, the link with private sector involvement should be reinforced. In addition to the suggestions made in the paper, there should be a sort of check list which would guide staff and management when they examine a country's eligibility for this facility. We will have to come back to this issue when we discuss private sector involvement next week, but at this stage I would suggest that the check list include: the existence of private sector lines of credit, the introduction of British-style clauses in new international bonds issues, and an on-going process of reducing the weight of external short-term debt. This list is not necessarily compulsory, but the more of these elements are present, the stronger would be the chances of eligibility under the facility.

On this issue, I would also appreciate staff comments on the hypothesis made regarding countries deemed eligible for the CCL, as mentioned in the tables used to assess the impact on the Fund liquidity. Could we have more information about this list? Also, more work obviously remains to be done on the issue of implications for the Fund's liquidity. I can say at this stage that it seems reasonable to assume that public bilateral contributors would participate in the financing of such a contingent facility, on a case by case basis.

#### Augmentation/Commitment options

Second, I am not sure that staff is right to focus as it does on the Commitment option. The Augmentation option presents the strong advantage

of leaving the Fund with some room for maneuver when considering its financing support. Staff makes the point that too much uncertainty on the availability of resources could excessively weaken the facility's credibility. But, in any case, at the time of activation, the Board will have to decide whether the policy reaction of the authorities confronted to contagion is adequate. Uncertainty is therefore unavoidable.

Why create two new facilities?

Third, I am extremely reluctant to accept staff's recommendation that we simultaneously create a new facility and a precautionary SRF (paragraph 8 and footnote 16). Such a step seems dangerous and unnecessary.

Creating two new facilities at the same time exceeds the scope of what seems necessary. We do not need a new facility for countries suffering actual imbalances: these countries can have recourse to existing precautionary facilities, and I do not wish to see them qualifying for potentially huge Fund resources. We need a facility designed to address the case of a country pursuing sound policies in troubled times or in a "blue sky" period, as the staff puts it (one could also have in mind the case of a member country considering an exchange rate exit strategy). Therefore, whatever our conclusion on the new window or on the new special facility may be, I think we should unequivocally exclude this double option.

Staff builds the above recommendation on two grounds: a legal one and a psychological one. Neither is totally convincing.

Staff's legal argument is that we cannot, within the SRF framework, deny access to Fund resources to a member experiencing a balance of payments problem which was not a result of contagion but nevertheless covered by the SRF decision. I do not buy this argument: the eligibility and the ongoing review process prior to activation provides adequate safeguards. If a sudden policy failure were to occur, as mentioned in the paper, by definition the member would disqualify himself: as clearly explained, failure to complete a review would prevent a member from requesting activation of the CCL. Conditionality should therefore provide sufficient safeguards on this ground. Eventually, if legal obstacles were deemed inescapable one could always clarify this point in a decision amending the SRF.

The second argument justifies the creation of a new facility by the need to create positive expectation. I believe that this kind of psychological objective, which is essential, is a matter of communication strategy which could be adequately handled within the SRF framework. On the contrary, creating two new facilities simultaneously will only create additional confusion.

Therefore, I strongly prefer adopting the first approach, i.e. the precautionary SRF. This is not to say I favor this approach because of its voting implications: in my view, it is necessary to obtain a large consensus in the Board before going forward. I strongly hope we will be able to reach this broad

consensus on these terms which seem reasonable, and to propose a satisfactory solution to Ministers in April.

Mr. Morais made the following statement:

We welcome the opportunity to discuss further, ideas for the possible establishment of CCLs, which we consider an important aspect of the broad effort toward strengthening the international financial architecture. The proposed CCL is envisaged as possibly a two-stage arrangement. In the first stage, the "precautionary phase", a member enters an upper credit tranche arrangement, but only the minimum amount required for the CCL to represent a commitment is made available to the member. Indeed, given that the member has no balance of payments need at this stage, there is a presumption that the amount will not be drawn. Nonetheless, the resources committed to the member under the arrangement, reinforced by the Fund's endorsement of the member's policies would, all being well, help to stave off a speculative attack resulting from contagion. A second stage becomes necessary when the preemptive steps taken fails to avert a contagion. In this, the "post activation phase", there is to be a review by the Executive Board, following which purchases by the member are approved from a mix of resources that is likely to include both credit tranche and SRF resources.

While we find the principle of the CCL and some of the elements proposed by staff attractive, this Chair has a number of difficulties with the broad framework presented. We see the need to focus more closely on ways of strengthening the preemptive character of the proposed facility, if CCLs are to play a role different from the SRF. The conditions of access under the facility, as presently formulated, are in our view unduly inhibiting, while the issue of private sector involvement remains open. What we have at the moment, a combination of precautionary upper credit facility and SRF does not appear to be adequate for the purposes for which the CCL is intended.

From the staff paper, the commitment option appears to be the most appropriate, having regard to the existing rules governing members' access to the Fund's own resources as well as the resources available under the NAB and the GAB. This said, we see the formal nature of the proposed CCL arrangement as potentially a substantial drawback. We are inclined to believe that it might lead to a situation in which countries are moved to request a CCL only when it seems inescapable, and perhaps too late. If this resulted in a bunching of requests for a CCL when a crisis erupts, this could contribute to panic in a situation that would already be very fragile.

The eligibility requirements proposed by staff seem consistent with the objective of limiting the availability of CCLs to members with fundamentally sound economies. We wonder, however, if countries undertaking adjustment and reform in the context of an ongoing Fund-supported program, should be excluded in a time of crisis, when a CCL might help such a member avoid or forestall a contagion. In this regard, it would be helpful if staff could say something on the 11 countries that were selected for purposes of the preliminary assessment.

Regarding the circumstances that should trigger the activation of a CCL, we agree that the Fund should be guided by developments in the capital markets and by the adequacy or otherwise of the member's response to such developments. The real difficulty as we see it, is how to decide when the difficulties in the markets have gone far enough to warrant activation, since our goal should be to limit the severity of a crisis as much as possible. Perhaps, staff could comment on this. Moreover, if as postulated by staff, the situation following a speculative attack is so severe as to disturb the real economy through pressures on competitiveness or an adverse terms of trade, we wonder whether, at that point, we could distinguish between the CCL--with its emphasis on prevention and early containment--and the SRF.

On the issue of size of CCLs, a reasonable conclusion at this stage, is that they are likely to exceed access limits currently applied to credit tranches and EFF in individual cases, while overall demand, especially when a crisis threatens, would likely be beyond the limited financing at the Fund's disposal including those under the GAB and NAB. Staff's preliminary assessment that the Fund could not carry the burden of CCLs alone without locking up a large part of its resource base means that progress on this issue depends on being able to secure private sector involvement as well as those of bilateral official creditors. In this connection, some of the ideas regarding private sector involvement under consideration, appear promising. In particular, we note that there has been some use of private sector credit lines. Also, the possible use of the call options in inter-bank lines which provide for extension of maturities as the contractual right of a borrower under specified conditions, are worth considering. One important limitation with both these instruments apparently, is the likelihood that they might be difficult to secure when a crisis is threatening.

Mr. Eyzaguirre made the following statement:

At the outset let me express that this Chair believes that there is a need to achieve progress in both the development of a contingent facility and in the spelling of mechanisms to ensure the early involvement of the private sector in crisis resolutions. We consider both lines of action as essentially complementary and by no means as substitutive.

Further efforts in developing private sector involvement will most likely perfect the operation of the CCL by limiting potential creditors' moral hazard. On the other hand, the adequate functioning of an "ex-ante" confidence building facility like the CCL will also have a positive effect on creditors' desirability to consider private contingent arrangements, since it will reduce the expected probability of a crisis spreading to soundly managed economies.

The complementary character of both courses of action arises from the fact that they pretend to limit different types of distortions in the functioning of international capital markets. While efforts to involve the private sector are necessary to provide the right incentives for creditors to conduct an adequate risk assessment of debtor countries and, as importantly, to dispel the notion that if they overinvest they could always get out on time, I believe that even if

significant progress in this domain is achieved, a cyclical behavior of capital movements that could be potentially disruptive, is likely to persist, albeit somewhat dampened. I am convinced that the problems associated with asymmetric information and the existence of high fixed costs to private creditors if they seek to develop a reliable assessment capacity of each debtor economy are also bound to result in herd type behavior of capital markets. Therefore, boom and bust cycles are going to be with us in spite of the - necessary- efforts that can be displayed to limit moral hazard.

Unwarranted net capital outflows are unlikely to be deterred exclusively by the existence of private contingent arrangements for the reasons explained in pa. 20 of the paper. It is the case of Argentina, Chile and Mexico (after '95), to cite a few countries with which I am more familiar with. They have all been recognized for their pioneering attempts to limit the capital account volatility through efforts to lengthen the debt maturity profile and mechanisms to involve the private sector. They have also exhibited recognized sound macroeconomic management. But they are all now facing binding constraints most noticeably in the access of their respective private sectors to international markets, a fact that could severely undermine their growth prospects. And this is harmful not just for their own economies but, as contagion spreads, for international prosperity as well.

At any rate, I am also aware of the fact that the design of the CCL is critical to achieve its intended purpose and, as explained by Mr. Faini, adverse selection and moral hazard (particularly on creditors and/or debtors) concerns should make us vigilant and careful with the details. This being said, however, I can hardly picture a new international architecture of the financial system without a new facility of this sort, unless we want to risk serious setbacks in the process of globalization. Against this backdrop, let me turn now to specific comments.

With respect to the criteria for eligibility, I find them generally well inspired. Indicator (a) in pa. 7 assumes that the "prevailing circumstances" are to be considered normal. This amounts to suggesting that interested members should seek eligibility when financial markets are calm and that access to CCL would automatically ban performing countries under existing arrangements from using Fund resources even though the prevailing circumstances are far from reassuring. Moreover, what happens if members approach the Fund at a later stage, for instance after its terms of trade have been hit by the deteriorating overall situation and market conditions to access private flows that are already too restrictive? In other words, if such a facility were established, how would this aspect be dealt with under current circumstances? I would also appreciate some clarification of what is meant by constructive relations with private creditors. In addition, the criteria on the "readiness to adjust policies as needed" needs further elaboration. Presumably affected members would consider activating the CCL if they believe it could provide them with more breathing space than otherwise.

With respect to the criteria for activation, I would underscore the need to strike a balance between preventing adverse selection and the need to make

this facility really--and not just in paper--available. I would place more weight in the incentives of the facility itself i.e. phasing and terms, than on the degree of the Board's discretion to allow the activation. And I believe the proposal to set the phasing and terms as in the SRF, with a provision for an extension should suffice to prevent unwarranted activation and encourage early repurchase. At the same time, it would seem reasonable to have some financial differentiation in favor of "ex-ante" good performers.

With respect to the pre-activation eligibility requirements they strike me as being too similar with the conditionality on current precautionary arrangements. If one expects members to seek a CCL in calm times, after fulfilling the high standards set by the eligibility criteria, it doesn't seem appropriate to monitor CCL members on a monthly basis with quantitative targets and structural benchmarks. To my mind this even contradicts the signaling purpose of the facility. I would suggest exploring a more flexible approach like periodical staff visits, say, at least twice a year, accompanied by general quantitative criteria which has been effective according to the experience with countries of this constituency.

I would appreciate further clarification on how the eligibility would evolve over time. If one wants to avoid a potentially disruptive effect that may arise if a member loses eligibility it might be appropriate to approve eligibility for a limited period, subject to a regular review process where countries could be alerted if they are headed in the wrong direction.

Similarly, the expression that a close application of conditionality would seem appropriate in the post-activation phase, would warrant further clarification.

Finally, I clearly favor the establishment of a new special facility. The alternative to establishing a precautionary SRF seriously impairs, in my view, the signal the CCL is intended to convey.

Mr. Cippá made the following statement:

The staff has done a remarkable job at distilling the broad array of comments that it received during our first discussion on a contingent credit line (CCL) last January. By describing the specific modalities of a possible CCL the paper provides a good basis for a more focused discussion on the pros and cons of such a facility. I have to state right at the outset that the further deliberations by staff have not helped disperse my authorities' serious reservations regarding a CCL, which I had presented at our last discussion.

Broadly speaking, three crucial issues determine this skepticism. First, the stringent conditions that would be necessary for the CCL to achieve its purpose would probably narrow down the target group to only a few countries. Since it is difficult to imagine that an international initiative has been launched for so few countries, there is a substantial risk that the CCL will turn out to be just a diluted version of the SRF. Providing credit lines with lower conditionality would exacerbate moral hazard and thereby destabilize rather

than stabilize the international financial system. Second, a successful CCL would necessitate adequate private sector involvement. The staff paper on this issue underscores that little progress has been achieved in finding a consensus on ways to involve the private sector more systematically. Moving ahead with a CCL without corresponding progress on private sector involvement would not only undermine the goal of the CCL, it would also lead to a greater reliance on Fund resources. This brings me to the third point, namely the weakening of the Fund's financial position. Since a credible CCL would presuppose the full commitment of large amounts of resources, the Fund's liquidity position would probably become unsustainable. Furthermore, given the nature of the contagion phenomenon, there is a high probability of a simultaneous activation of various CCLs. This could seriously endanger the Fund's ability to provide the resources.

This being said, I would like to comment more specifically on the modalities of a CCL described in the staff paper.

On eligibility, the staff proposes a strict set of conditions that would have to be met by potential CCL candidates. In my view, the application of these conditions would practically result in the non-use of the CCL. Let's consider indicator b) a positive overall endorsement of the member's policy by the Executive Board at the last Article IV consultation. If I mentally review our discussions of possible CCL candidates in the past (including Brazil, Indonesia or South Korea for instance), I cannot think of a single one, in which we did not express concerns about the implemented policy stance, whether it was the exchange rate system, the sustainability of the fiscal balance or the weakness of the banking system. We had always identified a need for ex ante policy adjustment. Similar arguments can be found concerning indicator c) constructive relations with private creditors and satisfactory efforts to limit external vulnerability. If a member succeeds in limiting its vulnerability and has access to private credits, it does not need a CCL.

Consequently, I suspect that eligibility criteria will not be applied strictly but generously. This would lead to a substitution of arrangements based on traditional conditionality with CCLs. A case in point is the fact that the press mentioned yesterday that Mexico was a potential CCL candidate. If I remember correctly, in substance Mexico was seeking new borrowed resources to refinance its external debt, including outstanding debt with the IMF. In the same vein, I have great difficulty in accepting Mr. Guzman's argumentation to consider members that are under a Fund arrangement as CCL candidates. Clearly such a member has adjustment needs and therefore does not have the required track record. To take care of such a country in the event of contagion, we have the SRF.

Turning to the triggering factors for activation, in my view similar arguments can be used as in the question of eligibility. If considered carefully, the triggers would not activate a CCL. If a country encounters difficulties in its access to international capital markets, it is almost certainly caused by structural weaknesses or macroeconomic imbalances or both. While I share the view that contagion may not always be fully rational, due to herd behavior and

overreactions by market participants, I doubt that a sudden change in market perception can have a lasting impact, if its policies are in order. In fact, we should not forget that there are countries in Asia and Latin America as well as countries in transition which have not been hit so far by the recent crises because of appropriate policy stances. These countries might be confronted with higher refinancing cost or weaker current account positions due to close trading relations with countries affected by the crisis. But higher refinancing cost itself is not a qualification for the CCL.

As regards private sector involvement, I must reiterate my concern that the creation of a new facility without substantial progress in this area of the new international architecture could lead to a Fund-credit-biased solution and would, therefore, severely weaken the catalytic role of the Fund. The Fund would end up more often than in the past financing more than the average 10 percent of the financing requirement. The Fund simply does not have the resources to act in such a way, even after taking into account resources that can be mobilized under NAB/GAB. Furthermore, my authorities are convinced that the introduction of a new facility like the CCL would signify a further step in pushing the Fund into the role of an international lender-of-last-resort. In their view, the Fund cannot play this role. Concerning bilateral contributions, my authorities are only willing to provide bilateral public credits in very exceptional circumstances, which probably will be fulfilled rarely in the case of CCL.

Turning to the implications of a CCL for the Fund's liquidity position, the staff estimates combined quotas of possible candidates in the order of SDR 25-30 billion. The illustrative calculation of the potential demand under the CCL (only one quarter of the potentially eligible countries draws five times the quota) shows that Fund liquidity would drop to the uncomfortable low liquidity level of last December. In my view, these assumptions are conservative, since in the event of contagion, all existing CCLs would be activated simultaneously. Moreover, as said by staff, "the ability of the Fund to provide the committed financing in the case of an activation of a CCL would need to be beyond doubt, if a CCL is to give confidence to members and convince markets." In other words, no "over booking" is admitted.

Mr. Taylor made the following statement:

We are, in principle, in favor of the development of this proposal. Given the potential for large market players to destabilize markets, there is a real risk that countries with solid economic performance and track records of sound policies could be victims of contagion. If developed properly, a contingent credit line could provide one way of responding to such pressures.

But, this alone will not adequately address the sources of instability or contagion. In this respect, there is a number of mechanisms that need to be in place, and questions that need to be answered, before we would be able to support a specific idea in practice. In particular:



- we do not consider it viable or acceptable to maintain that there is a need to establish a CCL to respond to the risks of contagion without accepting the need to take effective action about a key potential source of contagion, or means through which instability is magnified, namely highly leveraged institutions; and
- we do not consider it logical or acceptable to provide access to a CCL in advance of more fully developed means of private sector bail in. In this regard, we agree with much of what is raised in Mr Faini's statement on the involvement of the private sector, especially the need for establishing the appropriate incentives for countries to seek agreements with private creditors first.

Turning to the modalities of a CCL, there is a number of questions which require further attention.

- How do we identify countries that are "sound enough" (to which we are willing to provide up front large financial assistance), but at the same time are deemed to be susceptible to contagion? The possible criteria/indicators identified by staff, in my mind, still leave the issue of eligibility very open - very much a matter of "judgement". For example, the likelihood of being "at risk of contagion" is far more easily identified in the present environment than in a "blue sky" period. At the same time, we need to avoid an overly arbitrary process for determining eligibility - hard and fast rules would not be helpful. More information and guidance would be necessary for the Board to be able to make a valid judgement about eligibility.
- Why would not the basic indicators identified by staff also apply to countries emerging from crisis, with economic performance and policies now judged fundamentally sound, but still exposed to risk of contagion? I note that staff's supplement of today does not preclude the possibility of "adding" a CCL to an existing arrangement. However, it suggests that this would "normally" be in a situation where the arrangement is precautionary, not where the country is emerging from a fully-fledged program. I would be interested in staff's reaction to a possible role for a CCL in facilitating a more timely recovery of access to capital markets for countries emerging from crisis.
- How do we address the moral hazard problem (both in terms of the country and private creditors)? Pre-qualification could raise moral hazard risks. Circumstances can also change quickly. Taken together, this suggests that eligibility cannot be determined in advance. There may, however, be some benefit in considering whether there are any 'necessary', as opposed to sufficient, conditions which could usefully apply - i.e., we could

consider whether countries must have adopted certain codes before they will be eligible for consideration for a CCL.

- What seems to be needed is a very quick acting facility. If trouble begins to emerge, a country could ask the Fund to take a decision on whether it would qualify for a CCL. If the Board decided, "yes", this could trigger a process whereby comprehensive information on the country's economic performance would be regularly reported to the Board. In turn, and subject to ongoing sound performance, the country could come back to the Board at very short notice with a formal request for assistance. If a country was deemed not to meet CCL eligibility, this could put in train a process of consultations between the country and the IMF with the aim of laying the groundwork for a program if the need arises. But then, it is not clear that such an approach could not be adopted around the SRF.
- How would we ensure adequate conditionality, against a background of qualification which would imply a "clean bill of health"?
- Can the Fund afford this? The staff paper addresses the implications for the Fund's liquidity, but rightly points out that this is a difficult issue, which would depend on the modalities of a CCL. In this regard, in estimating the likely cost, what countries would have the staff assumed would be regarded as being eligible to seek access to a CCL?
- We consider the link with the NAB and the GAB to be sensible (as well as unavoidable), especially in terms of the implied conditionality. But, how would the activation of either the NAB or the GAB proceed? We would be interested in staff's thoughts on this matter.

Mr. Portugal made the following statement:

We think there is a case for the creation of a contingent credit line to be used for precautionary purposes by members whose economies are fundamentally sound but which can, nevertheless, be affected by sudden changes in market conditions. The reasons for such a facility seem clear, as mentioned in our earlier discussion on this topic last January. First, crisis prevention tends to be cheaper than crisis resolution. Second, in globalized financial markets where capital moves from one country to another at the speed of the touch of a computer button, where capital flows can be extremely large, and where information is incomplete and asymmetrically distributed, it is quite possible to have the case of the "innocent country" affected by contagion of a crisis for which it had not contributed. Third, the option of countries trying to protect themselves individually by generating large current account surpluses to increase international reserves is not viable as a general proposition, since it

would probably lead to deflationary trends. Fourth, many countries are reluctant to come to the Fund to use the current facilities in a precautionary mode because, unfortunately, markets still perceive coming to the Fund as a sign of serious difficulties. A new contingent credit line available only to good performers might help change these perceptions.

Although we strongly favor the creation of such a facility, we are not convinced that the present proposal, as currently designed, would fulfill the requirements of a truly contingent credit line. What seems essential for a contingent credit facility to effectively ward off the risks of a crisis are, first, speed in the provision of sufficient resources and, second, certainty of their availability when the conditions specified for their use materialize. Ideally, this would require a scheme in which all necessary and sufficient conditions for use were clearly specified at the date of approval (including phasing), with any future decision about activation being limited exclusively to establishing whether those conditions have been met or not, without adding new conditions.

We are not convinced either by staff's arguments for choosing the Commitment option among the three possibilities discussed in the earlier paper. We would favor keeping both the Fund monitored program option and the Commitment option to increase flexibility in meeting the varied needs of different members, and would like to ask that consideration continues to be given to this option.

The Commitment option encompasses a very demanding list of eligibility criteria specified in paragraph 7, requires a program of monthly monitored quantitative fiscal and monetary benchmarks, carries a commitment fee of a quarter of a percentage point, and requires a member that, at the moment, is not in need of special financing to enter into what is called "good faith negotiations" with the private sector. In exchange for all these requirements, the member would get a small amount of resources available up front upon approval, with the rest being available upon activation, but with the phasing and conditions becoming dependent on implementation of a revised program encompassing conditionalities and corrective policy adjustments. It is not clear, therefore, what are the incentives for a member to apply to a contingent credit line under the conditions proposed.

From a market perspective, what would probably be counted as contingent resources available for precautionary purposes is just the small amount that would be available up front on approval. The degree of certainty attached by markets to the rest of the committed resources would probably not be different from that attached to resources committed under any other existing Fund facility. In order for the contingent credit line to work for precautionary purposes, it would be necessary to raise substantially the minimum (5 percent of quota) which is now customarily available up front on approval. Otherwise, there would not be very much difference in this respect between the Fund monitored option, under which no resources are committed, or the Commitment option, under which only 5 percent of quota would customarily be available up front. If due to liquidity constraints is not possible to establish a much higher minimum initial amount, it would be even more important to keep

the Fund monitored option available to members together with the Commitment option as argued earlier.

We fully agree that it is essential to ensure private sector participation in the post-activation phase. This need is not clear, however, during the precautionary phase. We acknowledge that serious issues of moral hazard exist in the post activation phase that need to be addressed, while recognizing that it is impossible to completely eliminate moral hazard. The main question is what are the most efficient ways to ensure private sector participation. Any scheme for private sector involvement must be defined before hand in general terms. Voluntary participation should always be preferred. It is also important to avoid that attempts at burden sharing are transformed into burden-shifting exercises, with private creditors reducing their exposure in some countries to compensate for staying in other countries. Another important consideration is to find mechanisms to discriminate between the long-term, prudent and risk-avoiding investor and the speculative, risk-taking investor. If one does not make this distinction, in the long run this will adversely select out of emerging markets precisely the type of investor we want to attract. The problem of adverse selection is as important as the problem of moral hazard.

Mrs. Hetrakul made the following statement:

During the previous discussion in January, we -- like other Directors -- welcomed an idea of establishing a precautionary facility through a Contingent Credit Line (CCL). Among the forms of the CCL the staff proposed i.e. the FMP Option, the Augmentation Option and the Commitment Option, we did not see the benefit derived in real terms for a country opting for the FMP Option as a form of the CCL. We do foresee that the availability of a commitment in the CCL is essential. Therefore, we support staff's proposal that the Commitment Option becomes a form of the CCL aimed at tackling the threat of the contagion effect. For its success, the CCL must go along with other Fund's policy direction, among others, the improved transparency and information etc. Regarding the form of the CCL, we thank the staff for providing us with broader information regarding the drawback of the CCL if it is incorporated in the current SRF as mentioned in point 29. This leads us reconsider our position where, at that time, we tended to amend the SRF decision to make provisions for a precautionary SRF. All in all, we support the establishment of the CCL as a new facility rather than the amendment of the current SRF with a precautionary element to be integrated.

We concur with staff's view that a member who is seeking the CCL must be evident that its economy and policy stance are in good order. Generally, we agree with the prerequisites mentioned in point 7 as criteria that should be met by a country before receiving the CCL's commitment. It is worth noting that the timing the Fund's approval for a country's request for the CCL is critical, affecting the success of the CCL. In this regard, we believe that the CCL should be given when the market is calm. Approving the CCL at a time when the market is vulnerable may trigger undue speculative activities and create a contagion for other countries in the same region that do not have the

CCL's commitment. At this point, what would the Fund's action be if faced with this kind of situation ? Staff's comments on this will be appreciated.

Turning to activation of the CCL, we are in broad agreement with staff that the pre-conditions mentioned in point 10 should first be met by a country before purchasing or activating the CCL. In addition, the total amount and composition of deposits should be also regarded as an important criteria before activating the CCL. As in the Indonesian case and the Kyrgyz case, a shift in the composition of deposits in favor of US dollars rather than the domestic currencies as the Thailand and Russian crises emerged, caused a sharp depreciation of the domestic currencies. Furthermore, the availability of a quantitative guidance to assess the adverse development on the capital market, exchange rates, reserves, and deposits is essential. In this regard, the staff has yet mentioned a yard stick of how far a country is encountering difficulties in its access to international capital markets, and how large the depreciation or a fall in reserves could be tolerated etc. Staff's comments on this is welcomed.

A quick release of the Fund's resources will determine the success of the CCL. Thus, we feel that, as there is any adverse development on the variables mentioned above, the CCL should be released quickly, avoiding the emergence of contagion. Thus, any pre-requisite actions that must be fulfilled first by a country, as suggested by the staff in point 11, in our view, may create a sense of uncertainty on the availability of fund and may contribute to the deterioration of a country's condition. A delay in activating the CCL, due to those actions, will make the CCL, as a precautionary facility, no different than the current SRF. Moreover, we have concerns about the amount of resources that should be released when the CCL is activated. Past experiences show that front loaded release of resources as in the Korean case, seemed to be more successful in tackling the crisis compared with phased release as in the Indonesian and Thailand cases. How does the staff assesses this ?

Indeed, it is difficult to foresee an appropriate need of the CCL requested by a country, let alone determine the total amount for some members. In this light, we suggest that there is a limitation or ceiling in the amount of the CCL requested by a country. A huge request by several countries will strain the Fund resources dry, blocking a chance for other countries to access it. It could hamper the Fund's strength for helping countries that face a structural problem in the balance of payments. Setting a ceiling is also aimed at anticipating the activation of this facility by several countries in the same time which, of course, brings about a huge impact on the Fund resources. Accordingly, steps to enhance the Fund's resources is essential in setting the Fund as the lender of last resort. In facing a contagion that may emerge, resources derived from the Fund is not enough. As in the Brazilian case, the NAB/GAB is important to be included. In addition, any Fund action to strengthen its resources from other than the quota's increase is essential. Hence, deriving resources from the bilateral creditors and private sector may be an important consideration. Furthermore, in the face of the likely emergence of a contagion, the role of the private sector itself should be strengthen and enlarged in order to lessen the potential risk of moral hazard. Therefore, we support the staff's idea for the

enlarged involvement of the private sector, as mentioned in point 19, in the face of the possible crisis.

Mr. Faini explained that when he had referred to eligibility and the involvement of the private sector in his statement, he had meant to simply offer suggestions. His proposed list of sustainability checks was certainly open for discussion. On the involvement of the private sector, he stressed that it should not be an optional item to the contingent credit line, but an integral part of the proposal. The design of the facility should depend on the way the private sector would be involved.

Mr. Eyzaguirre, referring to the involvement of the private sector as a desirable feature for eligibility, asked how could the efforts displayed by the sovereign via the efforts of the debtor private sector be separated, given the laws that protect private property. In general, governments could not decide what the private sector should or should not put in their private contracts.

Mr. Ogushi, while noting that in his statement he had said that he was willing to join the consensus on the two options, stated that, after examining the report and the statements of other Directors, his authorities would like to think about the issue further.

Mr. Taylor felt very strongly about sorting out the eligibility criteria and conditionality before proceeding any further. Also, the issue of collateral seemed to have been dropped from the discussion. It would be interesting to know whether the staff thought that collateral would have any role to play in providing comfort both in terms of eligibility and conditionality, and, more generally, to sort out illiquid cases from insolvent cases.

Also, the paper did not make a distinction between fixed exchange rate and floating exchange rate cases, Mr. Taylor continued. Differences in exchange rate regimes should be taken into account since the two cases could involve different degrees of risk in relation to any version of the scheme.

The Deputy Director of the Policy Development and Review Department made the following statement:

A few Directors have asked whether we see any useful purpose to be served by a contingent credit line. I think we do. Mr. Sivaraman asked if a country has sound policies in place, would it then not be immune to contagion. We are convinced that that is not the case, given what has happened in the markets in recent years, such as herd behavior. Although the limited spillover from the Brazilian case is certainly a good thing, the outcome could have been different. Thus, a contingent credit line can be beneficial, but in a narrow context. However, even in a narrower context there are many considerations, and many of them go in conflicting directions. For instance, how to select countries with sound policies that the Fund would want to endorse and convey that endorsement to the country and to the markets, without defining the eligibility criteria so tightly that we wind up with an empty box, but not to define it so loosely that standards are eroded and incorrect signals are sent; how to ensure that once policies are endorsed, we keep close track to ensure that the policies are being sustained so that if we have to act, we can act quickly and confidently; how to avoid what some countries see as the stigma of coming to

the Fund; how to convey the signal that there is no problem but an endorsement of policies; how to convey a Fund commitment without establishing a presumption of automaticity or lack of conditionality; how to minimize the problem of moral hazard; how to ensure adequate safeguards for Fund resources; and how to engage the private sector. There are a lot of issues in this proposal.

The paper you have today takes into account the January Board discussion on the same topic. Directors have made a number of suggestions on the revised paper, and we will take them into account in the next round, particularly the suggestion for greater involvement by the private sector. Also, the next paper will incorporate any suggestions that are made in the forthcoming discussion on involving the private sector in financial crises. It seems that virtually all Directors see the involvement of the private sector as an integral part of the CCL proposal and the staff agrees with that. Mr. Faini pointed out that the availability of additional private financing could have an influence on the size of the CCL. Certainly, the firmer the private sector involvement, the lower the expectation that a CCL would have to be used or have to be in size. However, as it would be beneficial to proceed with a commitment of resources that was meaningful, we see a positive relationship between the two. Whether a new facility was created or not, the main positive feature of a new facility was the clarity with which the idea of sound policies could be conveyed, which we feel could be blurred if we proceeded with an amendment to the SRF. Also, there is the question of whether a CCL could be activated only in the case of contagion or whether it could be activated for other reasons, as would be possible under the SRF amendment approach. However, if Directors would prefer to proceed with the SRF amendment approach, we can do better than we have so far in trying to find a way to keep the distinction and keep the signal of sound policies that countries are looking for. Under either approach, as several Directors have noted, the Board would retain sufficient control to ensure that sufficient conditionality could be applied. The staff sees a way forward under either approach.

A number of Directors have asked about the list of potentially eligible countries, but there is no such list. The staff looked at a large number of developing emerging market countries that are heavily reliant or may become heavily reliant on capital markets, and grouped them together to provide a stress test of what the potential implications might be on a large number of those countries. Since the eligibility criteria has yet to be finalized, it is difficult to come up with a list of names. One would have to look carefully at the individual cases against the eligibility criteria that are eventually agreed, but at this point, only a relatively small number of countries could qualify.

Mr. Mirakhor, noting that the Fund could not be a lender of last resort because it did not have the resources, wondered to what extent did that influence the structure of the eligibility and activation criteria. The way the eligibility and activation criteria were set up, it seemed that the CCL was similar to a credit rationing device, rather than a preventive signaling device.

The Deputy Director of the Policy Development and Review Department stated that the resource constraint was something that the Fund had to live with. The structure of the CCL had not been approached from the point of view of a rationing device, but rather as a way to make a commitment, with the Board fully aware of the circumstances for which the commitment had been made. Moreover, during the activation phase, the Board would be in a position to judge whether additional conditions needed to be applied at that point.

Mr. Fernandez asked why the staff was proposing to have a precautionary SRF for countries who could not qualify for a CCL. It seemed that the staff was creating two instruments by including two different types of cases.

The Deputy Director of the Policy Development and Review Department explained that under one formulation, the CCL could, in fact, be a precautionary SRF. Even calling a precautionary SRF a CCL allowed for the possibility of triggering an activation for reasons that were not necessarily related to contagion. That was what had led the staff to think about the possibility of a separate facility. There were two situations that could arise. First, a clear CCL case with sound policies, no apparent need for adjustment, and no apparent balance of payments need. Second, there could be a situation where a country was facing balance of payments pressures, did have an adjustment need, but might still want to request access to a precautionary SRF, at least at the outset. However, the staff viewed adding features to existing facilities as complicating the entire process.

Mr. Sivaraman asked if a country had a CCL in place, and if that country faced a speculative attack on its currency, or contagion spread, could the CCL prevent that?

The Deputy Director of the Policy Development and Review Department responded that a CCL could certainly help instill confidence. However, the staff was not certain whether any instrument could prevent a crisis. Certainly, making progress on involving the private sector, for instance, would be helpful. While the CCL could perhaps not prevent a crisis, it had a positive role.

Mr. Giustiniani asked the staff to clarify whether it would be possible to add a CCL to an existing arrangement, including a precautionary one.

The Deputy Director of the Policy Development and Review Department replied that the CCL could be added to a precautionary arrangement.

Mr. Taylor recalled that when Brazil had experienced its financial turmoil, there had been some concern that contagion would sweep back into Asia. Specifically, would Korea, which was in the process of repaying its SRF, be eligible for the CCL if contagion returned? In the case of the Philippines, which also has an existing program and a good policy stance, but was externally vulnerable, could it also be eligible for the CCL to protect itself from contagion?

Mr. Guzmán-Calafell pointed out that the objective of the CCL was to provide those countries who wanted to use the facility with protection. As described in the paper, the economies have to be fundamentally sound and there has to be the fear of contagion. The view that only countries with precautionary arrangements could use the CCL implied that any country that was using Fund resources did not have a fundamentally sound economy.



However, that could not be said in all cases; thus, a case-by-case approach would be more appropriate.

The Deputy Director of the Policy Development and Review Department remarked that in the two cases mentioned by Mr. Taylor, both countries were undertaking adjustment programs. While both countries were doing well, there was a perceived continuing need for balance of payments adjustment. If necessary, in the framework of the arrangements that they have now, they could request an augmentation under their current facilities. The intent of the CCL was to in part identify countries that did not have a significant need for adjustment or exceptional financing, and it would also not apply to countries that have a demonstrable continuing need for significant adjustment.

Mr. Esdar noted that whenever the Board discussed a new facility, it was often difficult to keep track of what was possible under existing facilities. For instance, there was the possibility of augmentation under existing Fund arrangements. If there were no contagion, a country could consider a precautionary arrangement. There were already many instruments available to countries. It would therefore be preferable to establish one facility which covered all situations.

Mr. Cippá asked whether the list of potential CCL countries included any countries that were presently under a Fund program.

The Deputy Director of the Policy Development and Review Department replied that, under the present eligibility criteria, a country with a Fund arrangement could not qualify for the CCL.

Mr. Mirakhor said that he could not think of any country that could qualify for the CCL, except perhaps a few European countries and the U.S., and only if they were hit by contagion. Nevertheless, he took the staff's word that there were some countries who could qualify.

Ms. Lissakers pointed out that if a country had a program and if the CCL was part of that program, then there would be a need for some type of adjustment. Furthermore, if the CCL were to be established, there would be a transition issue, as some countries would appear to qualify but were currently in a program because there was no CCL at the time. For instance, Argentina has a Fund program, and it would be a good case for a CCL. It was not clear how to reconcile that reality with what the staff had just said that a country in a Fund program could not qualify for the CCL.

Mr. Mirakhor stated that in the previous Article IV discussion on Argentina, Directors had urged the authorities to undertake a number of measures. Thus, according to the eligibility criteria, Argentina could not qualify for the CCL.

Mr. Esdar remarked that a well-designed contingency arrangement would be useful for countries that did not have a balance of payments need.

Mr. Eyzaguirre stressed that the eligibility criteria should not be used to scrutinize countries on whether they have any shortcomings, as all countries have shortcomings. In parallel with the lender of last resort, the relevant question was whether those countries were sustainable under "normal conditions," but felt threatened by contagion. If that were the case,

they should be eligible for the CCL. He also agreed with Mr. Guzmán-Calafell and Ms. Lissakers that there was a transitional issue that when countries had arranged a precautionary program, the CCL was not available.

Mr. Guzmán-Calafell said that, if one assumed that Argentina was fully eligible for the CCL because its current arrangement was precautionary, what would happen if Argentina needed to draw on its precautionary arrangement? According to what the Deputy Director said earlier, Argentina would no longer be eligible for the CCL. That made no sense.

The Deputy Director of the Policy Development and Review Department, in response to Mr. Mirakhor, said that, according to the current eligibility criteria, there were a number of countries that could satisfy such criteria. In the case of Argentina, since it currently had a precautionary arrangement, the CCL could be integrated into an existing arrangement, including a precautionary arrangement. That approach required that an arrangement be in place before the CCL could be approved. However, if there was a significant need for adjustment, then the CCL would not be appropriate. In that case, a more traditional Fund arrangement would be called for.

Ms. Lissakers agreed with Mr. Eyzaguirre's formulation that one should determine whether a country's financial situation was sustainable under normal circumstances. She recalled that during the savings and loan failure in the U.S., even the good savings and loans had been affected by the panic. Under those circumstances, no savings institution had been able to survive because there had been a panic. If a country could be compared to a financial system, then the intention of the CCL would be to help in circumstances when there was a generalized country panic. If a country was soundly managed, then it should be eligible for the CCL. Whether it had a Fund program or not should not be a determining factor.

Mr. Wijnholds did not think it was appropriate to use the U.S. savings and loan episode as an example because it had not been caused by contagion but by imprudent lending policies.

The Acting Chairman pointed out that there had been two separate episodes, and Ms. Lissakers had not referred to the one Mr. Wijnholds was thinking of.

Ms. Lissakers clarified that she was referring to the savings and loans episodes in Ohio and Maryland. Those were state-regulated savings and loans, and a couple of them had gone under for good reasons. The state insurance fund covering those institutions had few funds, and suddenly there had been a generalized panic, indiscriminate against good and bad institutions.

Mr. Cippá thought that the new eligibility criteria in terms of a country being sustainable under normal circumstances was rather broad. Countries got into trouble because they had a bad debt structure. However, that debt structure was perfectly sustainable under normal circumstances.

Mr. Eyzaguirre pointed out that a country's debt structure was one of many relevant criteria. He did not think that a country should not be eligible because they did not meet one small criteria. Sound economic criteria should be used to stress test whether a country was sustainable or not.

Mr. Wijnholds made the following statement:

I remain opposed to the creation of a contingent credit line. The main reasons are that I do not believe a CCL would add anything to our existing facilities, nor that there is a true clientele for it. Here, let me just note that countries that are mentioned as being only affected by contagion and therefore candidates for CCL, may have an overvalued exchange rate. In fact, I believe a CCL - as yet another high disbursing facility - could do damage as it leads to increased moral hazard and depletes our resources as we play a game of chicken with private capital markets. I also fear that the creation of this facility is likely to generate its own demand.

As my views are well known, I do not want to rehash all the arguments against the creation of a CCL which I set out in my Gray for the previous meeting. Let me confine myself therefore to a few remarks.

First, the group of countries for which this facility/window is supposed to be created remains ill-defined. In fact, the bottom line seems to be that the Fund would be providing a seal of approval to a sub-part of the membership on the basis of what is essentially a judgement call. It is a judgement call by the Board as to which countries are healthy and which are less healthy, and I have little faith that we will be able to draw a clear distinction between the two on purely economic grounds. There is also an issue of what the positive bill of health for one group of countries signals about the other countries apparently not fit to qualify for the CCL stamp of approval. There is a clear risk of discriminating among countries. I am opposed to such a rating agency role of the Fund. Those countries wanting a Fund seal of approval to guard against contagion should seek access to a precautionary arrangements, as several countries have successfully done in the past.

Second, regarding the process with which we are moving forward, I do not feel the concerns expressed at the previous meeting are adequately addressed in this paper. This particularly refers to the manner in which we involve the private sector and bilateral official financing. The modalities of both remain to be determined. I would think that it would be extremely undesirable to move ahead and create anything which commits IMF resources, before the private sector's role is clear. Otherwise, there will be no incentive for the private sector to put forward its own resources. Frankly, I do not understand the sense of urgency which has crept into the process, also because I see no immediate candidates in need of a CCL.

As regards the paper's suggestion to amend the SRF to allow for precautionary SRFs, I have no objection in principle. In fact, making more use of our existing facilities in a precautionary manner is precisely the kind of thing that could ward off speculative attacks or contagion. It is not clear to me, however, what legal obstacle currently exists to the use of SRF's in such a precautionary manner. In fact, if there is a legal obstacle, why was this amendment not proposed at the time of our SRF-review, when staff also put forward an interest rate proposal which removed a disincentive to using SRFs in a precautionary manner.

Under existing credit tranche policies a member is not required to have a balance of payments need at the time the Board approves a program. The SRF is of course a special facility but I am not aware of any specific provision which rules out its precautionary use, should a member decide to do so. Therefore, I would welcome further staff clarification as to why exactly any amendment of the SRF would be necessary.

Finally, there may be a tendency among some to say: we are not keen on a CCL, but if you make it a window and not a facility, we can live with it. I would just point out that since it would be a window within the SRF, which facility does not have an access limit as regards its use, the difference between a facility or window is in reality only one of voting majorities, it seems to me.

Mr. Palei made the following statement:

After reading the staff paper and listening to other Directors, I remain skeptical about the need for a separate CCL. I believe that neither a new CCL facility nor a separate CCL element under the umbrella of the SRF are necessary. I would prefer a modification of the existing SRF instrument to allow for a precautionary SRF. Quite naturally, this would eliminate the need for the very term "CCL", since "precautionary SRF" describes the modified instrument well.

The list of criteria for CCL eligibility, presented in paragraph 7, does not seem to be substantially different from the requirements for SRF users. I fail to see any requirements that would unambiguously separate "innocent" economies from "guilty" ones. Moreover, the proposed criteria, are either not specific (such as successful completion of Article IV consultations or good faith negotiations with creditors), or not yet operational (such as the use of international standards).

On a more general note, it is hard for me to imagine an "innocent" economy; a country that simultaneously needs a commitment of large resources by the Fund, and, as stated in paragraph 2, does not have "a pressing need for adjustment or reform". Similarly, there is an inconsistency in the statement that a country has sound fundamentals, and, yet is characterized by significant external vulnerability, be it vulnerability to a speculative attack, to changes in risk perceptions, or simply to investors' moods. Vulnerability is a manifestation of a lack of market confidence. Therefore, if one says "A" in recognition of an economy's vulnerability to changes in capital flows, one should also say "B" as one is admitting that there must be some serious weaknesses that are the sources of markets' concerns. An economy can not be both externally vulnerable and fundamentally sound. If any country needs Fund resources on the basis of its vulnerability, on the basis of the possibility of a funding crisis, the IMF's commitment of resources should always be accompanied by a full-scale program with the Fund. The obvious and core problem associated with countries that are potential candidates for the CCL is their external and domestic debt. Hence, as a minimum, commitment of the Fund's resources in such cases should be accompanied by a comprehensive program aimed at changing the debt structure and its maturity profile, and improving debt

management practices. If necessary, and it usually is, this action has to be supported by the necessary economy-wide structural measures.

Even if there were to be "innocent" economies, there remains the issue of the Fund being able to sort its members into the "innocent" and the "guilty". Like many other Directors, I do not see any compelling reasons for the Fund to take on such a responsibility. The Asian, Russian, and Brazilian crises provide evidence that our insight is not perfect.

#### Modalities of the precautionary SRF

I reiterate the support of this chair for the commitment option under the precautionary SRF. I also agree with the staff that, given the size of commitments under the SRF, it makes sense to err on the side of caution and, for liquidity projections, to take into account more than 50 percent of the amounts committed on a precautionary basis.

Preferably, the modalities of the precautionary SRF should not significantly differ from the existing ones. Thus, at this stage, I would not limit access to the Fund's resources by tying it to existing quotas. We all know about the shortcomings of the existing structure of quotas. In the exceptional cases of the precautionary SRF, flexibility on the issue of the amount of access is warranted. I recall that, in the case of Korea, the committed resources far exceeded the numbers used by the staff for illustrative purposes. Reasonable access should be determined on a case by case basis. Similarly, the approach to phasing under the SRF is already flexible and should be extended to the precautionary SRF.

However, I would not rush to an outright dismissal of reconsideration of the timing of repayments under the precautionary SRF. It is true that a lack of sufficient resources is often cited when objections are raised to the provision of large funds by the IMF for a prolonged period of time. The potential strain on liquidity is a serious matter of concern and is certainly a major constraint on the Fund's activities. Still, it is not the only factor to be taken into account when the terms of repayment for precautionary SRF users are determined.

The modalities of the SRF, including the terms of repayment, should be evaluated from the perspective of efficiency in achieving the goal of crises prevention. On many occasions, including in the staff paper for today's meeting, the Fund has pointed to the benefits of medium- and long-term solutions for the debt problems. That is what the staff praise on page 9, in the description of potential private sector involvement. Among the listed useful arrangements are private sector medium-term credit lines with evergreen clauses and call options for maturity extensions. At the same time, the design of the SRF differs in this respect. Due to an expectation of repayment in one year, at times when market confidence is being tested, the use of SRF leads to a sharp increase in what is, essentially, short-term debt. It can be argued, then, that such a large increase in short term debt, in turn, increases countries' vulnerability to changes in the direction of capital flows. It is rather inconsistent

to ask the private sector for a medium term commitment when the IMF itself wants to be involved on a short-term basis.

When, in December of 1997, the SRF was established, the presumption was that the Asian crisis was a short-term liquidity crisis, a crisis of confidence, and that this latter could be quickly restored. It turned out to be the case only in Korea, where the burden of debt was extremely low and permitted a quick debt restructuring. At the same time, some countries—potential users of the precautionary SRF—faced and continue to face adverse market conditions for periods longer than one year. To address their vulnerability, the users of the precautionary SRF need time for appropriate policy responses with regard to their debt strategies. In my view, these vulnerable countries do need a medium term arrangement, similar to the approach we are preaching for the private sector.

Ms. Lissakers said that she was puzzled by Mr. Palei's and Mr. Wijnholds's logic behind their support for precautionary SRFs, because under a precautionary arrangement, the decision about whether or not the funds were actually drawn were in the hands of the member country, not the Fund, whereas what was being envisaged under the CCL, even under the commitment option, would be that the country would still have to come to the Board and there would be another threshold before any money could be drawn. Even under the augmentation option, there would be more discretion and control in the hands of the Board as opposed to the country.

Mr. Pickford made the following statement:

This has been a useful discussion thus far. The ideas that the staff present in this paper are more well thought out than in the papers we had a few weeks ago. I also agree with the Deputy Director of PDR when he said at the introduction that he thought that such a facility could be useful for countries with sound policies, but could nevertheless be hit by contagion. I think that puts it very well. I would like to focus on three main issues: whether there should be a new facility; whether we should go for the augmentation or commitment approach; and eligibility.

In an ideal world, we would prefer a new facility because it is the best way to ensure that the CCL is clearly distinguishable between existing forms of Fund assistance. It can also be presented more easily as explicitly targeting countries with sound policies, but nevertheless affected by contagion. However, we could also accept an amendment to the SRF. It is important to be clear what we mean by that, though. I would be grateful if the staff could confirm my understanding of this. One could think of a relatively minor amendment, which actually would not go very far in terms of meeting the needs of the CCL. Alternatively, one could go for a major amendment, in effect having the CCL as a separate compartment of the SRF facility.

On the augmentation versus the commitment option, this is again to some extent a question of how this scheme is to be presented and marketed. On the one hand, the commitment approach does offer a headline figure, which would define the level of support for a member, with obvious caveats behind

that. On the other hand, the augmentation approach would give the Board greater control over the size and scaling of the program. It would also allow the Board to restrict access to members with a CCL who then attempt to access funds for what could be noncontagion reasons. Therefore, we favor the commitment approach in an ideal world, but could also go along with the augmentation option.

When assessing eligibility, it is important to systematize the sort of checks that staff use when looking at any application, but in our view this should not be conducted in too rigid a manner. We would have to look at applications on a case-by-case basis, but to ensure equality of treatment, it is important to have some sort of common criteria. One essential component for any such checklist would be an assessment of how members conform to all the internationally agreed standards and codes, which staff appear to be a little dismissive of. They seem reluctant to link eligibility to standards, arguing basically that many of them have not been agreed to yet. This seems a slightly odd argument. There are at least two standards, for example, the Basle Core Principles and the SDDS, which are currently in existence. And I see no reason why they should not be used as eligibility criteria from the outset. I would argue further that any standards and codes that become operational, for example, the code on monetary and financial transparency, should also become eligibility criteria. And, the transparency reports could form part of a regular check on whether a member meets those criteria.

The other issue to do with criteria which has come out strongly in the statements is the issue of private sector involvement. While there is a need to try to put in place some criteria in this regard, we also have to be rather pragmatic about this. The further a member has gone in trying to engage the private sector ahead of an application for a CCL the better. But if prior to the application private sector involvement has been relatively limited, that should not necessarily rule out the CCL. Like Mr. Faini mentioned, we want to set the incentives in place to allow countries to build up private sector involvement. Once a country has received backing of the Fund in the form of a CCL, we could then encourage or insist that ahead of activation of the CCL, the member should increase private sector commitment. Indeed, in extreme cases, we could think of making some of those prior actions for activation of the facility.

It is important to draw out in detail what the position would be for a member, and indeed the Fund, in that period between approval of a CCL and activation. Arguably, this is the most important stage, so would the Fund, for example, be able to retain the right to withdraw the CCL before activation, and before the time limit runs out? Would the Fund be able to ensure that activation of an SRF, if one went down that route, to provide CCL resources could be presented as different in substance from normal use of the SRF?

Finally, I would welcome some more thoughts from the staff on the impact on the Fund's liquidity. The paper identifies the scale of resources that might be required, but does not suggest how this should be handled. Thus, I would welcome proposals from the staff about the treatment of CCLs, before the facility is activated. For example, would we actually be looking at a

50 percent offset or a lower level than that? Similarly, would the CCL be structured so that we could ensure that NAB or GAB activation could occur at the same time as a drawing under the CCL? Those are questions which I do not expect an answer today, but are important for the next phase of work.

Mr. Esdar made the following statement:

The establishment of the Contingent Credit Line indeed raises difficult questions which have to be addressed before we can go ahead with such a mechanism. We must find convincing answers in particular to the following questions:

- how to prevent moral hazards?
- and in this regard, how to safeguard the catalytic role of the Fund?
- and how to protect the Fund's resources?

And in this regard we should also not overlook the need for the Fund to remain able to satisfy legitimate "normal" credit demands of our membership.

The potential demand under the CCL as calculated by staff in the range of up to 125 billion SDR illustrates quite dramatically the dimension of these problems if we do not succeed in establishing a proper and prudent setting for any contingent financing.

Here, an appropriate private sector involvement is indispensable. This point has been repeatedly made, not only by this chair. In so far, it is somewhat unfortunate that this discussion precedes the Board discussion on private sector involvement which is scheduled for Wednesday next week.

Against this background, our discussion today can only be a preliminary one. Prudent contingency financing and private sector participation are closely inter-related elements of an effective crisis prevention and crisis response. We cannot decide upon one while treating the other one as a black box. Indeed, as Mr. Faini has put it, the private sector involvement has to be an integral part of the contingent line. Therefore, I appreciate Management's assurance to also come back to both the CCL-issue and the private sector involvement issue after our private sector discussion next Wednesday.

Let me now come to the institutional framework of the CCL.

First on the regime: We continue to favor a window approach. We are not convinced by staff's finding that a precautionary window in the SRF would have significant drawbacks. While we agree that a contingency orientation would require some adjustments of the SRF-decision, we believe, however, that this would not cause unsurmountable problems. By the way, we have some experience in adjusting facilities. I would like to remind my colleagues that we



did this in a quite substantial manner when we enlarged the CFF into the CCFF.

The major argument in favor of a window solution in our view would be that it would limit overblown expectations. It would also better reflect the fact that contingency or precautionary arrangements are already common elements of the Fund's policy arsenal. In so far, we would avoid the impression of developing a fundamental new approach with negative moral-hazard effects and lender-of-last-resort expectations.

A window approach would also avoid the need to consider an additional, ill-advised concept of "Precautionary SRF" in cases where a country does not meet the stronger eligibility requirements of the CCL. I was indeed puzzled by staff's consideration of a second-class contingency arrangement. In this regard, we should be absolutely clear that a contingency arrangement in general should only be considered in those cases where a country demonstrates sound economic management plus strong policy performance and fulfills a critical minimum of eligibility criteria.

Secondly, I was somewhat surprised to find staff making a beeline for the "commitment option". In our view -- and we had the impression that there was relatively broad support for this approach -- the "augmentation option" would provide more flexibility. It would also better reflect the fact that the magnitude of the financing requirements can hardly be decided up-front. Its determination would require careful consideration not only in light of the policy framework, the exchange rate regime, and the strength of the program, but also in light of the need to integrate the private sector effectively. A predetermined commitment of the official sector could rather be regarded as a bail-out guarantee than as an incentive to provide private resources. I also believe that the constructive ambiguity in the design of contingent financing will support and encourage constructive attitudes of all players involved.

Thirdly, on eligibility, I in principle concur with most of the criteria suggested by staff in para. 7. Indeed, a prudent policy implementation prior to the request of the CCL is crucial, and in this regard we have to refer to a wide range of indicators and factors to make the necessary assessment. The Article IV-process certainly is one element, the adherence to standards as well as the performance under former programs are also very relevant in this regard.

However, the reference to the private sector, requiring simply "... that the member would be able to represent that it has maintained constructive relations with private creditors and has made satisfactory efforts to limit external vulnerability through the management of its debt profile..." in my view is much too vague.

With the caveat that we have to come back to this issue after having discussed in more detail the private sector involvement, I, on a personal basis, could for example imagine that we establish an explicit eligibility criterion requiring a member to demonstrate that a framework is in place in which adequate private sector participation in crisis situations can be assured.

We should consider to test this assurance by a certain set of indicators, such as

- an appropriate sustainable debt-maturity profile (ratio of short-term to overall debt);
- existence of substantial private respective other bilateral contingency credit lines;
- the existence of appropriate bankruptcy laws;
- adherence to the Basle supervisory standards;
- open, constructive, and transparent dialogues with banks;
- adequate net reserves of the central bank;
- minimum level of country rating by Moody's.

These rating agencies are only some examples. I would invite Management, staff, and my colleagues to come forward with additional ideas in light of our future discussions on this topic. I could imagine that, based on such a set of indicators, we should require countries who ask for a CCL-arrangement to meet a critical mass of these "eligibility indicators".

Further on eligibility. Not at least because of the financing implications, we have to find ways and means to fence in the group of countries to which contingency mechanisms are targeted. Apart from policy and conditionality requirements, we should not detract from the fact that most countries should be in a position to deal with market disturbances without the crutches of official financial support or commitments. We have to prevent both

- that markets' perception of countries will be weakened by their access to the CCL; but also, maybe more importantly,
- that countries will be penalized by higher risk premia if they trust in their own capability to deal with contagion.

Also here, further work is necessary.

On conditionality, I very much agree with the point made by Mr. Faini. The first phase of the CCL will require a close monitoring of the member's policies through quantitative and structural benchmarks. We also reiterate our point that the activation of CCL will require a Board review and, if - and very likely - necessary, a substantial revision of the policy program in view of the changed circumstances. There should be a clear presumption that financing will be linked to policy adjustments.

On the amount, phasing and terms (charges and maturities), I broadly agree with staff's suggestions. However, the issue of the duration of an

individual CCL-agreement, which has not been activated, needs further clarification.

On the implications for the Fund's liquidity, the potential financing requirements of a CCL will have to be met by the Fund's regular resources. There cannot be a presumption that GAB or NAB would automatically provide the Fund with supplementary financing in order to mitigate the effects on the Fund's liquidity.

Finally, Mr. Chairman, I would strongly suggest to introduce a "sunset clause", stating that the CCL provisions would expire after three years unless extended by a decision of the Executive Board.

One additional last word, Mr. Chairman,

I am very concerned about an "inspired" US-press report that aim to create market expectations that Mexico might receive a 9 billion US\$ CCL. The masterminds behind such reports do the Fund and Mexico a big disservice. We should resist such attempts to force our hands on this CCL project.

Mr. Wei made the following statement:

At the outset, I would like to say that we support every effort made by the Fund to help members ward off "contagion" effects and maintain international financial stability. In this context, we are in broad agreement with the staff's views on the proposed new facility. I therefore support the establishment of CCLs as a new facility for the reasons as given in the staff's paper.

In the meantime, we also share the concerns as expressed in the grays of Mr. Shaalan and Mr. Sivaraman, for instance, the probable small target group of beneficiary members, the real effectiveness of the CCLs, and the liquidity implications for the Fund.

Let me briefly mention some of the issues.

First, on the eligibility. I hope the eligibility for CCLs will be a combination of relatively high standards and flexible applications. The aim here should be to encourage members whose economies are strong and policies are sound but facing "contagion" threats to approach the Fund proactively. Rigid eligibility requirements will only result in rare cases of the Fund being approached by potential candidates.

Second, I tend to agree that the amount, phasing, and terms of the precautionary SRFs once activated should be similar to those of SRFs. However, prior to activation, I think there should not be any specific duration (for instance one year as proposed by staff) for the CCLs. Instead, the duration of the facility should be determined on the Fund's judgement as to how long the "contagion" threats will last. If the threats persist, members under the facility should always have access to the resources.

Thirdly, the charges on CCLs should be carefully envisaged. I would support the idea that the charge schedule of the CCLs in the post activation period should be the same as the SRFs. But in the process prior to activation, it seems to me that in order to encourage members to use the CCLs as early as possible, the commitment fees should be levied as low as possible.

Lastly, this chair has been emphasizing the importance of the private sector's participation in the prevention and resolution of crises. There are always concerns about moral hazard in terms of the private sector, particularly in the case of the establishment of CCLs. While we can say that if the international community comes out with concrete measures with regard to the private sector's involvement at an early date, the issue of moral hazard can be effectively addressed, irrespective of the establishment of CCLs. We must also stress that the private sector should fulfil its responsibilities accordingly. I hope this issue will be thoroughly addressed in our March 17th meeting.

Mr. Hansen made the following statement:

At the outset, I'd like to say that I still find that this discussion would have been more beneficial and comprehensive had it taken place after the discussion on private sector involvement in resolving crises. In fact, this chair, like many other chairs, emphasized in the last Board meeting on the Contingent Credit Line that eventual establishment of a CCL should await the conclusions of the work on the international financial architecture, and especially on how to involve the private sector. This view was also contained in the conclusions of that Board discussion. I see no new developments since January justifying staff's proposal to actually establish a CCL.

In particular, basically no progress has yet been made with respect to involving the private sector more strongly, both in crisis prevention and management. This leads me to highlight the moral hazard problem. A CCL, by providing an up-front policy endorsement and financing commitment to countries, would do nothing but increase moral hazard. One could detect an act of sovereign credit rating in this exercise. In the view of this chair, that is not a direction to follow for this institution. We have talked a lot about the catalytic - and I emphasize "catalytic" - role of the Fund, including in the financing area. A CCL would be a move to the opposite direction. This arrangement would contain no actual balance of payments financing need, still it would be backed by large amounts of Fund money. A new group of countries - those too good to fail - would appear, which may not be that different from those too big to fail or similar, if one considers market incentives. The markets would be inclined to misprice the risks in those countries, which could lead to an unjustified increase of attractiveness of those countries to investors.

Staff has reviewed the implications of a CCL to the Fund's liquidity. The result is of concern. Staff concludes that recourse to NAB and GAB will likely be necessary if a CCL is established and the expected demand for its resources is actually present. We are against linking the financing of a CCL to NAB and/or GAB. These special financing arrangements should not be used unless systemic risks are involved, and the Fund should continue to be a quota-

based institution. The procedure outlined in paragraph 8 of the staff report effectively turns the Fund into both a credit rating agency and an international lender of last resort. I am deeply concerned that these two important policy issues are not discussed explicitly. They should be subjects of separate discussions and decisions by the Board.

While the presumption is that a CCL would become a weapon against ungrounded contagions striking out of a blue sky, it is more important that amending policy failures would remain the most important objective of the Fund's programs. Indeed, like Mr. Cippa, I doubt that a sudden change in market perception can have a lasting impact, if policies are in order. Furthermore, member countries must and should, by themselves, take precaution against possible contagion by designing credible contingency measures. This does not necessarily have to involve the Fund. On its part, the Fund should avoid overstretching itself.

Let me add a few more points. First, Like Messrs. Wijnholds and Esdar, I agree that exchange rate arrangements should be given due regard in determining on the need of a CCL. Predetermined public support in a case of country with unsustainable exchange rate fix would mean a bail-out guarantee. Also, I share Mr. Esdar's concern about the recent press publications where Mexico is seen as a "potential" candidate for a non-existent CCL. As we could only learn about that from the press, it seems that again some important considerations may not be reaching the Board. Furthermore, like Mr. Taylor, I would wonder if we should give more consideration to a collateral that could be used when providing countries with large amounts of Fund money.

Second, I wonder if making a country eligible for a CCL would send the best signal of approval from the international community. The Fund, which is owned by the governments, would have to become more of an independent credit rating agency in order to send a 100 percent credible signal. Otherwise, it should be the private sector which, acknowledging the risks of investments and with no promise of an IMF bailout, would be sending the best signal. After all, the Russian and Brazilian examples indicate that, even with the Fund's approval, economic policies weren't the best, and even strong hands-on Fund involvement in those countries didn't provide the markets with good prospects for the future.

In summary, Mr. Chairman, I see more arguments against a CCL than in favor. The Fund, in my view, has an arsenal of programs and arrangements needed to support members in times of trouble. At least at this stage, a CCL seems to bring more complications than benefits. Like Mr. Taylor, I agree with the ideas about the private sector involvement expressed by Mr. Faini in his buff. Particularly, the way the private sector is involved in resolving crises will determine the Fund's role in this endeavor. I am looking forward to our discussion about the private sector involvement in the near future.

Mr. Guzmán-Calafell clarified that there had been no Mexican announcement on the use of the CCL. Relatedly, he wondered how the press had been able to write detailed reports on Board members' views on the CCL.

Mr. Hansen also noted that some press announcements had stated that the Board had taken particular decisions with regard to the CCL.

Mr. Eyzaguirre, in response to some comments to include exchange rates in the discussion, pointed out that there should not be any presumption in favor of any one regime, only on the overall consistency of the exchange rate regime and macroeconomic policies.

The Acting Chairman said that he was not surprised that the Mexican authorities were aware of the CCL since they must have received a copy of the papers. The fact that the CCL was being discussed by the Board was not a secret.

Mr. Guzmán-Calafell said that he was unaware where the reports stating that the Mexican authorities were considering the CCL had come from.

Ms. Lissakers made the following statement:

In our view, the CCL represents a further evolution of the Fund's approach to balance of payments problems, reflecting the realities of the globalized financial markets in which crises originating in the capital account are larger in size, more sudden in onset, and with greater potential for contagion. In a sense, the CCL represents a return to the original intent of a SBA. If one looks back, what we are debating now with regard to the CCL is how the SBA was originally envisaged by the founders. Unfortunately, the SBAs and EFFs have evolved into semi-entitlements, almost routine sources of balance of payments financing and relatively inexpensive at that. But, the current structure of SBAs is clearly and demonstrably not an adequate response to the kinds of financial instability that our members have faced in the last couple of years, which is why we have made some ad hoc arrangements to respond as best we could. The CCL is an attempt to refine somewhat what we have been doing in an ad hoc manner. It is clearly important to maintain a reasonable balance between the traditional objectives of providing confidence to members, protecting the Fund's resources, and minimizing moral hazard, as others have said. There are also some related issues, particularly the role of the private sector, that need to be addressed, in this context as well as in the broader effort to develop a new financial architecture.

The availability of a CCL would be a form of insurance, but one that is contingent on strong policies, ex ante, and therefore would be an added incentive for countries to strengthen their policies before disaster strikes and before pressure arise from outside forces. The combination of strong policies by the country and the existence of this insurance should help protect countries against at least the severest forms of market contagion during bouts of international financial turmoil or investor panic. The form in which the insurance is provided will determine the balance between providing confidence to the markets and to the insured, and incentives for early action. And in this context, the distinction between the augmentation and commitment options rests on some very fine perceptions, which may be more apparent to Fund insiders than to the markets. Unfortunately, the paper we are discussing today did not really draw out the distinctions between the two options, which would

have at least reiterated what had been discussed earlier at this stage in our discussion and refinements of the CCL.

The commitment option would appear to provide the clearest signal to the member and the markets that the Fund stands ready to assist the country. At the same time, the Board would undertake reviews of the CCL's participants or clients' performance in the preactivation period and could seek additional measures as a condition for activation. Thus, there would be a second threshold to cross before the money could actually be drawn, unlike a precautionary arrangement. On the other hand, with the commitment option, the Board would not have full discretion in the preactivation phase to seek policy adjustments beyond the agreed benchmarks, or to alter the amount of contingent financing. Nevertheless, a change in objective conditions will almost certainly require further policy adjustments, even in the best performer if the CCL would actually have to be activated. Certainly, we should provide sufficient flexibility to enable the Board to obtain such adjustment if necessary, even under the commitment option. The augmentation approach has the advantage from the Fund's point of view of giving greater scope and flexibility for the Board to obtain policy adjustments even in the preactivation phase, particularly through the leverage that would derive from the scope to alter the size of the financial commitment in accordance with the members' willingness to take further measures. Under the augmentation option, that could be done in a way that would not signal to the markets that we are challenging the underlying commitment. Nevertheless, the augmentation option would somewhat reduce the signaling effect of the CCL. Part of the question here arises from the lack of specificity with regard to how augmentation would work with regard to commitment or some indication in public statements about the amount of augmentation, at least potentially available, and the threshold for accessing the augmentation. It makes a difference in how we define the augmentation option if we are going in that direction.

On modalities, obviously in the end there would have to be a judgment by the Board about the quality and sustainability of a candidates' policies. The latest Article IV consultation would obviously provide relevant information, but not be by itself sufficient. Some form of IMF-endorsed and monitored program would be appropriate. We agree with the staff that an IMF arrangement would be preferable to a Fund-monitored program. Although it might not be necessary to have all the bells and whistles of a traditional SBA or EFF, in view of the presumption that the participant already has strong and sustainable policies. Given that staff insist that the CCL would only come as an add-on to a traditional program, this question may be moot if we accept that view, which appears to be the Legal Department's view and I am not going to challenge that.

Similarly, consideration should be given to whether a country has adhered to internationally agreed standards, such as those that have been broadly agreed to and exist, particularly those relating to the Fund's core responsibilities. We do not believe the full compliance with these standards should necessarily be an absolute precondition for eligibility, given the judgmental nature of the standards and the need to consider individual country circumstances. But, reasonable progress in complying with the standards could

be considered in the activation decision. As others have stressed, it would also be important to consider other vulnerability criteria, such as a country's exchange rate regime as well as its debt management policies. I certainly agree with others on the exchange rate issue. I think we have learned some lessons in that regard.

The staff and other Directors have suggested that a country which was not eligible for a CCL might be able to obtain some of the benefits of the insurance through a precautionary SRF. First, this poses a risk of confusing markets as the staff paper says, and undermining the incentive element of the CCL as an a means of advancing sound policies. Particularly, it would appear to be inconsistent to permit a relatively weaker performer more automatic access to Fund resources, which is what a precautionary SRF entails, than a stronger performer might be able to obtain. Therefore, I do not think it is desirable to allow countries to arbitrage between a CCL and a precautionary SRF. In this regard, I would ask the staff to tell us what Board decision guides the design of a precautionary SRF.

With regard to activation, once the CCL is activated, the participant would be expected to implement remedial measures. In some cases, this might involve little or no further measures, while in others a more comprehensive macroeconomic or structural program might be warranted, including changes in exchange rate regimes. The experience with the SRF suggests that the amount of the CCL commitment would need to be determined on a case-by-case basis. However, the amounts are almost certainly going to be large if the desired confidence effects are to be achieved, and an approach along the lines of the no access limit used in the SRF is probably necessary. Under the circumstances, the terms similar to the SRF would be necessary to encourage a prompt return to the markets. Moreover, it would be useful if the surcharge applied to the full amount of the CCL commitments, rather than a portion in excess of normal access, but I gather the Legal Department will say that this is not possible.

The staff has drawn a distinction in monitoring conditionality between pre- and post-activation phases, which appears reasonable. However, monthly benchmarks seem excessive and staff-resource intensive, particularly for countries who are believed to be strong performers. I would suggest semiannual reviews or quarterly benchmarks, instead.

In the post-activation period, the approach to phasing of disbursements similar to an SRF would be appropriate, but again it depends on the circumstances we are responding to.

Next week we will have an opportunity to discuss the role of the private sector. At this stage, it may be premature to decide how the CCL and the private sector measures should be related. We need to have a better idea of the specific private sector measures that are being contemplated and when one can realistically expect those to be in place.

The liquidity effects of the CCL are difficult to assess, although using SRF terms with short maturities and high interest costs would certainly



encourage early repayment. Nevertheless, we recognize that the Fund is entering new territory, and multiple CCL requests could pose potential liquidity management problems, which suggest that we should obviously be cautious in using the CCL in committing resources under this arrangement.

Finally, on the question of window or facility, the staff make a strong set of arguments for why a separate facility would provide a sharper definition, which, in turn, would enhance the quality we are seeking. First is the incentive effect on the country to implement policies earlier, and, second, the calming element to investors to stem panic in periods of turmoil. Having a window in the SRF could blur the signals. The question in the end will be how clearly we define the facility regardless of whether it is a separate stand-alone facility or a window, and we are certainly not absolutely wedded to one concept or another. The key is to have a facility that meets the key objectives that we are trying to serve.

On balance, we lean toward a separate facility, but we are not absolutely wedded to that. We thought the staff made a pretty strong case.

Mr. Al-Turki made the following statement:

I join others in welcoming this further discussion of contingent credit lines. We can all agree that the Fund should continue to adapt its financial facilities to meet the evolving needs of its members in a globalized economy. In this connection, availability of the contingent financing to emerging market economies could help boost confidence in those economies and limit contagion effects. That said, it remains unclear that a new, special facility is preferable to a precautionary SRF, especially as it is difficult to clearly distinguish between members who require policy adjustments ex ante and those that do not.

Turning to the eligibility criteria, it appears that those countries who qualify under the staff's proposal to use the Fund's contingent financing are able to obtain adequate lines of credit from financial markets, and therefore should not need Fund financing. In some instances, however, an argument could be made that the availability of the contingent financing from the Fund may encourage financial markets to provide new lines of credit to members. It could also be argued that Fund contingent financing could create a moral hazard problem. Here, a well-designed incentive structure of Fund lending, including conditionality, will be an instrument to helping bring in the private credit lines, while reducing moral hazard. Those proposals need to be revisited, however, in light of any changes in eligibility requirements and agreements on the modalities of private sector involvement. It is also important that the CCL's phasing, conditionality, and activation requirements are not perceived by the market as diluting the availability of the member to access resources. Assessing capital account crises depends in large part on the success in involving the private sector, and, in this regard, I join other speakers in looking forward to the discussion of this issue next week.

Mr. Wijnholds said that, on being favorably predisposed to a precautionary SRF, a facility already existed, although he might have been too enthusiastic on second thoughts about a precautionary SRF. He would prefer precautionary EFFs and SBAs.

Mr. Palei did not see a big difference in Ms. Lissakers' arguments on the CCL and precautionary SRF in terms of the phasing of the disbursements, given that the SRF could be adapted.

Ms. Lissakers pointed out that, while technically there was no such thing as a precautionary arrangement, a member country could just say it was not their intention to draw. However, later, that member country could change its mind and draw and the Fund would have no recourse to say no. However, under a CCL, there would be a precommitment for a specified amount, but the member country would still have to come back to the Board to get final approval to activate the line. That was the difference. She was therefore puzzled by those who raised questions about moral hazard and automaticity.

Mr. Palei thought that it was up to the Board to decide on the phasing of disbursements and on the amount available at any particular point in time. Similarly, the CCL could be activated by a special review.

The Deputy General Counsel, in response to Mr. Wijnholds question as to why the Fund could not use the SRF in a precautionary manner, explained that the terms of the SRF required an existing balance of payments need. Therefore, a precautionary application of the SRF facility would require an amendment to the existing decision. Certainly, that would not imply that the precautionary SRF would be activated automatically. The Board could determine what events would have to occur.

Mr. Kiekens made the following statement:

What protects countries against contagion is not so much the conditional country-specific availability of Fund financing, but rather the credible assurance given by the Fund that the country's policies are sound, and its economy, particularly the financial sector, strong enough to absorb shocks to its external position.

Such assurance by the Fund should be given primarily on the occasion of Article IV consultations. Those evaluations of a country's macroeconomic policies will progressively be complemented by assessments of the country's compliance with international standards for data disclosure, financial sector supervision, fiscal and monetary policies, and other structural features relevant for the well functioning of the economy. Obviously, one of the strongest assurances the Fund can give about the soundness of a country's policies is a precautionary stand-by arrangement.

I still see little need to create a new facility under which the Fund would commit itself to provide balance of payments financing in excess of normal access limits to countries that are following sound policies but could be threatened by contagion. Such countries already have access to precautionary stand-by arrangements with normal access limits. If exceptional balance of payments difficulties emerge due to sudden loss of market confidence, these

countries are additionally entitled to financing above access limits through the Supplemental Reserve Facility, provided they can agree on additional adjustment policies if needed.

In the rationale of the proposal before us, the existence of the SRF policy should provide protection against contagion for countries receiving a good assessment by the Fund.

That being said, creating a new Contingent Credit Line or "precautionary window" within the Supplemental Reserve Facility is, in my view, only a relatively minor and acceptable change in present Fund policies, provided access to CCLs or precautionary SRFs is subject to the same strong conditionality as present upper credit tranche arrangements, including regular performance reviews. Failure to complete a review should suspend access to the CCL or precautionary SRF. In addition, it is essential that if a crisis occurs, actual drawings of exceptionally large amounts should be subject to the completion of a comprehensive review of the country's policies and of its ability to repay the Fund. However, we should be aware of some possible negative side effects of CCLs and precautionary SRFs. The first such side effect is that at the moment of crisis, the Fund may be in a difficult position to require needed policy adjustments for countries whose economic policies it previously assessed as sound.

A second possible side effect that market participants could erroneously believe the CCL is a firm commitment by the Fund to provide large sums of financial assistance, while in reality it is little more than a commitment to negotiate, when a crisis strikes, about a program that could justify such a large financial assistance.

I agree that a country will only be able to obtain a CCL or precautionary SRF for one year at a time, of course with the possibility of renewal.

As under the SRF, the country should seek to maintain or regain private sector credit to complement the Fund's exceptional financing. Effective burden sharing with the private sector in cases of crisis is essential to limit moral hazard. For this reason, we should consider postponing the adoption of a CCL instrument or amending the SRF decision until we have made progress on the issue of the private sector's role in forestalling or resolving financial crises.

Let me repeat my opposition to the suggestion that access to the CCL or the precautionary SRF must in principle be complemented by official bilateral credits. Official financial balance of payments support should in principle come exclusively from the Fund, through its general resources, supplemented if necessary by resources the Fund borrows under the NAB and GAB. A new quota increase should be considered if the Fund's liquidity position requires it.

In sum, I see no urgent need to add new lending instruments to the Fund's existing policies with respect to precautionary SBAs and the SRF. But at the same time, I view the introduction of a contingent credit line or a precautionary window under the SRF as relatively small and

acceptable adjustments to the Fund's present policies, provided that access conditions to such credit lines remain as strict as under present SBA policies, and that any actual drawing above normal access limits is made conditional on a comprehensive review of the adequacy of the member's policies and its ability to repay the Fund. Between those two options, I prefer amending the SRF decision to make precautionary SRFs possible.

Mr. Mirakhor made the following statement:

I want to thank the staff for the paper. Reading the statements and listening to the interventions, I am sure that this was not an easy paper to write, given the constraints. Putting a proposal together on a facility that has to serve as a useful signaling device that cannot be activated too quickly to cause a panic, but not too late to prevent a crash, while minimizing moral hazard on the credit side and the debtor side, must have been a difficult balancing act. The staff has done a good job, and has succeeded to a large degree.

There are some suggestions that have been made that might be usefully taken into account. I want to assure Mr. Esdar that I am fully aware of the resource constraints of this institution, but I also feel that the CCL is an important signaling device that is lacking in this institution, and we need it. It can serve a useful purpose as a stand-alone facility. However, I was a bit concerned about both the conditions for eligibility and activation. I feel more comfortable now after hearing Mr. Leddy's assurances that there are real countries out there that can actually access this facility if need be. I still believe that, on these conditions, it would be useful if we can perhaps do more in terms of maintaining high standards, while retaining flexibility. I like that characterization, not only because it makes sense, but also because it would provide good language for the summing up. I am also attracted by the suggestions of Mr. Faini, Mr. Palei, Mr. Esdar, and others as to the possibility of specifying a clear set of indicators for both eligibility and also for activation.

The involvement of the private sector is clearly very important. But, Mr. Portugal makes a critical point that one has to be careful not to adversely select out investors that take real risks in the long-term investment in the country.

Concerning activation, on the relevant evidence list on paragraph 10, does the difficulty in tapping international capital markets include the possibility that the cost may be too prohibitive? If not, could we include adverse market conditions if the price is too high in that list?

On the period of time that members would have access to the CCL, one can see the reasons why that period should be short, but I also see that the staff raises the possibility of the need for an extension. In the case of the Asian crisis, the threat of contagion is well into its second year. Perhaps that period could be made longer to avoid the possibility of interruptions because that in itself could give the wrong signal to the markets.

With these remarks, I wish the staff all the luck in the world in putting together a revised version of the paper.

Mr. N'guiamba made the following statement:

During a previous Board meeting, this Chair expressed its general support for a possible role of the Fund in providing contingent credit lines (CCLs) to members that apply sound macroeconomic policies. We pointed out, however, that more information was needed on the various aspects of such a mechanism, including the eligibility criteria, before a final decision could be taken on its establishment. Today's discussion is intended to review these aspects. Before commenting on some of them, let me say that we continue to believe that CCLs at the Fund could have some advantages for eligible member countries. First, declaring a member eligible to a CCL by the Fund would reassure foreign investors that it has strong fundamentals. Second, given the conditionality attached to that eligibility, the member would be encouraged to continue the application of sound policies, including the adoption of appropriate standards.

A word of caution is needed, however, as the eligibility of a member to a CCL could send an opposite message to the markets. In our view, the approval of a CCL could be perceived by some market participants as a signal that the country's economic and financial situation has weakened. Such a perception could intensify speculative attacks on the currency, because of sudden capital outflows. This could lead to a sharp decline in investor confidence and a destabilization of the economy in general. This being said, we believe that the CCL could be successful if the private sector is adequately involved. In that regard, applicants should be required to have in place a credible macroeconomic framework with private sector participation before they become eligible to a CCL in the Fund.

On the eligibility of members, we agree that it should be subject to conditionality as stressed by Mr. Milleron. In that context, we take note of the criteria listed in the staff paper. In our view, these criteria should be made more specific to facilitate the approval process. It appears that the broad criteria contained in the report limit the number of countries that could be eligible to a CCL.

On the activation of a CCL, we agree that it should take place only if a member is encountering difficulties in its access to international markets. In other words, it should be ascertained that the use of Fund resources under a CCL is the last possibility left to an applicant.

Regarding the two options proposed by the staff, the Commitment option is not flexible enough to accommodate changes in the external environment and/or member's policies. Here, we join Directors who argue that the adoption of that option will weaken the facility. Consequently, we favor the Augmentation option.

Concerning the amount of resources to be made available to a member country under a CCL, we share the view that it is difficult to determine its size for a specific member, as this facility is designed to deal with difficulties that result from a loss of confidence and not an identifiable balance of payments gap. Nonetheless, the size of a CCL matters because it will determine the degree of investor confidence it is expected to generate. As to the phasing, a CCL should be made available for one year only with the possibility of an extension as proposed by the staff. Given the uncertainty about the precise timing of its activation, there should be a provision to allow for an extension of a CCL up to a year from the time of its activation.

On the creation of a CCL as a new facility or a window in the Fund, this Chair has an open mind and is prepared to join a majority view. However, we believe that further work is needed on the subject. In that context, we join Directors who suggested to wait for the discussion on "The Role of the Private Sector in Forestalling crises" scheduled to take place next week, before we come back to the possibility of creating a CCL in the Fund.

The Deputy Director of the Policy Development and Review Department stressed that the staff would not propose establishing the CCL without first having a discussion on private sector involvement. The sequencing of the papers had resulted in the CCL meeting being discussed first, but the revised CCL paper would take into account the forthcoming discussion on the private sector.

While the Fund has the authority to require collateral when providing a waiver of 200 percent, it has rarely sought collateral because the Fund has traditionally considered its resources secure by a country's policies through conditionality, the Deputy Director continued. In the context of the CCL, countries would be required to have sound policies, so the case for requiring collateral would be even smaller. Also, certain countries did not always have collateral. Collateralization would tie up either liquid or liquefiable resources, reducing the net benefit of Fund support.

On the eligibility criteria, Mr. Eyzaguirre and Mr. Guzmán-Calafell's point about having a sustainable position on the basis of present policies was similar to what the staff had proposed, the Deputy Director noted. Nevertheless, the staff would look at the list of eligibility indicators to make that point clearer.

Under the option to amend the SRF, the eligibility criteria would apply to the CCL, but the activation criteria would apply to the SRF, the Deputy Director remarked. Thus, the activation would not necessarily depend on contagion. That would be the simple amendment to the SRF. There was another alternative, which was to create a separate facility with its own eligibility criteria and activation criteria that would be tied to contagion. That alternative would assume two separate facilities. The complication was that it would also be possible to do the second alternative as a window in the SRF, and it would require an 85 percent majority to change the nature of the SRF. The value of having a separate new facility, conceivably as a separate window in the SRF, was to provide a clear signaling effect.

The staff was reluctant to require that countries adhere to standards to be eligible for the CCL, the Deputy Director remarked. First, many of the standards had not yet been finalized. Second, there was a question as to how to monitor standards, and whether the Fund

had the capacity to do that. Third, and most important, the understanding from the outset has been that the adherence to standards would be on a voluntary basis.

In response to a question by Mr. Mirakhor, the reason for why countries might encounter difficulties in accessing markets could be due to a price phenomenon, the Deputy Director remarked. Certainly, the Fund would not want to encourage requests for access to Fund resources to arbitrage the rate of charge. However, the Fund would not want to face a situation in which the markets had absolutely snapped shut.

After the one-year extension of the CCL would expire, the Deputy Director explained that the CCL arrangement could be renewed. Thus, the CCL was not that limited.

The staff representative from the Treasurer's Department remarked that the number of countries potentially eligible for the CCL would have an impact on the Fund's liquidity. The actual impact would depend primarily on the agreed eligibility criteria. The illustrative calculations in the staff paper were based on a list of countries that could be subject to contagion and that were dependent on markets. However, under the current eligibility criteria, those countries would not be eligible for the CCL. Over time, as countries strengthened their economic policies, and as standards were developed and implemented, the circle of countries potentially eligible for the CCL could widen.

The staff would be wary of suggestions of any kind of automaticity about contingent financing by the Fund, the staff representative said. The Fund's liquidity situation was adequate, given that the fund had recently repaid all amounts borrowed under the GAB and the NAB. Therefore, a limited amount of CCLs could be accommodated with the Fund's own resources. That said, the GAB and NAB were an important buttress to the Fund's liquidity, and if the need should arise where the Fund's liquidity was impaired and where the other criteria for activation of the NAB applied, it would be possible to finance a larger numbers of CCLs.

Mr. Hansen asked whether the combined potential disbursement of SDR 25 billion plus the other drawings on the Fund compromised the Fund's liquidity ratio.

The staff representative from the Treasurer's Department replied that if the Fund were to commit an additional SDR 25 billion in financing through its own resources, then the Fund would return to a very uncomfortable liquidity ratio. However, that SDR 25 billion could not be compared with the SDR 25 billion amount that appeared in the paper; the latter number was derived from a different concept. It was essentially a listing of potentially eligible countries and their total quotas.

Mr. Hansen asked the staff to indicate which other countries, apart from the potential CCL countries, were likely to draw on the Fund's resources. At the time of the new liquidity exercise, that might be an occasion to discuss that subject. Also, that would be an occasion where the Board could discuss the CCL methodology in more detail.

The Deputy General Counsel stated that the paper had offered a few options in terms of linking the CCL to existing facilities. The next paper could elaborate further on those options and point out the differences more clearly.

On why a precautionary element in the SRF had not been established when the SRF had been created, the Deputy General Counsel explained that decisions responded to perceived needs at the time.

More generally, Mr. Pickford's questions, while quite provocative, dealt more with the future, the Deputy General Counsel noted. Nevertheless, he agreed with many of the points raised by Mr. Pickford.

Mr. Esdar clarified that he did not presume that the NAB or GAB resources would automatically be calculated as potential means of financing. If the CCL were established, the NAB and GAB resources were reserved to the Fund. In each particular case, there would be a strong majority requirement of NAB or GAB participants to agree to provide that financing. It certainly was not an easy way. Also, those participants would have to make a judgment as to whether contingency financing met the requirements of the NAB. That was still an open question. Relatedly, financial resources should also guide the design of any window to an existing Fund arrangement.

Mr. Fernandez noted that the paper, in paragraph 29, stated that the Fund could not deny access to the SRF if the balance of payments problem was not a result of contagion. However, the following sentence in that paragraph stated that the Fund could safeguard its resources through the imposition of appropriate conditionality and phasing. Would the Fund be able to protect its resources under the precautionary SRF with the conditionality process? Was the reason for requiring an 85 percent majority to provide such security?

The Deputy General Counsel explained that to introduce the CCL as a precautionary element in the SRF required a simple majority. On the other hand, amending an existing facility by changing the balance of payments criteria would require a special majority. However, that was not a contradiction. The complication was that if one worked within the SRF, there were certain balance of payments purposes to which one was responding to. The CCL was presented in a narrower concept in terms of balance of payments purposes. The problem was that working within the SRF might not provide the same degree of control over access as there would otherwise be if the CCL were a separate facility or a separate element.

Mr. Esdar remarked that one option would be to introduce a window in the SRF. That window could define a type of conditionality for activation, which would require a simple majority. If the Board agreed to create a contingency element under a facility, then the CCL could be activated only after a review of the situation and after the program was adjusted. The balance of payments situation of a country which wanted to activate the CCL was similar to that of a country which has regular SRF resources: both have a similar balance of payments need, although the origins might be different.

The Deputy General Counsel reiterated that if a separate window was established under the SRF with a different stated balance of payments purpose, then a special majority would be needed to amend the SRF. The conditions that would apply to activate the CCL under a precautionary SRF would be those stipulated under the credit tranche policies and the SRF decision.

Mr. Esdar thought that at the actual moment of activation a country would still have a balance of payments need, although the reasons for the development of the balance of payments need might be different. That need was derived from calculating the financing gap,



and it was not clear whether determining what constituted a balance of payments need required different majorities.

Mr. Newman wondered whether the eligibility criteria would be incorporated only in the context of conditionality relating to activation.

The Deputy General Counsel replied that initially, at least, those criteria would be part of the conditionality element.

Mr. Taylor pointed out that the staff had stated that it would be possible to have numerous rollovers, perhaps even for years. He questioned whether such rollovers should be allowed, given that if the contagion ran on for months and even years, then the problem was a homegrown problem.

On the collateral issue, Mr. Taylor disagreed with the staff that collateral would tie up liquid or liquefiable assets, on the contrary, it would liquefy currently illiquid assets.

The Deputy Director of the Policy Development and Review Department, in response to Mr. Esdar's comment about the staff's preference for the commitment option, explained that the augmentation option might appear to the country to be a weaker form of commitment to the market. Under the augmentation option, if the Board indicated its preparedness to consider an augmentation up to a certain amount, while that would not be a commitment, it was a serious indication of willingness to consider the request. The Fund would have to think of a way to take that into account in its liquidity calculations.

In response to Mr. Taylor, the Deputy Director clarified that the staff had not suggested extending the CCL year after year. On the contrary, what the staff had in mind was the possibility of an extension when a country had a one-year CCL and toward the end of it the problem struck. Also, after the CCL expired, the country could then, if it wanted, request another CCL for another year. On the collateral point raised by Mr Taylor, it depended on the type of asset.

Mr. Hansen asked whether it was in accordance with the Fund's Articles of Agreement to arrange for borrowing for a country that did not have a balance of payments need.

The Deputy General Counsel responded in the affirmative. An arrangement could be approved by the Board at the request of a member, even though there was no existing balance of payments need. However, for the member to make a purchase, there had to be a balance of payments need.

The Acting Chairman made the following concluding remarks:

Executive Directors have returned to the subject of a possible role for the Fund in providing members with contingent credit lines, following their discussion in January and in light of the staff paper that has explored this matter further. They generally recognized the danger of financial market contagion in transmitting financial market disturbances to economies that are fundamentally sound and well managed. Most Directors believed that the Fund should have a role in helping to forestall this, and as in the earlier discussion, there was general support for pursuing the concept of Fund-financed contingent

credit lines (CCLs). Some Directors, however, continued to express serious reservations about the provision of contingent credit lines, noting concerns about the adequacy of private sector involvement and the attendant risks of moral hazard, as well as the effect on Fund liquidity. In considering the provision of CCLs, however, all Directors who supported the concept insisted that more concrete ways need to be found of involving the private sector, both in crisis prevention and in the provision of finance when contagion strikes. This was considered important in order to avoid the problem of moral hazard and to ensure that the private sector plays an appropriate role in the provision of financing.

While Directors referred to the three options for the CCL outlined in the last paper, this discussion focused on the augmentation and commitment options.

With regard to the modalities of a possible CCL, Directors were broadly in agreement on the need for suitable criteria to determine eligibility for a CCL, and while considering the proposals in the staff paper to be broadly appropriate, asked the staff to consider making the criteria more specific. We have noted various suggestions, for example, referring to sustainability checks, adherence to standards, and other indicators of eligibility, while avoiding an overly restrictive list of eligibility criteria, and we will take these into account in trying to refine the criteria.

Directors also generally agreed on the staff proposals regarding conditionality, which could be expected to be strengthened if and when contagion were to strike; on the need for the member's policies to adapt to the relevant circumstances; and on the need to generally defer decisions on phasing until activation. On activation, they welcomed the requirement of a Board review and stressed the importance of a speedy response by the Fund. On the role of the private sector, it was recognized that we are not able to be very conclusive at this stage, and Directors looked forward to a more substantive discussion in the context of the staff paper on this subject due for consideration next week so as to make the role of the private sector, to the extent possible, an integral part of the CCL. Directors, nonetheless, noted the responsibility of countries in preventing crises through the avoidance of excessive short-term debts and the maintenance of close and constructive contacts with their creditors, as well as a possible role for the private sector in providing contingent lines of credit and other instruments to involve the private sector during a period of stress.

For a CCL to be fully separate from the Supplemental Reserve Facility (SRF), both in terms of eligibility and activation, it would have to be in the form of a separate facility, or a separate element within the SRF operating under rules separate from the present SRF. Directors noted the various arguments in favor of and against a special facility. A separate CCL would have the advantage of sending a clearer signal to the markets, but also the disadvantage of possibly adversely affecting market sentiment if it were withdrawn. Directors were broadly divided on this issue, and agreed to return to it later.

We will return to the CCL issue after a fuller discussion of the role of the private sector in forestalling and resolving crises. In the meantime, the staff will prepare a short paper taking up some of the suggestions and issues raised today. We will add to that what we can draw from the discussion of the private sector paper and come back to the Board soon thereafter, including with draft decisions for consideration, as appropriate.

### **DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING**

The following decisions were adopted by the Executive Board without meeting in the period between EBM/99/23 (03/8/99) and EBM/99/24 (03/10/99).

#### **3. SOMALIA—OVERDUE FINANCIAL OBLIGATIONS—REVIEW FOLLOWING DECLARATION OF INELIGIBILITY—POSTPONEMENT**

The review of Somalia's overdue financial obligations to the Fund provided for under paragraph 5 of Decision No. 9575-(90/154), adopted October 26, 1990, as amended, is postponed to a date to be determined by the Managing Director, when in his judgment there is once again a basis for evaluating Somalia's financial and economic situation, the stance of its economic policies, and its cooperation with the Fund, and in any event not later than September 17, 1999. (EBS/99/24, 3/2/99)

Decision No.11916-(99/24), adopted  
March 9, 1999

#### **4. APPROVAL OF MINUTES**

The minutes of Executive Board Meeting 97/121 are approved.

#### **5. EXECUTIVE BOARD TRAVEL**

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAM/99/38 (3/8/99) is approved.

APPROVAL: May 31, 2001

SHAIENDRA J. ANJARIA  
Secretary