

INTERNATIONAL MONETARY FUND

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10:00 a.m., November 20, 1987

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors

A. Abdallah
C. H. Dallara

M. Finaisn
G. Grosche
J. E. Ismael

M. Massé
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Y. A. Nimatallah

J. Ovi
H. Ploix
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A. K. Sengupta

S. Zecchini

Alternate Executive Directors

Jiang H.
M. K. Bush
J. Prader
E. V. Feldman

J. Reddy
J. Hospedales
C. Enoch

C. V. Santos
I. A. Al-Assaf
L. Filardo
M. Fogelholm
D. Marcel

C.-Y. Lim
O. Kabbaj
L. E. N. Fernando
M. Sugita

L. Van Houtven, Secretary and Counsellor
B. J. Owen, Assistant

1. Enhanced Structural Adjustment Facility - Considerations
Relating to Access and Monitoring Procedures Page 3

Also Present

African Department: A. D. Ouattara, Counsellor and Director;
E. L. Bornemann, R. C. Williams. Asian Department: W. M. Tilakaratna.
Exchange and Trade Relations Department: I. A. Whittome, Counsellor
and Director; J. T. Boorman, Deputy Director; S. J. Anjaria, M. W. Bell,
S. B. Brown, B. Christensen, K. Flug, J. Hicklin, H. Hino, M. Nowak.
External Relations Department: A. F. Mohammed, Director; P. C. Hole,
I. S. McDonald. Fiscal Affairs Department: V. Tanzi, Director.
IMF Institute: O. B. Makalou. Legal Department: F. P. Gianviti,
General Counsel; W. E. Holder, Deputy General Counsel; A. O. Liuksila,
R. H. Munzberg. Middle Eastern Department: A. S. Shaalan, Director;
S. H. Hitti. Research Department: H. C. Kim, P. Wickham. Treasurer's
Department: T. Leddy, Deputy Treasurer; J. E. Blalock, D. Gupta,
D. V. Pritchett. Western Hemisphere Department: S. T. Beza, Director;
J. Ferrán, Deputy Director. Personal Assistant to the Managing Director:
H. G. O. Simpson. Advisors to Executive Directors: M. B. Chatah,
A. G. A. Faria, S. M. Hassan, A. Ouanes, P. D. Pérez, P. Péterfalvy,
N. Toé, A. Vasudevan, J. F. Zeas. Assistants to Executive Directors:
N. Adachi, R. Comotto, E. C. Demaestri, F. Di Mauro, W. N. Engert,
V. J. Fernández, M. A. Hammoudi, C. L. Haynes, G. K. Hodges, J. M. Jones,
W. K. Parmena, A. Rieffel, V. Rousset, C. C. A. van den Berg, R. Wenzel,
Yang W., I. Zaidi.

1. ENHANCED STRUCTURAL ADJUSTMENT FACILITY - CONSIDERATIONS RELATING TO ACCESS AND MONITORING PROCEDURES

The Executive Directors considered a staff paper on considerations relating to access and monitoring procedures with respect to the enhancement of the structural adjustment facility (EBS/87/23C, 11/9/87; and Cor. 1, 11/16/87).

The Director of the Exchange and Trade Relations Department said that with regard to the projections of financing requirements of countries eligible to use the structural adjustment facility, he wished to emphasize the illustrative nature of the exercise that had been carried out by the staff, initially to calculate the possible global financing requirements of eligible members and subsequently to provide the background for the access policy for individual members.

There were two points on which guidance from Executive Directors would be helpful, the Director of the Exchange and Trade Relations Department added. First, the cutoff date of May 1989 for the approval of new three-year arrangements under the enhanced facility left a relatively short period within which to put together new arrangements, especially as experience had shown that they took a long time to complete. On the other hand, a later cutoff date was not possible unless potential creditors could extend financing for a longer period than had been envisaged. His second point concerned the proposal for annual reviews of the operation of the enhanced structural adjustment facility. Despite the work involved for the Board and the staff, there were so many uncertainties--especially about the resources that would be made available, and the use that would be made of them--that it had been concluded that an annual review would be necessary.

Mr. Nimatallah asked whether it was necessary to discuss the issues on the agenda in an informal meeting. Although no decisions were to be reached, the outcome of the discussion seemed likely to make a formal meeting worthwhile, as a preliminary step toward those decisions.

The Chairman remarked that he shared Mr. Nimatallah's hope that Directors' contributions to the discussion would be substantive ones that would make it possible for the subsequent formal meeting to be conclusive. As the preparation by Directors for the meeting had been influenced by its informal character, he suggested retaining the format of an informal session as planned.

Mr. Sengupta observed that the main reason for the informality of the meeting was the short time available to prepare for the discussion. In his constituency, the staff paper had either not been received or received only recently; thus, his authorities could not yet take a formal position.

Mr. Jiang made the following statement:

At the outset, it might be helpful to reiterate China's stand on the use of Trust Fund reflows. At the September 1985 meeting of the Interim Committee, we stated that although China was a low-income country, it would not make any request to use the funds under the present circumstances, and that that should not affect China's access to concessional funds.

China's stand was reaffirmed by the Managing Director in his summing up of March 26, 1986 at the conclusion of the discussion on the Special Disbursement Account (EBM/86/56, 3/26/86), when he stated that:

I wish to stress that Executive Directors reaffirmed their great appreciation to China and to India for having offered to forgo use of the facility: not because they are not low-income countries or have no need--they are low-income countries and they have needs--but as a gesture of international solidarity in favor of countries that are in even more dire straits. But China and India also want it to be absolutely clear that the arrangements on which decisions are being taken for use of Trust Fund reflows will not affect adversely the availability of concessional development finance to low-income countries that are not utilizing those reflows under the structural adjustment facility. The Board has unanimously reaffirmed that principle, which is contained in the Seoul communiqué of the Interim Committee, and which must now be implemented.

With respect to the enhanced structural adjustment facility, China--as a low-income country--is certainly eligible to use this concessional facility. However, China will again not seek to make use of the enhanced facility under present circumstances. But, I would like to emphasize that China's eligibility to use these resources must remain intact.

Recently, we have noticed a tendency on the part of certain multilateral institutions to exclude China from the use of concessional resources. China forewent its legitimate use of the structural adjustment facility as an act of goodwill. Unfortunately, it seems that this action is being used as a precedent to exclude China from the use of concessional funds. This is indeed unfair, and rather than being an incentive for countries to make similar gestures in the future, will certainly be seen as a discouragement. The international community should be alerted to this problem so that efforts can be made to forestall such a tendency.

Although China is a developing country with its own external financing needs, it has consistently supported--to the best of

its ability and in the interests of international cooperation--other developing countries experiencing difficulties. In addition to our action in forgoing both use of the Trust Fund reflows and use of the enhanced structural adjustment facility as our contribution to international cooperation, a more recent action was the commitment and support shown by China to African countries upon the Fifth Capital Increase of the African Development Fund.

Now let me turn to the staff paper on the considerations relating to access and monitoring procedures with respect to the enhanced structural adjustment facility. Here, I would like to stress that the guiding principles for use of the existing structural adjustment facility should also apply to the enhanced facility, that procedural arrangements associated with the use of the existing facility should be simplified, and that the conditionality should be more flexible rather than more stringent.

If the enhanced facility is to be based on the above considerations and to be an additional part of the existing facility, creation of a new facility would be unnecessary; this approach would also be in line with the Board's preference to have as simple a system as possible. The Board could perhaps take a decision to continue the existing facility until May 1989, which is the proposed cutoff date.

Taking into consideration that the financing requirements of members eligible to use the structural adjustment facility vary widely, I can go along with the principle of tailoring the amounts available under loans from the enhanced facility to the individual needs of borrowing members, within a range from a minimum of the same amount as under the existing facility, up to a maximum of 300 percent of quota. This tailoring would, of course, be on the basis of a careful assessment of balance of payments need and the strength of the adjustment program. However, I would like to stress that great caution must be used in making this assessment to avoid any element of subjectivity in assessing the adjustment program's strength. We also have to be very aware of the social and political ability of the borrowing members to endure certain conditions and requirements.

As for the use of benchmarks, it should be limited to those few variables that are considered most important for purposes of monitoring the program. I am not in favor of the staff proposal that some benchmarks should be constituted as performance criteria, especially not for making disbursements conditional on the observance of performance criteria. I am also not in favor of requests for prior action under the enhanced structural adjustment facility.

The annual discussion of programs should be maintained, but I have serious doubts about the proposal for a midyear review.

Any further addition to the procedural arrangements under the existing structural adjustment facility would be too burdensome to the authorities of borrowing member countries and also to the staff and the Board. Furthermore, I do not know if experience under the existing facility warrants such a review. However, as the staff has argued that this practice will ensure the timely provision of financial assistance, I would appreciate hearing more on the matter from the prospective recipient countries.

The Chairman said that he shared Mr. Jiang's view that to take the generous attitude of China with respect to its use of the structural adjustment facility as a precedent for diminishing concessional support to China would be unjust. The example of international solidarity shown by China, as well as by India, was valued highly by the Fund. The two members were making a contribution to other potential beneficiaries of the structural adjustment facility and to the membership at large. He hoped that their gesture would be matched by those industrial countries that had not yet finally settled their contributions to the financing of the enhancement of the structural adjustment facility.

Mr. Enoch made the following statement:

I can strongly endorse the staff paper and have very few difficulties with it. I see the proposals for the enhanced structural adjustment facility as a well-thought-out development of the existing facility: the various proposed adaptations are very welcome, particularly the proposal for differential access, which my authorities regard as essential.

I welcome the staff recognition of debt as a key element in balance of payments financing needs, particularly the reference on pages 5 and 6 of the staff paper to heavily indebted low-income countries, but my authorities are particularly keen to go further than the staff in targeting the enhanced facility to the poorest debt-distressed countries. The reason for this is very simple. These countries are, on any realistic projection, just not going to be able to meet their debt service payments over the foreseeable future without exceptional assistance. I suggest that at the very least, the staff, when it comes to explain access proposed for individual members, should include and articulate the weight given in each case to selected indicators of debt service.

I am also pleased to see the staff's proposal for semiannual disbursements and midyear reviews with the use of a few quarterly financial benchmarks as monitoring aids and a number of semiannual benchmarks as performance criteria. Greater specification of structural benchmarks and the proposed use of such indicators in the outlying years of a structural adjustment arrangement are also very welcome. But I attach importance to the idea of a

midyear review which will provide an important degree of flexibility and resolve some of the problems we have experienced with the existing facility in synchronizing program and fiscal years. I can broadly agree with the staff suggestions that reviews could be bypassed for relatively small loans and where there is negligible uncertainty about the achievement of program targets, but I would emphasize that this provision should be used very prudently.

On the appropriate objectives of the enhanced structural adjustment, I think it is important to be clear from the start that the facility should not be used artificially and unsustainably to try to achieve growth targets. I would also stress that the conditionality applied under the enhanced facility must reflect the reality of economic conditions in member countries. It could be, therefore, that the appropriate time frame within which to seek the achievement of necessary objectives could be less than the grace period of lending under the enhanced facility. In fact, a more realistic time frame might be the disbursement period. As the enlarged facility will be available for only a limited time, at the end of a program supported by the enhanced structural adjustment facility, a member must have adjusted back to a position that is sustainable on the basis of normal medium-term financing expectations. This adjustment is particularly important given the need to ensure the security of Trust claims. In this respect, the objective of assuring repayment is the irreducible minimum, but even this is just standing still; we should try to do more. I therefore welcome the intention of the staff to seek more ambitious adjustment and would attach particular importance to the objectives set out on page 6. The substantial relaxation of external restrictions, the clearance of arrears, and the normalization of relations with creditors are of course essential objectives for all Fund assistance.

On particular aspects of conditionality, I must emphasize that prior actions should not be regarded as exceptional. They are fully justified by the availability of disbursements at the very start of programs, and the concessional nature of the facility. The specification of such measures should depend on the scale of the member's problems and its previous record of implementation. Prior actions should therefore be mandatory where there is any degree of front-loading in disbursements. The test of prior action will be a vital safeguard for the security of the Trust.

The staff's proposals to direct a substantial element of the financing from the enhanced structural adjustment facility toward the buildup of reserves is particularly welcome. The thinness of reserve cover has made a number of programs rather fragile. It will be important, however, that members' enhanced reserves be used appropriately, and desirable that reserve

levels be maintained over the medium term. Application of the various "preventive" measures developed by the staff will be very helpful, and I note the recent successes that have been achieved with the use of the SDR in assisting members' reserve management. But I would also suggest that an adequate reserve level be incorporated in some indicator of performance under the enhanced facility.

One area where I do have some questions about the staff's proposals concerns the suggestion that the Fund's general resources might be used in conjunction with the resources of the enhanced structural adjustment facility. Given that the purpose of the enhanced facility is to meet low-income members' needs for concessional resources, qualification to use the resources of the facility would suggest that a member is not in a position to use the Fund's general resources. Perhaps there will be some cases where it is appropriate for a member to have both a structural adjustment arrangement and make use of the Fund's general resources, but we will want to look at such cases extremely carefully.

Similarly, use of the facility by members in arrears to the Fund raises difficulties for my authorities, particularly because of the need to ensure the security of claims on the Trust. I should emphasize, however that any flexibility that might be extended in the use of the enhanced facility by members in arrears would be very exceptional and would establish no precedent for use of the Fund's general resources.

The system of reviews proposed by the staff, of individual access, of common maximum access, and of the operation of the enhanced facility as a whole appear to be very desirable.

I must record some reservations about members' rights to switch between the existing and the enhanced structural adjustment facilities. The staff proposals are generally satisfactory but I have doubts about whether members should be allowed to cancel an arrangement under the enlarged structural adjustment facility and move back to the existing facility, even though this can only be done before the cutoff date. I would also like to emphasize that the cancellation of an existing arrangement before the end of a program year should be exceptional and should be reflected in an adjustment of access. It will also be particularly important for the staff to ensure that no member deliberately delays its transfer from the existing to the enlarged structural adjustment facility in order to maximize its overall access. On the proposed cutoff date of May 1989, I am flexible and could accept some extension if this would be helpful.

I rather think the staff does itself an injustice in suggesting that its proposals, in particular as they affect the transition from the existing to the enhanced structural adjustment facility, are unduly complex. I do not feel that they are any more complex than the situation they must address, including the need to honor the 1980 commitment on maintaining access to the existing facility for three years. If we sort out the issues involved at this stage, the apparent complexity in the proposed arrangements will hopefully lead to greater simplicity when we come to actual implementation.

The speed with which the details of the enhanced structural adjustment facility have been worked out has so far been quite impressive. I look forward to further rapid progress, and to our further discussions in formal session on December 9.

The Chairman expressed appreciation for Mr. Enoch's understanding of the difficulties encountered in establishing the enhanced structural adjustment facility. He also shared Mr. Enoch's concern about the need to help heavily indebted countries. The right balance had to be struck between assistance from the Fund and other official sources of debt relief.

Mr. Abdallah made the following statement:

Let me begin by thanking China for reaffirming its decision to abstain from using the resources of the enhanced structural adjustment facility. In the belief that Mr. Sengupta will be making a similar announcement, let me take this opportunity to thank him in advance.

Today's topic is of major interest to my constituency; however, our discussion being informal, I will only highlight the major areas of concern to my authorities without going into details.

First, we welcome the explicit incorporation of a growth target in programs supported by the structural adjustment facility. The annual growth target of 4 percent is quite moderate in our view as it implies only a modest increase, or stagnation, in per capita income. Indeed, since the growth target for some countries will be as low as 2 percent, per capita income in those countries would continue to decline. I have noted the staff observation that if the financing gap cannot be covered from expected flows, it should be eliminated through a strengthening of the adjustment programs, and I wonder whether further strengthening of adjustment programs will still be consistent with the targets incorporated in these programs. Furthermore, the staff projections which formed the basis for Appendix I were essentially based on the World Economic Outlook, but it is already

clear that recent developments in the capital markets are going to have some adverse effects on the growth prospects of most industrial countries. I would welcome staff comments as to what the revised global outlook is going to be.

It is our conviction that for the enhanced structural adjustment facility to effectively support strong growth-oriented structural adjustment programs, it should have adequate certainty so as to give authorities the necessary confidence to embark on the required reform measures. In other words, the authorities should be reasonably assured of a certain level of uninterrupted resource flow for the three-year period. The steady flow is also necessary to maintain the momentum of reform and economic recovery.

I agree that individual countries' financial needs are not uniform, especially in relation to quota, as illustrated in Table 2 of Appendix I, which shows a rough estimate of the eligible countries' financing requirements in 1988-90 as a percent of quota varying from about 64 percent to more than 500 percent. We therefore endorse the proposal to tailor the amounts of loans from the enhanced structural adjustment facility according to the needs of borrowing countries. We have noted the suggestion to set the access limit initially at 250 percent of quota, to be exceeded in exceptional cases only up to 300 percent of quota; these limits are based on the assumption that all eligible members will avail themselves of the resources of the enlarged facility. We know from the experience of the existing facility, however, that many of the eligible members may not come forward. We therefore feel that the staff is being excessively cautious. In view of the large financing need of many countries, and noting that these limits are over three years, we would prefer higher ceilings than are being proposed. We are also of the view that there should be front-loading of loans from the enhanced facility because of the long period required for structural adjustment to bear fruit. Once a commitment is made, it should not be reduced under any circumstances; otherwise, the confidence and certainty needed for the authorities to embark on implementation of a strong program will be eroded.

We have noted the recommendation that May 1989 be the cutoff date so as to accommodate disbursements from the enhanced structural adjustment facility through 1992 and repayments through 2002. However, we would urge management and creditors at the appropriate time to look into the possibility of negotiating the rollover of funds to assist those countries that might be at critical stages of program implementation, thus requiring continuation of such financing. This is important because the problems facing these countries are not likely to be resolved in a period of three years.

I now turn to the issue of my main concern, which is the excessive conditionality proposed by the staff. On previous occasions, this chair stressed that the level of conditionality attached to the use of the resources of the Special Disbursement Account has discouraged many eligible countries from using the facility. What is proposed now is further tightening of the already high conditionality. The Board is being asked to endorse prior actions as the norm, rather than the exception, under the enhanced facility; that benchmarks be proliferated to include quarterly as well as semiannual variables, some of which will also be turned into performance criteria; that some benchmarks be extended beyond the three-year period; that a midyear review be instituted; and that disbursements be made semiannual.

It is agreed that the adjustment effort must be strong enough to deal with structural and institutional problems facing countries eligible to use the facility. However, we must be guided by experience as to what is feasible and practical and avoid the temptation to go too far in formulating overelaborate programs. If a program is too intricate it is not likely to be fully implemented. This creates a credibility problem for governments as well as for the Fund. We should facilitate structural adjustment, not complicate it.

The staff has explained that with biannual disbursements, if the completion of the midyear review by the Board is delayed by three to four months, then the midyear disbursement will be interrupted and the country will opt for the extension of the program for another six months. Clearly, many countries will face such interruptions in their programs, and some of these interruptions will occur more than once within a three-year period, a situation which is not conducive to the attainment of the program objectives. Furthermore, as the staff has shown, the mission work involved in the midyear review will be at considerable cost to the authorities, the staff, and the Board. We therefore fail to see that any useful purpose will be served by such reviews, which will represent a major departure from the annual structure of the existing structural adjustment facility.

Let me say that we are not against conditionality. It is our conviction that there is no alternative to strong, comprehensive adjustment. But we also believe that excessive conditionality will only be counterproductive. The existing guidelines with regard to the program formulation, monitoring, and disbursement under the existing structural adjustment facility are in our view adequate. What is needed to make the existing facility effective is not additional conditionality, but additional resources.

On the relationship between the existing and enhanced structural adjustment facility we would offer the following comments:

(1) We do not see any good reasons why countries with arrangements under the existing facility should cancel them for new three-year arrangements under the enhanced facility. The operations of these facilities should not present countries with an "either/or" proposition.

(2) The enhanced facility might be envisaged as an upper tranche to the existing facility, and a member should have access to both on the basis of progression.

(3) The guidelines of the existing facility should remain in force, separate from those to be agreed with respect to the enhanced facility.

(4) As an upper tranche of the existing facility, it is understandable that appropriate conditionality should apply. We might quickly add, however, that conditionality should not be such that it drives away the very countries the facility is intended to help.

The purpose of the enhanced structural adjustment facility is to assist the lowest income countries, particularly the so-called debt-distressed countries. Some of those which are very heavily debt burdened in sub-Saharan Africa are in arrears to the Fund, and thus, under the existing regulations, are unable to avail themselves of the enhanced structural adjustment facility. The staff has made some proposals in this respect.

The suggestion that the Fund should endorse the policy framework papers of these countries, so that these papers can then be utilized to mobilize funds from non-Fund sources, might be a constructive move in cases of small amounts of overdue obligations to the Fund. In this connection, I wish to reiterate our position that the greatest input in policy framework papers should be by the governments themselves, if the papers are to serve their purpose effectively. Another suggestion is that some annual loans from the enhanced structural adjustment facility might serve as bridging finance, but this suggestion runs the danger that the member will thus forgo financial resources which would have flowed to the country from the enhanced facility for the purpose of attaining the program's objectives, such as the 2-6 percent annual GDP growth and reserve buildup. In the case of those with larger arrears to the Fund, such assistance will not be enough for bridging purposes.

The final staff suggestion, which has considerable merit, is that if a member with large overdue obligations adopts the necessary adjustment measures, then the Board should make an

exception and permit disbursement from the enhanced structural adjustment facility. I urge management and the Board to give this last proposal serious consideration so that it can be put into effect fairly quickly. Certain countries in my constituency are undertaking strong adjustment measures but cannot be assisted by the Fund because of arrears. We must find a way to help these countries regularize their positions with the Fund in a mutually beneficial manner.

Mr. Prader made the following statement:

We are all aware that without the enhancement of the structural adjustment facility, the Fund would arrive at the situation in which a large part of its membership--namely, its poorest members--will be rationed out of access to Fund resources, a scenario which cannot be accepted by the international community. Recognizing this danger, a considerable number of creditor countries have reacted positively to the Managing Director's initiative for enhancing the structural adjustment facility. At the same time, it is clear that the willingness of lenders to contribute to the facility's enlargement is based largely on the expectation of stronger adjustment efforts from the recipients of the enhanced resources, and of institutional and structural reforms in their economies.

Although it is true that the security of the enhanced structural adjustment facility will be taken care of largely by the buildup of a comfortable reserve in the Trust, adjustment policies that restore countries' economic capacity to repay their debts will probably provide an even more vital guarantee of the Trust's security. In the final analysis, only the return of growth and sustainable balance of payments positions can ward off the specter of a series of enhancements of the structural adjustment facility, a prospect intolerable to those creditors that regard their participation in the enhancement as a one-time contribution.

Therefore, the idea that the creditors' loans to the Trust will have to be paralleled by intensified adjustment and structural reforms on the part of the borrowers from the structural adjustment facility is central to our view of the facility's enhancement. In this connection, we note with satisfaction the staff's thoughts on access to and conditionality of the enhanced facility, because the staff's proposals establish a clear link between access and the strength of adjustment programs. While it may be difficult in practice to quantify this relationship, the principle of making access contingent on the size and timing of the adjustment seems to us an important one. We accordingly support raising the overall maximum ceilings from 63.5 percent of quota under the existing structural adjustment facility to 250 percent of quota under the new, enhanced facility, with the

ceilings being extendable up to 300 percent in very exceptional cases. These higher ceilings would also respond to one of the major criticisms of the existing facility, namely, that it requires too much adjustment in return for too little financing.

The increase in ceilings takes account of the large balance of payments needs of eligible members, although it must be stressed that the enhanced resources of the structural adjustment facility cannot substitute for other aid funds. Moreover, substantially increased access and flexibility with respect to the ceilings must not be misunderstood to imply unlimited recourse to those resources. It must be clearly spelled out that any residual external financing gap will have to be compensated by other sources of external financing and by more intense adjustment efforts. Also, extending the ceiling in certain cases to a maximum of 300 percent would be consistent with the approach of selectively committing the resources of the structural adjustment facility for countries that face exceptional difficulties and that are responding to them with particularly courageous adjustment efforts.

The guidelines and criteria suggested by the staff for determining individual access under the enhanced structural adjustment facility seem to strike an appropriate balance between borrowers' balance of payments needs on the one hand, and the Trust lenders' expectations about assurances of timely loan repayments and the strength and timing of the adjustment efforts on the other hand.

For similar reasons, we have some sympathy for the notion of flexible treatment of countries with large overdue obligations that are unable to raise enough up-front financing to clear their arrears, but which are cooperating closely with the Fund and implementing adequate economic policies. Sudan's recent implementation of economic adjustment might be a case in point.

The present difficulties with fund-raising for the enhanced structural adjustment facility demonstrate a dilemma, and explain the need to let certain eligible countries draw on the facility before they have cleared their arrears. It would be very difficult to approach creditors twice, once for the enhancement of the facility, and then a second time to seek money to clear the country's arrears to the Fund before the resources of the facility can be released to it. Thus, I would emphasize that there is a real dilemma between the difficulties created by fund-raising and the implication for the resources that can be provided to countries, and also the repercussions on other Fund operations, including the impact of overdue obligations. At the same time, if the Fund should agree to follow a flexible approach, which would admittedly involve a departure from present Fund procedures and could have serious repercussions for the Fund's treatment of

overdue obligations, we would have to insist on appropriate safeguards. My question would be what specific safeguards the staff has in mind.

On the issue of maximum safeguards against the emergence of arrears to the Trust, the staff's proposal that the same procedures and techniques be used as are applied to the Fund's own operations seems to us to be well tested and useful, with due allowance made for including eventual further suggestions growing out of wider discussions on the treatment of overdue obligations. But the application of penalty charges, although attractive from a creditor's viewpoint, does not seem a very practical solution in the context of the structural adjustment facility, since these countries already find it very difficult to pay the normal charges for use of that facility's resources.

As for monitoring procedures, we share the view that the enhanced facility should strengthen the procedures of the existing facility, while at the same time simplifying the procedures and performance criteria. The increase of the facility's resources should not cause any increase in Fund staff missions or in administrative procedures. The acceptability and success of the enhanced facility is not likely to benefit from expansion of the already very large machinery. There has been some frustration with and criticism of the existing facility arising from attempts to compensate--by the imposition of procedures and by overburdening the Fund staff--for the inadequate funding and poor success of programs supported by use of its resources. I think we have to recognize this fact.

Therefore, and with a view to the specific problems of countries using the facility that have been outlined by Mr. Abdallah, we suggest limiting the number of benchmarks. We are strongly against the bureaucratic illusion that if a structural adjustment arrangement is not a success, the staff simply has to produce more papers on reviews for the Board to approve, ostensibly for the benefit of the country's authorities.

For these reasons, in the light of the specific institutional and other problems of the countries eligible to use the structural adjustment facility, we are not convinced that midyear reviews would in all cases improve the performance of programs. Instead, we would prefer a solution that allows management of the Fund to decide on midyear or annual reviews, depending on the circumstances.

As to the program's objectives, our chair shares the view that the enhanced structural adjustment facility should strive for the same objectives as the existing facility, with reserve accumulation and adjustment assigned important roles. There we have to disagree with Mr. Abdallah.

There should also be continuity with the existing facility with respect to the criteria for eligibility and qualification of the borrowers. These elements of continuity, plus the subordination of the Special Disbursement Account to the Trust, reassure us that the staff's proposals for creating a new facility, the enhanced structural adjustment facility, are reasonable. On the proposed cutoff date, like Mr. Enoch, we could also be flexible.

Finally, we are inclined to the view that the new resources of the enhanced structural adjustment facility should be disbursed semiannually, given the specific problems of structural adjustment programs with respect to the statistical base and other structural and institutional constraints.

Mr. Sengupta made the following statement:

As I have already mentioned, I have not yet had the benefit of advice from my authorities because, in spite of our best efforts, they received the staff paper only a couple of days back. I would have liked to wait to hear from at least the authorities of Bangladesh and Sri Lanka, which have actual experience of negotiating a structural adjustment arrangement. My comments will thus be more tentative than I would have liked them to be, and I propose therefore to come back to some of the points during the formal discussion.

The monitoring procedures under the proposed enhanced facility should be so designed as to ensure not only security of resources, but also appropriate adjustment. By appropriate, I mean balance of payments viability together with sustained growth, and not just a country's ability to repay loans. It is also important that disbursements under the proposed enhanced structural adjustment facility take place quickly in order to avoid the time lags that were experienced in the preparation of the policy framework papers and the first annual arrangements under the structural adjustment facility.

The staff suggests differential access to the enhanced facility on the basis of, first, need, and second, the strength of adjustment programs. I would seek two clarifications of these two points. First, on the question of need, the staff mentions on page 8 that the application of the criterion of protracted balance of payments problems would be guided by the summing up of the review of the structural adjustment facility in June 1987 (EBM/87/93, 6/19/87), while in the following paragraph on page 9, there is a mention of the assessment of balance of payments need being guided by the present practices endorsed by the Board for other facilities. Presumably, the staff means that the same principle should apply, but for that reason, I want to quote

from the Chairman's summing up of March 1986 (EBM/86/56, 3/26/86), at the conclusion of the discussion on the Special Disbursement Account, which included the following statement: "In the assessment of a protracted balance of payments problem, the member's situation will be reviewed against a wide range of indicators, including, as a number of Directors suggested, the recent and prospective behavior of the current account, reserves, indebtedness, arrears, and growth performance. The assessment should be made on a case-by-case basis, and avoid the mechanical application of statistical indicators." The summing up of June 1987 on the review of the structural adjustment facility, to which the staff paper refers, reiterated this position, stating that "The existence of protracted balance of payments problems should remain a criterion for use of the facility." It also stated that "the assessment should involve considerable flexibility and should not be based on the mechanical application of statistical indicators." Therefore, I see no reason for referring to the present practices in other facilities. We should continue to adopt the definition of protracted balance of payments problems given in the March 1986 summing up by the Managing Director.

My second point, on the strength of the adjustment program, concerns the way in which the staff quantify that strength. Will the assessment be entirely subjective, or is the staff going to be guided by the simple rule of thumb that the greater the number of benchmarks, the stronger the adjustment? I hope that the staff will have a better idea for measuring the strength of adjustment; otherwise, it should be guided by the needs criterion alone. A much better explanation of this point is needed before the principle of uniform access under the existing facility is abandoned.

It is likely that the heavily indebted countries will obtain large loans under a policy of differential access because their needs would be larger. But differentiated access should serve the main purpose of assistance, namely, of providing support for structural adjustment. Its purpose is surely not just to meet overdue debt-servicing obligations. I might also add that the debt problems of many of these countries cannot be solved unless the creditors, particularly the major creditors, agree to substantial debt relief measures. Without such agreement, policy adjustments alone, however severe and painful they may be, would not assure balance of payments viability for these countries or even the ability to repay loans. Large access to Fund resources cannot be a substitute for the parallel, if I may say, prior action of the creditors.

Further, in the context of the program objectives as spelled out in Section III of EBS/87/230, what does the staff mean by policy programs being more ambitious in both the magnitude of adjustment measures and the timing of their adoption? While I

can see that, within the ambit of general objectives, specific country considerations will inevitably have to be considered, the implementation capacity, as well as the sociopolitical situations of the countries, will have to be given due consideration so that the adjustment process is not subjected to strain or disrupted. It would be a mistake to consider the enhanced structural adjustment facility--either in terms of resources or the time span--as a solution for all the problems of low-income countries. A span of three years may not necessarily be enough for some countries to achieve sustainable or even reasonable balance of payments and growth objectives. But as long as the direction of the country's policy is consistent with the objectives of the program, the aim should be to continue to help that country and prepare the annual arrangements with flexibility.

The staff suggests that loans from the enhanced structural adjustment facility be disbursed semiannually, subject to Board approval of annual programs on completion of midyear reviews. Deviating further from the existing structural adjustment facility procedures, it is suggested that benchmarks would be established on a quarterly basis, and that some of the benchmarks would be constituted as performance criteria on a semiannual basis. In addition, there is an indication of greater use of prior actions. Insistence on such prior actions might not only delay initiation of a loan, but could well dissuade countries from making use of the enhanced resources of the facility. As it is, it is expected that by the end of 1987 only less than half of eligible countries would be making use of the resources of the existing structural adjustment facility. I am also not sure that the assessment of the adjustment taking place in the countries availing themselves of the existing facility's resources suggests any need for tightening of conditionality by way of semiannual performance criteria, midyear reviews, and prior actions.

You may recall that the Managing Director, in a summing up at the time of the creation of the existing facility, stated clearly that there would be no performance criteria. He also mentioned that there was no intention of overloading conditionality with prior measures. In addition, most of the difficulties listed by the staff on page 17 regarding quarterly disbursements--namely, inadequate data, the difficulty of quantifying the short-term relationship between policy variables and growth and balance of payments objectives, the inappropriateness of deriving conclusions from the outcomes of a few financial variables, and the long lag in the impact of structural measures--should hold as true for semiannual disbursements as for quarterly disbursements.

Finally, the staff noted that "quarterly performance criteria would place a greater administrative burden (with uncertain benefit) on the authorities and the Fund." How certain will be the benefit if the benchmarks are monitored semiannually instead of

quarterly? We urge retention of the existing practice of early disbursement. Many countries may have structural difficulties in implementing strong adjustment measures right from the start. They would be encouraged to take strong measures if there is a larger certainty of inflows of funds throughout the full year.

I understand that problems will arise if the overdue obligations of countries eligible to use the existing structural adjustment facility are not resolved before the resources of the enhanced facility are made available to them. But I am apprehensive of the implications of key donors commenting on the policy framework papers of members with overdue obligations as a prerequisite for facilitating timely disbursements of additional financing by creditors and donor agencies. We have already complicated the operation of a Fund facility by bringing in the World Bank to clear policy framework papers, a step that to many of us has been responsible for the undue delays in disbursements. If key donors and creditors are brought into this process, the programs may not get off the ground at all. The preparedness of countries to have arrangements under the enhanced facility should be sufficient assurance to facilitate bridge or up-front financing by donors and creditors.

Let me conclude by reiterating our stand, which is quite well known, namely, that the terms and conditions for the existing and the enhanced structural adjustment facility should be the same as those for use of the original Trust Fund. We should avoid the introduction of new conditionalities which will make access to the enhanced facility more restrictive.

Mr. Dallara made the following statement:

Let me begin by welcoming the decision announced this morning by Mr. Jiang that his Chinese authorities do not intend to avail themselves of the resources of the enhanced structural adjustment facility. We certainly welcome this decision and recognize the generosity inherent in it. And we also accept the proposition that this should not adversely affect China's access to other concessional sources of finance.

Let me also welcome the proposals that have been developed by the staff on access and monitoring, which seem to us to reflect properly, in most respects, the lessons we have learned during our short experience with the structural adjustment facility, as well as more generally our experience in dealing with low-income countries that are facing protracted payments problems.

We have evaluated the proposals in terms of three basic principles:

First, access and monitoring under the enhanced facility should be consistent with the basic objectives of the existing facility, and with the policy framework process that will be used to guide the enhanced structural adjustment facility.

Second, the additional resources which are coming on stream in connection with the enhanced facility provide both the scope and support for more substantial and more ambitious reform efforts in the countries using these resources.

Third, a high degree of flexibility with respect to access and phasing should be built into the enhanced facility in order to ensure that the scarce resources of this facility are geared to the particular circumstances of individual low-income countries with protracted payments problems.

Measured against these principles, we found most of the proposals sound, and we can lend our support to them with a few exceptions. I will limit my comments to four areas: qualifying for access, access limits, monitoring and conditionality, and the question of exceptional cases. In addition, I would like to recall briefly proposals made by Secretary Baker at the Annual Meetings for strengthening the policy framework process in low-income countries.

First, on the question of qualifying for access to the enhanced structural adjustment facility, it is clear that the new facility, like the existing one, should be directed to low-income countries with protracted payments problems. While I would not disagree with Mr. Sengupta's argument that the interpretation of protracted payments problems should be consistent with prior summings up in the Board, I would have to say that we have not been fully satisfied that this criterion has been adequately and carefully applied in all cases to date. We believe that it is particularly important that the resources of the enhanced facility be focused on low-income countries with protracted payments problems. If they are not, then we will run the risk of being inequitable, not only toward those countries which do face such problems, but also toward countries such as China which are forgoing their use of these resources.

Turning to the staff proposals on access limits, I have some concern about the concept of a residual financing requirement. I understand the reasons why this approach has been considered, but I am not entirely comfortable with certain mechanistic aspects of the approach. We believe that a judgmental, case-by-case approach to access is appropriate.

I was concerned in particular in reading Appendix I that the growth figures used could give rise to a misinterpretation. Indeed, my concerns appear to have been validated this morning because either Mr. Abdallah or I have misinterpreted the growth figures. I think it is important that we look at the growth and payments objectives of each country on a case-by-case basis, and that we not fall into the trap of creating unrealistic and arbitrary growth expectations on the part of countries using the resources of the enhanced structural adjustment facility. That is not to say that we should not attach great priority to the growth as well as the balance of payments objectives of these programs. But we should be realistic and avoid creating undue frustrations on the part of members, or creating the perception that there is a particularly high correlation between the availability of external finance and the achievement of growth objectives.

While we have some sympathy for the approach to access developed by the staff, we are inclined to believe that the determination of access should be made case by case, based on a number of considerations, perhaps not dissimilar from the considerations used in reaching judgments concerning access to our regular resources. Specifically, these considerations could be the quality and strength of the adjustment effort, the extent of the domestic and external imbalances, the pace at which the country is capable of moving toward viability, the ability to repay obligations under the enhanced structural adjustment facility, and any exceptional circumstances that may apply.

From this perspective, the 250/300 percent access limit strikes us as an approach that might well lead to excessive financing in some cases and inadequate financing in others. It might be appropriate to contemplate an approach relating primarily to annual rather than cumulative limits, since it is clear that we are not engaged in an entitlement program, and the notion of cumulative limits does tend to imply some degree of entitlement. Perhaps annual access as a percent of quota in the range of 60-60-60 as a general guideline should be considered, with flexibility for exceptional cases of up to 120 percent or 125 percent of quota in any one year, maybe with some further flexibility with respect to the overall cumulative limit on a case-by-case basis.

However, if the majority of the Board wishes to go in the direction which the staff has proposed, we believe that limits of 200/350 might provide for a somewhat more effective differentiation among members using the facility.

As for questions of monitoring and conditionality, I agree with Mr. Sengupta that appropriate conditionality here means conditionality that will clearly promote the achievement of

viable payments positions and sound, sustainable growth objectives. Like Mr. Enoch, we would have preferred some greater emphasis in the staff paper on payments viability. We recognize, however, that the time frame for achieving payments viability under this approach need not be the time frame for achieving payments viability in connection with the use of the Fund's regular resources.

Here I would note--and this is related to another comment made by Mr. Enoch--that, in circumstances where it may be appropriate for a member country to use the general resources of the Fund in conjunction with the enhanced structural adjustment facility, the time frame for payments viability must be consistent with the use of those resources. In such a case, this will, of course, have implications for the structure and timing of the adjustment effort under the enhanced structural adjustment facility as well.

We support in general the proposals with respect to quarterly benchmarks, the use of certain benchmarks as performance criteria, semiannual reviews, and phasing. We do have a few concerns, however. First, we were struck by the discussion and the concluding statement on prior actions, which suggest that Directors might consider a request for prior actions being appropriate only in certain cases. It is difficult for us to see a wide range of circumstances which would not justify the use of prior actions, unless we were to move to an approach involving quarterly phasing and quarterly disbursements. I doubt very seriously whether such an approach is attractive, nor am I proposing it. But it seems to me that as one contemplates the need for prior actions, one has to take into account the fact that reviews will be semiannual and not quarterly.

Second, with respect to the selection of structural benchmarks, while we would not disagree with the basic approach outlined by the staff, we believe that it is critical that the selection of benchmarks be guided by the priorities which emerge from the policy framework process. In certain cases, especially in low-income countries with protracted payments problems, there appears to have been a tendency to focus structural reforms and structural benchmarks on areas where the potential for early progress seems to be greatest, rather than on areas where the need for reforms is greatest. This may be understandable, and may reflect political and economic realities in member countries. It is nevertheless particularly important, in the view of my authorities, that we face up to the need to push hard on some doors which are not very easy to open--in the interest of achieving the objectives of the policy frameworks.

Finally, in selecting structural benchmarks, we would underscore the importance of taking into account the efforts of the World Bank so that there is not undue overlap between the two institutions, while ensuring appropriate coordination.

Referring to the question of exceptional cases, I must say that my authorities cannot support disbursement of enhanced structural adjustment facility resources to countries which are in arrears to the General Resources Account of the Fund. While I appreciate the points which have been made by Mr. Prader and others, I would like to point out that all countries are contributing to the financing of arrears either through increased interest payments on the use of Fund resources, or through lower remuneration. And, if a Fund member contributes resources to the enhanced structural adjustment facility that are passed on to a country in arrears, then these members are making a double contribution. Thus, it seems to me the issue is not whether members should contribute twice, but to find a way to resolve the arrears problem which also protects the financial integrity of the Fund.

At this stage, let me simply say that we recognize that we must be rather imaginative and creative in ways in which bridge financing can be brought to bear on the elimination of arrears. In this connection, my authorities are willing to contemplate bridging arrangements, where appropriate, to enable programs to go forward with the elimination of arrears. But we have serious reservations about the notion contained in the staff paper.

Finally, I would simply wish to recall that, during the Annual Meetings, Secretary Baker put forward a number of proposals which we believe would improve collaboration between the Fund and the Bank. These entailed the establishment of a joint committee of the two Boards, the use of more highly integrated joint Fund/Bank missions, and better integration of policy-based loans from IDA into the policy framework process. We recognize that today is not the occasion to discuss these proposals, but we would hope that an opportunity could be found within the next four to eight weeks to return to them, perhaps on the basis of a brief staff paper.

Mr. Nimatallah said that as he understood it, under Mr. Dallara's proposal, access limits would be set at 60 percent of quota for three separate years, with the possibility of enhancement to 120-125 percent of quota, and with a cumulative limit covering a wider range of 200-350 percent of quota.

He had been disappointed to learn that Mr. Dallara had strong reservations about using the opportunity of the establishment of the enhanced structural adjustment facility, which was not actually financed from the

Fund's general resources, to introduce an element of flexibility by approving arrangements under the facility for members with overdue obligations, Mr. Nimatallah said. The staff had hinted that ways could be found to help such countries resume structural adjustment, and economic growth, as well as settle their arrears. In his opinion, that objective was central to the purpose and operations of the enhanced structural adjustment facility.

Mr. Dallara confirmed that he had in mind a cumulative limit of 200 percent of quota over the full three-year period of the arrangement, up to a maximum of 350 percent in exceptional cases. With respect to the annual limits, there would be a ceiling of 60 percent of quota--certainly, the average size of annual programs would not be much less than that--but accompanied by an understanding that in exceptional cases, the annual limit would not exceed 120-125 percent of quota. It might be unnecessary to have a separate cumulative ceiling for exceptional cases, so that there was some scope for flexibility. There would then be a certain capacity for front-loading, as well as greater flexibility in gearing access to the individual circumstances of members. Nevertheless, he recognized that his proposal raised somewhat conflicting considerations that would have to be examined further as the more formal discussions took place in the Board.

He appreciated Mr. Nimatallah's concern, and indeed his authorities shared the objective of using the enhanced structural adjustment facility in a manner that, first of all, supported low-income countries with protracted payments problems, Mr. Dallara added. It had to be recognized that some countries had substantial arrears to the Fund, and that ways had to be found to enable them potentially to benefit from the resources of the enhanced structural adjustment facility as well as from the Fund's general resources. However, it was not clear to his authorities at the present stage that allowing countries in arrears to the Fund to use the resources of the enhanced structural adjustment facility was the most appropriate way to meet that shared objective. The question was whether such use would give adequate incentive to countries to eliminate arrears. His impression was that continued disbursement of assistance by multilateral creditors, and bilateral creditors, despite the existence of growing arrears to the Fund, had in fact deprived creditors of an important form of leverage to encourage the elimination of arrears in certain cases. Similarly, disbursements from the Fund under one wing, albeit a trust, while arrears continued to exist under another wing, did not seem to offer the right incentives to eliminate arrears. He recognized that views might well differ on that point, but the challenge must be faced in particularly difficult cases of determining whether or not resources could be mobilized, possibly in conjunction with official bridging arrangements, to support countries that had large and mounting arrears in the elimination of those arrears. Creditors would also have to recognize that reality, although of course the countries themselves would have a substantial part to play. In the long run, there were substantial potential costs in moving forward in that direction, even in exceptional cases, but further reflection upon the matter by all concerned was called for.

Mr. Nimatallah considered that it was precisely because of the difficulty of finding bridge financing that more flexibility needed to be built into the use of the resources of the enhanced structural adjustment facility. He failed to understand how the annual limits proposed by Mr. Dallara would offer greater flexibility. Also, like Mr. Enoch, while he was opposed to introducing an inadvertent link between use of the Fund's general resources and those of the enhanced structural adjustment facility, he saw no reason for denying countries the opportunity to agree on a structural adjustment arrangement under the enhanced facility as long as they remained in arrears. He asked Mr. Dallara whether it was the possibility of such an inadvertent link that had led him to have strong doubts about the use of the enhanced structural adjustment facility by members with overdue obligations to the Fund.

In response to a question by Mr. Zecchini, Mr. Nimatallah said that the magnitudes of their overdue obligations made it very difficult for some countries to obtain bridge financing, either in the market or from official sources. The Board's recent informal discussion on the proposed financial arrangements for the enhanced facility had left him with the impression of a universal desire to guarantee the liquidity of claims. Overdue obligations had led to a feeling of uncertainty about the return of resources because some countries had no capacity to repay even if they wanted to do so. Incidentally, creditors, particularly private creditors, had found it difficult to extend credit to such countries.

Mr. Zecchini remarked that a bridge loan was to some extent self-insuring since it was linked to another financial arrangement that would come into effect at a specific moment, at the start of a program. If, in spite of such assurances, there was insufficient confidence in the behavior of the borrowing countries to honor their commitments to repay bridging loans, he failed to see how the Fund could boost that confidence by lending to a country that was in arrears. His concern was with the need for consistency in the reasons underlying the difficulties in arranging bridge financing, and the proposal that some Directors had made for greater flexibility in lending to countries in arrears.

Mr. Dallara commented that annual guidelines or limits on access seemed to him to provide more flexibility than three-year or cumulative limits simply because circumstances would change. The countries' financing needs would increase or decline during the second or third year of a program, and the Fund would have more flexibility to respond to those changing circumstances under an annual approach.

With respect to bridge financing, Mr. Dallara said that he wished to underscore the point made by Mr. Zecchini. The issue in bridge financing was the assurance of a source of repayment, not the creditworthiness of the borrowing country itself. But even though a country might not be very creditworthy in the private markets, those providing official bridging finance might have to look beyond the need to make bridge financing available to major debtors and the Fund as an institution might have to encourage them to do so, if the problems of some countries were to be resolved.

His concern relating to the disbursement of resources from the enhanced structural adjustment facility to member countries with overdue obligations to the Fund was of a recurrent nature, Mr. Dallara explained. It was not a question only of the disbursement of the resources of the enhanced facility in conjunction with a stand-by arrangement or extended Fund arrangement. The overdue obligations would have been incurred as a result of earlier use of the Fund's general resources. It was necessary to think carefully about the signals being sent to borrowing countries and to potential donors who might see a willingness on the part of the Fund to move ahead in face of continuing arrears. The cooperation the Fund would obtain from multilateral institutions and from bilateral aid donors in addressing cases of arrears to restore creditworthiness and a current position with the Fund would be adversely affected. Such an outcome would do a disservice to all concerned. It had to be recognized that the Fund's exposure in some countries, and its problem of overdue obligations, was not only a function of the difficulties those countries had faced but perhaps a function of the way in which bilateral aid agencies had looked to the Fund to provide resources. The growing lack of concern on the part of bilateral aid donors and other multilateral institutions for the problem of arrears to the Fund was a matter of concern to him, personally, and he believed should be to the Board as a whole.

The Chairman said that the matter of overdue obligations of countries eligible to use the resources of the structural adjustment facility was indeed a major question. The Board would have the opportunity to discuss the issue early in 1988. Attempts to find imaginative solutions could, and should be made, but the real key to the solution of such countries' problems lay in their resolve to embark on strong adjustment. The overdue obligations were the result of the failure to adjust. The challenge for the Fund was to know how to respond to a country that embarked on an adjustment program that would bring about structural change with growth and the clearance of arrears. The Fund would then have to be prepared to consider what role to play, on a case-by-case basis.

Mr. Nimatallah remarked that it was indeed when the Fund was confronted with a country that was doing its best to adjust, and had taken prior action but was waiting for bridge financing, that a more flexible response on the part of the Fund was called for. Unfortunately, in the real world, bridge financing was not forthcoming until the Fund made its contribution, however modest; and to enable the Fund to make progress in that direction, it was necessary to find a way for it to exercise that flexibility.

The Chairman remarked that he agreed with Mr. Nimatallah. He would add only that flexibility on the part of the Fund would be called for when other major creditors were also making an extraordinary effort. It was in the interest of the international community as a whole to ensure that countries resumed normal international financial relations.

Mrs. Ploix made the following statement:

First, like Mr. Dallara, I welcome China's decision to forgo use of the enhanced structural adjustment facility.

I would like to emphasize the specificity of this facility, which is designed to provide assistance to the poorest countries that are facing deep-seated structural problems. This basic objective is to be achieved in a medium-term perspective that is more conducive to growth. More substantial financing on concessional terms would of course imply a strengthening of structural adjustment measures with a view to enhancing the credibility of the whole facility. However, in our mind, the reformulation of conditionality should not end up with a program design very similar to that under a stand-by arrangement. In this regard, the staff document gives the impression that there would be no significant difference between a new enhanced structural adjustment arrangement and a typical stand-by arrangement. There are significant similarities: benchmarks constituted as performance criteria, the phasing of disbursements on a semiannual basis, and the rolling nature of annual programs.

Given the specific goals of the structural adjustment facility, we are of the view that its conditionality follows a different line of reasoning from that of the stand-by arrangement: it must be tailored mainly to the structural aspects of growth-oriented adjustment. At the same time, the countries eligible to use the facility, while implementing far-reaching adjustment measures, are likely to experience external financing needs. Consequently, they should remain eligible for the standard financial assistance of the Fund, namely, a stand-by arrangement. Such additionality, in the form of a structural adjustment arrangement and a stand-by arrangement, seems to be ruled out in the staff paper; I would appreciate clarification on this point.

If one considers that such additionality is to be a normal feature, the strengthening of conditionality on macrofinancial variables for use of the structural adjustment facility becomes largely irrelevant. Actually, this core component would be assured through a stand-by arrangement coupled with a structural adjustment arrangement. For my authorities, the stand-by arrangement embodies all the essential elements of the Fund's conditionality; even if the conditionality of a structural adjustment arrangement is strengthened along the lines suggested by the staff, it seems difficult to achieve the same result. However, we acknowledge that the particular situation of some countries can make the implementation of a stand-by arrangement difficult.

As far as the monitoring of structural reforms is concerned, we can support the introduction of prior actions on measures of institutional reform, which could facilitate a certain degree of

front-loading. We can also go along with the implementation of midyear reviews to permit a close follow-up of the program.

As regards access limits, we are in broad agreement with the general pattern proposed by the staff. We are also agreeable to differentiated access; however, a more structured approach, including precise guidelines, seems advisable. In this respect, the staff should examine the basic approach taken by the U.K. chair; likewise, when defining differentiated access, the guidelines should take into account the reliance of some countries on one or two export commodities.

Concerning the treatment of arrears, it seems to us that a cooperative approach involving all the main potential contributors is the only satisfactory way of resolving the problem. The Fund cannot envisage an arrangement under the structural adjustment facility as long as arrears exist; however, once these arrears have been cleared, the Fund must resume its own financing, which should include structural adjustment and stand-by arrangements.

A continuing cooperative approach on the part of all contributors--which after all underpins all the Fund's actions--is necessary for the effective implementation of the enhanced structural adjustment facility.

Mr. Grosche made the following statement:

I should like to note at the outset that I agree with most of the staff's considerations relating to access and monitoring procedures. In particular, I agree with the staff that the objectives for programs supported by the enhanced structural adjustment facility should be the same as for the existing facility, namely, to support structural reforms and thus promote sustainable growth and external viability. As envisaged by the staff, the programs should bring about substantial and sustainable progress toward an overall position that is consistent with orderly relations with creditors and a liberal trade and payments system.

As my authorities have not reached a conclusive view on all of the points raised by the staff, we welcome the opportunity for an exchange of views in an informal meeting.

Against this background, let me address briefly the key issues raised by the staff.

As regards access limits, I support the staff proposal to differentiate access to the enhanced structural adjustment facility according to need and the strength of adjustment programs. I see a symmetry between the amount provided and firm adjustment

efforts that I encourage the staff to maintain clearly in future. In this context, I fully subscribe to the requirement mentioned on page 9 of EBS/87/230 that "adequate safeguards be provided to ensure the repayment of SAF loans on a timely basis." The best safeguards in my mind are strong and consistent policies. In assessing the need, all relevant factors should be taken into account, including the debt burden of a country, but I would caution somewhat against applying a strict formula. The proposed access limits look reasonable to me in the light of the likely financing requirements of eligible countries. I realize, however, that these limits are quite high compared with those of the existing facility; of course, they can be implemented only if the target amount of enhanced resources of SDR 6 million is reached.

I noted Mr. Dallara's suggestions for more flexibility in the access limits; his points are well taken. The idea of having a somewhat larger spread between the normal and the exceptional access limits, by reducing the former and expanding the latter, might warrant some more reflection. We should not force an early decision on this matter.

On phasing, we consider that the assessment of need should also determine the phasing of the disbursements. In general, phasing should be fairly flexible. I agree with the staff that there may be cases calling for a front-loading of disbursements, but I feel that there may also be cases for back-loading, if the policy measures are not yet in place to the extent that they should be. In any case, front-loading should go hand in hand with strong and comprehensive prior action. In general, prior actions seem to me most helpful to ensure the success of the programs in cases where the record of adjustment or cooperation with the Fund is weak or where there is a need and urgency for comprehensive reform measures.

On monitoring--more specifically, benchmarks, midyear reviews, and disbursements--I believe that benchmarks have been quite useful in monitoring the progress of programs under the existing facility and should also be a feature of the enhanced facility. In addition to some key financial benchmarks, structural benchmarks should be used and formulated as much as possible in specific terms. In certain cases, benchmarks should, indeed, be formulated as performance criteria, particularly in the case of front-loading of annual disbursements. I agree also with the staff that the experience with the existing facility has demonstrated a need to provide for midyear reviews, which therefore should be a standard feature of programs under the enhanced structural adjustment facility.

I noted Mr. Prader's reservations, and I certainly share his concerns about overburdening the staff with bureaucratic

procedures. A delicate balance has to be struck between the need to provide appropriate assistance to the country in formulating and conducting its policies and the avoidance of mechanical procedures.

The proposed cutoff dates seem appropriate but I share the view of the Director of the Exchange and Trade Relations Department and previous speakers that flexibility might be necessary.

On the problem of disbursements and overdue obligations, I agree with the staff that it will be important to ensure to the greatest extent possible against the emergence of arrears to the proposed Trust. However, given the mixed experience with the emergence of arrears to the Fund so far, it will be very important in my view to follow a careful and cautious approach when assessing a member's need and deciding on the distribution of the annual disbursements over the program period.

The issue of members eligible to use the structural adjustment facility but that are already in arrears to the Fund is indeed a serious one. Although I see some advantages in the proposal to permit such countries to enter into an enhanced arrangement, and even to permit disbursements, such a deviation from established Fund policies will have serious implications for the Fund's general policy on overdue obligations. More thought should be given to this issue, and I am grateful to the Chairman for his proposal to return to this issue and to discuss it thoroughly later, perhaps in the context of the midyear review of overdue obligations.

Let me conclude by expressing my appreciation to Mr. Jiang for his authorities' continued willingness not to seek the use of the resources of the structural adjustment facility under present circumstances. I fully share his view that China's attitude in this respect should not be taken as a precedent for cutting concessionary flows to China. This, indeed, would be most unfair.

Mr. Ovi made the following statement:

The Nordic chair supports the establishment of the enhanced structural adjustment facility, by and large, under the same set of rules that apply to the existing facility. Further, we support the transfer of unutilized Special Disbursement Account resources to the enhanced facility. We also agree that these two facilities should run parallel until May 1989. For the new facility, we can accept a maximum access of 250 percent of quota, and, as proposed by the staff, of up to 300 percent in exceptional cases. Nevertheless, if necessary, these access limits should be adjusted in light of the amount of the overall

contributions to the enhanced facility. Maintenance of the present low rate of interest must take priority over a higher volume of lending. We find it important that actual access limits be differentiated on a case-by-case basis, based on the strength of individual adjustment programs. At the same time, we agree with the staff that the existence of financing gaps also plays a substantial role. The Nordic countries find it of great importance that the enhanced facility will benefit primarily debt-distressed sub-Saharan countries. Furthermore, we support annual revision of access limits.

We share the staff's view that, in general, there should be some strengthening of monitoring in the enhanced facility as compared to the existing facility. Regarding program design, we consider it appropriate that more prior actions be requested and that reserve targets be set at higher levels than in the existing facility, not least taking into account the difficulties in providing adequate security for loans to the Trust. We are also in favor of establishing quarterly benchmarks for a few central financial variables. The staff proposes that some of these benchmarks be used as performance criteria. The staff is not very specific on its intentions in this area. In our view, such use should basically apply in cases where there is an especially large need for adjustment. We agree that disbursements should take place following satisfactory midyear reviews or after an approval of the yearly programs. Only in exceptional cases should front-loading of disbursements be considered. This presupposes, however, that the program is particularly strong, that the need is especially large, and that the experience of cooperation with the country in question has been good.

We agree that the discussion taking place in the Board today can substitute for the general review of the existing structural adjustment facility, and that the first general review of the enhanced facility should take place before March 1989. We support a cutoff date for both facilities of May 1989.

Further, we agree with the staff that the enhanced facility relative to other Fund facilities should take into account, in particular, countries' debt-servicing capacity. We are, therefore, of the opinion that the Fund's financial involvement in eligible countries should primarily take the form of loans from the structural adjustment facility. In this connection, the catalytic character of arrangements under the facility has to be underlined. Considerable caution should be exercised with regard to the utilization of other Fund facilities in these countries.

Finally, some remarks on the section in the staff paper dealing with members having overdue obligations: our position in this area is very clear. Loans from the Trust should be

treated in the same way as other loans from the Fund. Thus, we cannot envisage circumstances--at least, not as of now--under which resources of the enhanced structural adjustment facility could be disbursed to countries in arrears to the Fund. As pointed out in the staff paper, there are a few cases of a gap between the amount available under the first tranche of an enhanced arrangement and the level of arrears to the Fund. Several ideas have been launched to overcome this problem, in order to restore the access of such countries to the resources of the facility. One suggestion is for bilateral donor agencies to extend some sort of bridge financing, whereby bilateral loans will be repaid subsequently from proceeds of later loans from the facility. We have serious doubts as to the feasibility of such an idea. First of all, experience shows that there is little scope for such flexibility in most donor countries and in most donor programs from one year to another. Second, future loans--and thereby repayment to these agencies--would be subject to conditionality. As recent experience has shown, we seem to be experiencing sufficient complications already in handling the relationship between use of Fund resources and lending by commercial banks.

Also, it is suggested that in certain exceptional circumstances, loans from the structural adjustment facility should be extended to a member still in arrears. As I have already said, we cannot accept such an idea, which could indeed take the Fund down a very slippery road. Too many Fund principles would be at stake.

In order to mobilize additional financing for members with overdue obligations, another suggestion is that key bilateral and/or multilateral donors be offered a closer involvement in the preparation of policy framework papers for countries in arrears. I have no firm opinion about whether such a procedure could be at all productive. Indeed, I should like to invite the staff to comment on its experience in this area. However, I feel rather strongly that if we were to follow such a procedure, it should, as a matter of principle, apply to all countries eligible to use the structural adjustment facility. To put it differently--if Mr. Nimatallah and Mr. Abdallah will allow me--I have great difficulties in seeing a legitimate economic justification for offering Saudi Arabia a say in the formulation of a policy framework paper for Sudan, but not providing the same say for the Nordic countries in the case of Tanzania.

Generally speaking, one should be careful not to misuse the structural adjustment facility to reduce the responsibility of, and pressure on, a few major creditor countries in each of these cases of substantial arrears to the Fund.

Mr. Nimatallah, noting the concern expressed by Mr. Dallara and others about the possibility of arrangements under the structural adjustment facility for members that had not yet settled overdue obligations to the Fund, asked the staff whether it could explain the mechanisms it visualized using for implementing its idea.

The Director of the Exchange and Trade Relations Department responded that no specific mechanism had been worked out. One might consider providing some flexibility, without undermining the principles that had ruled in the past, to permit the Fund to assist a member in the situation described by the Chairman. In some degree, the issue was one of presentation: in substance, the objective had not been questioned. Once the principle had been accepted, a number of options for applying it could be examined, but they all needed to be thought about more thoroughly before they were opened up for discussion in the Board.

Mr. Nimatallah then made the following statement:

I found the staff paper very helpful in visualizing how the resources of the structural adjustment facility will be channeled to eligible countries. On the main issues discussed in the paper, first, I agree with the idea of the staff to create a new, enhanced facility to be operated in parallel with the existing facility.

Second, I can go along with the May 1989 cutoff date. However, I would like to leave the possibility open for an extension beyond that date, if needed. Because resources are borrowed, I accept a slightly higher conditionality for the enhanced structural adjustment facility, in general.

Third, with respect to access limits, given the diversity of circumstances of eligible countries, I fully agree that there should be more than one level of access limits. I also agree with the staff that access should be differentiated on the basis of need and strength of adjustment. I agree with the suggested minimum access limit of 63.5 percent of quota, to be guaranteed for countries that are not using the resources of the structural adjustment facility; and with maximum access of 250 percent of quota but, in exceptional circumstances, of as high as 300 percent. However, I would like to add, in light of the exceptionally difficult cases revealed in Table 2 of Appendix I, that the Board should give itself the discretion to permit use of additional resources, of up to 50 percent of quota, in highly exceptional cases, that is, if resources permit. I would like the staff to comment on this suggestion.

Fourth, I agree that the policy framework paper should remain the basic framework upon which adjustment programs and financing are based. However, on a voluntary basis, other donors may be

given the opportunity to be involved more closely in the preparation of the policy framework papers, provided that this will not unduly prolong the process. I also would like to emphasize that the World Bank should continue to be as involved at the staff level as it has been so far.

Fifth, the monitoring procedures proposed by the staff are acceptable. I only want to add, here, that the suggested quarterly benchmarks for a few key financial variables could be designed as follow-up on an informal basis only. In this way, the authorities can be helped in keeping the process going, but it should not be held against them if small slippages occur. Therefore, I suggest that benchmarks be applied on a six-monthly basis. Thus, I can agree with Secretary Baker's wise suggestion to monitor programs of this sort on a semiannual basis.

Sixth, I approve of the three flexibilities proposed by the staff for the enhanced facility:

(a) To leave the matter of front-loading use of the enhanced facility resources open and flexible, depending on the case and certain criteria, such as strength of adjustment, prior action, and certain special needs that may warrant more front-loading. What is important is to preserve flexibility.

(b) To review the maximum access limits annually, with a view to increasing them. However, in cases where it appears that a country is experiencing exceptionally favorable balance of payments circumstances, it should be expected not to make a purchase, instead of seeing its access limits reduced.

(c) To negotiate a program with an eligible member, and possibly disburse amounts to that member while the member is still in arrears. I am pleased with the imaginative and constructive approach to help the very few countries that have exceptionally difficult circumstances and large arrears to the Fund.

The problems of those few cases likely to benefit from the enhanced facility are mainly concentrated on finding sufficient upfront resources for clearance of their arrears. I can imagine the possibility of a country being totally ready to take advantage of this opportunity to normalize its financial relations with the Fund and other creditors, but whose efforts would be frustrated by having to wait too long for the needed bridge financing, in light of the cutoff date. Therefore, I would like to suggest that in such circumstances, the Fund and the member could enter into an enhanced structural adjustment arrangement once an amount

of arrears equivalent to what would be the initial disbursement had been cleared, and subsequently to secure further payments at each further disbursement, with a view to clearing all payments within the program period.

I realize that this proposed suggestion goes a little beyond what the staff has in mind. However, I recall that the essence of the enhanced facility was precisely to help countries in these difficult situations to overcome their inability to resume adjustment and growth. I can also see a number of advantages in this proposal:

1. It will bring the country into a formal adjustment process without waiting too long for bridging arrangements.

2. It would have an important catalyzing effect that will help the country get more resources and normalize its relations with other creditors.

3. The reduction of arrears would have a welcome, positive effect on the Fund, with associated positive effects on the rate of charge and the rate of remuneration.

4. It would certainly improve the maturity structure of the country's debt, and bring such debt more in line with the country's debt-servicing capacity. In this connection, the grace period will also provide the necessary breathing room for, on the one hand, the country to restructure its economy; and, on the other, for the restructuring efforts to bear fruit.

5. This suggestion, while very helpful in facilitating adjustment in these difficult cases, does not increase net Fund exposure.

Of course, there are a number of difficult issues that would need to be tackled, and, I fully support the staff when it states that this approach can only work if "proper safeguards" are put in place. I feel that the best safeguard would be preventive in nature, and, in that context, consists of insistence on strong adjustment and comprehensive policies.

I hope that we will come back to this issue and discuss it at the occasion of the forthcoming six-monthly report on overdue obligations to the Fund. I would also like the ideas presented on page 26 of the staff report relating to preventive measures to be fully fleshed out on that occasion.

Mr. Sugita made the following statement:

I welcome the discussion of the key elements of the future operation of the enhanced structural adjustment facility. My authorities, however, have not reached the final stages of their deliberations on the lending aspects of the enhanced facility and my comments today are necessarily of a tentative and preliminary nature.

First, on the access policy, the proposed access limit assumes the attainment of SDR 6 billion for the enhancement of the facility. To the extent that either the full enhancement or degree of concessionality envisaged is not secured, however, there may arise a need for reviewing the basic assumptions on the lending operations. I hope that such a situation will not arise, but given the quickly approaching deadline, we may have to be prepared for the contingency.

Having said that, as far as the determination of individual access limits is concerned, I think the staff's proposal will broadly serve the purpose of the enhanced structural adjustment facility. At the same time, I would like to emphasize the need for equal treatment of eligible countries based on the need for financial assistance and the strength of the adjustment program. In this connection, I welcome and appreciate the intention of China not to avail itself of the resources of the enhanced structural adjustment facility. At the same time, I note the point made by Mr. Jiang on China's continued need for the concessional flow of funds.

I support the annual review of access limits of an individual country as well as of the overall access policy.

Second, on the monitoring of arrangements, while the staff proposals aim at promoting structural adjustment as well as providing sufficient safeguards, which I can broadly support, like Mr. Prader and Mr. Grosche, I am somewhat concerned about the implications for the work load of the staff and the Board.

Third, on the availability of existing and enhanced resources, the staff proposal assumes the maintenance of the present facility in parallel with the new one. Conceivably, there could be another scheme, in which the existing Special Disbursement Account is amalgamated with the new trust account resources, and lending is made through one unified window. This type of scheme may have an advantage from the viewpoint of simplicity and of avoiding complexities arising from possible disparities in the conditions associated with two sources of funds. This point may become particularly important if the subsidy account turns out to be inadequately funded. Of course, such amalgamation cannot be made

before the end of the review period, namely, May 1988. But I would appreciate enlightenment by the staff on the feasibility of such a scheme.

Fourth, on the use of the resources of the enhanced structural adjustment facility by a member with overdue obligations, I see no need for changing the Fund's general policies regarding overdue obligations. I, therefore, would like to support the staff's proposal to preclude the use of the facility's resources by members with arrears, although I would not oppose further study on this issue by the staff.

Mr. Mawakani made the following statement:

I would like to express my great appreciation to Mr. Jiang for the decision taken by his authorities, under current circumstances, not to use the resources of the enhanced structural adjustment facility.

My reading of the paper before us left me with many questions and some misgivings about many aspects of the proposed procedures. Therefore, my intervention at this informal session will be devoted to seeking clarification from the staff and making a few suggestions.

Before raising the questions that I have, I would like to make the general comment that the proposed access and monitoring procedures for the enhanced facility, if agreed by the Executive Board, would make it a very different facility from the existing one. It was my authorities' expectation that the additional resources contemplated to supplement those of the existing facility would be pooled with the resources of the Special Disbursement Account and disbursed under the procedures of the existing facility. In this respect, the staff states in the paper that the basic structure of the existing facility should be retained under the enhanced facility. Yet, it is proposing differential access to the enhanced facility's resources, conditional and phased disbursements, and the introduction of midyear reviews.

The first set of questions concerns the relationship between the existing facility and the enhanced facility. Having stressed the need to ensure a use of the resources of the existing structural adjustment facility that is in conformity with the rules and regulations of the structural adjustment facility, including the uniformity of access, the staff proposes that the existing facility continue to operate in parallel with the enhanced facility through May 1989. However, in the last sentence of footnote 3 on page 8, it is stated that: "the SDR 2.2 billion of undisbursed SDA resources would be used for funding both enhanced and existing SAF loans." With such prospective transfer of resources

from one facility to another, I wonder how parallel and distinct the existing facility can be from the enhanced facility. On what basis would resources from the Special Disbursement Account be channeled to fund loans from the enhanced structural adjustment facility? I would appreciate staff clarification on this point. Another question that arises is to know what will happen to the existing facility after May 1989. If the Board decides, in the context of the next major review of structural adjustment facility operations, to put in place a second round of lending as was the case under the Trust Fund, what impact will this decision have on the relationship between the two facilities?

The staff proposes, on page 21 of its paper: "if a member chose to make use of the enhanced structural adjustment facility, that part of the resources that was drawn from the SDA would be subject to semiannual disbursements instead of annual disbursements as under the existing structural adjustment facility." How does the staff reconcile this proposal with the provisions of paragraph 5(5) and paragraph 6(1) of the Annex to Decision No. 8238-(86/56) SAF on the regulations for administration of the structural adjustment facility, stating that resources under three-year commitments shall be made annually in the form of loans and that one disbursement shall be made for each annual arrangement upon approval of the arrangement? If the existing facility is to operate in parallel with the enhanced facility as proposed by the staff, then its operational procedures should be kept distinct from those of the enhanced facility.

The second set of questions relates to access. It is proposed that eligible countries receive loans up to 300 percent of quota in very exceptional cases and that for members that have not yet entered into arrangements under the existing facility, access would be no less than 63.5 percent of quota. Will the minimum access for eligible members implementing, say, the second annual arrangement and that chose to cancel their structural adjustment arrangement and enter into arrangements under the enhanced facility be less than 63.5 percent of quota in certain cases? Case B in Appendix II assumes access of 150 percent of quota, but the staff stresses that this is for illustrative purposes only. An indication at this stage of a minimum access limit would be helpful.

During the discussions that led to the creation of the structural adjustment facility, it was argued and agreed by the Board that the commitment by eligible countries to undertake three-year macroeconomic and structural adjustment programs should be matched by three-year commitments by the Fund to provide resources to the qualifying members. As indicated by the staff, in the case of the enhanced facility a three-year commitment of resources would not be feasible. Can the staff explain to me what it means by the first sentence of the first full paragraph

of page 22, which reads: "Because the access limits for the enhanced SAF have been proposed on the basis of estimated financing needs covering only three years, it would not be feasible for the enhanced SAF to provide three-year commitments in the full amount that would otherwise have been available to countries which have already had annual arrangements approved under the existing SAF after January 1988." We think it is important to give the assurance, as in the case of the existing facility, that resources are committed subject to availability.

The proposed cutoff date may provide too short a period in view of the experience with the existing facility and the complex access and monitoring procedures that are likely to entail protracted discussions. While taking into account the need not to tie up over a long period of time the resources committed by lenders to the Trust, we should find ways to extend the cutoff date beyond the proposed date to accommodate some latecomers.

The monitoring procedures being proposed--quarterly performance criteria, prior actions, semiannual reviews--would unnecessarily tighten conditionality, and some would be cumbersome to eligible countries. Here, I fully share the concerns expressed by Mr. Abdallah. The expected increase in mission travel and work load for staff and the Board associated with the midyear review gives added importance to the need to do away with midyear reviews. I fully agree with the staff that the adjustment programs of eligible countries involve a large number of important measures, including structural policies, and that, given the structural and institutional constraints, the short-term relationship between domestic credit, fiscal transactions, and the growth and balance of payments objectives cannot be quantified. The staff has provided on page 17 of the paper a series of arguments against quarterly disbursements that apply just as well to the establishment of quarterly benchmarks and semiannual performance criteria. We are, therefore, surprised that on the issue of monitoring procedures the staff is proposing that quarterly benchmarks be used as performance criteria. In many cases the effects of structural measures on financial variables could not take hold within a six-month period.

I have the feeling that throughout the paper, the balance of payments need has been overemphasized at the expense of the need to finance growth. We should not lose sight of the fact that the primary objective of programs supported by structural adjustment arrangements should be the attainment of external viability with sustained growth. Financing such programs requires resources commensurate with this objective. We therefore believe that front-loading, subject to availability of resources, should be the norm, not the exception.

Finally, I have noted with interest the staff proposals that countries with overdue financial obligations should be allowed to receive loans from the enhanced structural adjustment facility to clear their overdue obligations to the Fund. I would encourage the staff to explore this avenue.

Mr. Massé said that he congratulated the Chinese authorities for forgoing their right to apply for use of the resources of the enhanced structural adjustment facility. It would indeed be unfair to penalize China for a gesture made in the interest of other countries.

The statement by Mrs. Ploix on the question of additionality in relation to stand-by arrangements and structural adjustment arrangements was important, Mr. Massé considered. That issue had an important bearing on other questions relating to use of the enhanced facility, including conditionality and access. He recalled that it had become clear from the Board's reviews of stand-by arrangements for a number of low-income countries that were debt distressed or had heavy balance of payments difficulties that continued lending by the Fund at normal interest rates was not only not in the interest of those countries--because it added to a debt that could not be repaid--but that it affected the credibility of the Fund by raising the risk of increased overdue obligations. The latter question called for careful reflection, in terms of the Fund's role and the effect on its resources, as well as because of the impact on views about the enhanced structural adjustment facility.

His authorities' initial assessment of the proposed procedures for the operation of the enhanced facility was favorable, Mr. Massé noted. They felt that the staff had developed a broadly acceptable framework.

As regards access policy, the suggested overall ceiling of 250 percent of quota should not, in the view of his authorities, be seen as a target, Mr. Massé said. In that connection, the expectation of an average loan from the facility of about 150 percent of quota appeared reasonable. Also, given that not all eligible countries would qualify for, or desire a loan from, the enhanced facility, considerations of differential access should permit a reasonable emphasis on heavily indebted countries and on strong adjustment programs. In addition, he supported the idea of reviewing annually commitments and the maximum access limit.

With respect to phasing, an even distribution of financing over three years was reasonable, although in exceptional cases, some front-loading might be appropriate, Mr. Massé considered.

As for the program objectives, he supported retaining the basic approach of the existing facility, with programs based on policy framework papers, Mr. Massé went on. In addition, programs should, as the staff had suggested, aim at achieving a comfortable level of reserves and be ambitious in both the magnitude and timing of adjustment measures. His Canadian authorities agreed that programs should have quarterly benchmarks,

some of which could serve as performance criteria, although the latter should be on a semiannual basis. He also endorsed the suggestions made on the top of page 16 concerning financial and structural benchmarks.

Midyear reviews as a standard feature and semiannual disbursements should help ensure that programs were well monitored and that the resources of the enhanced facility were safeguarded, Mr. Massé remarked. His authorities would also agree that midyear disbursements could take place when no midyear review on the basis of observance of performance criteria was envisaged.

As for the relationship between the two facilities, his authorities believed that the existing facility should continue to operate in parallel with the enhanced facility through May 1989, the recommended cutoff date for the new facility, Mr. Massé stated. However, he took note of the comments by the Director of the Exchange and Trade Relations Department concerning the cutoff date for approval of new arrangements under the enhanced facility. The operational aspects suggested by the staff relating to the relationship between the two facilities and the review procedures appeared reasonable.

On the question of financing gaps, it was gratifying to note that the proposed access limits could accommodate the entire residual financing needs for over two thirds of eligible members, Mr. Massé remarked. However, as a general principle, the Fund should not be regarded as responsible for closing gaps in each individual case through the various resources of its different facilities. Care should be taken to avoid defining the role of the Fund in a way that would give it that responsibility; otherwise, the behavior of other lenders, and of the country itself in terms of its commitment to adjustment programs, might be affected.

With respect to members having overdue obligations, his authorities endorsed the usefulness of the policy framework paper process as a means of assisting members to formulate policies to help attract financing that would facilitate the clearance of arrears with the Fund, Mr. Massé stated. For a number of countries that would be prepared to adopt programs that could be supported by the enhanced facility, bridge financing should be possible through official or commercial sources to help clear arrears and lead to an agreement on an arrangement. However, his authorities would not at the present stage be willing to support enhanced structural adjustment arrangements with members that were still in arrears to the Fund, and they would not be in agreement with permitting disbursements from the Fund while members remained in arrears, basically for the reasons suggested by the staff on page 26 of its paper.

Mr. Posthumus made the following statement:

In general, I agree with the proposals in the staff paper, including the somewhat stronger conditionality, in particular through midyear reviews and semiannual disbursements.

The question to what extent countries with programs supported under structural adjustment arrangements can also draw under stand-by arrangements, and such other facilities as the compensatory financing facility, is important. In a legal sense, of course, there can be no doubt about the answer. But as a policy matter one may have to look at this further. One approach is to say that countries using the structural adjustment facility cannot repay short-term, market-interest loans--which is the reason why they are eligible--and that they should therefore not draw on those other facilities. However, these countries may face adjustment problems, as other countries do, and in the absence of other financial resources the Fund should be willing to assist them in carrying out a smoother adjustment process by providing short-term finance. If the choice for those countries is between immediate (and therefore costly) adjustment, and slower adjustment (less costly in economic terms, more costly in terms of repayment at market interest rates), then even for a low-income, highly indebted country the choice of a stand-by arrangement may be the most economic choice. However, other assistance on softer terms would in these cases clearly be more urgent than ever. I agree with Mr. Enoch that we should look at these situations with great care.

It is much better for a country eligible to use the resources of the facility to be assisted, while it is adjusting, with soft loans, grants, and development assistance. There is a huge shortage of development assistance funds, in particular in quantity but also in quality--by which I mean supportive of good economic policies, including the policies advised by the Fund. The statement of Mr. Jiang in fact underlines this fact, and it is disturbing indeed that China and India should have to be thanked for not applying for these and other concessional resources. The Fund should perhaps point out much more clearly than it is already doing that while stronger adjustment efforts and economic policies are necessary, financing in most cases is insufficient. The experience of both developing and industrial countries showed that additional finance without strengthening of adjustment and conditionality will not work and is not sustainable. I am therefore somewhat concerned by Mr. Abdallah's statement on conditionality and adjustment, because it does not point in the direction of the right combination of adjustment and finance.

I do not think that it is desirable to make countries with arrears eligible for programs under the enhanced structural adjustment facility, or for other programs. The question of how to deal with the arrears should be taken up, but case by case and not in the framework of this discussion. Clearly, the country's own efforts then become vital: I agree with the Chairman's remarks in this respect.

Finally, I wonder whether the proposed cutoff date for the enhanced facility of May 1989 is not so early that a substantial burden will fall on the staff to process requests in time. I also wonder whether it would not be wise to maintain the cutoff date of the existing facility at May 1988: would that strengthen the reserve position of the Trust? It is not clear to me what happens with the unutilized resources of the structural adjustment facility after May 1989 because the staff paper on the proposed financial arrangements (EBS/87/225, 10/29/87) did not mention them as a source for the reserve.

Mr. Zecchini made the following statement:

The staff paper before us is long and repetitive in many respects, but in spite of this serious shortcoming, it addresses most of the crucial issues of the enhanced structural adjustment facility in such a way as to draw the attention of the Board to the far-reaching implications of the choices it has to make on the features of the structural adjustment facility.

The first and fundamental issue is the distinction between the existing facility and the enhanced facility. Quite frankly, from the staff paper, it is not at all clear what overriding reason can justify the separation of the two facilities. Both facilities have the same objectives, are aimed at the same group of countries, and have the same financing terms for the borrowers. The only clear difference is represented by the amounts of financing available for individual borrowers and the upgrading of conditionality. We understand that there is a trade-off between increased financing and more effective conditionality, but this is not sufficient to justify the existence of two distinct facilities. Instead, it seems more appropriate to envisage two tranches of the same facility; to be specific, from 1988 on, each borrower's access will depend on its balance of payments need and the strength of the adjustment effort rather than on the choice between drawing on the existing facility or on the enhanced one. As a consequence, there would be only one structural adjustment facility and the level of access between the existing tranche and the enhanced one would be decided by the Board on the basis of the above-mentioned criteria. Of course, even with one and only one facility, there is enough scope to introduce provisions aimed at subordinating repayments to the Special Disbursement Account to the repayment of the lender to the Trust Account. To conclude on this point, we have reservations on the advisability of establishing an enhanced facility separately from the existing facility.

Let me turn now to a few specific features of the structural adjustment facility, to stress our support for some staff proposals or to propose some adaptations.

First, on the cutoff date for program approval, we can accept the May 1989 date, but we find the 1992 deadline for the extension of the disbursements to be too distant. Therefore, we would like to shorten this period, for instance, to the end of 1991.

On the level of access, we fully endorse the staff proposal. The proposed upper ceiling of 250 percent of the quota, with a 300 percent ceiling in exceptional cases, seems appropriate provided it is consistent with the amount of resources available, and it leaves the Fund with enough flexibility to tailor access to the specific country's circumstances.

Effective access to the enhanced facility's resources ought to be differentiated on the basis of program strength, financing needs, and the capacity to repay the beneficiary countries. The criteria should, therefore, be strictly judgmental and based on an overall assessment. It is for this reason that we do not favor any kind of mechanical differentiated access based, for instance, as proposed by some, on specific debt ratios. Such an arrangement, by giving too much emphasis to the debt burden rather than financing needs, would tend to limit access on the part of countries with a temporary balance of payments need and relatively light debt burden. It would instead tend to allow larger access to debt-distressed countries which could not offer enough assurances on their policy conduct. In this respect, it is necessary to reiterate that increased access should by no means imply a more lenient examination of the country's ability to repay.

By another token, the proposed differentiated access is only an apparent method for overcoming the problem of the overdue financial obligations, not a real one. While, in fact, such arrangement would allow a better match between the amount of overdue obligations to the Fund and the potential access for the whole set of countries involved, such an outcome would not be so desirable at the individual country level. A better solution would be to deal more specifically with the individual cases of countries having overdue obligations.

The proposed criteria for differentiated access tend to make the resulting assets riskier than in the case of equiproportional access among all eligible countries. This consequence has to be taken into consideration in remunerating the resources that will be lent to the Trust Account at market rates; this remuneration has to cover the increased risk in a market-related manner.

Commitments and disbursements for each year of the program must be in line with the implementation of the programs and the availability of resources in the specific year. Consequently,

front-loading of disbursements cannot be the general rule if the resources are insufficient, as disbursements to the Trust Account are phased on a yearly basis.

Turning to the conditionality aspects, we can endorse what is proposed by the staff, particularly the emphasis on the specification of structural measures and benchmarks, which could even be incorporated into performance criteria. To this end, midyear reviews of programs seem appropriate. Nevertheless, we must study ways to streamline Board consideration of these reviews in order to avoid making the work load of the Board unduly heavy. Too heavy a burden for the Board would be at the expense of the quality of the Board's assessment.

With respect to the program objectives, we share the views expressed by the staff. The reserve buildup argument is an interesting one which should be spelled out in terms of gross reserve buildup rather than on a net basis. A net reserve buildup over the medium term would imply a prolonged excess of national savings over investment, which might seem inconsistent with the development needs of these low-income countries that are the beneficiaries of the structural adjustment facility.

As to the review proposals for the existing facility and the enhanced one, we can go along with the suggestions of the staff. A more cautious approach should be followed for countries in arrears vis-à-vis the Fund; here, there is no valid justification to depart from the established rules and practices of this institution. Consequently, it is not advisable, even in the presence of some safeguards, for a member to enter into a structural adjustment arrangement or to permit disbursement to a member while it is in arrears to the Fund. Furthermore, preventive measures to ensure timely discharge of obligations to the Trust Account have to be considered and applied when necessary. This is also in line with what the staff proposed in case of arrears to the Trust Account.

Finally, as to the staffing costs associated with the operation of the enhanced structural adjustment facility, we agree that a substantial increase has to be envisaged. In this connection, we would like to know how this additional burden is going to be financed.

As an appendix to my statement, I wish to thank China for not availing itself of its right to draw on the resources of the enhanced structural adjustment facility, while at the same time I fully endorse the view that the development of China's economy still calls for substantial external financing on concessional terms.

The Executive Directors agreed to resume their discussion in the afternoon.

LEO VAN HOUTVEN
Secretary