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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/138

10:00 a.m., September 15, 1987

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

Executive Directors	Alternate Executive Directors
A. Abdallah	E. T. El Kogali
	Jiang H.
C. H. Dallara	M. K. Bush
J. de Groote	J. Prader
	L. Hubloue, Temporary
A. Donoso	
M. Finaish	
G. Grosche	
	J. Reddy
	J. Hospedales
T. P. Lankester	
	G. D. Hodgson, Temporary
Mawakani Samba	
Y. A. Nimatallah	I. A. Al-Assaf
G. Ortiz	
J. Ovi	
H. Ploix	D. Marcel
	G. P. J. Hogeweg
C. R. Rye	
	M. A. Hammoudi, Temporary
A. K. Sengupta	L. E. N. Fernando
K. Yamazaki	
S. Zecchini	

J. W. Lang, Jr., Acting Secretary
S. L. Yeager, Assistant

Also Present

IBRD: E. R. Grilli, Economic Advisory Staff. Administration Department: N. S. Jackson. African Department: G. E. Gondwe, Deputy Director; E. M. Taha, R. C. Williams. Asian Department: W. M. Tilakaratna. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; S. J. Anjaria, M. W. Bell, E. Brau, B. Christensen, H. Hino, H. B. Junz, S. Kanesa-Thasan, M. Nowak, A. Schubert, R. L. Sheehy. External Relations Department: A. F. Mohammed, Director; P. C. Hole, J. M. Landell-Mills. IMF Institute: O. B. Makalou. Legal Department: F. P. Gianviti, General Counsel; H. Elizalde, A. O. Liuksila, R. H. Munzberg. Middle Eastern Department: S. H. Hitti, S. Thayanithy. Secretary's Department: C. Brachet, Deputy Secretary; A. P. Bhagwat. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, D. Gupta, D. V. Pritchett, G. Wittich, B. B. Zavoico. Western Hemisphere Department: S. T. Beza, Director; J. Ferrán, Deputy Director. Personal Assistants to the Managing Director: R. M. G. Brown, H. G. O. Simpson. Advisors to Executive Directors: M. B. Chatah, L. P. Ebrill, A. G. A. Faria, S. M. Hassan, A. Ouanes, P. Péterfalvy, G. Pineau, I. Furo, D. C. Templeman, A. Vasudevan, K. Yao, J. E. Zeas. Assistants to Executive Directors: N. Adachi, A. R. Al-Abdullatif, O. S.-M. Bethel, R. Comotto, F. Di Mauro, V. J. Fernández, G. K. Hodges, S. King, M. Lundsager, V. K. Malhotra, J. A. K. Munthali, D. V. Nhien, C. Noriega, L. Rieffel, S. Rouai, V. Rousset, G. Seyler, H. van der Burg, I. Zaidi.

1. STRUCTURAL ADJUSTMENT FACILITY - ENHANCEMENT OF RESOURCES

The Executive Directors considered a staff paper on further considerations on the mobilization of resources in association with the structural adjustment facility (EBS/87/190, 9/2/87). They also had before them information provided by the staff on the utilization of the resources of the structural adjustment facility (see Annex I).

The Chairman remarked that the staff paper reflected the extensive discussions that had been held with potential contributors to an enhanced facility. Most contributors preferred funding the enhancement either through the General Resources Account or through the creation of a special trust arrangement. The choice was a difficult and crucial one, especially in view of the important considerations underlying arguments favoring each of those alternatives. A third alternative, combining the advantages inherent in the other two, had also been presented by the staff for the Board's consideration. That alternative, it was hoped, could satisfactorily meet the needs of most contributors.

He hoped that a decision on the framework for the enhanced facility could be reached quickly so as to facilitate decisions by contributors on the source and amount of their commitments, as well as the timely initiation of discussions on operations of the enhanced facility, the Chairman added. The present discussion would also provide the background for his status report to the Interim Committee on the initiative to enhance the resources of the structural adjustment facility.

Mr. Nimatallah made the following statement:

When the structural adjustment facility was established, most members had hoped that additional resources would be mobilized in association with the facility's resources whenever an eligible member implemented a convincing program of adjustment and reform supported by a structural adjustment arrangement. I recall Mr. Dallara vividly stressing the importance of the additionality of resources during our last discussions on the facility (EBM/87/91, 6/18/87; and EBM/87/93, 6/19/87). But, this additionality did not materialize. As a result, members with programs supported under the facility started to feel that the meager resources available to them did not match their considerable efforts of reform and adjustment.

The objective of enhancing the facility's resources is to make sure that members' financial requirements are met through commitments, arrangements, and built-in mechanisms, so that once a program under the facility is agreed, additional resources would be readily available. It has to be clarified at the outset that the structural adjustment facility itself is not to be charged. The question is whether to channel the additional resources that would be made available through the General Resources Account, through a special trust fund, or through bilateral lending in tandem with lending under the facility.

The objective behind the enhancement of the facility is appropriate, and the initiative deserves the support of all those who can help. The surplus countries will find it worthwhile to come forward with the financing that they can afford, as this will also eventually help them to correct their imbalances. Those countries in arrears to the Fund can facilitate the task of enhancing the facility by making a greater effort to reduce their arrears.

Of the alternative funding arrangements put forward by the staff, the establishment of a new trust account administered by the Fund appears to be the most appropriate for three reasons. First, at this juncture, the Fund needs to find a slightly different route for addressing the structural adjustment needs of countries eligible to use the facility. The resources of the General Resources Account are normally used for stand-by arrangements having a shorter time frame than that needed for countries facing structural, deep-rooted difficulties. Thus, the Fund needs to be able to offer structural adjustment arrangements in support of programs that are for longer periods and on softer terms than can be allowed under the provisions governing the use of the General Resources Account.

Second, the magnitude of the imbalances in these countries and their financing needs greatly exceed their quotas. Furthermore, the intensity of the debt burden in some cases also requires less adherence to the principle of uniform treatment, and more attention to the case-by-case approach. Some eligible countries might need more financing than others, depending on the strength of adjustment, among other factors.

Finally, although channeling funds through the General Resources Account offers potential donors the advantages of the enhanced security and liquidity that they seek, the staff has proposed helpful steps to alleviate concerns on those two scores associated with the establishment of a trust arrangement. Furthermore, a trust arrangement will give the Fund the greatest flexibility to accommodate donors' contributions, whether they take the form of loans or grants, or a combination of the two. In any event, my authorities would not consider it prudent to finance an enhanced facility through the sale of the Fund's gold.

The Regulations governing the administration of the structural adjustment facility may have to be reviewed to ensure flexibility in using these additional resources for the benefit of eligible countries. It would be helpful if China and India would not only continue their commendable "voluntary exclusion" from the list of countries eligible to use the structural adjustment facility, but would also--along with other large developing countries--contribute to the enhanced facility, even if only on a symbolic basis.

Saudi Arabia will be happy to contribute to the enhancement by utilizing a significant portion of available capital through the Saudi Fund for Development. The Saudi Fund for Development and the Fund are now working out the modalities for a contribution to the enhanced facility, and just recently, further progress was made along these lines.

Mr. Abdallah made the following statement:

All my authorities are deeply appreciative of the Managing Director's initiative taken on the occasion of the Venice Summit to press for a trebling of the resources of the structural adjustment facility by the end of this year. They are looking forward with great anticipation to the larger catalytic effects of an enhanced facility in inducing a significant net transfer of other external official and private resources to facilitate the attainment of economic growth with structural adjustment in their countries.

In considering the modalities for bringing the desired enhancement into effect, the paramount general consideration should be extending enhanced assistance of a concessional nature to eligible member countries in the context of sound, but realistic, adjustment programs. I stress the realism of such programs because in the recent past, adjustment programs have proved unrealistic in terms of quantitative performance criteria, their time frame, and the recognition of the existence of external shocks. This should be kept in mind especially when interpreting the statement in the staff paper that "the Fund should reinforce its policies so as to improve the quality of structural adjustment facility loans...." While it is necessary to provide assurance to potential contributors to the enhancement, this should not be done through a qualitative tightening of conditionality designed to substitute benchmarks for performance criteria. In this context, we look forward with some anticipation to the forthcoming staff paper on the implications of enhanced lending for the monitoring of structural adjustment arrangements.

A second consideration is the need to resist the temptation to overemphasize the differences between the existing facility and the enhanced facility based on their sources of funding, and to follow this up by devising complex, elaborate schemes to assure the claims of contributors to the enhanced facility. This approach would surely result in an undesirable fundamental change in the character of the structural adjustment facility. The Regulations already approved for the facility, together with the Fund's reputation and record of stewardship, should suffice to satisfy even the most skeptical of contributors regarding the security and liquidity of their claims. Of course, in the last analysis, the Fund would stand ready to consider means for assuring greater security and liquidity of all financing made available to it.

As a final consideration, it would be highly regrettable if the perceived need to satisfy potential contributors in respect of monitoring arrangements were in any way to imperil the enhanced facility from coming into effect at the beginning of 1988. In this context, we strongly urge all potential contributors to expend their maximum efforts to ensure that the clear mandate given by the Heads of State or Government of the Group of Seven in this respect is fully honored.

Four specific approaches to funding arrangements have been considered in the staff paper. The first--lending to the General Resources Account--was advanced mainly to obviate the requirement of budgetary appropriation for some potential contributors, while at the same time safeguarding the liquidity and maintaining the quality of their claims. We fully agree with the staff that substantial legal considerations, particularly the principle of uniform access to resources in the Account and the restrictions on enlarged access that would apply to potential users, would change fundamentally the character of the structural adjustment facility as originally conceived. In this connection, I was heartened by the staff's recent report on a meeting of the Group of Ten Deputies, particularly, the perception that this approach was not now being generally canvassed.

A second approach, the sale of gold, should for the time being, be considered only in relation to the "topping-up" of shortfalls in loan commitments. In that regard, the amounts of gold offered for sale should be small so as not to disrupt the market in any significant fashion.

As for a "conditional" SDR allocation, this proposal has been exhaustively discussed by the Board. Although we see considerable merit in a special allocation of SDRs, the problem of mustering political support for it still remains. If such support were to materialize, I have little doubt that the associated problems relating to access and other policies and the operations of the Fund would be easy to resolve.

The fourth approach, a "protected" trust fund, was arrived at by the staff after discussing and discarding the three approaches suggested by potential contributors. Without prejudice to my authorities' views regarding the need to provide assurance to potential contributors, I recognize that the staff has wrestled valiantly to come up with a compromise proposal that would preserve the restricted eligibility for use of the facility while at the same time assuring the security and liquidity of resources lent to the Fund for the enhancement. I agree with the staff that the Fund's Articles of Agreement preclude the extension of a guarantee against the resources of the General Resources Account in respect of payment of loans from the Trust. However, I am not convinced that the security of claims on the Trust is best secured by subordinating claims on the Special Disbursement Account to the Trust, because of the implied preferential treatment of contributors. Moreover, as a practical matter, a country's failure to meet its repayment obligations to the Trust is likely to reflect a more general problem of serious payments imbalances, which would inhibit repayments to the Special Disbursement Account as well.

As to the proposed establishment of a reserve and associated funding mechanisms to assure the security of claims on the Trust, in general, I agree with the staff position, subject to a few reservations. The proposals for financing the reserve put forward under subparagraphs (a) and (b) on page 10 of the staff paper would be appropriate because they do not place an additional burden on users. The interest income earned from investments and the interest earned on outstanding structural adjustment loans could, therefore, be used to build up such a reserve. However, the application of a surcharge should be avoided, as it would imply a 40 percent increase in the effective rate of interest chargeable to borrowers. I have even stronger objections to the creation of a sinking fund because it would entail contributions by borrowers toward servicing costs immediately after disbursements are received. Moreover, it would effectively eliminate the grace period now enjoyed under the facility, which all my authorities feel strongly should be retained. I would urge, therefore, that at this stage we concentrate our attention on the task of setting up the proposed reserve for the Trust and leave the modalities for its termination to a later date nearer the time when the facility is to expire.

To enhance the liquidity of claims on a protected Trust, I would have no objection to applying any combination of the proposals described in subparagraphs (1) to (4) on pages 14 and 15 of the staff paper, if thes were agreeable to participants. Furthermore, mutual agreements at the outset that would facilitate the purchase of a claim by a participant having a balance of payments need is a feature already applicable under the General Arrangements to Borrow. In any event, it would be helpful to hear from potential contributors to the Trust on this issue.

I agree with the staff that the rate of interest applicable on loans under the enhanced facility should remain at 0.5 percent. To this end the staff proposals for creditors to extend loans at less than market interest rate or for funding the interest subsidy explicitly through grant contributions are indeed practical and acceptable to me.

Finally, the fundamental belief on the African continent is that when conditionality becomes elaborate and detailed it tends to be self-defeating. Conditionality itself is accepted; at issue is its degree and severity. An enhanced facility should receive stronger political backing simply because the flow of resources will be greater. Moreover, in view of accumulated Fund-Bank experience with structural adjustment, as well as the stronger political will being exhibited by the users of Fund resources, there is an expectation of even better performance under an enhanced facility. I would therefore strongly urge potential contributors not to delay the commencement of enhanced lending on January 1, 1988.

Mr. Zecchini made the following statement:

We are still among the staunchest supporters of the idea of enhancing the resources of the structural adjustment facility because its features, in terms of effective economic policy requirements and financing terms, are best suited to the needs of low-income indebted countries at this economic juncture. The economic conditions of these countries, in fact, do not leave enough room for the necessary degree of stabilization over the short term, but call for gradual and extensive structural reforms in order to make their economic development less dependent on foreign aid over the long term. To this end, the formulation of policy framework papers can be of great benefit to these countries; the framework paper gives a multiyear orientation to the economic strategy and allows a more precise monitoring of the progress in structural areas where results are perceivable only gradually. Nevertheless, policy framework papers should not be overemphasized as the only guide and prerequisite for granting foreign aid to these countries since other social and humanitarian considerations are also relevant. The enhancement of the structural adjustment facility can, however, prove useful to spur the authorities of recipient countries to embark on more extensive efforts to redress economic imbalances.

Although there is no absolute certainty regarding the resources required for an enhanced facility in view of estimates made by the staffs of the Fund and the World Bank on the likely financial needs of these countries to pursue extensive economic reforms, the figure of SDR 6 billion can be taken as a starting point for discussions.

The modalities of such an increase are an open question. A trade-off might emerge between the specific modalities of the enlargement and the actual amount governments could lend. The staff paper goes to great length to explain mechanisms which can meet the requirement of potential creditors concerning the security and liquidity of their loans. It is clear that, barring the use of the General Resources Account, the assets held by the proposed Trust Account would not have the requisite characteristics that qualify other assets held by the Fund as international reserves. We understand that there are legal obstacles to the use of the General Resources Account as a source of guarantee for these claims and that these obstacles are insurmountable unless we amend the Articles. A confirmation by the staff on this point might be helpful.

In this context, it is evident that the proposed loans to the Trust Account share the nature of foreign aid, albeit in the form of a subsidized loan, more than the characteristics of monetary assets held by a monetary authority. This nature seems more in line with the proposal for a Trust Account, which is administered separately from other accounts and which adds a new instrument to those already available to the Fund for intervention in the debt problem.

Even after taking into account the aid characteristics implicit in these loans, contributors should receive some guarantee against risks and some liquidity features. As to risk, it is not appropriate to resort to mechanisms of mutual assurance among contributors and debtors as envisaged in some options presented by the staff. The Fund membership at large should share the burden of this assurance. Furthermore, it is essential that the conditions and the terms of these loans should be equal or equivalent to those of the existing facility. If we relax this precondition, then the number of alternative options may become so large as to make the entire philosophy underlying the project very uncertain.

In light of these considerations, surcharges on loans, discounts on loans, and prepayments to create a sinking fund do not seem acceptable. Subordination of claims of the Special Disbursement Account to claims of the Trust Account, and use of Special Disbursement Account reflows or of the interest earned on that Account's resources or on outstanding structural adjustment loans seem viable, practicable means to create a reserve until the claims on the Trust Account are settled. These latter mechanisms, nevertheless, have a limited financial scope and need to be integrated with more effective instruments. This is particularly true with respect to the nonpayment of principal to the Trust Account. In that event, we could consider other options, including the sale of a fraction of the Fund's gold with the commitment to direct the excess profit to the repayment of overdue obligations to the facility.

With these clarifications, we would not object to granting loans to the Trust at subsidized rates or at market rates with the necessary addition of an equivalent contribution to an interest subsidy account. Neither would we object to parallel bilateral financial schemes, if they are subject to the same conditions and terms as those governing the structural adjustment facility and are available on call by the Fund. However, the Trust option might be preferable for reasons of transparency and ease of management. We do not favor an allocation of SDRs for enlarging the facility because it would confuse the monetary role of the SDR and the main aims for its allocation. Furthermore, in view of the concerns expressed by management, we do not advocate funding the Trust solely through gold sales.

Finding ways to shelter the contributor from the risk of being called at a time of balance of payments difficulties to contribute or to mobilize assets vis-à-vis the Trust is a more complex issue. Of course, there is no objection to the transfer of these claims to other participants, members, or other official entities through a voluntary agreement. However, a voluntary transfer might prove to be cumbersome at times, or unfeasible in a short time, or costly if it involved a capital loss. A solution could be to resort for a limited time to the Reserve, but its resources would most likely be inadequate. The staff mentions the possibility of mutual, open-ended undertakings by Governments extending beyond their commitments so as to enable drawdowns on the commitment of a participant in the event of the suspension of calls on that participant or its encashment of assets during a period of temporary balance of payments difficulties. We have some doubts about these options, because they are inconsistent with the budgetary process, which is at the root of funding the Trust. Moreover, open-end budgetary appropriations do not seem appropriate to the character of the enhancement, which to a large extent resembles bilateral aid. As an alternative, a "mobilization facility" could be funded by resorting to other reserves of the Fund, including the "hidden reserve" resulting from the undervaluation of gold holdings in the Fund's accounts. If this alternative is not allowed under the Articles, then other possibilities have to be considered, including a short delay in the drawdown without compensatory drawings on other sources.

In conclusion, we encourage the staff to explore further imaginative solutions to build a sufficient measure of financial guarantee and flexibility for loans to fund an enhanced facility. We also agree strongly that the ultimate guarantee lies in the pledge of the recipient country and the Fund to optimize the use of these resources.

Mrs. Ploix made the following statement:

At the outset, let me reiterate my authorities' commitment to this important initiative to enhance the resources of the structural adjustment facility.

As for the proposed financial arrangements, my authorities prefer loans to the General Resources Account because this approach is the most feasible approach on legal or regulatory grounds. Moreover, this approach would help overcome the difficulties experienced by many countries which are unwilling to commit budgetary resources to the operation.

Lending to a Trust Account could be envisaged by my authorities, but only if loans were guaranteed by the Fund and the liquidity of claims were assured in a way that would allow their inclusion in official reserves. From this perspective, the best solution would be a full guarantee and assurance of perfect liquidity by the Fund, but this approach would bring us back to lending to the General Resources Account.

With respect to a "protected" trust arrangement, at this stage I can only offer some personal remarks, which are not binding on my authorities.

First, the resources available within the existing Special Disbursement Account should be transferred to the proposed Trust Account at the outset of the enhanced facility's operations, so as to generate the maximum amount of reserves. However, the creation of a sinking fund is not justifiable: it would not provide an effective additional guarantee and would essentially eliminate the five-year grace period that is an integral part of the facility's concessionality.

Second, a 0.2 percent surcharge levied on contributing and borrowing countries could be contemplated, but it should not lead to an increase in the rate of charge, which should remain at 0.5 percent. Moreover, the staff paper confirms our view that the rate of charge, which is supposed to cover management expenses, is at present excessive.

Third, some clarification is needed regarding the possible assurances to be given by the Fund. Would it be feasible to pledge all of the reserves of the General Resources Account? If so, what majority of the total voting power would be required?

Finally, as a last resort and after having exhausted all other options, some limited sales of the Fund's gold would be acceptable to assure claims on the Trust; however, the scope of these other options should render the resort to gold sales very unlikely.

With regard to the liquidity issue, my authorities consider that mutual undertakings by all contributors--along the line of the encashment provisions of the General Arrangements to Borrow--are necessary. Moreover, the establishment of a mobilization facility is an interesting idea. It would enhance the liquidity of loans by utilizing the Fund's general resources to assist a contributor facing liquidity difficulties. Could the mobilization facility be activated not only to respond to balance of payments problems but also when a country needs to mobilize its reserves for any other reason?

Let me conclude by recalling the deadline set by the Group of Seven in its Venice communiqué and by reiterating our desire to reach an agreement as soon as possible. My authorities stand ready to review alternative approaches as long as these approaches do not prevent creditor countries from lending to the enhanced facility, and they look forward to the rapid implementation of this initiative.

Mr. Lankester made the following statement:

My authorities fully recognize the problems of the low-income, debt-distressed countries. Our own initiative for alleviating the burden of official bilateral debt service was set out by the Chancellor of the Exchequer at the spring meeting of the Interim Committee, and we would like to make rapid progress in securing the support of other creditor governments for this initiative. We also support the Managing Director's initiative to enhance the structural adjustment facility as complementary to our own proposals, along with the World Bank's proposals for additional cofinancing.

My authorities have been actively examining ways in which they might contribute to an enhanced facility, and they have benefited from recent discussions with senior members of the Fund staff in this regard. From a technical point of view, a budgetary contribution to help finance the concessionary element--the interest subsidy account--should not encounter any great problems, but a capital contribution would present some difficulties.

More specifically--and I am speaking on a personal basis--a capital contribution would have to be classified as public expenditure, and public spending over the next few years is already tightly constrained. My authorities are examining how a capital contribution could be made without its being classified as public expenditure. Moreover, the need for parliamentary approval of a contribution may pose legislative constraints. Finally, there are questions regarding the security and liquidity of contributions, which, among other things, have a bearing on how a capital contribution would be classified in our public expenditure accounts.

The key question is whether contributions should be channeled through the General Resources Account or through a Trust Fund. There are valid arguments against lending to the Account based in part on the technical issues given in the staff paper--although some of these are overstated in our view--and in part on the desire to keep the special financing available under the facility separate from the Fund's general resources. That said, funding the facility through a Trust Fund raises all kinds of problems. In that regard, the staff have made a number of imaginative, and on the whole, helpful suggestions for improving the security and liquidity of creditors' contributions to a Trust Fund. My authorities welcome these suggestions, but they have not yet taken a firm view. My own view is that some form of reserve will be essential and that it should be funded primarily by the income and repayments accruing to the Special Disbursement Account. I am certain that any proposals for the use of SDR allocations to help finance an enlarged facility would be opposed by my authorities.

If we were unable to reach agreement on substantially strengthening the security and liquidity of claims on the Trust Fund, then the option of lending to the General Resources Account should be held open.

My authorities have an open mind on the possibility of gold sales, either to enlarge the facility directly or to provide additional security on a contingency basis for the Trust Fund. We do not find the arguments in the staff paper against the use of gold entirely compelling. We accept the need for prudence against the uncertainties of the next decade in view of the possible arrears problems but we believe that a modest gold sale to "top up" a shortfall in commitments to an enhanced facility would probably be acceptable from the point of view of the Fund's overall financial position. If others feel that gold sales to finance the facility directly should be avoided at all costs, then we would hope that the idea of a preapproved contingent sale of gold to cover the credit risk associated with the Trust Fund would be examined carefully. The argument that the sale of a portion of the Fund's gold holdings would depress the market price of gold and the valuation of members' reserves is a curious one. If the Fund cannot sell a modest amount of its gold now or sometime in the not too distant future, then it is unlikely that it would be able to do so in the 1990s in the unhappy event of a marked weakening of the Fund's overall financial position.

Finally, we agree with the staff and management that the best guarantee available to creditors is ultimately the use of the facility to support adequate adjustment efforts.

Mr. Rye made the following statement:

In focusing on the modalities for mobilizing resources for an enhanced facility, a few general points should not be overlooked. First, the precarious balance of payments positions of the countries which an enhanced facility is intended to assist are symptoms of more deep-seated problems. They reflect domestic policy failures in many cases and the restriction by the industrial countries of access to markets for those products in which, in a freer market environment, countries eligible to use the facility would have a comparative advantage. For example, the recent World Economic Outlook shows that sub-Saharan Africa has experienced almost no growth in nominal export earnings since 1980. Moreover, a greater than expected deterioration in the debt position of non-oil developing countries is, in large part, explained by the poor price performance of their exports.

Second, policy slippage is undoubtedly a factor in some sub-Saharan countries. Still, we can agree that program adherence might be better if countries could see some light at the end of the tunnel. An enhancement of the structural adjustment facility could play a role in providing that sort of encouragement.

Finally, my authorities wish to reiterate their view that the myriad problems encountered in trying to fit an enhanced facility into the framework of the Fund's policies serve to demonstrate the basic incompatibility of the facility with the Fund's broad functions. Problems might not arise to the same extent if the World Bank was the main conduit for structural adjustment financing.

The central consideration is who bears the risk attached to enhanced lending under the facility. My authorities see some advantage in placing the risk on the Fund, first, to enhance the incentive to ensure that programs supported by the facility's resources perform adequately, and second--and more important--to attract more resources for the enhancement than would be available if the burden of risk was on the contributors.

With regard to the second point, loans to the Fund that are open to any question about risk of repayment are unlikely to be acceptable international reserve assets, at least as far as my authorities are concerned--although I should add that their examination of the issue has not been concluded. The issue of risk bears not only on the prudence of the investments but also on their potential liquidity. If loans for an enhanced facility could not be regarded as reserve assets, the principal cost would fall on national budgets, which would greatly limit potential contributions, certainly from Australia.

With that in mind, my authorities would prefer that the option of using the General Account, with its potential to provide acceptable reserve assets, should not be ruled out unless the reasons for doing so were unassailable. The staff's argument against this option is not convincing. In our view the situations an enhanced facility is meant to address could be regarded as a special category of balance of payments problems. The use of balance of payments difficulties as a criterion should allow sufficient scope for operation of an enhanced facility through the General Account and effectively cover countries currently eligible to use the facility.

The staff's point that use of the Account might entail the establishment of criteria for access that do not perfectly fit the current list of eligible countries seems to ignore the object of the exercise. If each criterion is correct in relation to the problem, it is irrelevant whether the eligible countries turn out to be those eligible to use the existing facility, irrelevant whether some countries now eligible do not gain access to the enlarged facility, and irrelevant that the group of eligible countries might change over time.

The staff indicates that use of the Account would also raise concerns about the revolving nature of the Fund's resources and its liquidity. The real danger to the Fund's financial position is the risk of default, and we would not disagree that that risk is significant. That is why potential contributors are concerned to gain security against their claims. Indeed, the staff paper may be too sanguine about the possible development of arrears under structural adjustment arrangements.

As to the other alternatives canvassed by the staff paper, my authorities agree that the sale of gold should not be contemplated. They agree also that an SDR allocation is not appropriate, since they do not believe that the preconditions set forth in the Articles for an SDR allocation have been met.

This leaves the various possibilities canvassed under the heading "a 'protected' trust arrangement." First, my authorities agree that guarantees from the General Account are not a feasible way to strengthen the security and liquidity of claims. Subordination of the resources of the Special Disbursement Account to claims of the Trust would go some way toward the Fund's bearing the risk, but the extent of coverage is uncertain. If a borrower failed to repay its obligations to the Fund, where the Account's resources had been advanced in tandem with those of the Trust, giving priority to repayments to the Trust would not provide complete cover. If balances in the Special Disbursement Account were used as a reserve, the protection available would be limited by the balance in the Account at the time. There would need to be some guarantee that the reserve component of liquid resources would not be disbursed for other uses, including the structural adjustment facility--which seems to be contrary to the objective of enhancing the facility.

Many of the possible sources for establishment of a reserve in the Trust would offer only a small degree of protection in respect of an SDR 6 billion facility. The interest income on the Special Disbursement Account, interest on outstanding structural adjustment loans, and the surcharge fall into this category. They would serve to cover only interest shortfalls, which by definition would be insignificant. It would be a moot point whether they were worth the effort.

A reserve financed by early repayments by debtors would mean that creditors would bear the entire risk of possible default by borrowers. While the reserve would build up in the early years, its resources would ultimately be due to creditors even if there were no default. This idea therefore offers no more than a short-term palliative.

As for the distribution of the general reserve, the reserve was recently increased because of the risk posed to the Fund's liquidity by the rise of overdue obligations. That risk has not diminished, and it would not be sensible to dedicate the reserve for a second contingency. Also, the logistics of a reserve distribution and recycling are daunting.

The special mobilization facility seems to be a complex and cumbersome approach to providing liquidity for the claims of contributors to the enhancement. Moreover, it would be just as much a special facility under the General Resources Account as would be on-lending by that Account for an enhanced facility.

In sum, while the staff has striven mightily to overcome the objections to a trust arrangement, its efforts have not been fully successful. We would like to see a more thorough examination of the General Resources Account approach--the difficulties of which seem to have been substantially overrated.

Mr. Hodgson made the following statement:

The staff paper was helpful in clarifying some of the operational considerations with respect to the financing of an enlarged structural adjustment facility. I am not in a position to give definitive views today, since my authorities have not yet fully articulated their views on all aspects of the arrangements. However, my Canadian authorities have announced, at the recent Francophone Summit, that they intend to participate in the enlargement of the facility.

My authorities' initial preference was for participants to lend to the Fund directly through the General Resources Account. That preference was largely due to concerns about the need for some form of repayment guarantee, and also due to concerns about the liquidity of claims. We appreciate, however, that lending directly to the General Resources Account might have major adverse implications for the policies and operations of the Fund. If the Fund is to preserve its nondiscriminatory and monetary character, and if the resources of the facility are to be targeted to a specific group of countries on terms which are well-tailored to their needs, then a trust arrangement might be more appropriate. We nevertheless wish to ensure that whatever arrangement is agreed, is suitable to a large range of potential participants, and we hope there is sufficient flexibility to accommodate all lenders.

The staff paper outlined a number of useful suggestions on enhancing the security and liquidity characteristics of lending to the Trust. Many of these should be integrated into an eventual agreement if a consensus in favor of loans to the Trust can be reached. At this point, I would emphasize that we do not see a conditional SDR allocation as an acceptable financing option. We also would prefer not to give any consideration to gold sales for the moment, since there is not likely to be adequate support for that option.

It is clear from the staff's analysis that the Fund has no power to extend a guarantee against contributions to an enhanced facility. However, a number of useful ideas were advanced by the staff to provide greater protection to a trust arrangement. The subordination of Special Disbursement Account claims to the claims of lenders to the Trust is a particularly good idea, and we would expect it to be a part of any security package. Added assurance to creditors would also be useful.

With respect to a reserve, its size should depend on the actual amount and nature of loans made to the Trust, as well as the amount and distribution of structural adjustment arrangements with recipient countries. If an enhanced facility is directed largely toward the most seriously indebted low-income countries, or if resources come from reserves, then a higher degree of reserve security should be built in. Conversely, if the risk is spread more broadly, or if financing comes largely from government budgets, then the reserve might not need to be so large.

On proposals for establishing a reserve, the use of interest income to finance a reserve is appropriate. We would be reluctant to see a compulsory discount on loans to the Trust, since this would effectively increase the already large effective grant element of the loans. We also have some concerns about a sinking fund, which would reduce the financial benefits of the facility to users. A surcharge on loans from the facility would also reduce concessionality, but might increase the incentive for users of the facility to ensure that other users discharge their obligations to the Trust on time. We would not want to rule out the idea of a refundable surcharge.

The staff paper also mentions the possibility of distributing some portion of the Fund's general reserve as a form of security, but in light of the existing strains on the Fund's financial position, we would not support such an approach.

Claims should be as liquid as possible, and we should consider all practical measures to assure that liquidity. My authorities would be reluctant to commit themselves at this time, however, to acquire the claims of other lenders in the event they faced balance of payments difficulties. Any mutual undertakings to assure liquidity among participants in the Trust will have to be negotiated among them. We also have some questions on how a mobilization facility might operate. Further staff work in this area would be desirable.

My authorities agree that grants would be the best way to fund an interest subsidy account. They would prefer that subsidy contributions should be spread over five years, and that there should be periodic reviews of grant commitments. Finally, we fully agree with the staff that the strongest assurance for creditors lies in the appropriateness of the adjustment programs supported by an enhanced facility, and we look forward to the forthcoming paper on the monitoring of arrangements under the facility.

Mr. Yamazaki made the following statement:

Since Japan joined other major industrial countries in welcoming the proposal to enhance the resources of the structural adjustment facility on the occasion of the Venice Summit, my authorities have intensively explored possible ways to contribute to the proposed enlargement. However, they have not yet reached definite conclusions. My remarks are therefore based on their studies to this time.

At the outset, I would like to underscore the importance which my authorities attach to the principle of fair burden sharing in the funding arrangement for the enhancement. My authorities regard this principle as a premise to grant budgetary contributions. In my authorities' view, Fund quota shares would be an appropriate criterion for determining the shares of grant contributions, while consideration may be given to the use of other criteria in deciding the shares of loan contributions. I also urge that further discussions on the funding arrangement proceed rapidly so as to facilitate participation by as many contributors as possible. A difficult question is whether the envisaged expansion is feasible. The staff estimates that the resources required amount to SDR 7.7 billion. It may be desirable to examine the issue of the size of the facility after a decision on the funding arrangement has been taken.

In view of the prevailing fiscal constraints among member countries, my authorities believe that due consideration should be given to the sale of the Fund's gold holdings to finance perhaps half of the additional resources required.

The staff has dismissed the possibility of lending to the General Resources Account, primarily because it would be impossible to limit access to an enlarged facility in the Account. I wonder whether prior arrangements could be made so that countries not eligible to use the existing facility would refrain from the use of the enhanced facility. Would it be possible to limit access to a new facility in the Account through a decision of the Board of Governors?

The trust arrangements proposed by the staff pose several problems for my authorities. Our present institutional setup requires that loans be made from foreign exchange reserves. But while we could extend loans to the Fund's general resources, the law does not provide for loans to a trust arrangement. Under these circumstances, it does not appear feasible to change the law. My authorities have therefore concluded that it is impossible to participate in the proposed trust arrangement through loans from foreign exchange reserves. Although my authorities are examining other sources of funding for lending to the Trust, their efforts have not yet been successful. The staff's efforts to increase the security and liquidity of claims on the Trust is commendable. My authorities encourage the staff to explore further the possible arrangements to reduce the risk to creditors. In this context, I would like to hear the staff's view on pledging the Fund's gold as collateral to creditors.

I urge the staff to negotiate with the Organization for Economic Cooperation and Development to allow budgetary grants to be counted as official development assistance in the statistical reporting of the Development Assistance Committee, which would certainly facilitate the participation of some potential contributors in an enlarged facility.

My authorities consider it feasible for Japan to extend a loan to the General Resources Account at market rates, and at the same time, to grant contributions from the budget to an interest subsidy account.

Mr. Ovi remarked that the Nordic countries supported the Managing Director's initiative to increase the resources of the structural adjustment facility. His authorities found it highly desirable that the necessary decisions for implementing the proposal should be taken in the coming months. The countries in his constituency had not yet taken their final decision regarding participation. Among other considerations, their prospective contributions would be subject to a broad participation of donors providing some degree of additional resources to developing countries and would be based on a reasonable burden sharing. In that latter respect, the balance of payments situation and actual official development assistance performance were considered to be important criteria.

He agreed with the staff that, among the alternatives available, the channeling of contributions through a Trust Account administered by the Fund appeared to be--all things considered--the most appropriate solution, Mr. Ovi continued. It would allow the necessary flexibility with respect to the form of individual contributions. Furthermore, it seemed that a clear majority of the potential contributors preferred that alternative.

Through a suitable combination of the proposals set forth by the staff, claims on a prospective Trust Account should be guaranteed the highest possible degree of security and liquidity, Mr. Ovi considered. While at present he did not rule out a somewhat broader burden sharing among debtors, creditors, and the Fund, it was natural that the debtor countries should largely guarantee repayment and liquidity to creditors both indirectly through the existing Special Disbursement Account and more directly, for example, through a surcharge, but not through mechanisms involving a shortening of the grace period.

He doubted that the suggestions put forward so far could provide a sufficiently high degree of liquidity to enable donor countries to use official exchange reserves for lending to the facility, Mr. Ovi added. Whether the encashment of claims would suffice in that regard depended heavily on the amount reserved for that purpose. More complicated solutions to the liquidity problem, for example, mutual agreements among donors to purchase each other's claims, or a mobilization facility, could presumably be established. However, those options would undoubtedly require further negotiation. Moreover, a drawing on the mobilization facility would involve a somewhat lower degree of liquidity than a reserve tranche drawing. In sum, more work was needed on assuring the liquidity of claims.

Mr. Ortiz made the following statement:

> In view of the extremely severe economic conditions facing low-income countries with debt-servicing problems, there is an urgent need to provide them with substantially increased financial assistance on concessional terms. There is little point in providing additional credits or rescheduling on concessional terms; piling new debt on old has proved to be the wrong solution to the problems of these countries, as well as other heavily indebted developing countries.
>
> At the same time, strong, continuous adjustment efforts must be made by low-income countries if their economic stagnation and financial difficulties are to be overcome. It is increasingly evident that, given the protracted nature of these difficulties, the implementation of policies leading to structural change is of the essence. The Fund has a substantial contribution to make, and in view of the problem of overdue obligations, the logical approach to channeling resources to these countries is through an enlarged structural adjustment facility, preferably operating separately from the General Resources Account.

The staff paper focuses on the question of guarantees for potential creditors. Although I understand the concern of some potential participants in an enlarged facility--and, indeed, the authorities of countries in my constituency that may be in a position to participate share some of these concerns--I agree with the staff that the best guarantee lies in the strength and credibility of programs and the commitment of the Fund.

This, of course, does not mean tightening conditionality so that disbursements under the facility cannot be made--which would defeat the purpose of the facility--nor that consideration of various options for implementing the enlargement of the facility should be limited. The Fund should be responsive to the legitimate concerns of donors and lenders, and it should be left largely up to them to decide the modalities for their participation. My authorities consider that, at this stage, it is essential to keep several doors open.

Indeed, the authorities of those countries in my constituency who are in a financial position to participate in the enhancement remain quite flexible regarding the financial modalities being contemplated. They expect that the main contributions to the enlarged facility would come from the major industrial countries and especially, but not exclusively, from those having the strongest balance of payments positions. They would also expect that these countries will make a more substantive contribution regarding the financial modalities. I will therefore remark on more general issues.

Although my authorities see the advantages of channeling contributions through a Trust Account operating separately from the General Resources Account, they understand the concerns and reservations expressed by other potential contributors regarding this approach. The legal limitations on restricting access to the General Account do not present an insurmountable difficulty. As the staff suggests, criteria for access to a new facility in the Account could be devised that would apply to countries eligible to use the existing facility. We would expect that the present criteria for eligibility would be unchanged. As Mr. Yamazaki has suggested, some countries might voluntarily refrain from using the new facility, a practice presently followed with respect to the use of the compensatory financing and the extended Fund facilities.

My authorities also see considerable merit in a conditional SDR allocation, and are somewhat disappointed that little attention was given to this possibility in the staff paper. The benefits of such a mechanism, utilized in combination with an interest subsidy account, were pointed out by Mr. de Groote some time ago. 1/

1/ See "Note by Mr. de Groote on Alternative Financing Methods for Increasing the Resources of the Structural Adjustment Facility," reproduced in Annex II.

In the absence of a consensus on an SDR allocation and in view of the difficulties encountered with concessional lending to a trust arrangement, perhaps we should consider the establishment of a new approach that will permit the catalyzation of sufficient resources for enhancing the structural adjustment facility.

Mr. Mawakani made the following statement:

The main difficulty encountered with proposals on financing an enhanced structural adjustment facility while satisfying the legitimate concerns of potential contributors regarding the security and liquidity of their claims, is that some contributors prefer to lend to the General Resources Account. But this option raises some problems. Among those mentioned by the staff, the most disturbing are first, the fact that it would not be possible to limit access to a specific group of countries, as originally intended when the structural adjustment facility was established. Second, if funding was channeled through the General Account, the terms of lending might have to be changed. Finally, funding through the Account "would seem to raise a series of interrelated problems that could have adverse implications for the Fund's policies and monetary character." For these and other reasons, at this time it would be difficult to fund the facility through lending to the General Account.

Funding the enhancement through a "protected" Trust would seem to be a better option. It would ensure that the original character of the facility is maintained, while alleviating the concerns of potential contributors regarding security and liquidity. Moreover, funding through a trust arrangement would not put added pressure on the Fund's limited resources, and the flexibility of the facility would be maintained. The staff also has suggested a few ways to strengthen the Trust to allay the major concerns of contributors with respect to liquidity and security.

As for the two other options presented by the staff, I agree with the views expressed by the Managing Director in his report on his meeting with the Group of Ten regarding the sale of gold to help finance the enhancement of the facility (Executive Board Informal Session 87/4, 7/15/87). I believe that gold sales could weaken the Fund's ability to assist adequately its members. I would, therefore, prefer that this option not be considered at the present time.

Although I could support a conditional SDR allocation, especially along the lines described earlier by Mr. de Groote, unfortunately the majority view is against this option. I therefore favor the establishment of a protected Trust arrangement with a reserve, because it would meet most of the concerns of all parties. The funds for the reserve could be derived from the sources described under subparagraphs (a) and (b) on page 10 of the staff paper. However, I would not, at this time, favor the addition of a surcharge on loans extended by the Trust to finance the reserve. Preliminary calculations by the staff suggest that the amounts secured from (a) and (b) would be sufficient to provide assurance against delays in repayment. I have some reservations about option (d), which would temporarily preclude the use of some of the proceeds from repayments of loans to the Trust. Option (e) also is interesting and would not add to the burden of borrowers. However, whether this option is chosen will depend entirely on participants. I am definitely not in favor of option (f), which would eliminate the five-year grace period for the repayment of loans under the facility.

We are very thankful to those countries which have agreed to contribute to enhance the facility's resources. This added financial support will go a long way to encourage those countries adopting strong adjustment programs under the facility to persevere in their efforts. Toward this end, potential contributors should take the necessary steps to release their contributions so that the operations of the enhanced facility could commence on January 1, 1988, as envisaged. Because low-income debtor countries will continue to need concessional financial assistance for some time, the enhanced facility should be aimed at providing additional resources under the same, or as favorable, terms as those of the original facility. Any hardening of these terms will place an undue burden on the limited finances of recipient countries. In fact, the availability of additional resources should be used to lessen their financial burden, thereby giving them a better chance to achieve the objective of higher noninflationary growth, and improve the living standards of their people.

Finally, could the staff elaborate on the statement that "it is the intention of management to propose a reinforcement of Fund policies to improve the quality of structural adjustment loans?" I hope this does not mean an increase in conditionality. If so, the structural adjustment arrangement will lose its intended character and will become more like a stand-by arrangement. We should try to avoid this at all costs. The facility was created because stand-by arrangements did not provide the proper context for solving the problems of these countries, and an increase in conditionality would only discourage many of them from utilizing the facility, thereby defeating the purpose for which it was created.

Mr. Grosche made the following statement:

We welcome the Managing Director's initiative and hope that it can be realized as soon as possible.

Since no decision has been taken yet on the enhancement itself, the discussion on the proposed modalities can only be preliminary in character. At this stage, our position on the main issues is as follows. First, we consider the arguments put forward by the staff against possible lending to the General Resources Account to be convincing. We therefore believe that the resources to support enlarged lending in association with the structural adjustment facility should be channeled through a trust fund, administered by the Fund. To be sure, there are still many difficult issues to be addressed with regard to funding as well as to the security and liquidity of claims on the Trust. The staff has advanced a number of proposals for improving security and liquidity, which, if implemented, seem to provide a large degree of guarantee. They will have to be carefully examined to determine whether they offer enough assurances to attract the desired amounts of financing. However, one possibility--"guarantees" extended by the General Resources Account--has to be ruled out.

Some additional backup mechanisms may have to be considered. For this reason, I would not at this stage shut the door completely on a very limited use of the Fund's gold, although I have a lot of sympathy for the Managing Director's view on this issue. I was also impressed by the arguments put forward by the staff. Clearly, the use of gold cannot and should not be considered as an easy way out of the problems we are facing in making this initiative a reality.

I am opposed to a conditional SDR allocation. A conditional allocation for purposes related to the structural adjustment facility would represent a fictitious solution; in economic terms, it means nothing more than extending credit to the Fund--an objective we are all aiming at, but in a clearer, sound, and straightforward fashion.

The issue of liquidity is very much dependent on the character of the resources provided to finance the enhancement. Liquidity is not an important issue if long-term, nonmonetary resources were provided to finance the enhancement. Raising such resources will pose difficult problems domestically. If, therefore, the source of financing was loans and not budgetary reserves, solutions should be found to address the liquidity problem.

A number of the difficulties arise from the need to provide budgetary resources for the purpose of interest rate subsidies. A lot of work remains to be done not only with regard to burden sharing, but also with regard to budgetary commitments, before decisions can be taken on the modalities of financing the enhancement. At this stage it would be helpful if a consensus could be developed on adopting the Trust Fund approach for financing an enhanced facility.

Mr. Hospedales made the following statement:

The financing needs of some countries eligible to use the structural adjustment facility are potentially quite large, in some cases amounting to several multiples of their Fund quotas over the period of an arrangement. For this and other reasons relating to current access guidelines and uniformity of treatment of members, the Executive Board agreed to establish a modestly financed facility distinctly targeted to deal with the need of the Fund's poorest members for debt relief and concessional resources in increasing amounts. More recently, in recognition of their deep-seated and protracted balance of payments problems, the facility's operations were strengthened through an increase in the limit on second-year disbursements to 30 percent of quota. The present effort to triple the facility's resources--a strong initiative being led by the Managing Director--through a trust arrangement is critically important to support meaningful, realistic adjustment policies in order to restore growth and make substantial progress toward external viability in these low-income countries.

We agree with the staff that the structural adjustment process is evolving in a manner consistent with the adjustment needs of low-income countries. Any attempt to dilute the facility's role at this stage would be unfortunate, as would be any attempt to change its eligibility criteria. The staff is, therefore, pursuing a correct strategy to ensure through extensive dialogue with potential contributors that an enlarged facility with new modalities and financing arrangements meets the mutual interests of all parties--potential contributors and the Fund itself. We are particularly attracted to the staff's imaginative proposals--in the light of the concerns expressed by potential contributors--to enhance the security and liquidity characteristics of lending through a protected trust arrangement, including the establishment of an interest subsidy account to ensure that the terms and conditions of enhanced lending are similar to those under the existing facility. Nevertheless, alternative financing arrangements proposed by potential contributors also should be given further consideration in the light of the budgetary, legislative, and political concerns of contributors. The question of selling gold should also be explored, if a shortfall in financing requirements materializes.

In line with the concept of adjustment with growth, an allocation of SDRs assumes considerable significance, since SDRs provide unconditional liquidity, which would help countries avoid growth-inhibiting import compression. The staff should evaluate the mechanisms that have been proposed to improve the distribution of allocated SDRs, especially for onlending to developing countries in need. Finally, considerable benefit could also be derived from the provision of technical assistance by those countries which are not in a position to provide financial resources to the enhancement.

Mr. Dallara made the following statement:

During the 1985 Annual Meeting, Treasury Secretary Baker, building on many suggestions and comments by Governors and by Executive Directors in the Board, pointed out that creditor and debtor countries alike have a common interest in growth that rests on productivity, innovation, and investment. He called attention to the opportunity available to members of the Fund to address more effectively the economic problems of low-income countries facing protracted payments difficulties by suggesting that Trust Fund reflows be utilized to support comprehensive economic programs adopted by these countries and designed in close collaboration with the World Bank.

We have come some distance since that time. Most important, through the creation of the policy framework process, the expertise of the Bank and the Fund has been combined to help ensure that needed policy measures are identified and that external financing is catalyzed. The Fund itself has made steady, important progress in carrying out lending operations under the facility. Three weeks ago, the seventeenth structural adjustment loan was approved by the Board, and soon one member will begin its second annual arrangement under the facility.

Lending by the International Development Association (IDA) in support of the policy framework process has also been significant in a number of cases. At the same time, certain problems remain with the implementation of the policy framework process and the operation of the facility; problems, in part, of coordination with the Bank--including the need to gear IDA lending more effectively to the priorities identified in the policy framework papers--and problems relating to the overall amounts of financing available to support the policy framework process. Certainly, in the end, the overall amounts of financing will depend upon the ability of this process to catalyze additional financing.

With this perspective, my authorities were pleased to join other countries at the Venice Summit in welcoming the Managing Director's proposal to increase the facility's resources. At the same time we pointed out that the bulk of the additional resources must come from countries with payments surpluses, since they are clearly in the strongest position to provide such financing. This remains our firm view. The United States is providing important support for developing countries and is working to provide more. In this connection, it should be noted that the Administration is experiencing difficulty obtaining full funding for the multilateral as well as the bilateral aid programs proposed in the fiscal 1988 budget. In these circumstances, the first priority with respect to multilateral support for these countries must be to secure funding for our share of IDA-8, and we cannot make any commitment regarding a contribution to the enlargement of the structural adjustment facility.

While there has been broad agreement on the need to enlarge the facility, differences of view remain on how best to provide financing. We believe that enlargement by means of a trust fund is the only approach that will put the Fund in a stronger position to help its low-income members, not only in the coming year, but also in the decade ahead. Moreover, it is the only approach that could accomplish the twin objectives of enabling the Fund to continue to play a viable, visible role in supporting policy changes in these countries while protecting the Fund's monetary character.

A variety of other reasons have been elaborated by the staff and touched on by other Directors--particularly Mr. Nimatallah, who stressed the need for flexibility--which also argue in favor of a trust fund. We are persuaded by these arguments.

We understand the appeal of direct lending to the General Resources Account for a number of potential contributors, but this approach is fundamentally flawed with respect to the overall objectives of the enlargement. Particularly difficult problems arise in light of the need to target resources to be channeled through the Account toward countries in need of concessional financing. For a variety of other reasons, we consider this approach inappropriate, and we have serious doubts that it merits further attention.

We also agree with the reasons given by the staff for not pursuing further the possibility of gold sales or SDR allocations. As for bilateral parallel lending, it would be imperative that countries adopting that approach should provide lending on terms and conditions identical with those of the trust arrangement and genuinely parallel in all senses of the term.

As initially presented, the trust approach generated a number of concerns by potential contributors relating to security and liquidity. The staff has put considerable effort into developing possible approaches to deal with these concerns.

We agree with the staff that the Fund has no power and should not explore the possibilities of offering guarantees in any form, whether for borrowing for the benefit of the Trust, or for offering access to the resources of the General Resources Account to help members meet payment obligations to the Trust. Two options that present no serious difficulties are the subordination of the claims of the Special Disbursement Account to claims of the Trust, and assuring that payments with respect to structural adjustment loans could be made available to meet any obligations of the Trust to its lenders that it is unable to meet because of a delinquent payment.

The various options for establishing a reserve for the Trust pose more fundamental issues. We are certainly willing to consider, in principle, establishing a reserve if it proves helpful to potential contributors. But some of the suggestions made by Directors point toward a reserve that would be excessively large.

We have no objection to allocating income earned on investing the resources of the facility to the reserve. Furthermore, we would be willing to consider adding the interest paid on structural adjustment loans to the reserve. We would also be willing to consider raising the rate of interest on loans to build reserves at a more rapid pace, or the possibility of a surcharge. But frankly, we are not sure that these are the most potentially productive avenues to pursue. Allocating semiannual repayments of loans to the reserve has substantial potential, and we would be prepared to consider that approach if it proved critical to the successful outcome of the initiative.

We would be willing to consider a sinking fund if participants and users were willing to consider it, but we wonder whether some variation of this approach could be considered. Borrowers from the Trust could perhaps be required to make certain arrangements to reduce the risk of nonpayment through management techniques for managing their own reserves, perhaps along the line of arrangements that have been adopted by some countries to ensure that SDR holdings are sufficient to meet scheduled obligations to the Fund.

On issues relating to liquidity protection, we would be willing to consider most of the suggestions set forth in the staff paper. The possibility of a mutual arrangement among contributors to purchase the claims of a contributor having a payments need does have some limitations. On the one hand, an arrangement that extends only to undrawn balances of contributions may not provide sufficient liquidity. On the other hand, depending on the legal and financial structure of certain contributors' arrangements with the Fund, the transfer of claims among contributors might actually reduce the total commitments available to the Fund.

In addition, we would have major difficulty with the establishment of a special mobilization facility, for reasons which are related in part to our views concerning the General Account approach.

We agree with the staff that the best protection to potential creditors lies in the strength and appropriateness of the adjustment programs their resources would support. For this reason, we welcome the forthcoming staff paper on suggestions for strengthening the monitoring of structural adjustment arrangements. It is critical that this paper address, inter alia, the use of reviews and possible phasing of disbursements, the selection of benchmarks, and further steps to build on the progress already achieved in enhancing cooperation between the Bank and the Fund.

On conditionality, many of the problems of the last decade arose in the presence of excessively narrow, sporadic, or isolated conditionality. If financing is made available to countries without the proper program design, those countries may have even greater debt-servicing problems in the 1990s than they do today.

Mr. Sengupta made the following statement:

Considering the urgent nature of the problems facing the low-income debtor countries, the modalities of financing the enhanced facility should make additional resources available to them in the fastest, least complicated manner. While recognizing that the modalities adopted would have to take into account the concerns of potential contributors, we must not overlook the concerns of recipient countries.

During the discussion on the review of the facility, many Directors noted that its high conditionality and the delays in approving programs had made use of the facility less attractive to eligible countries. Adequate and timely assistance should be the cornerstone of the enhanced facility. In this context, I am apprehensive about the preparation of a staff paper on the implications of enhanced lending for the monitoring of structural adjustment arrangements. I hope this will not mean that separate, more conditional monitoring procedures will be established for the enhanced facility. Some clarification on this point would be welcome.

I was happy to note the Chairman's confirmation of Mr. Nimatallah's understanding that the existing facility would remain as is, and the enhanced resources would "sit" in the General Resources Account or the proposed Trust to be used to supplement the resources of the facility. In the near future we would like to discuss how to relax or moderate conditionality so that the facility's resources can be used more effectively and quickly. In any case, there should be no change in the nature of the facility, particularly with respect to its purpose, terms, and eligibility criteria.

As for financing requirements, if an enhancement of SDR 6 billion can be secured, it will be an achievement. We have grave reservations about equating the financing requirements of recipients' structural adjustment programs to countries' potential default on their obligations to the Fund. The size of the enhancement should be based on the financing needs for structural adjustment, including the need to overcome the immediate debt problem. Countries eligible to use the present facility which are not facing a debt problem should be able to utilize the enhanced facility if their balance of payments situation deteriorates and if they fulfill the conditions for doing so.

As for India's intentions regarding the use of the enhanced facility, I must reiterate that India had voluntarily refrained from the use of Trust Fund reflows as a gesture of international solidarity but continues to consider itself eligible to use the facility. Accordingly, appropriate provision should be made for India's potential use of the enhanced facility. This does not mean that India would use the facility in the immediate future, but rather that it does not wish to preclude that possibility, nor does it want to be treated differently from any other member with respect to eligibility and access.

It is only natural for potential contributors to seek assurances regarding the security of their assets and the liquidity of resources in the event that their own circumstances deteriorate. All lending carries some risks, but since the borrowers are sovereign governments, fears about the security of loans to the enhancement are perhaps overstated. In addition, the experience with arrears in respect of Trust Fund obligations has so far been favorable, with only 5.8 percent of total obligations outstanding at present. Moreover, an insistence on greater security would not send positive signals to the capital markets, which otherwise might be inclined to provide some financial support to countries eligible to use the enhanced facility. I therefore share the staff's view that the best protection to potential creditors lies in the success of the adjustment policies adopted by recipient countries.

Nevertheless, we recognize the concerns of potential contributors regarding the security of their resources. Thus, if lending to the General Resources Account would alleviate these concerns and would thereby make more resources available to the facility, we would support this approach. We are not persuaded by the staff argument that since access to the Fund's general resources cannot be limited, lending to the Account may not serve the purpose of assisting countries eligible to use the structural adjustment facility. If members who are not eligible to use the existing facility refrain voluntarily from the use of enhanced resources channeled through the General Account, that approach could work well. Even if such understandings are not legally binding, there are few instances where sovereign governments have repudiated or gone back on commitments to an international organization.

The staff would prefer to see enlarged lending channeled through a trust account, and in view of the potential concerns of creditors, it has described possible steps for strengthening the security and liquidity of claims on a trust. Most of these safeguards take account of creditors' concerns, but are not helpful to countries eligible to use the facility. For example, subordination of the claims of the Special Disbursement Account to claims of the Trust would freeze the use of reflows to the facility. Likewise, the establishment of a reserve, financed from investment earnings on balances held in the Special Disbursement Account, interest on loans under the facility, income from a possible surcharge on loans from the Trust, and from the proceeds of payments of loans under the facility, is unacceptable, since it would siphon off resources from the Special Disbursement Account and keep them idle in the reserve. That is not the purpose of the Special Disbursement Account. Nor would a distribution from the general reserve be appropriate in view of its distinct purposes, which are not related to the considerations at hand. A sinking fund would disadvantage the users themselves, since it would eliminate the initial five-year grace period applied to loans under the facility. The suggestion that creditors could be given a limited assurance by the Fund through a special mobilization facility would only add to the multiplicity of arrangements. No new facility needs to be established for this purpose, since the Articles provide for situations arising from balance of payments needs or reserve shortages.

As for enhancing the facility through the sale of a portion of the Fund's gold holdings, I have some sympathy for the staff's view, not because gold should not be sold for these purposes, but because I believe that the donor countries should not take this easy way out. Creditor countries should support the structural adjustment of low-income countries as part of their obligation to contribute to international cooperation for an orderly development of the world economy. Until they do so in their own interests, a durable basis for international cooperation cannot be built up.

Mr. Donoso remarked that his authorities acknowledged the especially difficult situation facing low-income debtor countries, and they fully endorsed the initiative to enlarge the structural adjustment facility. They were willing to contribute to the facility in ways consistent with the serious financial constraints facing them at present. They attached great importance to the enhancement and would like to see the arrangements for its implementation finalized soon. In their view, the industrial countries must be the major source for financing and developing an enhanced facility. It was disappointing that there had been little support for financing the enhancement through an SDR allocation; some of his authorities had considered that approach to be a potentially promising one.

Some speakers had made a distinction between capital contributions and grants, Mr. Donoso observed. Those concerned about preserving the reserve character of their capital contributions preferred to channel resources through the General Resources Account, whereas others preferred parallel bilateral lending to maintain a greater degree of concessionality. Perhaps a middle path could be found so that contributions could be made either through the General Resources Account or through a parallel account--which perhaps would not even have to be administered by the Fund--to allow for the concessionality element. Although operating through the General Account meant that access to the facility could not be limited, the demand for enhanced resources could be rationed through prices--namely, lending at an especially high rate which, for specific countries, could be reduced through a subsidy provided by the parallel account.

The sale of the Fund's gold raised the problem of committing resources belonging to the general membership, Mr. Donoso noted. He would prefer an approach that did not commit Fund resources to so specific a purpose. However, lending through the General Account at especially high rates would help compensate for the risk being taken by the Fund. In that regard, a combined approach utilizing both the General Resources Account and a separate subsidy account would be a move in the direction of an "a la carte" solution to the structural adjustment problems of low-income countries.

Mr. Hogeweg made the following statement:

> In principle, my authorities support the initiative to mobilize additional resources for lending in association with the structural adjustment facility. Countries eligible to use the facility clearly need more concessional financing. Structural adjustment and sound macroeconomic policies reinforce each other. The way the facility has been set up--with a policy framework paper, annual disbursements in the context of a three-year arrangement, the collaboration of the Fund and the World Bank, and the monitoring system--is conducive to the best possible results.
>
> The character of loans to these low-income countries necessarily differs from normal Fund credit, both in terms of maturity and of the degree of concessionality. In view of this, my Netherlands authorities prefer, as a matter of principle, that the World Bank should play as large a role as possible in handling flows of this kind. Nevertheless, we are actively looking into the possibilities to support the Managing Director's initiative.
>
> We agree with the staff that a Trust is the preferred approach for mobilizing resources and extending loans under the facility. One of the advantages of a Trust would be that loans to

some countries with a history of prolonged use of Fund resources and arrears problems could be channeled through the Trust, thereby assuring the revolving character of the Fund's general resources. However, the establishment of a Trust still has some shortcomings.

The staff argument that flows should not be channeled through the General Resources Account because doing so might endanger the revolving character of the Fund's resources implies that there are serious risks attached to claims on a Trust. Moreover, the staff's suggestions for protecting the Trust against these risks show clearly and explicitly the risks to the Fund's solvency and liquidity that would result from channeling these flows through the General Account. In this connection, it is important to recall that in its most recent paper on the Fund's liquidity (EBS/87/176, 8/5/87), the staff also noted that some factors might endanger the Fund's present comfortable liquidity position as early as end-1988.

The suggestions made by the staff to protect the Trust against the risk of arrears and to enhance the liquidity of claims to the Trust are insufficient. The proposed subordination of the Special Disbursement Account to the enhanced facility would diminish the credit risk, but not eliminate it, not only because the size of the reserve will be smaller than that of the proposed Trust, but, more important, because the reserve carries essentially the same credit risk as the Trust. The possibility to transfer claims on the Trust to other creditors increases the likelihood of the liquidity of these claims at all times but provides no certainty, and certainty is necessary to allow claims to be part of official reserves.

Finally, we strongly oppose gold sales to finance the enhancement. We believe the staff is entirely correct with respect to the serious drawbacks of that approach.

Mr. Hammoudi remarked that he agreed with the staff's analysis to a large extent, except with regard to new charges on borrowers and the shortening of maturities. It was crucial that the concessional nature of the facility's resources should be maintained.

Extending his remarks, Mr. Hammoudi submitted the following statement for the record:

The staff report leaves the impression that contrary to the concessional spirit of the original Trust Fund and the cooperative character of the Fund itself, creditor members and other potential contributors to the enhancement of the structural adjustment facility are more concerned about the security of their "investments" than the concessional nature of the facility and the underlying reasons for its enhancement. Regrettably, this attitude has increasingly prevailed in the international financial community and is greatly responsible for the plight of developing member countries, especially those poorer members facing protracted balance of payments difficulties and having little or no access to other sources of external financing. An exception would be those potential contributors who, despite their own vulnerable economic positions, have expressed willingness to actively support the enhancement, albeit with the legitimate concern that their claims on the facility should be sufficiently liquid to enable their encashment in the event of a balance of payments need. Indeed, the enhancement of the facility--in terms of its size and origin, as well as the handling of the issue by creditor members--contrasts sharply with the establishment of the oil facility in the 1970s.

I would like to make two general observations. First, I can hardly agree with the staff that "the Fund's gold holdings are an essential element in its financial strength." I continue to maintain that as an international cooperative institution, the Fund's strength depends mainly on the strength and resolve of the membership in supporting it. This stems from the fact that the Fund is primarily a quota-based institution. The need for an enhancement of the structural adjustment facility, the General Arrangements to Borrow, and other external financing has arisen partly as a result of the reluctance of large industrial countries to support the institution by agreeing to adequate quota increases and regular SDR allocations. Such reluctance tends to undermine the strength of the Fund.

A second general observation respectfully concerns the management's intention "to propose that in administering the enhanced facility, the Fund should reinforce its policies so as to improve the quality of the facility's loans." In this regard, while I wish to associate myself with Mr. Abdallah and look forward to the discussion on the implications of enlarged lending for the monitoring of structural adjustment arrangements, I feel compelled to reiterate the consistent position of this chair that the original Trust Fund was a highly concessional, low-conditionality, quick-disbursing facility for the express benefit of poorer members with protracted balance of payments problems and with due concern to their difficult access to other resources of external financing. By contrast, the newly established structural adjustment facility has amounted to an "extended Fund facility for the poor," in view of the facility's highly conditional character and the burdensome and lengthy negotiation process associated with arrangements. Those colleagues representing countries eligible to use the facility and other less developed countries that agreed to the highly conditional character of the facility did so in the light of assurances given regarding its future enhancement by means of additional resources. After a long lapse of time and as a result of the Managing Director's own strenuous and commendable effort, such enhancement is only now being contemplated. We should therefore be aware of the original understanding on this enhancement and avoid introducing additional or tightened conditionality, which could, in the long run, prove counterproductive.

On the proposed modalities of the enhancement, the staff's analysis and legal interpretations on lending to the General Resources Account are convincing. That approach raises concerns about the violation of uniformity of treatment, which could result in discrimination among members and is fundamentally against the cooperative character of the institution. Moreover, possible legal and budgetary complications for some potential contributors could, in all likelihood, defeat the intended purpose of the enhancement by delaying the commencement of operations beyond January 1, 1988.

As for the proposal on the sale of gold, I agree with the staff on the adverse influence that such an undertaking by the Fund might have on market conditions and the implications for the Fund's gold holdings as well as those of the membership.

A discussion on a "conditional" allocation of SDRs is not relevant at this stage in view of the reluctance of a minority of members to agree to moderate regular allocations, let alone any special allocation. As a matter of principle, however, I continue to insist on proceeding with regular allocations under the basic periods before considering whatever changes or modifications in the system that the majority of the membership may desire.

On the proposed establishment of a protected trust arrangement, the intended purpose of the facility is to "provide balance of payments assistance on concessional terms, on a uniform basis, to low-income developing members of the Fund in need of such assistance...." Therefore, programs supported by the facility should help eligible members to correct their imbalances while promoting growth, and enable them to not only discharge their obligations to the Trust--or whatever form contributions to the enhancement may take--on a timely basis, but also to honor all other financial obligations to the Fund. Undue emphasis by some potential contributors on the security of their claims creates doubts regarding the quality of adjustment and undermines the credibility of programs supported by the facility. This is not, however, to imply that the security of contributions to the facility, as any other financial investment, should not be assured, but rather to stress that the concessional aspect of the facility should likewise be given its proper weight and priority.

Accordingly, I would oppose any surcharge to be paid by borrowers, as this would effectively increase their interest burden by some 40 percent and would clearly be contrary to the concessional character of the facility. I could, however, agree with the creation of a reserve in the Trust to be financed in any one or combination of the proposed alternatives suggested by the staff, provided that such financing would not involve any additional burden on users. Considering the complexity of the issues, the urgency of an early enhancement and the commencement of operations, and the uncertainties surrounding future operation of the enhanced facility, I agree with Mr. Abdallah that modalities for the termination of a reserve could be worked out at some future point.

Finally, the concerns of some potential contributors regarding the liquidity of claims on the enhanced facility are legitimate, especially those concerns with respect to balance of payments needs in the foreseeable future. The staff's suggestion regarding the participation by potential contributors in this category on a bilateral basis seems reasonable. In short, any one or combination of proposals which could ameliorate the concerns of these potential contributors would be acceptable.

Mr. Jiang observed that potential contributors had expressed some reservations about the trust arrangement put forward by the staff. It was understandable that contributors should be concerned about the security and liquidity of their claims on the Trust. Three alternatives had been raised by potential participants during their discussions with the staff--financing the enhancement through lending to the General Resources Account, through the sale of the Fund's gold, or through a conditional allocation of SDRs.

Unfortunately, all three alternatives carried some negative consequences, Mr. Jiang continued. Lending to the General Account would have a number of implications for the policies and operations of the Fund, and might not conform to the spirit of the Articles of Agreement. The sale of the Fund's gold holdings in the present world economic environment might not be advantageous. And, an allocation of SDRs for the purpose of onlending to the General Account by contributing members might give rise to the same adverse implications as would direct lending to the General Account. In the circumstances, he would prefer some type of protected Trust arrangement.

As for the three possible means proposed by the staff to assure the security and liquidity of contributions, he had no problem with giving claims of the Trust priority over those of the Special Disbursement Account, Mr. Jiang added. He had some reservations regarding the use of the Account's resources to repay the obligations of the Trust, because that approach might alter the nature of the Account. He had no difficulty with the general thrust of the proposal to establish a reserve in the Trust, but did have some reservations regarding a 0.2 percent surcharge on loans extended by the Trust and the establishment of a sinking fund, because those proposals would unduly increase the debt burden of users and would modify the procedures of the facility.

Finally, he was concerned about the slow progress of the enhancement, Mr. Jiang commented. In June the Heads of State or Government of the Group of Seven had urged at their meeting in Venice that discussions on the enhancement should be brought to an end, and that whatever steps were needed should be implemented by the end of the year. The Board should not spend too much time on the issue of protection against loss, since losses might not occur; if too much attention was devoted to that single issue, then the whole scheme could become too complicated, and the commencement of enhanced operations might be postponed. The staff had emphasized that the best protection to potential creditors lay in the strength--or in the success, as Mr. Sengupta put it--and appropriateness of the adjustment programs those resources would support. He fully agreed with that view as long as it entailed no increase in conditionality, and he could also agree to a protected trust arrangement, in principle, with the formalities to be worked out later. That approach would encourage the timely implementation of the enhanced facility.

Mr. Finaish said that his remarks were tentative, since he had not received the views of all of his authorities on the various specific proposals put forward in the staff paper. He hastened to add, however, that his authorities continued to support fully the initiative to enhance the resources of the structural adjustment facility; they considered the enhancement essential if the facility was to achieve its far-reaching objectives.

In principle, the choice of the specific mechanism for enhancing the facility's resources should strike a balance between two basic criteria, Mr. Finaish remarked. The first criterion was to avoid any change in the existing terms for using the facility's resources, including both the interest rate and the repayment schedule. Thus, the suggestions of a surcharge or a sinking fund did not seem appropriate. The second criterion was to try to focus on mechanisms that were likely to expedite the flow of resources from creditors and donors by addressing the concerns which some of them had raised regarding the security and liquidity of their claims. In this regard, the staff paper had provided a useful and comprehensive discussion of various ways of dealing with those concerns.

On the question of conditionality, Mr. Finaish said that his remarks made during the Board's discussion on the world economic outlook (EBM/87/134, 9/11/87) were particularly valid with respect to the structural adjustment facility.

In view of the continuing deliberations of his authorities and the comments of other speakers, he believed that some discussion and reflection might be necessary before a consensus on the best possible course could be achieved, Mr. Finaish commented. In concluding, he again stressed his support for the initiative and his hope that the additional resources would be put in place as quickly as possible.

Mr. Hubloue made the following statement:

From the outset my authorities have been highly supportive of the initiative to enlarge the resources of the structural adjustment facility. They are convinced that an enlargement is the best possible way of meeting the low-income countries' need for financial assistance on highly concessional terms to support structural adjustment.

Also from the outset, this chair has felt it necessary to caution strongly against the proposal to finance the enlargement with contributions to a trust account funded from budgetary appropriations. The proposals which Mr. de Groote submitted in his note of June 19 on the conditional use of an SDR allocation in connection with the enlargement and on the sale of a part of the Fund's gold to subsidize interest payments on loans under the facility were basically intended to avoid excessive reliance on budgetary fundings and to promote an understanding on funding methods from monetary sources. The main reason my authorities prefer monetary financing is, of course, to ensure an enlargement of sufficient size, which will be difficult to obtain if contributions have to come from budgetary resources.

In the midst of a difficult adjustment of their own public finances, my authorities cannot justify a budgetary contribution at this stage. They also entertain the more general concern that budgetary funding of the facility would seriously confuse parliamentary discussions on the needed increase of the World Bank's capital, and on other exceptional donor efforts that will be needed, beside the structural adjustment facility, to establish a favorable financing climate for the continuing adjustment and development of low-income African countries. For these reasons, my authorities can only consider a contribution from monetary sources. However, they find that the ideas submitted by the staff for facilitating monetary contributions to the proposed trust account fall short of the much more coherent financing scheme to be obtained by operating through the General Resources Account, and they find that the possible use of the Account has been rejected on the basis of questionable arguments.

My authorities consider that no mechanism will ever succeed in giving the claims of the Trust a degree of liquidity comparable to that of claims on the General Resources Account. The staff's proposal seems to suffer from a contradiction of principle: to protect the monetary and revolving character of the Fund's general resources, the operation of the structural adjustment facility and its funding would be diverted to a separate trust account; but doing so contradicts the basic idea that the importance of the monetary character of the Fund's resources stems precisely from the need to guarantee the liquidity of claims made by creditor members, who now will be asked instead to contribute to a trust account with less liquidity.

There is also a contradiction inherent in the staff's view that claims on the Trust can best be protected by the strength and appropriateness of the adjustment programs those resources will support. We fail to understand how the quality of structural adjustment programs can reassure the creditor countries if it is insufficient to justify the involvement of the Fund's own resources. We propose instead that the Fund should give an important signal of confidence by committing its own resources to adjustment programs whose chances of success will be much enhanced by the combination of structural emphasis and appropriate concessionality.

Moreover, the staff sees difficulty in establishing balance of payments criteria that would qualify countries eligible to use the structural adjustment facility for access to concessional borrowing from the General Account. Clearly it cannot be a major stumbling block to establish criteria in terms of the balance of payments problems associated with a country's limited resource base, which the programs supported by the facility are to address. The staff's contention that the list of countries qualifying for eligibility under such criteria will probably never completely match the present list of eligible countries should certainly not restrain us from attempting to establish proper balance of payments criteria to ensure that the available funds will be directed where they are most needed and where they can support the strongest adjustment efforts.

Finally, my authorities regret that the staff's proposals so far have not given more constructive consideration to the conditional use of an SDR allocation or to the use of the Fund's gold in connection with the enlargement. My Belgian authorities in particular are of the view that the extraordinary efforts that are now required of everyone to give the adjustment process of the low-income countries a new momentum would more than justify the use of a part of the Fund's gold to subsidize interest payments on loans under the facility.

In conclusion, the staff's proposals give the contradictory impression that the Fund desires to increase its role in the adjustment process of the low-income countries, while at the same time it is taking steps to bail itself out of those same countries. My authorities strongly hope that these contradictions can soon be overcome so as to enable them to contribute to an initiative that unambiguously reinforces the role of the Fund in the adjustment process.

The Director of the Exchange and Trade Relations Department remarked that for the reasons given in the staff paper, the staff felt strongly that the Trust Account was the preferred instrument for enhancing the facility. In light of the comments made by Executive Directors, it would consider to what extent the arguments for establishing a Trust could be strengthened so as to persuade those who still had some doubts about the desirability of that course.

If the Board chose to establish a Trust Account, then it was normal that creditors would seek some assurance regarding the security of their loans to that Account, the Director added. Various mechanisms for that purpose had been put forward in the staff paper. It was not expected that all those mechanisms should be used, but two safeguards had received general support in the discussion, namely, subordinating the claims of the Special Disbursement Account to claims of the Trust and using the interest or repurchases flowing to that Account, which together amounted to some SDR 4 billion. Compared with an enhancement of SDR 6 billion, that sum represented an impressive degree of protection against risk. For example, nonrepayment of loans amounting to SDR 6 billion would involve default by approximately 60 countries, which only seemed possible in the context of major systemic difficulties. It was difficult to imagine that the Fund's membership would allow a situation leading to that worst-case scenario to occur. More realistically, looking at the experience with the Trust Fund, arrears represented about 6 percent of total obligations. In that light, provision of an SDR 4 billion safeguard for an SDR 6 billion facility was conservative.

On other matters, the amount of resources required for the enhancement--SDR 6 billion--was based on a careful consideration of the financing needs of the countries eligible to use the facility, the Director explained. However, that estimation had been made months earlier; at present the amount required would be even greater. On guarantees, Mr. Zecchini's understanding was correct; indeed, the Articles would have to be amended. On the monitoring of structural adjustment arrangements, the staff paper would not be ready until after the Annual Meetings. The question regarding the method of recording official development assistance would be raised with the Organization for Economic Cooperation and Development; a decision on that question might have to be taken by the Development Assistance Committee itself.

The implications of the use of the General Resources Account approach with respect to eligibility and access were indeed great, the Director of the Exchange and Trade Relations Department remarked. A combined approach, as suggested by Mr. Donoso, consisting of loans to the Account and some form of trust, would be carefully examined by the staff. His first impression, however, was that that approach would pose most of the problems inherent in the General Account approach.

The staff representative from the Legal Department remarked that the staff's arguments concerning the exclusion of a guarantee by the General Resources Account for the Trust or of transfers of resources from the General Resources Account to the Trust were based on Article V, Section 2(a), which described permissible operations and transactions. A change would require an amendment to the Articles.

The mechanism discussed in the staff paper involving the use of the Fund's reserves in the context of safeguarding claims on the Trust was based on a distribution of reserves and a voluntary retransfer of proceeds to the Trust, the staff representative added. That practice would be limited, however, to the Fund's general reserve, because in accordance with Article XII, Section 6(b) the Fund's special reserve could not be distributed.

The mobilization faclity would not address balance of payments problems, but developments in a member's reserves in accordance with Article V, Section 3(b)(ii), the staff representative noted. It could offer access to the Fund's resources for liquidity reasons under adequate safeguards, as explained in the staff paper.

Obviously member countries could refrain voluntarily from using the resources of the General Resources Account, the staff representative from the Legal Department remarked. The Fund could also establish a facility that prescribed criteria for access to the General Resources Account on the basis of circumstances of balance of payments difficulties. Limiting access to the General Resources Account to countries eligible for the existing structural adjustment facility, however, could not be achieved through a decision of the Board of Governors. The principle of uniformity of access to the Fund's general resources was established by the Articles, and any change would therefore require an amendment to the Articles.

The Chairman made the following summing up:

We had a fruitful discussion today on enhancing the structural adjustment facility (SAF), primarily on issues related to the mobilization of resources. I think it would be helpful, as a guide to further staff work and as an indication of how I will cast my report to the Interim Committee on the status of the SAF initiative, if I were to indicate a few general observations that have emerged from the meeting.

General observations

All Directors reiterated their strong support for the enlargement of the resources available for SAF-associated lending. Directors noted that although the figure of SDR 6 billion is ambitious, the amount is not large in relation to the needs of SAF-eligible members. Most Directors stressed the urgency of initiating lending operations under the enhanced facility and urged all concerned to move forward as quickly as possible, bearing in mind the different legislative and other considerations affecting contributions by individual members.

Lending arrangements

The staff paper discussed two alternative funding arrangements for an enhanced SAF--lending to a Trust or lending to the General Resources Account (GRA). Many Directors felt persuaded, on the basis of the considerations raised in the staff paper, that operating through the GRA would raise very difficult policy issues. Those Directors generally felt that a trust arrangement would provide greater flexibility in operating an enlarged SAF and would provide for consistency with established policies on access and prolonged use. Other Directors thought that the staff may have overstated the policy problems that could arise in operating the SAF enhancement through the GRA and, on balance, felt that such a mechanism was to be preferred. Some of these Directors believed that, in light of the known institutional, legal, and budgetary constraints faced by some potential contributors, commitments may be forthcoming more quickly and, possibly, in larger amounts, if contributors could lend to the GRA.

We have listened carefully to the concerns expressed by Directors on this issue and shall hold them clearly in mind as we proceed in our efforts to craft an acceptable mechanism for enlarging the resources available for SAF lending. I am encouraged, however, by the view that if adequate protection can be provided to the Trust, it seems likely to receive broad support. I should add that we are also exploring the possibility of bilateral lending arrangements in parallel with SAF lending in our discussions with some potential contributors.

Directors considered that whatever the funding mechanism, the enhanced resources should be available on a broad basis, as at present. At the same time, there was a general sense that such resources should be provided to individual SAF-eligible members in accordance with the member's balance of payments need and the strength of the adjustment program being undertaken.

In considering the issues arising from our efforts to provide a possible Trust with a degree of liquidity and security against the risk of nonrepayment, a number of Directors, mainly those representing potential contributors, thought that the suggestions contained in the staff paper were helpful, even if some thought that they did not go far enough. Other Directors wondered whether the provisions for the GRA to provide liquidity for contributing countries that experienced balance of payments difficulties were appropriate. Also, a number of Directors observed that certain of the proposed mechanisms to protect the liquidity and security of the Trust required that SAF-eligible members themselves would have to assume a disproportionate share of the risk through, for example, the setting up of reserves or of a sinking fund to cover possible nonpayment.

This is obviously a very difficult area. We need to strike a balance between the call for greater protection and liquidity of claims as a means of securing a rapid and sizable increase in SAF resources available for immediate use and the possible burden on SAF-eligible countries as a group resulting from such protection.

We will continue to explore, in the most expeditious fashion, all possibilities for the consideration of potential contributors and of the Executive Board.

Some Directors suggested the possibility of selling or pledging the Fund's gold, either to fund the enhanced SAF or to provide security and/or liquidity to the Trust. However, a number of other Directors stressed that the Fund's gold holdings are an essential element of its financial strength and, in the present world economic environment, it is important that this strength should be maintained. Gold serves not only to underpin the Fund's current operations and financial position, but also to enhance its ability to respond to unexpected developments of a systemic nature. Moreover, the Fund's gold holdings could be of particular relevance to members in considering future increases in the resources of the Fund, whether through quota increases or borrowing. Accordingly, we will examine with the utmost caution the proposals involving the use of the Fund's gold in any way.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/137 (9/14/87) and EBM/87/138 (9/15/87).

2. FORTHCOMING ANNUAL MEETINGS - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/87/197, Sup. 1, 9/14/87) on the canvass of votes of the Governors on Resolution No. 42-2, with respect to the forthcoming Annual Meetings of the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes	880,036
Total negative votes	0
Total votes cast	880,036
Abstentions recorded	0
Total replies	880,036
Votes of members that did not reply	57,589
Total votes of members	937,625

Decision No. 8694-(87/138), adopted
September 14, 1987

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 87/20 through 87/24 are approved. (EBD/87/227, 9/8/87)

Adopted September 14, 1987

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/87/200 (9/11/87) is approved.

APPROVED: May 3, 1988

JOSEPH W. LANG, JR.
Acting Secretary

Further Considerations on the Mobilization of Resources in Association with the Structural Adjustment Facility

The following information is provided in response to a question raised by an Executive Director.

Commitments and disbursements under the structural adjustment facility as of September 11, 1987 as well as staff estimates for the remainder of 1987 are presented in the table below. Given the time required for presentation of requests for loans under the facility, the estimates are subject to only a small margin of error. Of the total resources of the Special Disbursement Account available for the facility--SDR 2.7 billion--about 44 percent would be committed by the end of the year.

Table. Utilization of Resources Under the Structural Adjustment Facility

	Arrangements Approved (Number of countries)	Commitments 1/ (Million SDRs)	Disbursements (Million SDRs)
Outstanding Sept. 11, 1987	17	855.5	269.4
Sept. 12-Dec. 31, 1987 (estimated)	7	345.5	277.8 2/
Outstanding Dec. 31, 1987 (estimated)	24	1,201.8	547.2 2/

Source: Staff estimates.

1/ Calculated as 63.5 percent of quota over a three-year period.

2/ Includes estimated second-year disbursements of SDR 169.0 million for eight countries.

By the end of 1987, disbursements under the facility are estimated to exceed SDR 0.5 billion, leaving about SDR 2.2 billion of projected resources available for disbursements beyond 1987. This is approximately equivalent at current exchange rates to the figure of slightly less than $3 billion that could be made available during the period 1988-90 that was referred to in the paper on "Proposals for Enhancing Assistance to Low-Income Countries Facing Exceptional Difficulties" (EB/CW/DC/187/6, 8/19/87).

It is difficult to estimate with precision the number and amount of new structural adjustment arrangements that may be approved during the first five months of 1988. Discussions are in various stages of advance with member countries which, if arrangements were approved, would involve additional commitments of about SDR 1 billion. The actual level of commitments will depend to a large extent on the outcome of negotiations with a few countries representing a relatively large proportion of the quotas of countries eligible to use the facility. These commitments assume that total access during the three-year program period will amount to 63.5 percent of quota, which implies potential access of 13.5 percent of quota for the third-year disbursement. The amount of the third-year disbursement is to be reviewed by May 1988.

Note by Mr. de Groote on Alternative Financing Methods for Increasing the Resources of the Structural Adjustment Facility
June 19, 1987

Introduction

The objectives of the proposed increase in the resources of the structural adjustment facility are twofold: to supoprt the adjustment process of the low-income countries with additional resources, and to increase the concessionality of the external financing available to these countries in order to better match their limited debt capacity. In this context, the possibility of financing the enlargement through long-term loans from national governments at highly concessional interest rates comes naturally to mind. However, an excessive reliance on funding from budgetary resources could have serious drawbacks from the standpoint of the Fund's overall role in the external financing process: it may not, in fact, be capable of rapidly and substantially increasing financial assistance from a wide circle of countries when many of them are facing severe budgetary restraints; it does not address the need for strengthening the Fund's responsibility on behalf of the indebted countries in general; and finally, it risks creating unnecessary confusion about the Fund's own financial role as distinct from bilateral aid programs and multilateral aid initiatives such as the operations of the International Development Association.

The Fund's financial role in the external adjustment process has traditionally built on its unique ability to generate monetary resources either through its members' quota subscriptions or through the allocation of SDRs, both of which reflect the Fund's function as a lender of last resort. Past decisions to rely on exceptional borrowings from members have always been designed to respect this monetary quality of the Fund's intermediation. The following proposals on alternative financing methods for increasing the resources of the structural adjustment facility attempt to protect the monetary character of the Fund, while at the same time placing the initiative in a more general context from which a global reinforcement of the Fund's role in the debt strategy can logically be expected. These proposals obviously do not exclude the possibility of a number of countries spontaneously and directly lending to the Fund from their Treasuries on highly concessional terms. However, few countries today seem in a position to do this; the actions of these countries would gain greatly in effectiveness if they were embedded in a wider, more permanent framework supported by a large number of Fund members.

Conditional use of an SDR allocation

The possibility of allocating SDRs gives the Fund a powerful instrument for generating additional resources to support the international adjustment process. Repeated Board discussion on a proposal for the conditional use of the SDR allocation have created a set of understandings on which the provision of exceptional financing in support of the adjustment efforts of one subgroup of Fund members might now be based. 1/ If made according to the principles of such a proposal, an allocation of SDRs in the present basic period could easily be adjusted to channel additional resources toward countries that adopt programs supported by a structural adjustment arrangement. A similar approach, proposed last year by Mr. Nebbia, suggested that the industrial countries would transfer their share of an SDR allocation to the Fund in order to finance contingency mechanisms, such as those contained in the Mexican program (see EBM/86/125, 7/30/86). In practice, an allocation of some SDR 9 billion over the next three years would enable the industrial countries to transfer their allocations to the Fund in order to meet the Managing Director's request for an increase of SDR 6 billion in the resources available to support structural adjustment arrangements, while the developing countries would keep their allocations. This approach would have the great merit of placing the exceptional effort envisaged in favor of one specific group of countries in the context of an overall reinforcement of the Fund's role in the adjustment process. Moreover, the decision to fund the facility with SDRs transferred from members who do not need their allocation is in full compliance with the principles of the SDR mechanism as presently defined by the Articles of Agreement: no changes would need to be introduced in the rules concerning acceptance limits, designation, and remuneration. In sum, a decision to make conditional use of an SDR allocation in support of the facility's operation would permit the enlargement to be based on long-standing Fund mechanisms, and would preserve the monetary character of the Fund's financial intermediation.

The only adjustment which would have to be considered has to do with the concessionality of the SDR loans extended to beneficiaries of the facility and would accordingly consist in an adjustment of the terms under which industrial countries would transfer their allocation to the Fund. The original scheme for the conditional use of an SDR allocation, which the Legal Department endorsed in EBS/84/191 (9/5/84) and Supplement 1 (9/11/84), proposed that the Fund should borrow, at the SDR interest rate, currency from each country in amounts equal to the amount of SDRs to be transferred to the Fund for onlending, and should purchase those SDRs from the country in exchange for the borrowed currency. The only change in this technique to be envisaged would be to reduce the interest paid by the Fund on its currency borrowings from industrial countries so as to offset the interest forgone by the Fund through its concessional lending of SDRs to beneficiaries of the facility. An alternative method of accomplishing this offsetting might be the establishment of a subsidy account. Depending on the means at its disposal, such an account could cover, completely or partly, the difference between the SDR interest rate and the concessional rate at which the beneficiaries of the facility would borrow SDRs from the Fund; however, it is not a necessary component of the proposed mechanism.

1/ See, inter alia, my statement at EBM/84/45 (3/26/84); Minutes of Executive Board Meeting 86/35 (2/26/86); and the staff paper entitled "Proposals for Post-Allocation Adjustment in the Distribution of SDRs" (SM/86/154, 6/27/86).

Establishment of a structural adjustment facility subsidy account

Establishing a subsidy account would make it possible to dissociate the funding of additional resources for the structural adjustment facility from the concessionality to be attached to those resources. Such a dissociation would give members flexibility in shaping the modalities of their individual contributions to the subsidizing of interest payments. The operation of this subsidy account would be fundamentally similar to that of other accounts which the Fund established in the past for reducing the interest costs of the 1975 oil facility and the supplementary financing facility. The resources of the account could be drawn from a variety of sources: budgetary contributions by donor countries, the remunerations which creditor members earn from their reserve positions in the Fund, interest-free loans which would over time be reimbursed by transfers to the account of reflows to the Fund's Special Disbursement Account, and the sale of part of the Fund's gold holdings. The establishment of a subsidy account would also facilitate the recycling of surpluses from large creditor countries, insofar as they might be ready to contribute large amounts to the financing of the enlargement without necessarily accepting a concessional interest rate on the totality of these amounts.

While the sale of gold is not an essential component of the proposal for a subsidy account, it must be admitted that the subsidization of interest payments through the proceeds of gold sales is hardly a new idea for the Fund: the Fund's gold was indirectly already used in a similar manner with the decision to channel part of the original Trust Fund loan repayments into the Supplementary Financing Facility Subsidy Account. Indeed, the proposed use of gold sales seems especially appropriate when we reflect that the structural adjustment facility itself was created through a logical extension of the original decision, taken more than a decade ago, to sell gold and use the proceeds to benefit the lowest-income countries. It would also be fully justifiable in connection with the envisaged replacement of part of the Fund's stand-by loans by concessional loans better suited to the limited adjustment capacity of the beneficiary countries: such a replacement would significantly enhance the possibility for the Fund to be reimbursed from its members and therefore improve the quality of its loan assets. Used in this way, gold sales would have a direct and positive impact on the Fund's financial exposure. Finally, gold sales would also facilitate participation in the enlargement by the middle-income developing countries, which could be invited to transfer a part of their shares in the gold sale proceeds to the proposed subsidy account.