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Minutes of Executive Board Meeting 87/176 Corrected

3:00 p.m., December 18, 1987

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

Executive Directors	Alternate Executive Directors
A. Abdallah	
Dai Q.	
	M. K. Bush
	J. Prader
A. Donoso	R. Morales, Temporary
	E. C. Demaestri, Temporary
M. Finaish	A. M. Othman
G. Grosche	B. Goos
J. E. Ismael	J. Reddy
A. Kafka	
	C. Enoch
M. Massê	D. McCormack
	C. V. Santos
Y. A. Nimatallah	I. A. Al-Assaf
	P. D. Pêroz, Temporary
G. Ortiz	C. Noriega, Temporary
J. Ovi	M. Fogelholm
E. Ploix	D. Marcel
G. A. Posthumus	G. P. J. Hogeweg
C. R. Rye	C.-Y. Lim
G. Salehkhou	O. Kabbaj
	L. E. N. Fernando
K. Yamazaki	S. Yoshikuni
S. Zecchini	

C. Brachet, Acting Secretary
L. Collier, Assistant
R. Gaster, Assistant
S. L. Yeager, Assistant

Corrected: 8/10/88

Also Present

J. Tyndall, Minister, Embassy of Guyana. IBRD: S. T. Voyadzis, Latin America and the Caribbean Regional Office. African Department: A. D. Ouattara, Counsellor and Director; P. A. Acquah, R. C. Williams. Asian Department: W. M. Tilakaratna. European Department: O. P. Brekk, J. J. M. Kremers. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; M. W. Bell, J. Berengaut, S. B. Brown, D. Burton, A. Chopra, B. Christensen, H. Hino, G. G. Johnson, H. B. Junz, S. Kanesa-Thasan, D. Lee, C. Puckahtikom, P. J. Quirk, R. L. Sheehy. External Relations Department: C. S. Gardner, Deputy Director; D. D. Driscoll. Fiscal Affairs Department: V. P. Gandhi, P. S. Heller. IMF Institute: Wong C.-H. Legal Department: F. P. Gianviti, General Counsel; A. O. Liuksila, R. H. Munzberg, J. V. Surr. Middle Eastern Department: M. D. Knight, M. Yaqub. Research Department: J. A. Frenkel, Economic Counsellor and Director; N. R. Chrimes, M. S. Kumar, G. R. Le Fort. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, K. Boese, D. Gupta, D. V. Pritchett, P. S. Ross. Western Hemisphere Department: S. T. Beza, Director; M. Caiola, Deputy Director; J. Ferrán, Deputy Director; S. M. Fries, J. A. Gons, T. Gudac, M. S. Lutz, C. G. Muñiz B., T. M. Reichmann, S. J. Stephens. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: A. A. Agah, M. B. Chatah, A. G. A. Faria, G. D. Hodgson, K.-H. Kleine, A. Ouanes, P. Péterfalvy, G. Pineau, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: M. Adachi, J. R. N. Almeida, R. Comotto, S. K. Fayyad, S. Guribye, M. A. Hammoudi, C. L. Haynes, M. Hepp, G. K. Hodges, L. Hubloue, S. King, K. Kpetigo, M. A. Kyhlberg, V. K. Malhotra, D. V. Nhien, W. K. Parmena, L. M. Piantini, S. Rebecchini, A. Rieffel, G. Schurr, R. Wenzel, I. Zaidi.

1. MONITORING OF STRUCTURAL ADJUSTMENT IN FUND-SUPPORTED ADJUSTMENT PROGRAMS

The Executive Directors continued their discussion on a staff paper on the monitoring of structural adjustment in Fund-supported adjustment programs (EBS/87/240, 11/20/87; and Cor. 1, 12/28/87). They also had before them a paper containing background material on monitoring of structural adjustment in Fund-supported adjustment programs (EBS/87/254, 12/3/87), and a departmental memorandum on approaches to trade liberalization in developing countries (DM/87/4, 12/3/87).

Mr. Nimatallah said that structural adjustment was a medium-term process that appeared necessary, in many cases, for both balance of payments viability and sustained growth. The issues that had been raised by structural adjustment--inter alia, whether it was within the mandate of the Fund, its sequencing, monitoring, and the role of the World Bank--were increasingly important for the Fund, which was about to launch the enhanced structural adjustment facility.

He agreed with most of the points raised in the staff paper, Mr. Nimatallah remarked. However, he wished to emphasize the importance of the case-by-case approach; the Fund had much to learn about structural adjustment, while the World Bank had vast experience with it. The Fund should therefore draw on that experience by enhancing its collaboration with the Bank. Structural adjustment was the very area in which the spheres of competence of the two organizations met, and where genuine cooperation was essential in pursuing the best interests of the membership. Thus, cooperation was no longer a matter of choice--it was a necessity. The managements and staffs of the two organizations would have to find further specific steps to take for more effective collaboration.

Pragmatism and flexibility would be needed in the design and implementation of structural adjustment measures to ensure that the member's social and political objectives were not jeopardized, Mr. Nimatallah noted. It was essential not to be overambitious in designing a structural adjustment program: more time was needed for the implementation of programs, and wide-ranging structural reforms might overtax a small member's limited administrative capacity.

Mr. Demaestri made the following statement:

> I partly share the skeptical view expressed by several Directors on the implementation of structural adjustment in Fund-supported programs. However, the role of structural reforms in growth-adjustment programs must be emphasized; reliance on macroeconomic policies based solely on demand-management adjustment is not sufficient. Structural reforms--particularly reforms aimed at enhancing the efficiency of resource allocation and at facilitating the growth of aggregate supply--are also important.

The inclusion of both macroeconomic and structural adjustment policies in economic programs is frequently necessary; they are interconnected and should be implemented together. Structural reforms increase the effectiveness and durability of macroeconomic adjustment; similarly, the implementation of structural reforms in a nonsatisfactory macroeconomic environment has little chance of success.

The staff papers provide good background material for discussion on the role of structural reform in Fund-supported adjustment programs, but the staff does not take a clear position on the main issues. In particular, there is no explicit opinion expressed as to whether introducing or complementing adjustment programs with structural reforms will require further monitoring and further conditionality.

I support the incorporation of structural reforms in Fund-supported programs with the consent of the member country involved. Structural adjustment policies are absolutely necessary for solving the real problems of several borrower countries. The kind of measures needed combine demand management and structural reforms. The latter are aimed at establishing an adequate environment, inducing a better response to incentives for exporting, saving and investment, and facilitating structural changes that promote a sustained increase in production--especially of tradables--with the objective of achieving growth and reaching balance of payments viability in the medium term.

The particular economic structure of the country involved should be an important factor in developing appropriate programs for adjustment with sustained economic growth. As economic structures and problems differ among developing countries, I support the case-by-case approach. Moreover, the scope of structural reforms should be so complete that it embraces most of the problems experienced by borrower countries, not just those problems in attaining external viability. Reforms aimed directly at increasing production--for instance, reforms of labor policies--should be emphasized.

Structural reforms go to the heart of a country's institutional framework, often involving the need to deal with special interest groups and to embark on legislative and administrative changes. In consequence, structural reforms have certain special characteristics, including, inter alia, uncertainty about their effects, and considerable lags before these effects are completely felt--as the staff paper on issues in the design of growth exercises pointed out.

Quantitative estimates of the effects of structural reforms are very imprecise, sometimes because of the difficulty involved in measuring certain variables, or because the estimates are subject to a wide margin of error. The lags, due to the longer time needed to implement the required changes, can be distinguished from those lags related to delays between the implementation of policies and the time when their effects are fully felt. Lags are in some cases too long and may result from an initial lack of program credibility, particularly adverse expectations about the durability of structural policies. Given these lags, quick implementation of the whole program is most appropriate, as that would help to reverse unfavorable expectations. Thus, the difficulties inherent in structural reforms are greater than those associated with macroeconomic policies.

The costs related to the implementation of structural reforms are so important that countries are frequently unable to implement these reforms without appropriate financing. The supportive role of external financing, especially from multilateral organizations such as the Fund, is essential in implementing structural reforms and in obtaining successful growth-oriented adjustment.

Appropriate external financing includes the availability of larger amounts of credit with longer maturity periods. That financing is needed because of the initially unfavorable disequilibrium between the benefits and the costs of structural reforms, to provide a protective cushion against speculative pressures while the authorities demonstrate the extent and viability of their objectives, and to help to sustain imports and investment during the period in which structural reforms are in place, but before the positive outcomes have been completely achieved. The longer maturity periods of the structural reforms should therefore be associated with a longer maturity period for financing. Thus, in Fund-supported programs including structural adjustment, the amount of financing available to borrower countries should be increased, the disbursements should be tied partly to macroeconomic measures and partly to structural reforms, and longer maturity periods should be considered for the financing related to structural reforms.

A primary function of monitoring should be to facilitate effective policy implementation and to assure members and the Fund of the circumstances under which a Fund-supported program can be considered on track.

As I support the partition of disbursements between structural and macroeconomic adjustments, respectively, the monitoring techniques to be applied should be different in each case. To monitor structural adjustment, the staff paper proposes reliance on policy instruments and intermediate targets emphasizing the utilization of prior actions, performance criteria, and reviews. Given the characteristics of structural reforms--particularly the uncertainty of their quantitative effects and the presence of lags--monitoring of programs should be managed flexibly, taking into account individual country circumstances and considering intervals longer than those used in demand-management programs. The use of performance criteria is not advisable; I prefer the use of benchmarks--such as those used in the context of the structural adjustment facility--which explicitly consider the existence of margins.

Annual reviews of multiyear arrangements might complement benchmarks in monitoring structural adjustment. Those reviews should be aimed at evaluating the performance of the structural program as a whole, considering in particular the outcomes of the program and the eventual effects of lags.

Prior actions should be limited to special cases in which severe distortions exist and the immediate implementation of measures is needed. In those cases, the implementation of prior actions should be accompanied by more incentives--increased, cheaper, or longer-term financing--to compensate countries for the higher costs associated with those actions. Front-loading disbursements, in particular, could be effective compensation for prior actions.

The early identification of structural problems is essential. The sooner the problems are identified, the better the possibilities of correcting them. Consequently, I support a careful analysis of structural aspects of members' economies as part of Article IV consultations.

On conditionality, I firmly reject the notion that it should be increased. Today, we have to discuss methods of improving Fund-supported programs by including structural reforms in them. We should try to avoid considering further restrictions; increasing conditionality in Fund programs would discourage the introduction of structural reforms, and on balance may be detrimental rather than beneficial.

Finally, on Fund-Bank collaboration, the inclusion of structural reforms in Fund-supported adjustment programs raises questions about the division of responsibilities and the need for cooperation between the two institutions. Those questions do not have to be seen as problems that complicate the consideration of structural reforms. They should be treated in a way that does not interfere with the functions of either institution and does not damage their relations with member countries. The avoidance of cross-conditionality is therefore essential.

The Director of the Exchange and Trade Relations Department said that the staff had sought to rely on the World Bank for the design of structural reform measures in areas outside the fiscal, financial, and exchange rate areas, subject to three caveats. First, there were areas--trade being the most obvious--where the responsibilities of the two institutions clearly overlapped. Therefore, both had an involvement, and care would always be needed to sort out priorities between them. Second, in some areas overlapped the jurisdictions of both institutions overlapped: for instance, the effect of agricultural subsidies on income distribution was clearly within the competence of the World Bank, while the effect of agricultural subsidies on public sector finances was clearly within the competence of the Fund. Such issues would have to be divided according to the particular problem being considered. Third, there were a number of member countries where the World Bank's involvement was not particularly heavy, and where the Fund might be called upon to provide a stand-by arrangement or use of Fund resources that might--in some cases--involve questions touching on structural adjustment. Thus, there seemed to be practical limitations on the clear delineation of responsibilities between the two institutions. Some areas of overlap were inevitable, and had to be accepted.

The staff representative from the Exchange and Trade Relations Department said that program monitoring was the subject of ongoing work, particularly at the present time when further papers were being prepared on the extended Fund facility and on the review of conditionality. Some of the specific suggestions that Directors had made about ways in which program monitoring could be made more effective were being looked at, such as the role of revised intermediate indicators, and there were also the proposals already made by the Group of Twenty-Four and Secretary Baker. Some of the points could profitably be discussed bilaterally with Directors, perhaps for clarification or presentation in forthcoming papers.

The Chairman made the following summing up:

> This has been an interesting and important discussion that has addressed both the broad policy issue of the role of the Fund in promoting and monitoring structural reform and the more technical question of the suitability of alternative techniques for monitoring structural adjustment. It has effectively complemented our discussion earlier this week on issues in the design of growth exercises.
>
> Directors were in broad agreement that structural reform could play a critical role in external adjustment and in laying the basis for the durable growth that was needed for adjustment to be sustained. Indeed, the need for structural reforms should be identified early, and for all members, and the annual Article IV consultations could play an important role in that respect--a point which Directors had made on numerous previous occasions. At the same time, it was stressed that structural reform in Fund-supported adjustment programs should not be at the expense of adequate macroeconomic adjustment. In my view, that goes without saying. Demand management and structural adjustment were to be viewed as complements, not substitutes.

But it also was noted that the impact of comprehensive policies must not be reduced by structural rigidities or the restrictive policies of trading partners. Some Directors also stressed that the adequacy of financing, especially foreign financing, should be taken into account.

While there was general agreement on the role of structural reforms, views on the extent to which they should be required as part of Fund-supported adjustment programs were more varied, with some Directors more tentative in their views. Most Directors supported the principle that conditionality should be attached to structural reform when the latter was seen as essential for the achievement of external viability--often but by no means always the case--and hence for safeguarding the revolving character of the Fund's resources. In that sense, structural reforms were expected to figure prominently in and be a central justification for extended arrangements and arrangements under the structural adjustment facility and the enhanced structural adjustment facility. However, difficulties were foreseen by some Directors in establishing a clear link between structural reform and external viability given the currently limited knowledge about the effects of structural policies, and various views were expressed about the weight to be attached to particular types of reform.

Many Directors stressed the importance of reforms that removed distortions and enhanced overall economic efficiency, and measures that promoted increased domestic savings. Other Directors emphasized reforms that increased the effectiveness of macroeconomic policy or focused specifically on the external sector. In that regard, some Directors also noted that liberalization of the trade system ought to be given primary attention. Despite those differences in emphasis, however, there was agreement that the structural areas to be addressed in adjustment programs must be determined on a case-by-case basis in the light of country circumstances, particularly the magnitude of the distortions involved. An important consideration was to adapt the mix of policies to the need of the country, and to seek to avoid a mix that relied too heavily on demand management when more promising avenues were available.

On the question of the approach to be adopted in dealing with specific structural problems, Directors felt that that too should be decided on a case-by-case basis. It was noted that the Fund had accumulated considerable experience in addressing severe distortions in several structural areas, especially the exchange system. However, in other areas the implications of alternative approaches were not well understood, and several Directors called for caution in advocating measures that could lead to adverse domestic repercussions and could thus defeat the very purpose of the measures. In that connection, a number of

Directors also noted that full liberalization might not always be appropriate, particularly where importance was attached by countries to the role of the public sector. Nonetheless, a shift from "discretion" to "rules" could enhance the efficiency and quality of policy intervention in such areas as administered prices. The sequencing of structural reforms and the coordination of reform implementation with demand management also had to be gauged carefully, and Directors called for further work to be undertaken on those important and complex issues.

On the issue of the techniques available for monitoring structural reform, many Directors emphasized the importance of structural prior actions, particularly when there was a significant lag between implementation of a reform and the time when its effects took hold. It was stressed that a bold start to a program of reform increased the likelihood of successful growth-oriented adjustment. Other Directors, however, were concerned about excessive use of structural prior actions. They emphasized the need for careful attention to timing and phasing, warning that overambitious action could lead to political difficulties and a consequent breakdown of the adjustment effort.

Scope was seen by a number of Directors for the use of performance criteria to monitor implementation of structural reform in cases in which timetables for taking well-specified actions could be established, although the potential for applying performance criteria to quantitative structural indicators was thought by most Directors to be rather limited. The proliferation of performance criteria should be avoided. At the same time, the need for flexibility in the timing of many reform measures and difficulties in specifying precisely the measures to be taken suggested that reviews might often be a more useful monitoring technique. But it was emphasized that for reviews to be effective, expected progress with structural reforms needed to be specified in detail at the outset of a program.

In considering the implications of Fund involvement with structural reform for the Guidelines on Conditionality, Directors noted that the Guidelines in fact allowed considerable latitude, although several felt that a review of some of the Guidelines would still be desirable. Directors reaffirmed the importance of Guideline 4, which required the Fund to pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems. The Guideline did not preclude emphasis on structural reforms, and such reforms were clearly required when needed for external viability and for safeguarding the revolving character of the Fund's resources. Directors also held the view that it would be helpful to have the Fund staff take greater initiative in pointing out to members the growth implications of structural problems even when reform was not essential for external viability. Many Directors also considered that Guidelines 7 and 9, which covered the use of prior actions and performance criteria, respectively, were broadly consistent with the application of program monitoring to structural reform in cases in which the latter was essential for the achievement of external viability. However, some Directors felt that consideration could be given to revising those two Guidelines to provide more explicitly for the role of structural reforms. The question of the continuing appropriateness of the Guidelines on Conditionality will be taken up again in the discussions on the comprehensive review of conditionality early in 1988.

All Directors emphasized that the strong commitment of the member concerned was indispensable for successful implementation of structural adjustment. Prospects for effective implementation of structural adjustment could be enhanced by limiting the scope of reform so as not to overextend the administrative capacity of a member, and by careful design of a reform strategy. Technical assistance was viewed as having an important role to play in the design of structural reforms in the areas of particular Fund expertise, such as the fiscal and financial sectors, and the exchange system. The Fund should be especially prepared to extend technical assistance in its area of expertise in support of arrangements with a strong structural content.

Thorough preparation for structural adjustment would also be facilitated by the early identification of structural problems, and Directors saw scope for more systematic tracking of structural aspects of members' economies as part of Article IV consultations. In that context, Directors noted that in some structural areas, indicators could be helpful in monitoring and quantifying economic performance. Some Directors, however, stressed the practical difficulties involved in such quantification, since analytic work in many of those areas was still at an early stage of development. Thus, a mechanical use of indicators was to be avoided and indicators should be interpreted carefully on a case-by-case basis. Also, while structural indicators were potentially helpful signposts, especially for the early identification of emerging problems, they were not preconditions for tackling severe structural problems.

Many Directors commented that growing Fund involvement with structural reform intensified the importance of close collaboration between the Fund and the World Bank. It was felt that the involvement of the two institutions with the process of structural reform could be handled effectively on a pragmatic case-by-case basis. However, a number of Directors expressed the view that greater interaction on structural issues could lead to a blurring of the roles of Fund and Bank, roles which were based on the distinction between balance of payments and development financing. Directors reaffirmed that cross-conditionality was to be avoided and indicated that overlapping monitoring should be kept to a minimum. They also stressed that intensified collaboration should not lead to a blurring of responsibilities for technical assistance and that, for instance, assistance to central banks--particularly in the design of monetary policy instruments--should remain in the purview of the Fund.

The Deputy Managing Director assumed the chair.

2. GUYANA - 1987 ARTICLE IV CONSULTATION; AND OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered the staff report for the 1987 Article IV consultation with Guyana (SM/87/270, 11/17/87), together with a paper (EBS/87/268, 12/16/87) on the further review of Guyana's overdue financial obligations to the Fund following the declaration of Guyana's ineligibility to use the Fund's general resources on May 15, 1985. They also had before them a background paper on recent economic developments in Guyana (SM/87/284, 12/4/87).

Mr. Kafka made the following statement:

My authorities broadly endorse the analysis and assessment in the well-balanced report of the staff.

After many years of steady economic deterioration and the emergence of substantial financial imbalances, my authorities have strengthened adjustment policies. They are now in the process of formulating a comprehensive set of measures to address, in a medium-term framework, the problems facing the country. They are firmly committed to developing a policy framework with the help of the staff, and it is their hope that it could provide the basis for an arrangement under the structural adjustment facility with appropriate international financial support, including concessional finance and exceptional debt relief, and the resolution of the external arrears problem.

There has been encouraging progress in a number of areas where the general deterioration has been arrested despite the absence of international capital inflows. Modest growth has resumed in recorded GDP, public resource management is improving, tax reform is in train, the price-determination process and exchange rate policy are becoming increasingly flexible, and efforts are also under way to make the wage determination process more flexible. Nonetheless, Guyana remains in a precarious economic situation. In this context my authorities are now focusing their attention, within a medium-term adjustment program, on two important areas of public policy--economic stabilization and rehabilitation of the productive sector.

A decisive first step in the process of economic stabilization is the emphasis being placed on improving domestic resource mobilization. A key element is the continuing containment of the overall public sector deficit, which will be reduced in 1987 to 38 percent of GDP from 50 percent in 1986. Action on this front is considered to be crucially important by my authorities in the light of the decline in revenue by the equivalent of 9 percentage points of GDP, stemming in part from the tax reform effect of lower personal income taxes and consumption tax exemptions granted in the wake of the January devaluation. With little room for any significant improvement in revenue over the near term, government expenditure is being compressed and geared toward meeting the requirements of structural adjustment consistent with the availability of domestic and foreign resources.

To this end, noninterest current expenditure is subject to stringent control. Thus in 1987 current expenditure will be reduced by the equivalent of 11.5 percentage points of GDP, notwithstanding the large share--45 percent--of interest payments. Furthermore, noninterest expenditure is to be restructured in such a way as to promote stable labor relations and an efficient and appropriately paid public sector with access to the necessary goods and services for its efficient functioning. The recent wage settlements in the public service followed a five-year period in which the public sector wage bill was reduced by 23 percent in real terms.

The second major element in the economic stabilization program is the continuation of the process of restructuring public enterprises. The reform exercise has aimed at addressing the problems of individual public sector corporations through rehabilitation programs or, where entities are not considered viable in their present form, through their liquidation. Additionally, employment and management policies are being rationalized and realistic pricing policies are being adopted. Under this program, the overall balance of the public enterprise sector is expected to shift from a deficit of 6.5 percent of GDP in 1986 to a surplus of 5.5 percent in 1987--a substantial contribution to the public sector resource mobilization effort.

My authorities' determined efforts to contain the overall financial deficit of the public sector and to enhance domestic savings will enable them to exercise stricter control on the factors of domestic origin that have been contributing to the excessive expansion of money supply. At the same time productive credit needs of the private and public enterprise sectors could be met.

The third major element of the stabilization program is the reform of the exchange system, which is expected to improve the country's competitiveness. In the process of arriving at a realistic and competitive exchange rate and incorporate parallel market activities into the official economy, the Guyana dollar was devalued by 56 percent in January 1987. The authorities have also ensured a full pass-through into prices of the exchange rate action with the exception of some essential and sensitive commodities. In addition, a secondary foreign exchange window in commercial banks was established in February 1987, where the exchange rate is being determined at a level closer to the parallel exchange rate. On the supply side, tourism and remittance receipts are sold on this market; since September 1987, gold and diamond exports are paid at the window rate but not transacted in the window market. On the demand side, access is limited to a small number of import items. My authorities regard the dual exchange market as a temporary mechanism, and they are committed to its eventual unification and subsequently to trade liberalization, once the macroeconomic situation makes it advisable and appropriate. Recently, the exchange rate in the secondary market--G$21 = US$1--was about 20 percent below the rate prevailing in the parallel market.

The rehabilitation and restructuring of productive activity constitute the second major plank in the current policy framework. With the adjustment measures taking root, there is a clear need to raise growth, investment, imports, and exports. Significant progress has been made in the reform of the public enterprise sector with a commensurate reduction in the financial burden on public resources, namely, an increase in domestic savings. Nevertheless, the continuation of the structural adjustment effort, in particular in the public sector--which accounts for approximately 66 percent of economic activity in the country--will require, in coming years, sizable and well-coordinated external financial support. Substantial access to raw materials and critical inputs is required if manufacturing capacity is to be restored, key plants rehabilitated and modernized, economic growth resumed, and the external debt problem resolved.

My authorities recognize that Guyana's economic prospects are severely constrained by the very high external debt and debt service burden and an arrears problem which is becoming intractable. Accordingly, they view the regularization of financial relations with the Fund as a critical first step in restoring their international creditworthiness and in laying the foundation for resumption of international capital flows. They believe, therefore, that a strong medium-term adjustment program, which is now under active consideration, could constitute the basis for eliciting the additional financing, including concessional and exceptional debt relief from key bilateral and multilateral sources, and, in due course, an arrangement under the enhanced structural adjustment facility. They look forward, therefore, to early finalization of the policy framework paper.

Mr. Noriega made the following statement:

The improvement, albeit modest, in Guyana's economic performance during 1986 reflected the efforts undertaken by the authorities to correct the large internal and external imbalances, notably the shift in the public enterprises' position from a deficit to a substantial surplus and the moderation of inflation. For 1987, however, the picture is somewhat mixed; on the one hand, real growth, together with an improvement in the trade balance, is expected to continue while on the other hand, inflation is rising and financial arrears continue to accumulate.

Mr. Kafka's statement provides us with an insight into the main lines along which the medium-term economic program is being designed. We deem the direction to be appropriate. We also share the staff's appraisal of the current situation and, consequently, wish only to emphasize one point that deserves further attention.

The analysis of the monetary sector indicates that although the authorities are trying to diminish drastically their absorption of loanable funds so as to be able to restrict credit expansion while increasing the proportion directed to the private sector, there already appears to be excess liquidity in the system in 1987. Currency circulation, which registered a negative nominal rate of growth from December 1985 to December 1986, has already risen during the first semester of this year by 60 percent. This expansion more than validates the exchange rate adjustment of 56 percent effected in January 1987. The inflation rate reached 24 percent in June and is expected to be about 50 percent by year-end. These developments could jeopardize the rest of the measures contemplated in the new economic program. We believe, therefore, that the authorities need to move more flexibly and assertively to arrest this increase in liquidity.

Regarding medium-term prospects, the scenarios presented in the report indicate that, with proper policies, the economy may respond relatively soon and resume growth spurred by the export sector. Unfortunately, the level of foreign debt and arrears limits the viability of the balance of payments, and without a permanent correction in this area foreign support will not be forthcoming. To attract that support, without which the program cannot succeed, the authorities need to move quickly in setting a comprehensive adjustment program. Only an unambiguous signal of the authorities' willingness to correct present imbalances and to cooperate with the international financial community will allow a solution satisfactory to all parties. In this respect, the clearance of arrears to the Fund remains of utmost importance at this juncture and, therefore, we will expect concrete actions by the Guyanese authorities to this end.

Mr. Morales observed that owing in part to the existence of a negative external environment and in part to the lack of adequate policies, Guyana had experienced serious economic difficulties during the past decade. Most important at present was the fact that the authorities recognized the need for a reorientation of economic policy and had recently implemented exchange rate and fiscal measures.

The Guyanese authorities were considering the formulation of a medium-term program that, as a policy framework paper, would serve as a basis to use the Fund's resources under the structural adjustment facility, Mr. Morales said. The program could also be presented to the country's creditors for their consideration with the aim of solving Guyana's debt problem. He welcomed that approach, and he encouraged the authorities to follow that path; he was prepared to support in the Board those steps leading to a structural adjustment arrangement for Guyana.

He agreed with the authorities that the main areas of concern were the fiscal deficit, the exchange rate, and the need to find a sustained path of economic growth, Mr. Morales remarked. In that connection, he welcomed, first, the commitment of the authorities to restructure the public enterprises through realistic price policies and through their liquidation when the enterprises were not found to be economically viable. At the same time, he noted that Guyana would make every effort to restrain the Government's current expenditures. Second, the intention of the authorities to unify the exchange rate system at a competitive rate was praiseworthy, as it was a necessary step to achieve a better balance of payments position. Third, he agreed with the staff that to successfully implement a growth-oriented program in the present case, external support would be essential and exceptional debt relief would be needed.

Only within that medium-term context, through the execution of a comprehensive economic program and with the support of all creditors and exceptional debt relief, could Guyana find a global solution to its economic and financial difficulties, Mr. Morales considered. On that basis, he supported the proposed decision to review the matter of Guyana's overdue financial obligations to the Fund within six months of the present meeting.

Mr. Enoch made the following statement:

> The Guyanese authorities have taken a number of positive steps toward reversing the long-standing deterioration in the Guyanese economy. In particular, there has been some movement on the exchange rate, preliminary measures to liberalize prices, and a serious attempt at cutting the fiscal deficit; we commend the authorities for these measures. However, as the staff and Mr. Kafka note, extremely large imbalances have built up in the Guyanese economy in recent years and they will require considerable time and effort to be overcome. The arrears to the Fund are one important symptom of the problem.

There can be no doubt that urgent action is needed to tackle the situation. While the measures that have been taken recently--particularly those affecting the exchange rate--have been in the right direction, their beneficial consequences have not been maximized. In the circumstances facing the authorities, a firm and convincing overall adjustment program is far more likely to lead to growth in both the short and long run than further piecemeal efforts. I am therefore encouraged that the authorities recognize the need to design and implement a comprehensive medium-term adjustment program and look forward to seeing details of this package.

With regard to the exchange rate system, the massive overvaluation of the currency in recent years has not only deterred exports and driven economic activity into the parallel economy, it has also led to important distortions in the economy. Unifying the exchange rates at a realistic level is clearly an essential prerequisite for a successful adjustment program; I therefore welcome the authorities' intentions in this area. I agree with the staff on the need to liberalize the transactions in the commercial bank window.

Action on the exchange rate front is unlikely to prove effective, however, if the effects are not allowed to pass through to change the incentives facing domestic producers and consumers. Thus the authorities' delay in passing through some of the recent devaluation is worrisome. More generally, I agree with the staff on the need to continue the process of price liberalization. In this connection, I also share the staff's concern that recent nominal wage increases may reduce the overall impact of exchange rate action.

In the same way, if the planned devaluation of the currency is to be effective, it will also need to be supported by prudent fiscal policy. A situation where the government deficit is equal to more than one third of GDP cannot in any way be consistent with sustainable economic recovery. Although some progress has been made on the fiscal front and more is planned, there is little doubt that much more will be required. I was disappointed and somewhat surprised to see that the authorities consider that there is little scope for increasing tax yields. Although the improved performance of the public enterprises is important, it is unlikely to prove sufficient on its own and a strengthening of central government finances will also be required.

An improvement in the fiscal position will also be essential if more restrained monetary policies are to be put in place and the strength of the financial system improved. Real interest rates appear to have been negative for prolonged periods in the recent past; this issue will need to be addressed during the discussions on a policy framework paper.

It is, of course, difficult to estimate the exact extent to which real interest rates have been negative because of the limitations of the official price index. On a more general point, during our discussion of growth exercises earlier this week (EBM/87/173 and EBM/87/174), this chair argued that, especially in difficult cases, it might be salutary for the staff to try to provide confidence estimates for some of the key statistics in staff reports. I suspect that if this had been done in the present case, the results would have been very instructive. The staff has clearly faced an extremely difficult task in analyzing developments in the economy when so many of the key statistics are flawed. Two lessons can be drawn, however. First, it would have been useful to discuss more fully in the staff report the nature and extent of the main statistical shortcomings. Ultimately, if the statistics are too poor in certain areas, the staff should either not present them or should give range rather than point estimates. Second, because this problem is likely to become more important as discussions on the policy framework paper continue, this might prove a useful area for technical assistance.

I can support the proposed decision. I wonder, however, whether an earlier review might be a useful way of informing the Board of the discussions' progress. Perhaps the staff could comment on when a further discussion could be held if it were considered useful.

Mr. McCormack made the following statement:

At the time of the 1985 and 1986 Article IV consultation discussions, this chair spoke at length on Guyana because of concern both for Guyana and for the impact that its economic performance has had on some of the countries in this constituency. We have emphasized a consistent theme: Guyana desperately needs to implement a strong and comprehensive adjustment program. Its economic situation is precarious, marked by low per capita income, large fiscal and external imbalances, and an alarming accumulation of arrears.

We are encouraged by the positive measures that the Guyanese authorities have implemented since the last consultation and by their willingness to prepare a medium-term program. The long-overdue devaluation of the Guyana dollar in January 1987 was particularly welcome and indicated that the authorities were willing to take decisive steps to come to grips with the massive problems facing them.

We can endorse fully the staff's appraisal and its assessment of what must form the basis of a comprehensive and credible medium-term economic program. First, the authorities need to build on the devaluation of the Guyana dollar and move rapidly toward a more flexible and unified exchange rate. Second, regarding fiscal policy, we recognize that the room for maneuver of the authorities is extremely limited. Still, more needs to be done on both the revenue and expenditure side of the central government budget if the unsustainably large deficits are to be reduced in the medium term. In this connection, the reduction in revenue in real terms this year is disturbing. It is essential that the revenue base be broadened and made more elastic. Given the magnitude of the imbalance, the decision to grant exemptions from tax in an effort to cushion the impact of the devaluation on lower-income groups needs to be compensated elsewhere. The scope for reducing central government expenditure is limited by the large proportion of expenditure accounted for by interest payments. At the same time, I encourage the authorities to make every effort--through pay restraint, reduction in the numbers employed in the Central Government, and further control over nonpay expenditure--to bring about the required reduction in the scale of government expenditure.

Perhaps most important if the economy of Guyana is to be relaunched on a sustainable basis, there must be early and decisive action with respect to liberalization of the economy. The authorities envisage the process of liberalization as being a gradual one. I join the staff, however, in stressing that what is called for is a substantial and early liberalization of the economy, with the first steps being such as to demonstrate that the authorities are clearly and irrevocably committed to the liberalization process.

Guyana needs to develop a comprehensive and radical adjustment program if it is to extricate itself from its present difficulties. Anything less will not carry conviction with donors and creditors--who will be called on to give exceptional treatment to Guyana--or with Guyana's own citizens. The latter is essential if the size of the parallel economy is to be reduced and capital flight reversed. I therefore urge the authorities to act boldly and decisively and to bring forward, as soon as possible in the new year, a program that is both strong and credible and that clearly matches the requirements of a grievously serious situation, notably the need to eliminate arrears, particularly those to the Fund. I support the proposed decision on arrears, but I would be interested in the views of the staff as to whether an earlier discussion might be helpful.

Ms. Bush made the following statement:

We welcome the evolution of policies since our discussion of the previous Article IV consultation one year ago (EBM/86/204, 12/19/86). The authorities seem to have a better grasp of the policies needed to achieve satisfactory rates of economic growth, and they have modified policies in a number of areas in the appropriate direction. At the same time, we are concerned about the pace of policy adjustment. We urge the Guyanese authorities to intensify their work with the staffs of the Fund and the Bank to define a medium-term program that will permit Guyana to normalize relations with all of its creditors and to move the balance of payments measurably toward viability.

We regret that the authorities have not been able to eliminate or even reduce their arrears to the Fund, and especially those to the Trust Fund, especially as the authorities had indicated in September that they might be eliminated before the end of 1987.

Four areas of policy weakness will have to be addressed in designing a credible program. First, in our recent discussion of the enhanced structural adjustment facility, there was broad agreement that prior actions would be appropriate in cases where certain policy reforms were necessary to lay the basis for a long or difficult adjustment process. The case of Guyana appears to fall in this category, and with the steps that have already been taken, unification of Guyana's exchange rates at an early date would be appropriate if the authorities request access to the enhanced structural adjustment facility.

In the meantime, we agree with the staff that the authorities should begin immediately to transfer export transactions to the commercial banks' window in order to pave the way for later unification. Furthermore, in keeping with its status as a member that has assumed Article VIII obligations, we place particular importance on the elimination of restrictions on current international transactions.

Second, we welcome the commitment expressed by the authorities to adjust prices, but a speedier pace is necessary. The authorities should recognize that an adjustment horizon substantially longer than three years raises questions for external creditors and donors.

Third, the turnaround in the fiscal position of the public enterprises is perhaps the most dramatic evidence that the authorities will be able to implement a successful economic reform program. With a projected surplus for 1987 equivalent to 5.5 percent of GDP compared with a deficit of 6.5 percent in 1986, the authorities appear to be in a strong position to rationalize the sector and to reduce the role of public enterprises in the economy.

We also welcome the intention of the authorities to reduce the central government deficit from the projected 1987 level, which is equivalent to 47 percent of GDP. This level is very high, and we do not believe that Guyana can have a sustainable economic reform program without major improvements in revenue collection and expenditure restraint.

Fourth, with regard to monetary policies, we fully share the view of the staff that credit needs to be tightened in the short term to curb inflationary pressures and that interest rates need to be raised to positive levels in real terms.

The medium-term outlook indicates that the financing gaps in 1988-92 will be very large and some exceptional capital inflows will be needed. At the same time, these projections assume substantial improvement in policies over the period ahead, and the financing gaps will be considerably larger if policies are not strengthened. Of course, the gaps could be smaller if the authorities took action more rapidly than assumed in the staff report. In short, these projections underscore the urgency of early implementation of needed reforms.

I have some difficulty with the emphasis placed by the staff on the need for exceptional debt relief, which appears to imply relief on concessional terms. Creditors who might provide debt relief are generally the same official agencies that could provide new capital in the form of loans or grants. It should not be prejudged whether assistance from these creditors should be in the form of new money or debt relief. For example, a number of creditors have great difficulty with the notion of providing debt relief on concessional terms and would prefer to provide equivalent support for a sound adjustment program in the form of new aid.

With respect to Guyana's overdue obligations to the Fund, I am concerned that a decision to hold our next review in six months could send the wrong signal to the authorities. In view of the importance placed by a number of Directors on urgent action, I suggest that we review Guyana's overdue obligations at an earlier date, such as after three months.

It appears that we are close to completing a circle. Guyana was one of the first cases of overdue obligations to the Fund considered by the Board, and a number of our procedures for addressing such cases were developed in discussing Guyana. Now, with a medium-term policy framework in sight to form the basis of arrangements to clear Guyana's arrears to the Fund, I hope that we can come full circle and that the circle will in fact be closed. The evolution of Guyana's policies over the past year has been positive. In the weeks ahead, the authorities need to build upon the progress to date and accelerate the pace of their efforts.

Mr. Salehkhou made the following statement:

Although many of Guyana's extremely difficult economic and financial problems persist, the report before us indicates that the authorities have taken, and continue to take, decisive steps to address these prolonged problems. Indeed, in spite of continuing internal distortions related to price and income as well as financial and monetary policies, and despite external constraints and imbalances, sincere efforts are being made by the Government to strengthen adjustment policies in a number of areas that are clearly outlined by Mr. Kafka.

Despite the fact that the flow of international capital to Guyana has come to a halt since the declaration of ineligibility, further economic deterioration has been prevented through modest growth in recorded GDP, improved management of public resources, tax reform, and an increasingly flexible price-determination process and exchange rate policy, followed by ongoing efforts to make the process of wage determination more flexible.

In the face of Guyana's continued economic difficulty and financial imbalances, the authorities, cognizant of the need for a substantial reorientation of economic policy, seem to be firmly committed to formulating a comprehensive set of measures and to developing a medium-term policy framework with the help of the staff.

Nevertheless, such a policy framework for implementation of a growth-oriented economic program in Guyana would, as the staff has also explicitly recognized, "require substantial external assistance to support the rehabilitation and liberalization of the economy," which is severely constrained by a heavy external debt and debt service burden and an arrears problem.

Given the crucial and central role of the Fund in helping Guyana to overcome its economic difficulties, I welcome the staff's assistance in developing a viable economic policy framework that could pave the way for eliciting additional financing, including concessional credit and exceptional debt relief from the donor community, and in due course, resources under the enhanced structural adjustment facility. In this connection, and on a more general note, the draft decision again urges the authorities--as in all cases of overdue obligations--"to make full and prompt settlement" of those obligations to the Fund. This wording, as I have consistently maintained, implies the authorities' lack of willingness rather than ability to fully and promptly discharge their overdue obligations which, in turn, involves the Fund's judgment on the credibility of the authorities. It further creates the wrong impression that the member is recalcitrant, which could prove most damaging to the authorities' efforts in attracting external assistance and to their resumption of normal relationships with the country's creditors. Another possible negative consequence of the repeated use of this cliché in Fund decisions on overdue obligations is the damage to the Fund's credibility by creating an unrealistic image on its part.

It is clear that domestically introduced changes in Guyana's economic policies alone cannot facilitate meeting its economic objectives and clearing its external arrears, including its overdue financial obligations to the Fund.

The staff representative from the Western Hemisphere Department suggested that, pursuant to Directors' comments on the scheduling of the next review, the six months proposed in the decision be retained, but as future developments warranted, management could bring the matter to the Board within that period. The staff planned to discuss the policy framework paper with the authorities during the second week of February.

The staff representative from the Exchange and Trade Relations Department noted that following the staff mission to Guyana in February, some time would be required to finish the report. Including the 30-day period between circulation of the paper and Board discussion, the time elapsed would be close to the six-month period proposed in the decision.

Mr. Kafka remarked that while his authorities would have no objection to an earlier review, they did not expect the budget to be submitted to the Legislative Assembly before February or March. Perhaps the timing of the review could be handled flexibly.

He appreciated the speakers' recognition of the efforts made by the Guyanese Government to improve the economic and financial situation. He assured the Board that the authorities attached top priority to clearing the arrears to the Fund and to strengthening the situation of government finances not only through expenditure cuts but through revenue increases. However, in a poor country like Guyana, the increase in revenues must accompany a further resumption of growth if it was to be effective and acceptable to the population. Increased growth would require a significant amount of external assistance, some of it on concessional terms.

Ms. Bush suggested that, as the medium-term plan described in the policy framework paper being prepared might lay the basis for clearing arrears, it might be valuable to have another review by the end of April when the Board could consider the paper and any other potential arrangements that might have been made for the clearance of arrears.

The staff representative from the Western Hemisphere Department said that by the end of April 1988 the staff could report to the Board on the status of the negotiations with the authorities on a possible policy framework paper so long as some flexibility was allowed in the presentation of that information.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal contained in the report for the 1987 Article IV consultation. They noted Guyana's very difficult economic situation, and they welcomed the corrective measures taken by the authorities in early 1987 in the exchange rate and fiscal areas and supported the authorities' plans to carry out a substantial reorientation of economic policy. Directors urged the authorities to move more forcefully and quickly in this direction and to develop a policy framework paper that could provide a basis for arrangements under the structural adjustment facility once the overdue obligations to the Fund had been settled.

Directors remarked that while the devaluation of the Guyana dollar in early 1987 had improved external competitiveness, the currency remained substantially overvalued. They also observed that the regulations governing the operations of the secondary foreign exchange window in the commercial banks did not allow for the emergence of a truly market-oriented exchange rate. Thus, Directors urged the authorities to carry out without delay their plans to unify the exchange rate system at a competitive rate and to implement thereafter a flexible exchange rate policy. In their view, such actions were crucial to help restore economic growth and a viable balance of payments position over the medium term.

Directors observed that economic growth in Guyana had been adversely affected by the introduction of widespread controls and regulations over the economy. They therefore encouraged the authorities to move quickly to put into effect their intention to liberalize private sector prices and to remove exchange and trade restrictions.

Directors noted the authorities' efforts in the past two years to deal with the country's fiscal problem and, in particular, to improve the financial performance of the state enterprises. They stressed, however, that the deficit remained unsustainably large and continued to be a major factor behind Guyana's economic imbalances. While welcoming the authorities' plans to reduce substantially the public sector deficit in the context of the medium-term program, Directors underlined the need for early action and emphasized that both a reduction in expenditures in real terms and revenue increases would be required to bring the public finances to a sustainable path over the coming years. They also stressed that it was necessary to allow for a full pass-through of the devaluation.

Directors observed that a substantial reduction in the fiscal deficit would help the Bank of Guyana to regain control over monetary policy. It was noted that domestic credit had continued to expand at a fast pace in 1987, negating in part the effect of the exchange rate adjustment, and that there was a need to tighten credit without delay. A flexible approach to interest rates also was necessary to create appropriate incentives for private savings and to ensure an efficient pattern of investment.

Directors viewed with concern the substantial overall accumulation of external payments arrears by Guyana. They noted that Guyana's overdue obligations to the Fund had continued to build, and that arrears to the Trust Fund had been allowed to develop in the course of 1987. Directors emphasized that the resumption of normal financial relations with external creditors required the adoption of a comprehensive economic program.

Directors noted that while implementation of a strong economic program in Guyana would enhance domestic savings, substantial external assistance also would be needed to support such a program. In Guyana's circumstances, such external assistance would need to be on concessional terms and, it was noted by some, might need to include some form of exceptional debt relief. Guyana, however, would need to move firmly to establish the credibility of its policies for external assistance to be forthcoming.

In sum, Directors welcomed the renewed emphasis given by the authorities to addressing Guyana's very difficult economic situation and urged them to implement without delay a strong set of policies aimed at creating the basis for sustained economic growth and a viable balance of payments position. They were of the view that time was not on the side of Guyana and that further delays in adjusting would entail even heavier costs at a later stage.

It is expected that the next Article IV consultation with Guyana will be held on the standard 12-month cycle.

The Executive Board then took the following decision:

1. The Fund has reviewed further the matter of Guyana's continuing failure to fulfill its financial obligations to the Fund in light of the facts and developments described in EBS/87/268 (12/16/87) and SM/87/270 (11/17/87).

2. The Fund deeply regrets the continuing failure by Guyana to fulfill its financial obligations to the Fund and again urges Guyana to make full and prompt settlement of those obligations.

3. The Fund stresses the importance of active steps by Guyana to implement promptly the economic reforms needed to address Guyana's imbalances, restore economic growth, and regularize its relations with external creditors.

4. The Fund will review again the matter of Guyana's overdue financial obligations to the Fund within six months of the date of this decision.

Decision No. 8756-(87/176), adopted
December 18, 1987

The Managing Director assumed the chair.

3. STRUCTURAL ADJUSTMENT FACILITY AND ENHANCED STRUCTURAL ADJUSTMENT FACILITY

The Executive Directors considered a staff paper on legal documentation to give effect to the proposed enhancement of the structural adjustment facility (EBS/87/253, Rev. 2, 12/16/87).

The Chairman remarked that it would be appropriate to review the status of contributions to the enhanced structural adjustment facility. The objective was an enhancement of SDR 6 billion. Assuming a six-month SDR interest rate of 6.5 percent and the repayment of the loans over a 13-year period, a subsidy grant of SDR 2.8 billion would be required to allow the Trust to lend at an interest rate of 0.5 percent. In fact, the six-month SDR interest rate had been 6.13 percent the previous week, which implied a total grant requirement of SDR 2.6 billion; however, to be on the conservative side, the target for the grant would remain SDR 2.8 billion.

Mr. Enoch recalled that Mr. Lankester had reported on the U.K. contribution at the previous discussion on the enhanced facility (EBM/87/171, 12/15/87). The Chancellor had subsequently announced that contribution in Parliament.

At the previous discussion, his chair had noted the concerns of other potential contributors, particularly with respect to the timing of the adoption of the decisions before the Board, Mr. Enoch continued. While he understood those concerns, he was somewhat worried about losing the momentum for completing the arrangements for the enhancement on schedule. A tight timetable had been set at the Venice Summit, and an enormous amount of progress had been made since then. He continued to hope that the end-year deadline for implementing the enhanced facility could be met. He therefore urged Executive Directors to accept the revised decisions, which produced a framework for the enhanced facility without closing many avenues or reducing the flexibility needed to meet the concerns that had been raised.

For the record, while his authorities did not intend to hold up their contribution, they regarded it as very desirable that the United States should contribute to the enhanced facility, Mr. Enoch commented.

Mr. Yamazaki remarked that ever since Japan had joined other major industrial countries in welcoming the Managing Director's initiative for the enhancement of the structural adjustment facility at the Venice Summit, his authorities had strongly supported the initiative. He fully supported the proposed decisions. He also wished to underscore the importance of flexibility at the present juncture to facilitate the widest possible participation of member countries.

Japan had always been willing to assume its fair and increasing responsibility in the international community and had also attached particular importance to addressing the plight of low-income developing countries, Mr. Yamazaki continued. In that context, his authorities had decided to contribute to the enhancement of the structural adjustment facility in the following way. First, a grant of SDR 300 million would be provided, as well as a loan corresponding to that grant, given present interest and exchange rates. Second, assuming that the interest rate on loans from the Trust would be maintained at 0.5 percent, further capital contributions would be required to match subsidies that were firmly committed at present. His authorities were therefore willing to extend a capital contribution of SDR 2 billion to cover all firmly committed subsidies. Third, Japan stood ready to make further capital contributions of up to SDR 500 million and to make a total capital contribution up to SDR 2.5 billion until additional firm commitments of grants had been received to assure an interest rate of 0.5 percent on loans from the Trust. Moreover, that further commitment would stand until the total enhancement reached SDR 6 billion and additional grants were firmly committed. It was hoped that that further offer would encourage potential contributors to participate in the enhancement. Finally, during their discussions with the Fund staff on Japan's contribution, some of his authorities had strongly emphasized that Japan's present quota share did not reflect underlying economic realities, Mr. Yamazaki commented.

Mr. Grosche remarked that the German Federal Government would endeavor to ensure that German financial institutions provided a loan of up to SDR 700 million, or the equivalent of that amount in a national currency, to the Enhanced Structural Adjustment Facility Trust on the basis of the provisions governing the Trust. In doing so, it expected that adequate arrangements would be reached with regard to the security and the liquidity of claims on the Trust Account.

The Federal Government was prepared in principle to contribute the equivalent of SDR 130 million to the Subsidy Account, and it was assumed that disbursements to that Account would be made over the life of the Trust in proportion to the disbursement requirements of the Account, Mr. Grosche continued. His authorities reserved the right, however, to advance disbursements to the Subsidy Account. In that event, the present value would be the basis for disbursements. That commitment was made on the understanding that there would be a broad participation in lending to the Trust as well as in contributing to the Subsidy Account. It was further assumed that there would be satisfactory agreement on the overall operation of the enhanced facility. Finally, the contribution to the Subsidy Account was subject to approval by the German legislative bodies.

Mr. Massé remarked that while he did not yet have a final response to management's latest request, his authorities had considered a significant increase in their contribution to SDR 300 million. The Minister of Finance had signed a letter to the Prime Minister indicating his approval of the contribution, and indications were that the proposal would be positively received and that the contribution would be fully subsidized.

Mrs. Ploix recalled that her authorities' announcement of a contribution of $500 million had launched the enhancement of the structural adjustment facility. That morning her authorities had decided to increase that amount by 17 percent, to SDR 600 million, with corresponding subsidies of more than SDR 240 million.

She wished to support Mr. Enoch's comments, Mrs. Ploix continued. Her authorities also regarded a U.S. contribution as highly desirable.

Mr. Posthumus stated that the Netherlands authorities had decided to contribute to the enhancement of the structural adjustment facility in the form of a grant to the Subsidy Account. They would make available f. 10 million a year in the first three years, starting in 1988, and f. 15 million a year over the next seven years. According to the staff's calculations that might make it possible for the Trust to extend loans amounting to SDR 110 million at the targeted interest rate of 0.5 percent. He referred Directors to his previous statement on the subject for the background of that contribution.

The Chairman commented that he had received assurances from Group of Five countries, as well as one country which was not a member of the Fund, of capital contributions totaling SDR 4.75 billion. Assurances and commitments from a wide range of other countries amounted to a minimum capital contribution of SDR 1.5 billion. On the basis of those figures, he was pleased to note that the financing target of SDR 6 billion for the enhancement was in sight.

Further work remained to be done on grants for the Subsidy Account, the Chairman remarked. At present interest rates, about SDR 2.6 billion was needed; to date, firm assurances had been received for some SDR 2 billion. He had also received several personal assurances that additional amounts could confidently be expected. To assure some room for maneuver, the objective of SDR 2.8 billion would be maintained, and all steps would be taken to achieve that objective in coming days.

Ms. Bush commented that Directors were certainly aware of her authorities' general support for the enhanced facility, as well as their position with respect to a possible U.S. contribution and the reasons for it. In view of the further comments by Directors regarding a U.S. contribution, she would again convey their concerns to her authorities.

Mr. Ortiz remarked that he wished to thank Ms. Bush for her encouraging words. Some countries in his constituency, specifically, Mexico and Venezuela, were considering contributions to the enhanced facility on the basis of a broad regional effort. For the record, his Spanish authorities were hopeful about a possible U.S. contribution. In the context of a regional effort, his Mexican authorities were considering a contribution of up to SDR 45 million in the form of subsidized loans to be distributed over a three-year period. His Venezuelan authorities were also favorably considering participation in the enhancement.

Mr. Kafka stated that he had been authorized by his Colombian and Brazilian authorities to inform the Board that they expected to contribute to the enhanced facility. They had not yet determined the precise amounts and modalities but they, like Mexico and Venezuela, expected to do so in the context of a regional effort. He hastened to add, however, that the Brazilian Finance Minister had resigned a few hours previously, and he therefore had no authority to repeat the commitment that had been made. He hoped it would not be affected by the change in Government.

Mr. Donoso remarked that countries in his constituency were still considering their contribution to the enhanced facility. His Chilean authorities had indicated that they would make a capital contribution of up to SDR 12 million; the grant element was expected to be proportional to that of other countries in the region. Other members of his constituency that were considering contributions were close to deciding on a figure.

Mr. Finaish stated that his Kuwaiti authorities had decided to make a contribution to the enhanced facility. They had not yet determined a precise amount, but they expected to do so in a few days.

Mr. Prader remarked that at present it was impossible for his Belgian authorities to give their formal agreement to participate in the enhanced facility. Although they recognized that the text of the Chairman's summing up went a long way toward meeting their concerns, in fact, if the need to sell gold arose at once, the appropriate majority for a decision to do so would probably not be present, so that the Chairman's remarks could be made inoperative.

For that reason, incorporating a claim on the Trust as an asset remained a difficult problem for the central bank, Mr. Prader explained. The possibility of solving that problem by the adoption of appropriate arrangements between the central bank and the Government could not be formally discussed at present, owing to the government crisis in Belgium. Decisions on arrangements of that nature were outside the limited scope of the day-to-day decisions that the resigning Government could take. He therefore hoped that he would be able to announce Belgium's participation in the enhancement once the new Government was in place. In that regard, the postponement of the adoption of the decisions under discussion for a few weeks might have been helpful.

His authorities' decision would have been facilitated if all of the Fund's major members had participated in the enhancement, Mr. Prader added. It could then have been more reasonably assumed that all necessary measures to assure the security of claims on the Trust would indeed be taken.

His Austrian authorities remained committed to making a reserve loan of SDR 60 million at an interest rate of 0.5 percent, which would be subsidized, Mr. Prader remarked. His Turkish authorities would also contribute to the enhancement in an amount of some SDR 35 million, on terms and conditions to be discussed with the Fund at a later stage.

The Chairman explained that the modifications proposed by Directors on December 15 were fully reflected in the revised text of the decisions to give effect to the enhancement of the structural adjustment facility. He proposed to proceed to the formal approval of those decisions and invited Directors' comments.

Mr. Grosche, referring to subparagraph (4) of the Amendment of the Regulations for the Administration of the Structural Adjustment Facility, proposed that after "may be extended" the words "once up to a period of six months" should be added to indicate how many delays in disbursements would be allowed and that the extension was not for an unlimited period.

The staff representative from the Legal Department commented that the proposed amendment did not seem to change the substance at the present stage. However, if, as a result of the extension of commitments beyond the present commitment period, there was room for additional flexibility, then the amended subparagraph, as proposed, would have to be changed. The phrase "subject to these Regulations" avoided the need for later revision.

The Chairman proposed that Mr. Grosche's understanding of the text should be recorded in the minutes of the discussion and that the text should remain as it was.

Mr. Grosche remarked that the Chairman's suggestion was acceptable to him.

Commenting on the Instrument to Establish the Enhanced Structural Adjustment Facility Trust, Mr. Grosche recalled that with respect to Section I, paragraph 3, "Unit of Account," he had previously indicated that his authorities were not yet sure whether the provisions of that paragraph, particularly regarding denomination and, indirectly, the interest rate of loans, were fully compatible with their framework for making a capital contribution to the Trust. He hoped and expected that

that would be the case. Nonetheless, his authorities would prefer that the staff should maintain a degree of flexibility in its discussions with the German finance institution that was going to provide the loan. Therefore, he preferred that the framework being decided should not be legally binding at the conclusion of the present discussion, and that the decisions should be adopted later on a lapse of time basis. Nevertheless, if the consensus favored taking a decision at the conclusion of the present discussion, and if others did not expect to encounter major difficulties in providing their contribution in SDRs, he could go along with the consensus. However, the Board might have to reconsider those elements in the text if his authorities could not comply with them. Apart from those, it would be helpful if, at the present meeting, a provision could be inserted in the texts stipulating that the SDR currency basket would remain unchanged over the period of the loan.

The Chairman remarked that he was grateful for the flexibility shown by Mr. Grosche. Indeed, it was not absolutely necessary to adopt the decisions at the present meeting, but it was highly desirable to do so, and several speakers were pressing for their adoption.

The staff representative from the Legal Department commented that under Section VII of the Instrument, the same rules applying to the operation of the General Resources Account would apply to the operation of the Trust. Thus, the valuation of the SDR referred to in Section I, paragraph 3 of the Instrument would change as the reference basket changed.

The Deputy Treasurer commented that although a dated SDR had not been provided for in the Instrument, a provision for a dated SDR could conceivably be included. However, that would raise certain policy issues for the Fund that would have to be considered in detail. The concern about possible changes in the composition of the SDR basket at the time of the periodic reviews was understandable, and the staff would be prepared to discuss that concern with the German authorities when the opportunity arose; certain techniques had been used in other contexts to hedge and protect against risks arising from changes in the basket's composition. It was possible that the potential difficulties might not be as great as they might now appear to the authorities.

Mrs. Ploix remarked that her authorities were encountering difficulties similar to those mentioned by Mr. Grosche. They also had the same flexibility in mind, but flexibility on the part of the staff, as well as further discussion with the staff, would be welcome.

Mr. Zecchini observed that the rationale behind the provision in question was that the denomination of the Trust's operations and transactions in SDRs clearly entailed a reference to the SDR interest rate applied to claims on the Trust, and flexibility on denomination could affect both aspects. The staff should therefore consider very carefully the financial implications of opening up the question of the denominations of claims.

In light of the previous discussion on the interpretation of the words "provided that," he would like to confirm that the staff's interpretation of that phrase would be included in the record so as to avoid any ambiguity, Mr. Zecchini added.

The staff representative from the Legal Department observed that the interpretation previously given by the staff was confirmed by an examination of the Articles. The most striking illustration of a provision setting forth a rule with an exception was Article V, Section 8(e), which stated that "a member shall pay all charges in SDRs, provided that in exceptional circumstances the Fund may permit a member to pay charges in the currencies of other members specified by the Fund...or in its own currency." That same structure was used in Section I, paragraph 3, of the Trust Instrument.

Mr. Grosche, referring to Section IV, paragraph 5 of the Instrument, remarked that he still preferred not to mention an interest rate target because it could raise expectations that might not be realized. Nevertheless, if a broad majority wished to include such a target, he could reluctantly go along. However, as a minimum, the words "to the extent possible" should be reinserted in paragraph 5(a) following "reducing," in order to be as precise as possible with regard to the character of the target interest rate of 0.5 percent. Also, for the record, despite the provisions of the text, his authorities did not feel compelled to close resource gaps in the Subsidy Account.

The Chairman observed that the text explicitly provided for raising the interest rate on loans from the Trust if sufficient resources to subsidize the target rate did not materialize. He therefore understood and shared Mr. Grosche's concerns. For his part, he could accept the reintroduction of the words "to the extent possible" in a spirit of consensus, but he was in the hands of the Executive Board.

Mr. Zecchini recalled that he had proposed the deletion of the words "to the extent possible" to distinguish the resources of the enhanced facility from other Fund resources. If the interest rate on loans from the Trust was to approach market rates, he did not see any need to establish the enhanced facility as a separate facility. It was therefore crucial to retain not only the objective of a 0.5 percent interest rate, but also a firm understanding that that objective had to be reached.

The Chairman observed that in view of the resources already committed to the Subsidy Account, the concessionality of the enhanced facility was not at issue. Moreover, the objective of attaining an interest rate of 0.5 percent was strongly supported.

The staff representative from the Legal Department commented that the word "objective" had been used throughout the text to indicate that 0.5 percent was not a fixed interest rate. "To the fullest extent possible" had been inserted in the original version not to point in the direction of a market-related interest rate, but rather to indicate that everything possible would be done to attain the 0.5 percent interest rate objective. Thus, the phrase pointed in the direction of the objective rather than qualifying it.

Mr. Zecchini remarked that he did not understand the staff's line of argument in the general context of paragraph 5. Subparagraph (c) clearly stated that "should adequate additional resources not be forthcoming to reduce the rate on Trust loans to 0.5 percent, the Trustee shall recalculate the subsidy...." That provided enough flexibility, so that an addition to subparagraph (a) was not required. Moreover, he had previously expressed his reservations with respect to subparagraph (c); those reservations would extend to an amended subparagraph (a) as well.

The Chairman, observing that "to the extent possible" was redundant, asked whether Mr. Grosche insisted on the amendment.

Mr. Grosche stated that he so insisted.

Mr. Enoch suggested that to satisfy the concerns of both Mr. Grosche and Mr. Zecchini, paragraph 5(a) might be revised to read: "The amount of the subsidy shall be determined by the Trustees in the light of (i) the objective of ensuring that the enhanced structural adjustment facility is a highly concessional facility and, to the fullest extent possible, reducing the rate of interest charged to 0.5 percent on Trust loans...."

Mr. Grosche and Mr. Zecchini accepted Mr. Enoch's suggestion.

Mr. Grosche remarked, for the record, that his authorities considered that the various elements proposed to secure claims on the Trust were the very minimum, and they would therefore not wish to see any impairment of those elements of security. In particular, his authorities considered that the Reserve within the Trust might provide sufficient security for claims in the order of an enhancement of SDR 6 billion. However, if there was any enlargement of the Trust in the future, the Reserve would have to be strengthened proportionally, at least.

By way of clarification regarding repayment modalities, although his authorities recognized that there was a cross-reference to the existing structural adjustment facility in the legal documentation, they nevertheless felt that the Instrument governing the enhanced facility's operations should include a provision for the repayment of Trust loans, Mr. Grosche added. He therefore suggested the introduction of a subparagraph, perhaps into paragraph 4 of Section II, stating that "the Trust loans shall be repaid in equal semiannual installments beginning after the grace period of five years"--namely, the repayment schedule for the existing facility.

The staff representative from the Legal Department remarked that legally, that provision would not be needed because the Instrument contained a cross-reference to the Regulations for the Administration of the Structural Adjustment Facility. Moreover, if one provision was quoted verbatim from the Regulations, then every provision of the Regulations referred to would have to be quoted.

Mr. Grosche commented that even though the substance was there, he had had difficulty explaining the decisions to his authorities because cross-references to other provisions made the Instrument extremely complicated for the nonexpert. It would help if a provision on repayment were included in the text, because it was an important point.

The staff representative from the Legal Department observed that the explanation of the provision could be included either in the record of the meeting or, when the final text of the decisions was approved, a commentary or clarification could be issued.

The Chairman suggested that the record of the meeting would clarify the point raised by Mr. Grosche.

Mr. Ortiz remarked that, for the record, he had two questions regarding the liquidity of claims on the Trust. First, would the Fund consider loans to the Trust by central banks as part of their reserves in the Fund's statistical publications? Second, could the staff describe more precisely the steps that central banks would have to take in order to draw on the general resources of the Fund in case of a liquidity need?

The staff representative from the Legal Department confirmed that loans to the Trust by central banks would be considered as part of their reserves.

Access to the Fund's general resources was available in the event of a liquidity need arising from developments in a member's reserve position, the staff representative continued. A representation of that liquidity need would have to be made by the member, and the Fund would have to examine the justification for the purchase under Article V, Section 3(b)(ii), taking into account, in particular, the amount of the required purchase and also the existence of a claim on the Trust. The exact procedure had not been specified, and would involve a decision by the Board. The procedure could be implemented as quickly as possible. The staff envisaged that the decision would be taken on lapse of time, if that was agreeable to the Executive Board.

Two types of decisions would be required if special features, such as special repurchase periods and the floating character of the purchase under that provision were desired, the staff representative noted. A decision on those special features would require a majority of 85 percent of the voting power. The decisions could be presented to the Board at a later stage.

In response to a question by Mr. Ortiz regarding the representation of the liquidity need that would need to be made by the authorities, the staff representative from the Legal Department remarked that at the present stage he was not in a position to elaborate further on the specific procedural steps that would have to be taken in individual cases.

Mrs. Ploix stated, that for the record, with regard to the security of claims on the Trust and the Fund's pledge with respect to the residual risk, her authorities would like the Fund to consider, among "all such initiatives as might be necessary," the use of all other possible reserves.

The Chairman remarked that such an indication had been included in his summing up at EBM/87/171 of the discussion at EBM/87/168.

Mr. Ovi commented that he understood from the previous discussion on the enhanced facility that the draft decisions on the use of the Fund's general resources in the event of a liquidity need would be considered at the present meeting. While he had no problems whatsoever with the legal texts presented to the Board, he considered those additional decisions to be an integral part of the implementing documentation. If it was the understanding of the Board that it would adopt a decision to make the reserve tranche floating in the event of the use of the Fund's general resources to meet a liquidity need, then he could accept the texts presented as they were.

Mr. Prader stated that he shared Mr. Ovi's views.

Mr. Zecchini suggested that the Chairman's summing up might reflect the sentiment expressed by several Directors that all industrial countries, including major ones, were expected to join the initiative at some stage. Moreover, for the record, he still had reservations on some textual points, and he was not fully convinced that the decisions should be adopted at the present meeting. However, if a large majority of the voting power favored their adoption, he would not stand in the way.

The Chairman remarked that he had indeed noticed the broad desire of the membership to have all major industrial countries participate in the enhancement at some stage. He shared that desire. With regard to the decisions, it was important that they should be adopted at the present meeting in order to meet the deadline suggested at the Venice Summit for implementing the facility.

Mr. Nimatallah stated that he shared the Chairman's views and that he supported the decisions, as amended.

Mrs. Ploix observed that the staff had proposed that the decisions on the initial interest rate and on access limits should be taken separately. Would there be another meeting of the Board to consider the decisions on those two issues?

The staff representative from the Legal Department responded that it was correct that two decisions would have to be taken: one on access limits under the Instrument and one on the interest rate under the Instrument. With regard to access limits and the 0.5 percent interest rate, it was important to know the exact amount of confirmed commitments. The decisions should be taken as quickly as possible, either in another meeting or on a lapse of time basis.

Mr. Posthumus, recalling the discussion between Mr. Grosche and Mr. Munzberg on the need for flexibility with respect to the loan agreements yet to be concluded, remarked that the Board should be informed once agreements had been finalized.

The staff representative from the Legal Department commented that every agreement with an individual lender would be presented for Board approval.

The Chairman made the following concluding remarks:

> I would like to offer a few concluding remarks. You have been most kind in your comments on my efforts in this initiative, but this has truly been an effort by all of us, and especially the Executive Board. I know the energy you have spent on persuading others that this initiative represents the best way for the Fund to play its proper role in assisting our poorer members. You have also argued that contributions should be as generous as possible, despite the difficult situations of many potential creditors. During these past few days, I have become even more deeply aware of the constraints facing countries generally. I thank you for your strong support in the face of what was understandably some initial skepticism, particularly regarding the amounts which we have been seeking; without your help, we would not have had this meeting today.
>
> We are now well on our way to fulfilling the mandate we were given by the heads of state of the largest industrial countries and the EEC in Venice and by our own Governors at the Annual Meetings. I will continue to press until all the necessary financing is secured to ensure that we can reach our target of a 0.5 percent interest rate on all lending under the enhanced structural adjustment facility. For your assistance in bringing us this far, I am most grateful.
>
> The contributions that so many of you have indicated on behalf of your authorities are generous indeed. There will be temptations to make comparisons, but these would be unproductive. I asked all countries not to wait for their neighbors, but rather to focus on the needs that were evident to all and to ask themselves what they might contribute. Some have responded in the context of aid efforts that already approach 1 percent of GNP; some are already beyond this. Others are finding means beyond their budget to participate in this initiative. Many of your governments face severe budgetary constraints of their own, but have nonetheless found ways to help.
>
> These contributions have been impressive. I have to mention especially the generous contribution of the Government of Japan and the tremendous personal effort of Mr. Yamazaki to help put it together. I also note the strong desire expressed in the

Executive Board that all major industrial countries should eventually find a way to contribute to the Enhanced Structural Adjustment Facility Trust. I too strongly wish to see this common hope realized. This initiative will benefit all of us if it is used wisely, and it is to that task that we will now need to turn our energies.

There is no cause for hurried announcements to the press. I suggest that we wait until the end of the month, possibly December 29, before issuing a statement to the press. This statement will not mention the specific contributions of each country. The text will be made available to Directors before it is released to the press.

Two issues of substance raised during this meeting deserve special mention. First, it was reconfirmed that lending to the Enhanced Structural Adjustment Facility Trust could be considered as part of a member's official reserves by the Fund. Second, it was explained that access to the Fund's general resources could be provided for members that had extended loans to the Trust and that needed liquidity in an amount not exceeding their claim. Purchases under these circumstances would be allowed if the member represented that it had a need, because of developments in its reserves in the sense of Article V, Section 3(b)(ii), and the Fund agreed that the purchase was justified taking into account the amount of the requested purchase and the existence of a claim on the Trust. If the liquidity problem can be addressed on its own, there would be no need for an adjustment program to solve the balance of payments problem. Moreover, those purchases could be given certain characteristics by a decision to be taken when required. For instance, it could be decided, with respect to such purchases, to provide for special repurchase periods and for their exclusion from the definition of reserve tranche purchases. Those decisions would need to be adopted by an 85 percent majority. On the occasions on which this question was discussed, I heard no objections by an Executive Director to this approach, which had been suggested in the staff papers that have been discussed by the Board.

The Executive Board then adopted the following decisions:

Structural Adjustment Facility - Review; and Enhanced Structural Adjustment Facility - Establishment

1. The Executive Board has reviewed the operation of the Structural Adjustment Facility within the Special Disbursement Account, as provided in Decision No. 8241-(86/56) SAF, adopted March 26, 1986.

2. (a) The Executive Board decides to establish a Facility to be known as the Enhanced Structural Adjustment Facility. Loans under that Facility shall be provided by the Enhanced Structural Adjustment Facility Trust, normally in conjunction with loans under the Structural Adjustment Facility, on concessional terms, to low-income developing members that qualify for assistance.

(b) The use of resources provided by the Structural Adjustment Facility shall be subject to the Regulations for the Administration of the Structural Adjustment Facility, as amended by Decision No. 8758-(87/176) SAF, adopted December 18, 1987.

(c) The use of resources provided by the Enhanced Structural Adjustment Facility Trust shall be subject to the provisions of the Enhanced Structural Adjustment Facility Trust Instrument adopted by Decision No. 8759-(87/176) ESAF, adopted December 18, 1987.

3. Resources provided by lenders that agree to support arrangements under the Enhanced Structural Adjustment Facility through loans to qualifying members shall be used in association with loans under the Enhanced Structural Adjustment Facility and in accordance with the arrangements between the Fund and the lenders.

4. The Fund shall review the operation of the Enhanced Structural Adjustment Facility, of the Structural Adjustment Facility, and of the Enhanced Structural Adjustment Facility Trust, not later than March 31, 1989.

Decision No. 8757-(87/176) SAF/ESAF,
adopted December 18, 1987

Structural Adjustment Facility - Amendment of Regulations for Administration

1. The following paragraph shall be added to the Regulations for the Administration of the Structural Adjustment Facility annexed to Decision No. 8238-(86/56) SAF:

Paragraph 14

Assistance from the Structural Adjustment Facility, in conjunction with loans from the Enhanced Structural Adjustment Facility Trust, under the Enhanced Structural Adjustment Facility established by Decision No. 8757-(87/176) SAF/ESAF, adopted December 18, 1987 shall be governed by these Regulations subject to the following provisions:

(1) The amounts of such assistance shall be identified in any commitment, arrangement, or disbursement under the Enhanced Structural Adjustment Facility.

(2) Disbursements under each annual arrangement shall be made in two installments, the first after approval of the corresponding annual arrangement, and the second after

(i) a finding by the Managing Director that the performance criteria that have been established for that disbursement have been met, and a determination by the Fund that the midterm review of the program supported by the arrangement has been completed to the satisfaction of the Fund, or

(ii) if so specified in the annual arrangement, a finding by the Managing Director that the performance criteria that have been established for that disbursement have been met.

(3) Disbursements shall be made at the same time as the corresponding disbursements under Trust loans.

(4) If, pursuant to subparagraph (2) above, a second disbursement under an annual arrangement is not made, the period of the three-year commitment may be extended, and the corresponding amount may be made available during the extended period, subject to these Regulations.

2. In paragraph 6(2) of the Regulations referred to above, the terms "to the Fund as Trustee under the Trust Instrument" shall be replaced by "to the Fund as Trustee."

Decision No. 8758-(87/176) SAF,
adopted December 18, 1987

Enhanced Structural Adjustment Facility Trust - Establishment

1. The Fund adopts the Instrument to Establish the Enhanced Structural Adjustment Facility Trust that is annexed to this Decision. 1/

2. The Fund is committed, if it appeared that any delay in payment by the Trust to lenders would be protracted, to consider fully and in good faith all such initiatives as might be necessary to assure full and expeditious payment to lenders.

Decision No. 8759-(87/176) ESAF,
adopted December 18, 1987

1/ See Annex.

Transfer of Resources from Special Disbursement Account to Enhanced Structural Adjustment Facility Trust and Retransfer to Special Disbursement Account

1. The following resources held in, or to be received by, the Special Disbursement Account shall be transferred to the Enhanced Structural Adjustment Facility Trust ("the Trust") for its Reserve Account upon the establishment of the Trust or upon receipt of these resources by the Special Disbursement Account, whichever is later:

(i) all income already received or to be received from the investment of resources available for the Structural Adjustment Facility within the Special Disbursement Account;

(ii) all interest already received or to be received, including from special charges, on loans under the Structural Adjustment Facility;

(iii) all repayments of loans under the Structural Adjustment Facility; and

(iv) all the resources held in the Special Disbursement Account that are derived from the termination of the 1976 Trust Fund and that can no longer be used under the Structural Adjustment Facility;

provided that the above resources shall be retransferred to the Special Disbursement Account when and to the extent that they are needed for the reimbursement of the expenses incurred by the General Resources Account in the administration of the Structural Adjustment Facility and the Trust, which must be reimbursed in accordance with paragraph 10 of the Regulations for the Administration of the Structural Adjustment Facility and paragraph 3 of this Decision.

2. Whenever the Trustee determines that amounts in the Reserve Account of the Trust exceed the amount that may be needed to cover the total liabilities of the Trust to lenders that are authorized to be discharged by the Reserve Account, the Trustee shall retransfer such excess amounts to the Special Disbursement Account. Upon liquidation of the Trust, all amounts in the Reserve Account remaining after discharge of liabilities authorized to be discharged by the Reserve Account shall be transferred to the Special Disbursement Account.

3. The Special Disbursement Account shall reimburse the General Resources Account annually in respect of the expenses of conducting the business of the Enhanced Structural Adjustment Facility Trust.

4. This Decision replaces Decision No. 8237-(86/56) SAF, adopted March 26, 1986.

Decision No. 8760-(87/176), adopted
December 18, 1987

APPROVED: August 5, 1988

JOSEPH W. LANG, JR.
Acting Secretary

Instrument to Establish the Enhanced Structural Adjustment Facility Trust

Introductory Section

To help fulfill its purposes, the International Monetary Fund (hereinafter called the "Fund") has adopted this Instrument establishing the Enhanced Structural Adjustment Facility Trust (hereinafter called the "Trust"), which shall be administered by the Fund as Trustee (hereinafter called the "Trustee"). The Trust shall be governed by and administered in accordance with the provisions of this Instrument.

Section I. General Provisions

Paragraph 1. Purposes

The Trust shall assist in fulfilling the purposes of the Fund by providing loans on concessional terms (hereinafter called "Trust loans") to low-income developing members that qualify for assistance under this Instrument, in order to support programs to strengthen substantially and in a sustainable manner their balance of payments position and to foster growth.

Paragraph 2. Accounts of the Trust

The operations and transactions of the Trust shall be conducted through a Loan Account, a Reserve Account, and a Subsidy Account. The resources of the Trust shall be held separately in each Account.

Paragraph 3. Unit of account

The SDR shall be the unit of account for commitments, loans, and all other operations and transactions of the Trust, provided that commitments of resources to the Subsidy Account may be made in currency.

Paragraph 4. Media of payment of contributions and exchange of resources

(a) Resources loaned or donated to the Trust shall be received in a freely usable currency, subject to the provisions of (c) below, and provided that resources may be received by the Subsidy Account in other currency.

(b) Payments by the Trust to lenders or donors shall be made in U.S. dollars or such other media as may be agreed between the Trustee and such lenders or donors.

(c) Loans or donations to the Trust may also be made in or exchanged for SDRs in accordance with such arrangements as may be made by the Trust for the holding and use of SDRs.

(d) The Trustee may exchange any of the resources of the Trust, provided that any balance of a currency held in the Trust may be exchanged only with the consent of the issuers of such currencies.

Section II. Trust Loans

Paragraph 1. Eligibility and conditions for assistance

(a) Any member eligible for assistance from the Structural Adjustment Facility shall be eligible for assistance from the Trust.

(b) This assistance shall be committed and provided under the same conditions and on the same terms as prescribed in paragraph 14 of the Regulations for the Administration of the Structural Adjustment Facility, subject to the provisions of this Section.

(c) Before approving a three-year arrangement, the Trustee shall be satisfied that the member is making an effort to strengthen substantially and in a sustainable manner its balance of payments position.

(d) Commitments under three-year arrangements may be made during the period from January 1, 1988 to November 30, 1989.

Paragraph 2. Amount of assistance

(a) An initial maximum limit on access to the resources of the Trust shall be established by the Trustee, as a proportion of members' quotas in the Fund, and provision shall be made for a limit up to which that maximum limit may be exceeded in exceptional circumstances. The maximum access limit and the exceptional maximum limit shall be subject to review from time to time by the Trustee in the light of actual utilization of resources available to the Loan Account, and in any event not later than March 31, 1989.

(b) To the extent that a member has notified the Trustee that it does not intend to make use of the resources available from the Trust, the member shall not be included in the calculations of the access limits on Trust loans.

(c) The access for each member that qualifies for assistance from the Trust shall be determined on the basis of an assessment by the Trustee of the balance of payments need of the member and the strength of its adjustment program.

(d) The amount of resources committed to a qualifying member under a three-year arrangement and the amounts for the second- and third-year arrangements shall be reviewed at the time of consideration of each annual program. The amounts committed to a member shall not be reduced because of developments in its balance of payments, unless such developments are substantially more favorable than envisaged at the time of approval of the three-year arrangement and the improvement for the member derives in particular from improvements in the external environment.

(e) Any commitment shall be subject to the availability of resources to the Trust.

Paragraph 3. Disbursements

(a) Any disbursement shall be subject to the availability of resources to the Trust.

(b) Disbursements shall normally be made on the fifteenth and the last day of the month, provided that if these days are not business days of the Trustee, the disbursement shall be made on the preceding business day. Following a member's qualification for a disbursement, the disbursement shall be made on the first of these value dates for which the necessary notifications and payment instructions can be issued by the Trustee.

(c) No disbursement under a three-year commitment to a member shall be made after the expiration of the period specified in Section III, paragraph 3.

Paragraph 4. Terms of loans

(a) Interest on the outstanding balance of a Trust loan shall be charged at the rate of one half of one percent per annum subject to the provisions of Section IV, paragraph 5, and provided that interest at a rate equal to the rate of interest on the SDR shall be charged on the amounts of any overdue interest on or overdue repayments of Trust loans.

(b) Trust loans shall be disbursed in a freely usable currency as decided by the Trustee. They shall be repaid, and interest paid, in U.S. dollars or other freely usable currency as decided by the Trustee. The Managing Director is authorized to make arrangements under which, at the request of a member, SDRs may be used for disbursements to the member or for payment of interest or repayments of loans by the member to the Trust.

(c) Paragraph 7(3) of the Regulations for the Administration of the Structural Adjustment Facility shall not apply to Trust loans.

Paragraph 5. Modifications

Any modification of these provisions will affect only loans made after the effective date of the modification, provided that a modification of the interest rate shall apply to interest accruing after the effective date of the modification.

Section III. Borrowing for the Loan Account

Paragraph 1. Resources

The resources held in the Loan Account shall consist of:

(a) the proceeds of loans made to the Trust for that Account; and

(b) payments of principal and interest on Trust loans, subject to the provisions of Section V, paragraph 3.

Paragraph 2. Borrowing authority

The Trustee may borrow resources for the Loan Account on such terms and conditions as may be agreed between the Trustee and the respective lenders subject to the provisions of this Instrument.

Paragraph 3. Commitments

Commitments of loans to the Trust for the Loan Account shall extend through June 30, 1992. The commitment period with respect to a loan to the Trust may be extended by mutual agreement between the Trustee and the lender.

Paragraph 4. Drawings on loan commitments

(a) Drawings on the commitments of individual lenders over time shall be made so as to maintain broad proportionality of these drawings relative to commitments.

(b) Calls on a lender's commitment shall be suspended temporarily if, at any time prior to December 31, 1991, the lender represents to the Trustee that it has a liquidity need for such suspension and the Trustee, having given this representation the overwhelming benefit of any doubt, agrees. The suspension shall not exceed three months, provided that it may be extended for further periods of three months by agreement between the lender and the Trustee. No extension shall be agreed which, in the judgment of the Trustee, would prevent drawing of the full amount of the lender's commitment.

(c) Following any suspension of calls with respect to the commitment of a lender, calls will be made on that commitment thereafter so as to restore proportionality of calls on all lenders as soon as practicable.

Paragraph 5. Payments to lenders

(a) The Trust shall make payments of principal and interest on its borrowing for the Loan Account from the payments into that Account of principal and interest made by borrowers under Trust loans. Payments of the authorized subsidy shall be made from the Subsidy Account in accordance with Section IV of this Instrument, and, as required, payments shall be made from the Reserve Account in accordance with Section V of this Instrument.

(b) The Trust shall pay interest on outstanding borrowing for Trust loans promptly after June 30 and December 31 of each year, unless the particular modalities of a loan to the Trust make it necessary for the Trustee to agree with the lender on interest payments at other times.

Section IV. Subsidy Account

Paragraph 1. Resources

The resources held in the Subsidy Account shall consist of:

(a) the proceeds of donations made to the Trust for that Account;

(b) the proceeds of loans made to the Trust for that Account; and

(c) net earnings from investment of donated or borrowed resources held in that Account.

Paragraph 2. Donations

The Trustee may accept donations of resources for the Subsidy Account on such terms and conditions as may be agreed between the Trustee and the respective donors, subject to the provisions of this Instrument. To the extent possible, annual contributions should be made before May 30 of each year.

Paragraph 3. Borrowing

The Trustee may, in exceptional circumstances, borrow resources for the Subsidy Account from official lenders on such terms and conditions as may be agreed between the Trustee and the lenders; in order

(a) to prefinance an amount that is firmly committed to be donated to the Trust for the Subsidy Account; repayment of principal and any payments of interest on such borrowing shall be contingent upon the receipt by the Subsidy Account of the Trust of the donation that has been prefinanced;

(b) that the Subsidy Account may benefit from net investment earnings on the proceeds of a loan extended at a concessional interest rate; repayment of principal and any payment of interest on such borrowing shall be made exclusively from the proceeds of liquidation of the investment and the earnings thereon.

Paragraph 4. Authorized subsidy

The Trustee shall draw upon the resources available in the Subsidy Account to pay the difference, with respect to each interest period, between the interest due by the borrowers and the interest due on resources borrowed for Trust loans.

Paragraph 5. Calculation of subsidy

(a) The amount of the subsidy shall be determined by the Trustee in the light of (i) the objective of ensuring that the Enhanced Structural Adjustment Facility is a highly concessional facility and, to the extent possible, of reducing the rate of interest charged on Trust loans to 0.5 percent, (ii) the rate of interest on resources available to the Loan Account, and (iii) the availability and prospective availability of resources to the Subsidy Account.

(b) The Trustee shall keep the operation of the Subsidy Account under review. If at any time it determines that resources available or committed are likely to be insufficient to reduce the rate of interest on Trust loans to 0.5 percent throughout the operation of the Trust, the Trustee shall seek such additional resources as may be necessary to achieve this objective.

(c) Should adequate additional resources not be forthcoming to reduce the rate on Trust loans to 0.5 percent, the Trustee shall recalculate the subsidy with a view to reducing that interest rate to the lowest feasible rate that could be applied throughout the remaining life of the Trust. The rate of interest charged on all outstanding loans by the Trust shall be adjusted accordingly in the succeeding interest periods. Borrowers shall be notified promptly of such adjustments. Further recalculations and adjustments shall be made in subsequent interest periods, as necessary in light of developments with respect to the rate of interest on resources available to the Loan Account and to the availability of resources to the Subsidy Account.

(d) If the interest due to lenders for an interest period has exceeded the interest due by borrowers together with the authorized subsidy under paragraph 4 of this Section for that period, and payment to lenders of that difference :1s been made from the Reserve Account in accordance with Section V, paragraph 2, an amount equivalent to that difference shall be added to the interest due by borrowers for the succeeding interest period. Payment of that amount shall be made to the Reserve Account in accordance with Section V, paragraph 3. The additional interest due shall not be taken into account in the calculation of the authorized subsidy for that same interest period.

Paragraph 6. Termination arrangements

Upon completion of the subsidy operation authorized by this Instrument, the Fund shall wind up the affairs of the Subsidy Account. Any resources remaining in the Subsidy Account shall be used first to reduce to the fullest extent possible, in accordance with this Instrument, to 0.5 percent the interest rate paid by borrowers, by means of payments to borrowers. Any resources remaining after that subsidization shall be distributed to donors and lenders that have contributed to the subsidy operation, in proportion to their contributions. For the purposes of this distribution, account will be taken of donations, the net earnings from investment of the proceeds of concessional loans extended to the Subsidy Account under paragraph 3(b) above, and the subsidy element of concessional loans extended to the Trust under Section III; the subsidy element associated with such loans shall be calculated as the difference, if positive, between the SDR rate of interest and the interest on such loans, applied to the amount of the loans during the period they were outstanding.

Section V. Reserve Account

Paragraph 1. Resources

The resources held in the Reserve Account shall consist of:

(a) transfers by the Fund from the Special Disbursement Account in accordance with Decision No. 8760-(87/176), adopted December 18, 1987;

(b) net earnings from investment of resources held in the Reserve Account;

(c) net earnings from investment of any resources held in the Loan Account pending the use of these resources in operations; and

(d) payments of overdue principal or interest or interest thereon under Trust loans, and payments of interest under Trust loans to the extent that payment has been made to a lender from the Reserve Account.

Paragraph 2. Use of resources

The resources held in the Reserve Account shall be used by the Trustee to make payments of principal and interest on its borrowing for Trust loans, to the extent that the amounts available from receipts of repayments and interest from borrowers under Trust loans, together with the authorized subsidy under Section IV, paragraph 4, are insufficient to cover the payments to lenders as they become due and payable.

Paragraph 3. Payments to the Reserve Account

Any payments of overdue principal or interest or interest thereon under Trust loans, and any payment of interest under Trust loans to the extent that payment has been made to a lender from the Reserve Account, shall be made to the Reserve Account.

Paragraph 4. Review of resources

If resources in the Reserve Account are, or are determined by the Trustee likely to become, insufficient to meet the obligations of the Trust that may be discharged from the Reserve Account as they become due and payable, the Trustee shall review the situation in a timely manner.

Paragraph 5. Reduction of resources and liquidation

(a) Whenever the Trustee determines that amounts in the Reserve Account of the Trust exceed the amount that may be needed to cover the total liabilities of the Trust to lenders that are authorized to be discharged by the Reserve Account, the Trustee shall retransfer such excess amounts to the Fund's Special Disbursement Account.

(b) Upon liquidation of the Trust, all amounts in the Reserve Account remaining after discharge of liabilities authorized to be discharged by the Reserve Account shall be transferred to the Special Disbursement Account.

Section VI. Transfer of Claims

Paragraph 1. Transfers by lenders

(a) Any lender shall have the right to transfer at any time all or part of any claim to any member of the Fund, to the central bank or other fiscal agency designated by any member for purposes of Article V, Section 1 ("other fiscal agency"), or to any official entity that has been prescribed as a holder of SDRs pursuant to Article XVII, Section 3 of the Fund's Articles of Agreement.

(b) The transferee shall, as a condition of the transfer, notify the Trustee prior to the transfer that it accepts all the obligations of the transferor relating to the transferred claim with respect to renewal and new drawings, and shall acquire all the rights of the transferor with respect to repayment of and interest on the transferred claim.

Paragraph 2. Transfers among electing lenders

(a) Any lender to the Loan Account ("electing lenders") may inform the Trustee that it stands ready, upon request by the Trustee, to purchase claims on the Trust from any other electing lender, provided that the holdings of claims so acquired shall at no time exceed the amount communicated to the Trustee and subject to the other provisions of this Section. A list of electing lenders and the amounts communicated by them shall be established separately by the Trustee. This list may be extended and the amounts therein increased in accordance with communications received subsequently.

(b) An electing lender shall have the right to transfer temporarily to other electing lenders part or all of any claim arising from its loans to the Trust under Section III, if the electing lender represents to the Trustee that it has a liquidity need to make such transfer and the Trustee, having given this representation the overwhelming benefit of any doubt, agrees.

(c) The Trustee shall allocate each transfer by an electing lender under this provision to all other electing lenders in proportion to the amounts by which the respective maximum holdings listed in the attachment exceed actual holdings of claims acquired under this provision; provided, however, that no allocation shall be made to an electing lender if it represents to the Trustee that it has a liquidity need for exclusion from an allocation and the Trustee agrees, in which case allocations to the remaining electing lenders shall be adjusted accordingly.

(d) The purchaser of any claim transferred under this provision shall assume, as a condition of the transfer, any obligation of the transferor, relating to the transferred claim, with respect to the renewal of drawings on loans to the Trust and to new drawings on loans in the event a renewal, having been requested, is not agreed by the transferor.

(e) Transfers of claims under this provision shall be made in exchange for freely usable currency and shall be reversed in the same media within three months, provided that such transfers may be renewed, by agreement between the transferor and the Trustee, for further periods of three months up to a total of one year. Notwithstanding the above, the transferor shall reverse a transfer under this provision not later than the date on which the transferred claim is due to be repaid by the Trust.

(f) Interest on claims transferred under this Section shall be paid by the Trust to the transferor in accordance with the provisions of the transferor's lending agreement with the Trust. The transferor shall pay interest to the transferee(s) on the amount transferred, so long as the transfer remains outstanding, at a daily rate equal to that set out in Rule T-1 of the Fund's Rules and Regulations; such interest shall be payable three months after the date of a transfer or of its renewal, or on the date the transfer is reversed, whichever is earlier.

Section VII. Administration of the Trust

Paragraph 1. Trustee

(a) The Trust shall be administered by the Fund as Trustee. Decisions and other actions taken by the Fund as Trustee shall be identified as taken in that capacity.

(b) Subject to the provisions of this Instrument, the Fund in administering the Trust shall apply the same rules as apply to the operation of the General Resources Account of the Fund.

(c) The Trustee, acting through its Managing Director, is authorized:

(i) to make all arrangements, including establishment of accounts in the name of the International Monetary Fund, which shall be accounts of the Fund as Trustee, with such depositories of the Fund as the Trustee deems necessary; and

(ii) to take all other administrative measures that the Trustee deems necessary to implement the provisions of this Instrument.

Paragraph 2. Separation of assets and accounts, audit and reports

(a) The resources of the Trust shall be kept separate from the property and assets of all other accounts of the Fund, including other administered accounts, and shall be used only for the purposes of the Trust in accordance with this Instrument.

(b) The property and assets held in the other accounts of the Fund shall not be used to discharge liabilities or to meet losses arising out of the administration of the Trust. The resources of the Trust shall not be used to discharge liabilities or to meet losses arising out of the administration of the other accounts of the Fund.

(c) The Fund shall maintain separate financial records and prepare separate financial statements for the Trust.

(d) The audit committee selected under Section 20 of the Fund's By-Laws shall audit the financial transactions and records of the Trust. The audit shall relate to the financial year of the Fund.

(e) The Fund shall report on the resources and operations of the Trust in the Annual Report of the Executive Board to the Board of Governors and shall include in that Annual Report the report of the audit committee on the Trust.

Paragraph 3. Investment of resources

(a) Any balances held by the Trust and not immediately needed in operations shall be invested.

(b) Investments may be made in any of the following: (i) marketable obligations issued by an international financial organization and denominated in SDRs or in the currency of a member of the Fund; (ii) marketable obligations issued by a member or by a national official financial institution of a member and denominated in SDRs or in the currency of that member; and (iii) deposits with a commercial bank, a national official financial institution of a member, or an international financial institution that are denominated in SDRs or in the currency of a member. Investment which does not involve an exchange of currency shall be made only after consultation with the member whose currency is to be used, or, when an exchange of currencies is involved, with the consent of the issuers of such currencies.

Section VIII. Period of Operation and Liquidation

Paragraph 1. Period of operation

The Trust established by this Instrument shall remain in effect for as long as is necessary, in the judgment of the Fund, to conduct and to wind up the business of the Trust.

Paragraph 2. Liquidation of the Trust

(a) Termination and liquidation of the Subsidy Account shall be made in accordance with the provisions of Section IV, Paragraph 6.

(b) All other resources, if any, shall be used to discharge any liabilities of the Trust, other than those incurred under Section IV, and any remainder shall be transferred to the Special Disbursement Account of the Fund.

Section IX. Amendment of the Instrument

The Fund may amend the provisions of the Instrument, except this Section and Section I, paragraphs 1 and 2; Section III, paragraphs 4 and 5; Section IV, paragraphs 4 and 6; Section V; Section VI; Section VII, paragraph 2(a) and (b); Section VIII, paragraph 2(b).