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M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
F. Cassell	
	Yang J., Temporary
C. H. Dallara	C. S. Warner
J. de Groote	
E. T. El Kogali	L. B. Monyake
E. V. Feldman	R. J. Lombardo
L. Filardo	M. A. Fernández Ordóñez
M. Finaish	M. B. Chatah, Temporary
M. R. Ghasimi	O. Kabbaj
C. Grosche	
J. E. Ismael	
B. Jalan	L. E. N. Fernando
A. Kafka	
	D. McCormack
Mawakani Samba	J. K. Orleans-Lindsay, Temporary
Y. A. Nimatallah	I. A. Al-Assaf
J. Ovi	M. Pétursson, Temporary
H. Ploix	D. Marcel
G. A. Posthumus	G. P. J. Hogeweg
	C.-Y. Lim
K. Yamazaki	S. Yoshikuni
	N. Kyriazidis

C. Brachet, Acting Secretary
C. E. Wahlstrom, Assistant

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Also Present
Asian Department: H. Neiss, Deputy Director; B. B. Aghevli, J. R. Marquez-Ruarte. European Department: M. Russo, Director; M. Guitián, Deputy Director. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; H. B. Junz, Deputy Director; H. Hino, L. Pauly, J. P. Pujol, R. L. Sheehy, B. C. Stuart. External Relations Department: H. O. Hartmann. Legal Department: F. P. Gianviti, General Counsel; P. L. Francotte. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; M. Goldstein, Deputy Director; M. P. Dooley, G. Hacche, Y. Harada, E. Hernández-Catá, F. Larsen. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; P. B. Clark, D. Gupta, I.-S. Kim. Western Hemisphere Department: S. T. Beza, Director; M. Caiola, Deputy Director; M. A. Da Costa, Y. Horiguchi. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, E. Ayales, M. B. Chatah, W. N. Engert, P. Péterfalvy, G. Pineau, M. Pétursson, D. C. Templeman, R. Wenzel, K. Yao, J. E. Zeas. Assistants to Executive Directors: F. E. R. Alfiler, S. Appetiti, R. Comotto, B. R. Fuleihan, J. Gold, L. Hubloue, P. Kapetanović, C. Y. Legg, S. Rouai, J.-P. Schoder.

1. EXCHANGE RATES - RECENT DEVELOPMENTS

The Executive Directors met in informal restricted session to exchange views on recent exchange rate developments. They had before them background material on exchange rate developments (EBD/88/356, 12/12/88) and charts on recent exchange and financial market developments (EBD/88/357, 12/13/88).

2. LENDING IN PARALLEL WITH FUND ARRANGEMENTS - PROPOSAL BY JAPAN

The Executive Directors resumed from a previous meeting (EBM/88/165, 11/9/88) their consideration of the proposal by Japan for lending in parallel with Fund arrangements.

Mr. Kyriazidis said that he would have preferred more notice of the meeting, especially as Directors had asked to be notified at least one week in advance before the matter under discussion was put back on the agenda.

Mr. Yamazaki said that he wanted to express thanks for Executive Directors' goodwill, which had made progress possible on Japan's proposal to lend in parallel with Fund arrangements. He hastened to add, however, that the proposal was just a modest one, and that his authorities had no intention or desire to play it up. With the Board's support, Japan wished to extend additional financing in the form of untied loans in parallel with the extended or other Fund arrangements. They hoped that the loans would help promote growth in the developing countries, as well as help solve the debt problem.

The loans would be extended on a case-by-case basis by the Export-Import Bank of Japan to middle-income countries in support of medium-term structural adjustment, Mr. Yamazaki explained. The parallel lending was to be additional, which meant--above anything else--that it should not bail out commercial banks. No policy conditions other than those of the Fund would be required by the Export-Import Bank of Japan. The loans would be bilateral and untied. The Export-Import Bank of Japan would decide whether or not to offer a loan, and the amounts, terms, and conditions of the parallel loans would be determined by the Export-Import Bank of Japan and the borrowing country on a case-by-case basis. In that connection, his authorities wished that the staff would help them and the Export-Import Bank of Japan by providing information--within the context of existing Fund practices--on prospective borrowing member countries, but only upon the agreement of the countries concerned. He wanted to make it clear that he was by no means requesting preferential arrangements with the Fund compared with other countries or Executive Directors.

He recognized that the proposal in the staff paper might have raised some unintentional questions about the loans' implications for Fund policies and procedures, Mr. Yamazaki commented. The Note on Lending in Parallel with Fund Arrangements attached to EBS/88/221 (10/26/88) had been intended merely to describe some lines of informal communication and procedures between the Japanese authorities and the staff. In order to allay any concerns which might have arisen, he wanted to inform Directors that the Japanese authorities viewed the planned financing by the Export-Import Bank purely as a bilateral financial assistance program, which in no way embodied any preferential arrangements with the Fund. If it would be of any help, he suggested that the Note on Lending in Parallel with Fund Arrangements could simply be set aside. Instead, the understanding, which would achieve the same objective as the conclusion embodied in the Note, should be that consultations with Fund staff and management would take place on an ad hoc, country-by-country basis. That would allow the authorities to obtain the benefit of information, as well as the staff's views on various country programs, which would assist the authorities in the conduct of their new bilateral assistance program in a way that would support the aims of Fund-supported programs. He hoped that that approach would be agreeable to management and the Board.

Finally, Mr. Yamazaki reiterated his thanks to all those who had made the discussion possible. Indeed, the way had been long and painful, and there had been moments in the past month or two when his authorities could have changed their minds. Fortunately, they had not, and he asked Directors for their support.

Mr. Dallara said that his authorities very much welcomed the willingness of the Japanese authorities to provide financing in support of sound adjustment and structural reform programs, and the prospective complementarity of the Japanese Export-Import Bank's financing in parallel with Fund arrangements. The proposed new bilateral lending program by the Export-Import Bank of Japan had the clear potential of making a very useful contribution to the success of the Fund's growth-oriented debt strategy.

He understood the keen interest of the Japanese Government and the Export-Import Bank of Japan in being kept fully informed of the status of Fund-supported programs that were being negotiated, and of their subsequent implementation, Mr. Dallara remarked. His authorities had a similar interest in connection with their bilateral programs, and they regularly discussed such matters informally with the staff on an ad hoc, case-by-case basis. He therefore welcomed Mr. Yamazaki's willingness to simply rely on ad hoc, case-by-case consultations for the purpose of the parallel lending. He encouraged staff and management to be helpful in providing information to the Japanese authorities within that context, as was done for other creditors, in order to make the new financial program a success for Japan, for the debtors involved, and for the broader interests of the Fund.

Mr. Kafka commented that he greatly welcomed Mr. Yamazaki's statement and the intentions manifested by the Japanese authorities. He said that he hoped that the Japanese parallel lending proposal would quickly be put into action.

Mr. Feldman said that his authorities also welcomed the Japanese Government's initiative to extend additional financing to developing countries under the form of lending in parallel with Fund arrangements. The Japanese proposal constituted a significant step toward solving the debt problem. It had the advantage of enhancing the Fund's catalytic role in solving the debt problem, and also in helping the Fund to exert strong leadership in that area.

As Mr. Yamazaki had mentioned, the crucial issue was that parallel lending should provide financing in addition to other sources of financing, and not as a substitute, Mr. Feldman commented. The question was how to ensure such complementarity.

Mr. Nimatallah asked the Chairman whether or not the Board, in addition to welcoming the Japanese initiative, also was agreeing to the request of the Japanese authorities, on a case-by-case basis, to provide them with information on country issues.

The Chairman remarked that the purpose of the informal session, subsequent to the previous discussion on parallel lending, was to seek a full understanding of the Japanese initiative. He believed that it would be desirable in general for management to have more frequent and longer informal meetings with Executive Directors on country matters. If Directors were kept informed about ongoing programs and negotiations, they would have a more complete picture of developments in the countries in question. He said that he would like to have such informal meetings perhaps every other month, instead of every three months, as at present. Moreover, if necessary, the meetings could be slightly longer than had traditionally been the case.

Mr. Nimatallah said that he agreed with the Chairman's suggestion. In addition, he supported the Japanese initiative.

Mr. Kyriazidis made the following statement:

> It is clear that Japan's initiative to grant lending to developing countries in parallel with Fund arrangements represents a major boost to the Fund's catalytic role. This is particularly welcome in the current period when an increasing reluctance toward new net lending to indebted developing countries has emerged among nonofficial creditors. Additional net lending is necessary to help countries overcome their structural debt difficulties by means of extensive economic reforms, and the revival of fixed investment aimed at accelerating economic growth over the medium term. That approach appears to offer indebted developing countries the best way to solve their debt difficulties, but it is not a simple solution. Economic reforms and rising investment manifest their impact--in terms of higher GDP growth and lower and more sustainable external deficits--with significant delays, and consequently, their continued implementation must be based on appropriate support from

external savings. The appropriateness of this support should be judged in terms of both the quantity and cost of the financing, compared to the capacity of a given economy to service external debt.

Japan's initiative seems to be in line with the objective of providing indebted countries with enough time to allow their structural reforms and accelerated fixed capital accumulation to work through the economy. It is within this strictly defined framework that we can endorse Japan's parallel lending scheme. However, if Japan, the Fund, or the borrowing countries were actually to use the scheme for objectives other than those stated, serious reservations would arise on the validity of this scheme from the Fund's point of view. I hope that the Fund, in the design and monitoring of adjustment programs, will make sure that Japan's savings and other external savings are used strictly in support of effective structural reforms and sound fixed investment.

Even within the guidelines I have emphasized, there are a number of aspects and implications that require careful attention on the part of the Fund. These aspects relate to the mix of external adjustment and financing, the additionality of Japan's financing, the adjustment of Japan's external imbalance, the financing of the Fund, and assistance the Fund provides to such an initiative.

On the first aspect, the mix of external adjustment and financing, the inherent risk in this lending scheme is the possibility of a weakening of a country's adjustment momentum. In fact, new financing implies a less stringent constraint on domestic demand expansion, which might lead to a lower degree of discipline in macroeconomic management. In order to counteract these effects, it is essential to put more emphasis in the programs on the composition of domestic demand, the improvement of the supply side of the economy, and the enhancement of domestic savings. On the demand side, capital formation should account for an increasing share of demand compared to consumption, and the country has to put in place the macroeconomic and microeconomic conditions that can lead to that result. In saying this, I do not intend to exclude another possible use of Japan's resources, namely, the accumulation of external reserves by the borrowing country. In such a case, the new resources do not become part of domestic expenditure, but contribute to improve the creditworthiness of the borrowing country and might reduce the cost for the country of borrowing in the markets.

As to the issue of additionality, there is no guarantee that Japan's loans will not replace resources from other private or official creditors. It is the particular responsibility of the Fund to devise and apply methods aimed at ensuring that the new Japanese initiative broadens the net transfer of resources toward a given developing country. To this end, I think that indicators of changes in the net exposure of official creditors--including Japan but excluding the parallel lending--and of nonofficial creditors should be calculated and monitored frequently.

The third aspect concerns the impact that these loans will have on the orientation of Japan's policies with respect to its continued trade and current account surplus. Japan has been recording significant surpluses for many years--a trend which is not in line with the Fund's recommendation to all members to reduce their external deficits. It is still debatable whether the Japanese surplus is so structural that it would not be possible to curtail it to a significant extent over the medium term. Given that a surplus would remain for several more years under the current policies, I, for one, have never endorsed the idea that such a surplus would be acceptable because developing countries could benefit from it. That is a dangerous proposition because by providing some justification for positive imbalances, it can lead over time to even larger imbalances--not only in the external accounts of several countries, but also in the international monetary and financial system. Consequently, I am of the opinion that the recycling of the long-standing surpluses of Japan or of other countries can under no circumstances be used to approve economic policies that actually perpetuate such a surplus position.

The fourth aspect relates to the financing of the Fund. The generosity of Japan and other countries in supporting the programs recommended by the Fund might be interpreted in some quarters as a sign that the Fund can carry out its crucial function in respect of external adjustment without committing a large amount of its own resources. That interpretation has some clear and disquieting implications for the general quota review. In this connection, I wish to stress that a substantial quota increase is dictated by various important considerations that all point to the same conclusion: namely, the size of the Fund is out of line with the needs of the world economy today and in the near future. Therefore, it is essential to reject this interpretation of Japan's initiative, and a clear reference to this aspect is necessary both by Mr. Yamazaki and the Board.

In light of Mr. Yamazaki's and the Chairman's clarfications, I can accept the operational procedures described by the staff. I welcome the ad hoc, case-by-case approach referred to in Mr. Yamazaki's statement, and the Chairman's suggestion to have more frequent meetings among management, staff, and Directors on various country matters.

These are some of the major aspects I wanted to draw the Board's attention to. I wish to repeat that these far-reaching considerations should not at all detract from our clear and strong support of Japan's proposal. However, our endorsement is predicated on very specific conditions in regard to the objectives and implications of the lending arrangement.

Mr. Jalan commented that he welcomed the Japanese proposal. There was no room for any misunderstandings about the intent of the Japanese authorities. It was an extremely constructive and far-reaching proposal--not only for the countries that would benefit from the loans, but also for the stability of the global system as a whole. It was his understanding that the parallel financing would be a bilateral arrangement between the borrowing country and the Japanese authorities, and not an arrangement under which the Fund would approach the Japanese authorities in order to provide financing. Moreover, it was his understanding from Mr. Yamazaki's very helpful remarks, that there was no potential for a trilateral negotiating process in working out any Fund arrangements, and that the Japanese authorities did not intend to participate in the negotiating process.

He was happy to note that the Japanese loans would be in addition to any other resources that the Fund would provide. It was important to ensure that a Fund arrangement did not depend on whether or not Japan would be willing to extend a loan to the country concerned, Mr. Jalan remarked. The staff should provide information to the Japanese authorities within the context of existing Fund practices. However, it would be premature to institutionalize new procedures for providing information to the authorities. Once the staff had gained some more experience with the Japanese loans and the procedures for providing information, other arrangements could perhaps be worked out in order to help the Japanese authorities as much as possible. In that context, it was his understanding that Mr. Yamazaki had suggested setting aside the staff paper on lending in parallel with Fund arrangements (EBS/88/221, 10/26/88).

Finally, Mr. Jalan said that his authorities warmly welcomed the Japanese initiative. He had no doubts about the success of Japan's new financing program.

Mr. Nimatallah stated that he believed that some speakers had put too much emphasis on the concept of additionality of resources; he hoped that additionality would not become a rigid condition of the parallel lending. He wondered how it would be possible to monitor the loans to ensure that they would not bail out commercial banks, and he asked who would do the monitoring: the staff, the Japanese authorities, or the borrowing country?

Mr. Fernández Ordóñez said that Japan's offer to extend additional financing to developing countries in the form of loans in parallel with

Fund arrangements was a concrete action to alleviate the inadequacy of financial flows to middle-income countries. He welcomed Mr. Yamazaki's statement and the Japanese initiative.

While the Japanese authorities would decide, on a case-by-case basis, whether or not to extend a parallel loan, his authorities regarded the Japanese proposal as a vote of confidence in the Fund's ability to judge whether or not to grant a loan, Mr. Fernández Ordóñez remarked. He hoped that the willingness of Japan to provide additional financing to middle-income countries would be interpreted by others as an explicit recognition of the need to supplement Fund resources. The commendable effort of the Japanese authorities would be seriously jeopardized if the availability of additional resources from Japan were matched by a relative reduction in alternative sources. Multilateral institutions, commercial banks, and creditor governments would have to make sustained efforts to provide the much needed financing to middle-income countries undergoing structural adjustment.

Mr. Lim welcomed the Japanese initiative to provide parallel financing, as it was a positive and significant contribution to the resolution of the debt problem. The scheme would undoubtedly enhance the Fund's catalytic role, especially since it was clearly the Japanese authorities' intention that financing under the scheme would be in addition to all other identified sources of external financing for Fund-supported programs. It was noteworthy that financing would not be tied in any way to imports from Japan. In addition, the loans in parallel with Fund arrangements would be, in effect, a vote of confidence in the Fund's ability to facilitate the borrowing countries' formulation of credible macroeconomic frameworks for adjustment. At the same time, the idea of additional financing could boost the borrowing country's confidence in implementing adjustment programs, which the authorities might otherwise be reluctant to pursue in view of the feared immediate adverse impact.

Mr. Yamazaki's statement in regard to providing the Japanese authorities with information on borrowing countries within the context of existing Fund practices, and only upon agreement of the borrowing countries concerned, was very reassuring, Mr. Lim noted. He would also be grateful if the staff could confirm that understanding. The most challenging aspect of the scheme would be how to ensure that commercial banks and other donors would not reduce their contributions to closing the identified financing gap. He encouraged staff and management to give considerable attention to that problem in order to ensure that the concept of additionality of resources and the Fund's enhanced catalytic role would not be significantly diluted.

Mr. McCormack remarked that he welcomed the Japanese parallel lending proposal. He attached particular importance to three features of the proposal: (1) the untied character of the loans, which was very significant; (2) the intention of the Japanese authorities to ensure that the loans would be additional to other sources of financing, as shown by Mr. Yamazaki's clear assurance that it was not his authorities' intention to bail out commercial banks; and, (3) finally and most important, the clear objective of providing additional financing to Fund-supported programs, thereby helping to give those programs a stronger growth orientation. However, it was important to emphasize that the ultimate responsibility for ensuring that the programs of borrowing countries were strong and well financed rested with the Fund, and that that responsibility was not in any way diminished by the Japanese contribution.

There were clearly some details that had to be worked out, and problems that had to be overcome before the proposal was put into practice, Mr. McCormack noted. Reliance would have to be placed on experience and, in that connection, he agreed with Mr. Jalan that it would be unwise and premature to institutionalize new procedures for providing information at the initial stage. The success of the Japanese proposal would depend on pragmatism and goodwill on the part of all participants. He looked forward to the very constructive initiative being put into place at an early date, and wished the proposal great success.

Mr. Ghasimi said that he welcomed Mr. Yamazaki's statement and the Japanese proposal, which seemed to have several positive merits. First, the loans would be extended on a case-by-case basis to a rather distinct group of countries for a specific purpose--import financing--although on a relatively flexible basis. The second and perhaps the main point was that the financing was intended to be additional. He hoped that every possible effort would be devoted to securing the element of additionality from other actual or potential resources as well, including other Japanese creditors. Third, it appeared that the administrative requirements of the facility would be reasonably limited, and the borrowing countries could therefore rely on the timely disbursements of funds.

He hoped that the lender would demonstrate flexibility regarding the currency of denomination of the loans, Mr. Ghasimi commented. It would be very useful to exercise flexibility in that respect and also in respect of arrangements for forward cover, if the borrowing country so requested. In addition, he hoped that there would be enough resilience in the criteria of eligibility, to encourage more countries to use the facility. He appreciated Mr. Yamazaki's statement, and he supported the Japanese initiative.

Mr. Grosche remarked that he very much welcomed the initiative of the Japanese authorities to provide loans from the Export-Import Bank of Japan on a case-by-case basis with the objective of complementing Fund-supported adjustment programs. He could fully endorse the framework as laid out by Mr. Yamazaki.

Mr. Cassell welcomed the Japanese initiative, but said that he still had a number of questions. However, it would be appropriate perhaps, as suggested by Mr. McCormack, to wait for experience to provide the answer. Nevertheless, it was unclear how Directors would be able to apply that pragmatic approach in their deliberations in the Board. He attached great importance to the principle that a country could receive higher levels of financing if it had agreed to higher levels of adjustment. In that connection, he wondered whether Directors would know, when discussing a Fund-supported adjustment program, if Japan would extend a loan in connection with that particular Fund-supported program. That was a vital piece of information; for example, if the Fund had granted SDR 100 million to a member in support of a particular adjustment program, but, in fact, another SDR 100 million had been extended by the Export-Import Bank of Japan, the level of adjustment would no longer match, but would be below, the level of financing.

The objective of additionality was fine in principle, but it would be a very difficult one to achieve in day-to-day operations, Mr. Cassell observed. He believed that the new scheme would enhance the Fund's catalytic role, but the Fund would probably be very lucky if the scheme did not also in fact result in a reduction in the flow of money from commercial banks. However, he recognized that that might be a very pessimistic assumption.

As to the currency denomination, which presumably would be made in yen, Mr. Cassell said that he recalled some rather uncomfortable moments in the World Bank when loans had been extended in a bilateral creditor's own currency. It would be helpful to know what the likely amount of the Japanese loan would be in any specific case, and whether swap arrangements could be made to, in effect, make the loans similar to SDR loans.

Mr. Kafka said that he welcomed Mr. Kyriazidis's support for Mr. Yamazaki's statement and the Japanese authorities. However, he did not understand most of Mr. Kyriazidis's comments; in particular, he did not quite understand how it would be possible for developing countries to import capital in order to aid their development, if, at the same time, other countries, including Japan, were not to be allowed to run a balance of payments surplus, which enabled them to export capital.

Mr. Jalan remarked that he did not regard higher levels of financing as a reward for higher levels of adjustment, as Mr. Cassell had suggested, but as a means of adjustment. There was no direct relationship between the level of adjustment and the level of financing. Therefore, he did not see a conflict between Fund-supported adjustment programs and additional loans from the Japanese authorities, as those loans would help finance higher levels of investment and economic development.

The Chairman commented that he believed that Mr. Cassell's question had been of a procedural nature.

The Director of the Exchange and Trade Relations Department, in response to Mr. Cassell's question, said that he believed that the Board would know at the time of its discussion on a request by a member for use of Fund resources, whether or not a loan would be offered by the Export-Import Bank of Japan. He assumed that, in virtually every case, the staff would be informed about the probability of there being a loan from Japan before it prepared the staff papers, and the levels of financing and adjustment would therefore be inherent in the program presented. The programs would thus be financed in accordance with existing Fund practices, but the financing would, of course, be larger under the proposal. As to the relationship between financing and adjustment, if more financing was available, certain measures--liberalization of imports and the further buildup of reserves, for example--could be financed as part of a comprehensive adjustment program.

Mr. El Kogali commented that he welcomed the Japanese initiative designed to provide additional financing to middle-income countries in the form of loans extended in parallel with an extended arrangement or other Fund arrangements. He viewed the loans as Japan's practical demonstration of its willingness to assist in finding effective solutions to the growth and external debt problems of developing countries.

The intention of the Japanese authorities was clearly that the parallel lending should be in addition to the resources that would normally be available to the recipient country under a Fund arrangement, Mr. El Kogali noted. Additionality would be basic to the success of the initiative. If additional resources did not result from the parallel loans, anticipated higher levels of investment and of potential output and a more rapid implementation of policy reforms would be difficult to achieve, and the objective of the initiative would be largely defeated.

The staff intended to seek maximum support from all creditors and donors, including commercial banks, to ensure that financing was not reduced owing to the availability of parallel loans, Mr. El Kogali noted. In that connection, the Fund should take the lead by ensuring that actual access to its resources was not reduced, in order to encourage all other parties concerned to cooperate. It was necessary for the staff to attempt--despite the apparent practical difficulties--to assess the appropriate level of resources for the programs, and the extent to which aggregate financing was larger than would otherwise have been the case in the absence of parallel lending. In that way, it would be possible to assess the potential financing impact of parallel lending over time.

As to conditionality, he welcomed the Japanese authorities' intention not to request any exceptional policy conditions, although presumably all the policies that the Fund expected a member to follow if it wished to use its general resources would apply, Mr. El Kogali continued. Essentially, that approach appeared to be the basis for the linkage of the parallel lending to Fund arrangements. However, the fundamental objectives of achieving growth and solving the debt problem, which the initiative sought to accomplish, might require both flexibility in the application of Fund conditionality and some modification in the design of the programs to incorporate growth elements. He joined other Directors in welcoming the initiative and hoped that a similar parallel lending program would be established for less developed countries.

Mr. Orleans-Lindsay said that he welcomed Japan's imaginative and constructive proposal for lending in parallel with Fund-supported adjustment programs to assist middle-income countries on a case-by-case basis in order to promote growth and help to solve the debt problem. In light of the Japanese initiative, he encouraged other creditors, especially commercial banks, to maintain their contributions and not reduce them. As for the modalities underlying the parallel lending arrangement, the main elements, as summarized by Mr. Yamazaki, were broadly acceptable. He noted that the only condition for granting parallel loans was for countries to undertake far-reaching, medium-term adjustment programs with financial assistance from the Fund, and to stay the course. That was a broadly acceptable condition, given that the additional resources would contribute substantially to the growth-oriented adjustment efforts of the middle-income countries. He supported the Japanese initiative and looked forward to its implementation in a pragmatic manner.

Mr. de Groote said that he welcomed Mr. Cassell's question on the level of financing in relation to the level of adjustment, as well as the staff's very pertinent answer. It was absolutely essential that the staff, when negotiating with borrowing countries, would know in due time whether or not additional financing would be available, as the scope of the program would depend entirely on the available financing. It was quite obvious that, for example, the degree of import liberalization that could be asked from a borrowing country would greatly depend on the resources that the country had at its disposal to finance the increase in import demand. Therefore, the staff's implicit decision to inform the Japanese authorities in due time about Fund-supported programs, and the authorities' notification to the staff about their intentions, would be important if the staff was to be able to propose a reasonable package of measures to the borrowing country.

Mr. Chatah expressed satisfaction with Mr. Yamazaki's statement on Japan's initiative to increase its financing flows to middle-income countries in parallel with Fund arrangements. Although the magnitude of such financing was not yet clear, he had little doubt that it would make a significant contribution to developing countries' adjustment programs. He also welcomed, in particular, the untied nature of the envisaged lending and the flexible procedures that were intended to facilitate a timely disbursement of the funds. To the extent that the additional, untied lending was intended to promote growth by, among other things, increasing investment and facilitating import liberalization, one could even argue that the Japanese initiative would contribute indirectly to balance of payments adjustment in some major industrial countries.

The authorities' emphasis on the additionality of the envisaged financing was appropriate, Mr. Chatah remarked. It would certainly be unfortunate if Japan's initiative were to be offset by a decline in financing from other sources. The difficult task of devising a mechanism to ensure additionality would be the collective responsibility of all parties involved in solving the debt problem. As to the procedures for providing information to the authorities, he had no particular difficulty with the approach outlined by Mr. Yamazaki, as it clearly conformed with existing Fund practices. Furthermore, he was convinced that Mr. Yamazaki would agree that Japan's initiative to extend lending in parallel with Fund arrangements did not reduce the need for a general quota increase.

Mr. Ismael said that he welcomed and endorsed Japan's initiative to extend bilateral loans in parallel with Fund arrangements, such lending would provide the much needed additional resources to finance strong structural adjustment programs in indebted middle-income countries.

Mr. Posthumus stated that he welcomed Japan's initiative, as well as Mr. Yamazaki's statement, which had clarified the procedures that would be followed. He also welcomed Mr. de Groote's and the staff's comments.

Mr. Pétursson commented that he joined other speakers in welcoming Japan's initiative to extend additional financing to middle-income countries. By tying bilateral loans to Fund arrangements, debtor countries would be given a further incentive to intensify their adjustment efforts. He recognized that it would not be possible to guarantee additionality, but it would be necessary for all parties involved in program negotiations--particularly staff and management--to try to ensure that additionality was actually achieved. As for the provision of information, it was his understanding that the Japanese authorities were not requesting any special treatment beyond what was already well-established Fund practice in relation to other creditor countries. He very much welcomed Japan's continued strong support of the Fund's central role in solving the debt problem.

Mrs. Ploix said that she welcomed the Japanese proposal. She hoped that the financing program would be successful, and benefit the Fund and the world economy as a whole.

Mrs. Yang endorsed and welcomed the initiative of the Japanese authorities, and hoped that the financing program would work well.

Mr. Jalan remarked that he did not agree with Mr. de Groote's statement that any decision on Fund-supported programs would depend on the assurance of parallel financing from Japan. Such a relationship would make it difficult to avoid a trilateral negotiating process, while Mr. Yamazaki had indicated in his statement that the loans from the Export-Import Bank of Japan would be bilateral and untied. In addition, how would the international financial community, including other Japanese banks, react if the Japanese authorities decided not to extend a loan in conjunction with a Fund-supported adjustment program? Would not that raise questions about the strength of the program to be supported by the Fund? It was important that the Japanese authorities had the freedom to decide by themselves whether or not to offer a loan.

The Chairman said that the Fund was used to dealing with the situation described by Mr. Jalan; it arose whenever the financing of a program was discussed. The Japanese initiative to provide additional financing would not create a problem in that respect. On the contrary, the Japanese proposal might change the situation in the right direction, as additional external financing could allow the country to open up its economy more rapidly, and facilitate the buildup of foreign reserves, giving the country an opportunity to carry out structural reforms without running too many risks.

Mr. Jalan said that he was glad to know that the Japanese lending would operate like any other bilateral assistance--World Bank assistance, for example. He had perhaps misunderstood Mr. de Groote's point that approval of Fund-supported adjustment programs would depend on the assistance provided from the Japanese authorities.

Mr. Dallara commented that his authorities had shared some of the concerns voiced by Mr. Cassell and other Directors, such as those regarding the appropriate balance between the levels of adjustment and financing. However, he had not mentioned those concerns in his statement, because Mr. Yamazaki had suggested that the Note on Lending in Parallel with Fund Arrangements should be set aside. Obviously, there were still other concerns that related to any bilateral lending in parallel with Fund arrangements and, in that connection, difficulties and complexities of additionality arose as well. Nevertheless, Mr. Yamazaki had stated clearly that his authorities were seeking no preferential treatment, and wished to be regarded as any other bilateral creditor. In that context, he hoped that the Japanese authorities would have access to the needed information on Fund programs.

He did not disagree with Mr. Jalan's point that only the potential borrowing country should approach the Japanese authorities to seek financing, but he did not believe that it would be inappropriate for the Fund to suggest to the Japanese authorities that they might want to consider supporting a particular program, Mr. Dallara remarked. The Fund and the Japanese authorities should have the flexibility that was inherent in any bilateral lending relationship. The Fund did not hesitate in some cases to suggest to the U.S. authorities that some additional lending might be useful, and he did not wish the Fund to be restrained in any sense from making such suggestions to creditor members.

Mr. Yamazaki thanked Directors for their constructive suggestions and responses to the Japanese lending proposal. However, in response to the comments that had been made about Japan's current account surplus, and even though the issue was not relevant to the discussion on lending in parallel with Fund arrangements, he wished to restate his authorities' position. The Japanese Government had made enormous efforts to stimulate domestic demand and increase imports; in fact, domestic demand had increased by 6 percent in 1987, while external demand had decreased by only 1 percent in that same period.

The Japanese loans would be in addition to any other resources that would otherwise have been provided to the borrowing country, and, therefore, financing from other sources, such as commercial banks, should not be reduced, Mr. Yamazaki commented. He requested that staff and management, together with the Japanese authorities, make every effort to ensure that financing from other creditors would not be reduced. He hoped that the new loans would lead to higher levels of investment, higher levels of output, and a more rapid implementation of policy reforms. Furthermore, it was important that the strive for additionality should not lead to the loosening of conditionality, but instead to the acceleration of growth-oriented adjustment.

The loans would presumably be in yen, but the exact terms and conditions would have to be decided by the Export-Import Bank of Japan, together with the borrowing country, Mr. Yamazaki explained. He greatly appreciated the many interesting comments by Directors, which he would study carefully.

The Director of the Exchange and Trade Relations Department, in response to questions about institutionalizing new procedures, said that the staff regarded the Japanese initiative as a means of providing another important addition to bilateral flows in support of Fund-assisted programs. He confirmed the Japanese decision not to seek any preferential treatment. The staff did not wish to develop a trilateral negotiating process, but it was common Fund practice to contact bilateral creditors to suggest what Fund programs to support. Any member requesting Fund-supported adjustment programs would have to consider three vital points: what would be economically necessary; what could be politically undertaken; and what kind of external financing could be made available. In that connection, the Fund would discuss financing possibilities with commercial banks, the World Bank and other development banks, and, in many instances, bilateral creditors, as had been indicated by Mr. Dallara. Finally, he reminded Mr. Cassell that all bilateral aid agencies denominated their loans in their own currencies.

Mr. Kyriazidis welcomed the Japanese initiative on the basis of the staff's comments, and the fact that Board approval of the proposal was not needed, unless a new institutionalized procedure for offering loans in parallel with Fund arrangements had to be set up.

The Chairman explained that the purpose of the discussion was simply to inform the Board about the Japanese lending proposal, and to see how it would fit with Fund arrangements. Japan was not asking for the approval of the Board, which, however, supported and welcomed Japan's initiative. On behalf of the Board, he took pride in the vote of confidence in the Fund's ability to facilitate the formulation of adjustment programs by borrowing countries. The discussion had also offered Directors an opportunity to recognize the need for more frequent informal meetings on country matters. Finally, he felt sure that all Directors would agree with Mr. Kyriazidis's view that, despite the initiative, continued efforts had to be made by both surplus and deficit countries to reduce international imbalances.

LEO VAN HOUTVEN
Secretary