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3:00 p.m., March 31, 1988

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

Executive Directors	Alternate Executive Directors
A. Abdallah	
F. Cassell	
	Jiang H.
C. H. Dallara	
J. de Groote	J. Prader
A. Donoso	E. V. Feldman
	A. M. Othman
G. Grosche	
J. E. Ismael	J. Reddy
A. Kafka	J. Hospedales
	D. McCormack
Mawakani Samba	C. V. Santos
	I. A. Al-Assaf
G. Ortiz	L. Filardo
J. Ovi	
	D. Marcel
G. A. Posthumus	G. P. J. Hogeweg
C. R. Rye	
G. Salehkhou	O. Kabbaj
A. K. Sengupta	L. E. N. Fernando
K. Yamazaki	
S. Zecchini	

L. Van Houtven, Secretary and Counsellor
M. J. Primorac, Assistant

Also Present

African Department: D. J. Donovan, S. N. Kimaro, M. G. Kuhn. European Department: M. Guitián, Deputy Director. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; E. Brau, P. D. Brenner, G. G. Johnson, H. B. Junz, S. Kanesa-Thasan, G. Oliveros, C. Puckahtikom, J. P. Pujol, K. P. Regling, B. C. Stuart, C. M. Watson. External Relations Department: A. F. Mohammed, Director; P. C. Hole. Fiscal Affairs Department: A. Cheasty. IMF Institute: O. B. Makalou. Legal Department: W. E. Holder, Deputy General Counsel, T. M. C. Asser. Research Department: J. A. Frenkel, Counsellor and Director; A. D. Crockett, Deputy Director; M. Goldstein, Deputy Director; W. M. Corden, D. A. DeRosa, D. Folkerts-Landau, E. Hernández-Catá, N. M. Kaibni, B. E. Rourke. Secretary's Department: C. Brachet, Deputy Secretary, J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: D. Williams, Deputy Treasurer; D. Gupta. Western Hemisphere Department: S. T. Beza, Director; E. V. Clifton. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: P. E. Archibong, K.-H. Kleine, P. Péterfalvy. Assistants to Executive Directors: F. E. R. Alfiler, H. S. Binay, F. El Fiky, S. K. Fayyad, V. J. Fernández, B. Fuleihan, M. Hepp, L. Hubloue, V. K. Malhotra, S. Rebecchini, A. Rieffel, S. Rouai, C. C. A. van den Berg, Wang X

1. FURTHER CONSIDERATION OF THE REVIEW OF THE EXTENDED FUND FACILITY, THE COMPENSATORY FINANCING FACILITY, AND EXTERNAL CONTINGENCY MECHANISMS IN FUND ARRANGEMENTS

The Executive Directors, meeting in informal session, considered staff papers on reconsideration of the extended Fund facility (EBS/88/7, 1/20/88 and Sup. 1, 1/27/88), on the compensatory financing facility (EBS/88/20, 2/3/88), and on external contingency mechanisms in Fund arrangements (EBS/88/30, 2/12/88 and Sup. 1, 1/26/88), together with a series of the Managing Director's concluding remarks and statements at EBM/88/31 (3/4/88), EBM/88/38 (3/11/88), EBM/88/47 (3/24/88), and EBM/88/50 (3/28/88) (see Annex I). They also had before them a copy of the Managing Director's oral presentation at the previous evening's informal meeting (see Annex II).

The Chairman made the following summing up of the Board's discussion on the extended Fund facility at EBM/88/46 and EBM/88/47, 3/24/88.

> There is a very broad consensus on the need, in seeking ways to deal more effectively with the problems facing the heavily indebted middle-income countries, for a strong, growth-oriented adjustment strategy. This has been an underlying theme in our discussion of the extended Fund facility, a facility that will indeed continue to be available to all members, regardless of their debt situation. Directors have restated that dealing with the debt problem will require in some cases implementation over an extended period of far-reaching macroeconomic adjustment policies and structural reforms. In order to help to foster the adoption of programs along these lines by member countries, we have considered some possible modifications to the extended Fund facility, modifications which may help to provide the basis for an increased effectiveness of this facility.
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> Nearly all Directors agreed on the need to reinforce the emphasis on sustained implementation of policies, in particular in the area of structural reform. In this vein, most Directors noted the need for a pragmatic approach to adaptation of programs and supporting arrangements--through, for example, the provision of contingent financing. Six-monthly monitoring patterns in appropriate circumstances would also help to strengthen program design and implementation. We shall return to these issues in more detail on Wednesday, April 6.
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> The emphasis in extended arrangements on structural reform increases the importance of close collaboration between the Fund and the World Bank. Executive Directors continue to support the view that in those instances in which activities of the two institutions overlap, the Fund and the World Bank should work together with the member country to ensure consistency in policy objectives; each institution should take the lead in its

specific area of competence, with special care being taken to make sure that the advice given by the two institutions is complementary and indeed mutually reinforcing.

Many Directors favored increasing current access limits under the extended Fund facility in order to provide support for countries ready to embark on well-designed growth-oriented, medium-term programs but facing substantial external financing needs. In their view, this would provide a clear signal to members, and to other creditors, of the Fund's willingness to play an active role in support of reform efforts. Other Directors were nevertheless concerned by possible misinterpretations of such a move. In the end, it appeared preferable to the Executive Board to make active use, on a case-by-case basis, of the latitude provided within current access limits and, where warranted, of the exceptional circumstances clause. The increase in actual access would certainly be an appropriate demonstration of the readiness of the Fund to match strong adjustment efforts with a strong, catalytic contribution.

Most Directors agreed, though with some nuances, on the need for a change in the mixing ratio of extended Fund facility purchases in favor of ordinary resources, which have on average an interest cost that is currently above one percentage point lower than borrowed resources and a maturity that is two years longer, to help to reduce the average rate of charge and to lengthen the maturity of repurchases. Broad support was expressed for making ordinary resources available first up to 140 percent of quota (excluding the first credit tranche) before purchases are financed with borrowed resources. There was support for raising this limit to 200 percent of quota, but before proposing that we move to 200 percent I would wish to see a broader consensus developed. A few Directors did not think that changes in the mixing ratio were called for at this time, while a few other Directors recalled the G-24 proposal for concessional interest rates in connection with the extended Fund facility, in particular for countries eligible for structural arrangements.

Broad support was expressed for keeping the initial duration of the arrangement period under the extended Fund facility to three years, but allowing for an extension to four years where appropriate. Although a few Directors emphasized its possible implications for the revolving character of Fund resources and for the momentum of the adjustment effort, many Directors felt that such an extension might prove to be a useful mechanism to accommodate unexpected delays that can occur when it is necessary to modify policies during the period of an arrangement. Some Directors were willing to consider extended arrangements with an initial duration of four years, and to increase the grace period for borrowed resources to four and a half years, whenever that would help in the resolution of debt service difficulties, and provided that the member country was in a position to formulate medium-term programs of that length. For this last purpose, as well as for the increase in the limit on the use of ordinary resources to 200 percent of quota, there seems to be enough support to merit some further reflection. Without prejudging its final decision, the Executive Board could return to these two suggestions again if the circumstances justify it.

To conclude, the Board has agreed that the extended Fund facility has an important role to play in the Fund's approach to the problem of growth-oriented adjustment. Strong programs of macroeconomic adjustment and structural reforms should be fostered through the availability of appropriate financing. In such cases, Directors have, therefore, agreed that actual access under the extended Fund facility could be increased within existing limits. Moreover, they also agreed that the terms attached to the use of these resources be improved by reducing their cost and lengthening the average maturity. Directors also endorsed extending, where appropriate, the duration of an arrangement under the extended Fund facility. These modifications to the facility should enhance its effectiveness in providing a consistent medium-term framework within which sustained policy implementation could take place and additional medium-term financing be catalyzed, with the Fund making available an appropriate level of resources.

Mr. Dallara asked whether the proposed change to the mixing ratio would ensure the use of ordinary resources exclusively up to 140 percent of quota, beyond which exclusively borrowed resources would be used.

Mr. Zecchini said that he understood the proposal in the sense that while ordinary resources would be used up to 140 percent, above 140 percent there would be a mix of ordinary and borrowed resources, not the exclusive use of borrowed resources.

The staff representative from the Treasurer's Department said that under the existing decisions, a mix of ordinary and borrowed resources was employed up to the point at which the use of resources under the extended Fund facility was 140 percent of quota (excluding the first credit tranche). Once that point had been reached, exclusively borrowed resources were used. To give a specific example, if a country had made no prior use of Fund resources, and an extended arrangement was established for 420 percent of quota, 140 percent of quota would be financed from ordinary resources and 280 percent from borrowed resources, with each individual purchase being financed in the same ratio of one to two. Under the proposal currently before the Board, the intention was that the first 140 percent of quota would be financed entirely with ordinary resources; all further purchases would be financed entirely with borrowed resources.

The difference between the present system and the one under discussion was that, under the latter, if the country drew the entire amount available under the extended Fund facility, the ratio of ordinary to borrowed resources would not change, but the ordinary resources would become available earlier, and at the first stages of the program.

Mr. Zecchini observed that the extent of the proposal was much more modest than he had originally thought, because he had believed that up to 140 percent of quota, ordinary resources would be employed, and that between 140 percent and 200 percent of quota, a mix of ordinary and borrowed resources would be used. Under the current proposal, the substance of extended arrangements and of financing for them would not be changed; there would be merely an adjustment of the time profile of the financing. It was important to understand that the proposal therefore offered fairly small advantages to the debtor, unless the level of resources used did not reach the maximum possible. That point was crucial for understanding the modesty of the proposal under discussion.

Mr. Yamazaki recalled that his chair had changed its position somewhat in the course of the discussions in order to achieve the necessary consensus before bringing the issue to the Interim Committee. Since it had not been possible to do so on the basis of the various previous remarks and statements by the Chairman, the thrust of which he had nevertheless been able to endorse, he would support the more modest proposals outlined in the summing up, concerning increased access within the existing access limits, the time period of extended arrangements, and the choice of 140 percent or 200 percent of quota.

The Chairman, turning to the question of the compensatory financing facility and the external contingency mechanism, made the following statement on the application of guidelines on cooperation:

<u>First Tranche</u>

I would like to elaborate on my discussion of point four of my presentation concerning the guidelines on the test of cooperation as they relate to the first tranche (see Annex II). As I said, there would be no need for a change in the guidelines.

1. If a balance of payments imbalance goes beyond the export shortfall but a country has a good record of cooperation and its policy actions and intentions are judged adequate, a first tranche drawing would of course be permitted without a Fund arrangement.

2. More difficult cases arise when balance of payments imbalances are large and a country's policies are judged deficient or the record of cooperation has been weak. Consistent with the guidelines, we would continue to require actions

that would provide "reasonable assurance" that the imbalances would be addressed. A Fund-supported program would not be required for drawing so in the first tranche.

3. In some difficult cases, however, a Fund arrangement may be requested or required to provide the "reasonable assurance." For example, such cases occur when a country can only implement and monitor policy actions over time or where a Fund-supported program may be necessary to catalyze external financing. In my oral comments last evening, I outlined how we might respond in such cases in a timely way that would recognize different country circumstances.

4. Where the need for a Fund-supported program is evident, and the country has a good past record, low Fund exposure, and negotiation has begun in good spirit toward a Fund-supported economic program and adequate progress has been made toward external financing arrangements, management could decide to support a request for an immediate drawing under the first tranche.

5. Where the need for a Fund-supported program is evident and balance of payments difficulties and economic imbalances are more severe, the past record of cooperation is weak, and policies are deficient, a drawing under the first tranche would be permitted only at the time of Board approval of a program.

Second Tranche

No change in guidelines or practices.

Mr. Sengupta asked what the difference would then be between conditions attached to the first tranche and those attached to the second tranche.

The Chairman said that for the second tranche there would be no change in guidelines or practices. In response to a question by Mr. Goos, he noted that the most difficult case would require approval by the Board of a program, but not necessarily the coming into effect of that program. In some situations, an approval in principle might also be sufficient.

He proposed that Directors express their views on the first approach as set out in his statement at EBM/88/50, the Chairman went on, whereby the compensatory and contingency elements would be distinct, with approximately equal access; the compensatory element would be made available in two tranches.

Mr. Cassell said that he would be reluctant to go above total access of 100 percent of quota, and would want the contingency element to be dominant over the compensatory element. Accordingly, he could accept a solution along the lines of 45/55, or perhaps 55/50.

Mr. Yamazaki said that he would like to have the contingency element as large as possible.

Mr. Sengupta said that, within the first approach, he would expect the compensatory element to stay constant, at 83 percent of quota, while on the contingency element he was flexible; 40 or 50 percent seemed reasonable. The essential point was that the compensatory financing facility be fully protected. The farthest he could go would be to accept a reduction of the compensatory element to 80 percent, leaving 40 percent for the contingency element, for a total of 120 percent.

Mr. Posthumus said that within the solution he would put forward, he considered the total access too high, the compensatory access too low, and the contingency access too high. However, he would present a solution of 150/50, for a total access of 200.

Mr. Rye said that his chair had a distinct preference for the first approach on the grounds of simplicity and ease of understanding, and would be prepared to go somewhat further in terms of the total access, perhaps to 110 percent of quota, split evenly.

Mr. Zecchini said that his preference would be for an evenly split facility, which, depending on the total access, could be 50/50, 55/55, or even 60/60.

Mr. Massé indicated that his chair preferred the first approach, with a total access of about 100 percent, split evenly.

Mr. Al-Assaf said that he could support total access of 110 percent, tranched 60/50.

Mr. Marcel indicated that 110 percent was the minimum total access that his chair could accept, and the compensatory element should be preponderant--perhaps at 70/40.

Mr. Goos stated that he supported 100 percent overall access, with the two elements evenly split.

Mr. Ovi said that his preference was for the first approach as a starting point, with 100 percent total access evenly distributed. He could perhaps go up to 110 percent total access, but in no case should the compensatory element be below 50 percent.

Mr. Kafka remarked that he found it difficult to declare himself for one particular solution without knowing in advance what other conditions would be attached to the complete package.

Mr. Feldman said that while he preferred the second approach, within the first approach he would favor tranching of 70/50, for a total access of 120.

Mr. Abdallah indicated that he agreed with Mr. Feldman's position.

Mr. Dallara said that he understood the point of other Directors that they would only accept the first approach if they were paid a price, so to speak, for doing so. He himself considered that a price would have to be paid for him to move to the second approach, since he preferred the first; his authorities continued to have a strong preference for a preponderance of contingency financing. On the question of total access, he did not think that he could go beyond 100 percent. Clearly, one could not simply define contingency access in terms of quota limits, and if the proponents of compensatory preponderance were prepared to associate compensatory financing with program size, then his authorities might be prepared to accept more of a balance between the two elements. If quota access for contingency financing remained slightly higher, average use would likely be lower than the average use of compensatory financing, given the attendant conditions. He was currently willing to accept something along the lines of 45/55 tranching, but sincerely wished that the concept of average access could be introduced in order to more fairly assess actual usage.

Mr. Zecchini remarked that he had never accepted the concept of linking actual access to the contingency mechanism to the level of access under the associated arrangement. In addition, some members of the Board had mentioned the concept of symmetry when discussing use of the contingency facility; that, too, would affect total access to that element. His chair's first preference was a total access of 100 percent of quota, split evenly; he had certain flexibility in going up to 110 percent or even 120 percent, also on a split basis.

The Chairman observed that there had been very broad consensus in the Board on the question of symmetry. On the question of linking contingency access to total access under the associated arrangement, Mr. Zecchini's strong view was supported by Mr. de Groote. While he could understand their position, there was a good case for somewhat limiting such access, since if the demand for contingent financing came close to the full amount available under the associated arrangement, there would then be a case for re-examining the original program. The views of Mr. Zecchini and Mr. de Groote had convinced him to accept a 60 percent link as opposed to 50 percent, but he would like to hear the views of Directors on that suggestion.

Mr. de Groote said that, coming from a preferred total access of 125 percent, he could reluctantly move to 110 percent, divided 50/60. However, in line with Mr. Zecchini's point, he had not accepted the notion that access to the contingency element should be limited to a fraction of the access under the associated arrangement, and there had not yet been any agreement in the Board as to what fraction would be acceptable.

The purpose of a contingency facility was to assist countries in the implementation of a Fund-supported program, Mr. de Groote continued. If they were not granted enough access through that facility, there was no point in establishing it in the first place. Accordingly, if it were agreed that contingency access should be set at a relatively low percentage of access under the associated arrangement, then he would prefer a larger percentage for the compensatory element.

The Chairman suggested that, in the Board's presentation to the Interim Committee, it could be indicated that several elements of the agreement were for an experimental period and should be reviewed and opened to discussion after a period to be agreed.

Mr. Zecchini asked whether the qualification of an experimental period would have implications for the level of majority required for subsequent changes.

The Economic Counsellor and Director of the Research Department said that it was not possible to respond to that question without knowing precisely what the proposals would be.

Mr. Dallara said that he did not question the propriety of linking contingency access to access under the associated arrangement, but felt that it should be taken account of either by skewing the total access limit toward the contingency element or by associating compensatory financing access with the size of stand-by arrangements. One of the concerns that both his and others' chairs had had from the very beginning on the compensatory financing facility review was that access to compensatory financing, in some cases, had been large in relation to total access in support of programs and might well have been a deterrent to persistent adjustment efforts. The Fund should not let its special facilities distort its basic program access policies.

Mr. Yamazaki said that he shared some of the concerns raised by other Directors about the first approach. For the sake of compromise, his chair could accept a joint total access of 100 percent of quota, split 45/55 or 40/50, since he was in favor of giving the contingency element as large a proportion as possible. While he had some difficulty with the proposal to link access under the contingency element with that of the original Fund arrangement, he could go along with the majority view.

Mr. Chatah remarked that the principle of symmetry in compensatory financing would, over time, lead to lower actual access than implied in the access limit. It seemed, therefore, that if a certain amount of contingency financing was desired, the required attendant reduction in compensatory financing would be less than that absolute amount. For that reason, his chair would be more inclined to agree with Mr. Feldman and Mr. Marcel on the access limits for each component, with total access of 110-120 percent and tranching of 70/40-50.

He appreciated the Chairman's clarification of conditionality of the first tranche and would welcome a similar explanation of what the practice would be for the second tranche, Mr. Chatah said.

Mr. Reddy said that, not knowing all the accompanying conditions, his chair would prefer total access of 120 percent, split 80/40.

Mr. Mawakani remarked that, while the first approach was not his preference, he would take a stand at total access of 120 percent, split 80/40.

Mr. Salehkhou stated that his position was to keep the compensatory financing facility intact and establish the external contingency mechanism as a separate facility.

Mr. Ortiz indicated that he held a similar position to that of Mr. Chatah. Mr. Dallara had indicated that a linkage between contingent access and associated arrangement access would lower the average access of that element. However, symmetry in compensatory financing would certainly compensate for the lower contingency access. He, himself, did not feel that there should be any linkage. Having said that, his position on the first approach would be total access of 120 percent, with tranching of 65/55.

Mr. Kafka commented that he could support total access of 120 percent, tranched 70/50.

Mr. Jiang said that he preferred total access of 120 percent, divided 80/40, but was prepared to compromise on total access of 110 percent, tranched 70/40.

The Chairman observed that it would be difficult to reach a decision in the Board on total access. While the gap between positions was not very great--between 100 percent and 120 percent--which showed a good deal of compromise from all Directors, it was a gap that apparently could not be bridged. Accordingly, that point would have to be presented to the Interim Committee in brackets. Even if there were agreement on, say, 110 percent, agreement did not seem feasible on the basis of the first approach as set out in his statement in Annex I, since positions were divergent on the question of which facility would be dominant. Accordingly, he suggested that Directors consider the approach in the postscript to his statement whereby basic access to each element would be approximately equal, with an additional fungible tranche whose use could be decided on by the member itself.

In response to a question from Mr. Kafka, the Chairman said that the report to Ministers would clearly indicate that several Directors' positions were dependent on other conditions as well.

Mr. Goos suggested that, since some Directors had set forward positions not knowing what other conditions would be included, the gap on total access might narrow if progress were made on the question of the first compensatory tranche's conditionality. Therefore, it seemed premature to discard the first approach altogether.

The Chairman indicated that he had not discarded the first approach, but was simply trying to come to a synthesis of views. While the magnitude of the first tranche could be discussed, its conditionality was already well known. Unless a majority of Directors was prepared to renounce the guidelines for a very low first tranche, the conditionality would remain the same; he would not suggest such a solution.

On the question of linking contingency access to the access under the associated arrangement, he would suggest a limit of 60 percent, the Chairman said.

Mr. Sengupta said that if the linkage were to be discussed, the question of automaticity would have to be considered simultaneously. He did not see the logic of limiting contingency access to a percentage of the access under the associated arrangement.

The Director of the Exchange and Trade Relations Department explained that access under the associated arrangement would normally be established initially at a level of financing that met the member country's needs as perceived at that time. Therefore, should a contingency arise during the course of the period in question that would justify use of the contingency mechanism in excess of, say, 60 percent of the amount originally agreed, then it was likely that the circumstances of that member had changed enough to raise serious doubts as to the program's viability. In addition, the staff had always seen the external contingency mechanism as part of an effort in which other creditors would also join. Therefore, the staff did not see the justification that some Directors did in the argument that the amount available under the contingency mechanism should necessarily be a large percentage of quota, or large relative to the associated arrangement.

Mr. Sengupta said that the question of whether a program was appropriate in changed circumstances was not necessarily linked to the desired contingency financing exceeding 50 or 60 percent of basic access; such a judgment could occur even at a level of 10 percent of financing. In any case, he supported Mr. Zecchini and Mr. de Groote, and did not accept the limitation of 60 percent.

Mr. Posthumus said that he supported a linkage between contingency access and basic access.

Mr. Cassell, Mr. Massé, Mr. Rye, Mr. Al-Assaf, Mr. Goos, and Mr. Marcel stated that they agreed with Mr. Posthumus.

Mr. Abdallah, Mr. Kafka, Mr. Mawakani, Mr. Yamazaki, Mr. Feldman, Mr. Jiang, and Mr. Reddy indicated that they did not support a link between contingency access and access under the associated arrangement.

Mr. Chatah said that while he did not support a link between the two levels of access, there should be a threshold after which a review of the program would take place.

Mr. Sengupta observed that the threshold at which a review would be required did not necessarily have to be the access limit.

Mr. Dallara said that, essentially, he supported a link between the two forms of access. Perhaps, a compromise would be to accept the staff's suggestion to link contingency access to access under the associated arrangement, but qualify that condition with "generally" in order to give it some degree of flexibility.

Mr. Rye said that he could accept such a condition, although the existing words "and would be expected to be no more than" 50 or 60 percent of the access under the associated arrangement already seemed to indicate some degree of flexibility.

The Director of the Exchange and Trade Relations Department remarked that it would not be a great problem to introduce flexibility to the linkage, for example, by adding the word "generally." He did take refuge in the remarks made by several Executive Directors on that point that their views depended much on other conditions. For example, if one moved away from automaticity in access--which had been an assumption underlying the staff paper--and moved to activation through reviews, that could result in a high degree of contingency financing. If the facility were established with some degree of automaticity as previously assumed by the staff, then he felt that the access should be set at about 60 percent of the principal access.

Mr. Zecchini, in response to a question by the Chairman on whether such flexibility would be sufficient in his view, said that he could not give a final word on that question until other aspects of the package were clear.

The Chairman noted that there was a clear preference in the Board for flexibility and a good deal of judgment on the size of contingency access.

Mr. Kafka indicated that there were some cases in which, as had been seen in the Mexican example, contingencies could be defined so precisely that it should be possible to make contingency access automatic, while in other cases a review would be necessary.

The Chairman agreed that there was a variety of cases and that, accordingly, it might not be advisable to have a single approach to the question of automaticity.

The Director of the Exchange and Trade Relations Department said that while there were, indeed, cases in which it would be possible to quantify the member country's contingencies with sufficient precision to introduce automaticity, that was certainly not always the case. In many countries that had complex statistics involving lags, such an automatic approach would cause difficulties. Any automaticity, as had been the case in the Mexican example, should be associated with supportive action from other creditors, which was not always easy to arrange. One could envisage circumstances in which the Board might decide to proceed with contingency financing while parallel financing negotiations were still continuing. In sum, while there would be cases in which automaticity would be feasible, he suspected that they would be the minority.

Mr. Kafka suggested that the staff attempt to reformulate paragraph 5 of the Managing Director's oral presentation, in which the question of automaticity versus reviews in external contingency mechanisms was set out (see Annex II).

The Chairman pointed out that two concepts were essential to that paragraph: the positive presumption of financing, and agreement on initiating an ad hoc review in order to avoid undesired delays in financing.

Mr. Kafka asked that the concept of automatic access to the external contingency mechanism when contingencies could be predetermined be added to paragraph 5.

The Chairman indicated that he had already accepted such a suggestion.

Mr. Goos said that he would have great difficulties with such an addition, since he had argued repeatedly against the provision of any degree of automaticity. Moreover, in the formula as presented in paragraph 5, the cases Mr. Kafka had in mind would be accommodated, because if a case was as clear cut as the Mexican one had been, there would be no difficulty in completing the review in a very short time. He would even have problems with the formulation on automaticity as it currently stood in paragraph 5. For example, several speakers in previous discussions had referred explicitly to the fact that activation of financing should be subject to a Board decision. Such a decision could be taken on a lapse of time basis, and on a very short circulation period, if management decided that no problematic aspects were involved. In addition, he would like to see mentioned in paragraph 5 the presumption of adjustment, together with the presumption of financing.

The Chairman noted that it was generally accepted that contingency financing would involve an appropriate blend of adjustment and financing.

Mr. Ortiz remarked that if it could be established at the outset of the program under which conditions contingency financing would be activated, then reviews were clearly redundant. That had been the case in Mexico, when compensation for the export shortfall declined over time, so that a mixture of adjustment and financing was incorporated into the agreement. Also, additional measures were implicitly required; they were to be included if the contingency was severe enough to require greater use of contingency financing. While his chair was interested in as much automaticity as possible, he recognized that it was not always possible to specify the type of contingencies that would lend themselves to such automaticity, and he would certainly go along with having reviews in those cases. However, in order to have access to contingency financing, a member had to be in compliance with the performance criteria of its program, which already included general reviews. Therefore, ad hoc reviews for establishing the validity of contingency financing seemed unnecessarily burdensome.

The Chairman indicated that he would prefer Directors not to discuss specific details at the current meeting. Issues such as the types of cases that would involve automaticity could be discussed after the Interim Committee meeting. In general, the Board would be working on the basis of a positive presumption of financing and reviews. However, the possibility of cases like that of Mexico in which automaticity could exist would not be ruled out. In addition, there could be cases, as suggested by Mr. Goos, in which the review would be dealt with in an expeditious fashion with a very short circulation period of a staff paper. All those issues would be finalized at a later stage.

Mr. Goos remarked that the text should then make it clear to the Interim Committee that that was the intention of the Board, since he himself had strong reservations on the issue of automaticity. If a country was in a position to receive financing automatically, the review could just imply a brief checking of whether the program assumptions were in place. However, each country applying for contingency financing should have its program examined to some degree to establish whether the assumptions made at the beginning of the program were still valid. That would imply the checking of the current account, together with the overall balance of payments situation, which could be done in a very short time period.

Mr. Ortiz said that he viewed such a process as a certification that the conditions were in place, but not as a review.

Mr. Dallara said that while he did not deny the possibility that a case like that of Mexico might once again emerge, the Board should not assume that. because that was the only actual example of contingency financing, it was the best example to follow. An important constraint in that case had been that the Mexican authorities had agreed to relate their contingency financing to one variable--the price of oil. If other countries were prepared to similarly constrain potential access to contingency financing, then perhaps the Mexican approach had more applicability. However, his authorities' notion had been that countries would have potential access to contingency financing for a range of variables. It was not clear that it would be in the interest of member countries to preselect the variables. His sense had been that a member would generally activate contingency financing in conjunction with a first program review. However, one would not rule out the possibility of earlier ad hoc reviews, if the size and timing of the contingency suggested a need for a more prompt response by the Fund.

The Chairman observed that in most cases several variables would be involved, some of them working in opposite directions, so that judgment, and accordingly review, would be of the essence. There could be cases, especially for commodity-producing countries, in which solutions "à la Mexico" could prevail, but in general, a certain element of judgment and review would remain.

Mr. Kafka pointed out that it might be possible to find "proxies" that were single valued, which could be used in cases in which one could not agree on a single commodity price.

If the Board was too vigilant in not allowing a contingency drawing without a review, then any advantage of the contingency facility would be lost, Mr. Kafka added. There was no use in having a contingency facility that required six months to be activated through a review; a review in the Fund was never a simple process.

The Economic Counsellor and Director of the Research Department said that, while it was possible to choose a single proxy value, the disadvantage would be that individual components of the country's situation would be filtered out in an attempt to simplify the analysis.

Mr. Sengupta pointed out that the importance of reviews depended on their implications. For example, the Fund could require a review in order to determine what policies or what corrective action should be taken, and that would not affect the country's access to contingency financing. However, if the Board decided that the amount of financing released would depend on the results of the review, then the contingency mechanism did not give the country concerned any confidence in going about its business.

Mr. Goos inquired as to why it should harm the country if the review discovered that there was a lesser need for financing than originally contemplated under the contingency facility. There was a presumption of a certain amount of financing, and if it turned out that the country was not in need of that amount, then it was simply not distributed. If there was a reduced need, why should that influence policy implementation?

Mr. Sengupta said that a better solution would be to make provision, if there were an overborrowing, for some method of recovering that excess financing at a later stage. However, it was not reasonable to prevent the country from receiving the pre-specified amount. If a country was affected by an external contingency, it did not have time to review, discuss, and negotiate before receiving the required financing.

Mr. Kafka commented that there already existed a well-established method for compensation in cases of overborrowing--namely, early repurchase.

Mr. Goos observed that facilities already existed in the Fund that operated the way he expected the contingency facility to work. For example, when a country failed to meet performance criteria, a program was considered off track, and the Fund stopped disbursing. On the basis of Mr. Sengupta's arguments, the Fund would have to continue disbursing in such situations because the country had been promised that it would receive a certain amount of financing on the basis of certain policies and to stop disbursing would unfairly complicate the life of the country. He did not accept that argument.

Mr. Sengupta pointed out that the difference between Mr. Goos's example and his own was that external contingencies were beyond the control of a country. If the Fund wanted to persuade the country to adopt certain types of policies, it had to offer the member an assurance that if uncertainties arose sufficient financing would be available for the country to continue with its policies. By making contingency financing dependent upon a review, as well as on parallel financing by the banks, the Fund was eliminating any confidence that might have been instilled in the authorities.

The Director of the Exchange and Trade Relations Department said that the objective would be to link Fund contingency financing to parallel financing by the banks so as to expect automatic disbursements by other creditors when the Fund disbursed. Certainly, it would not be desirable to trigger a whole series of other negotiations with the banks.

The activation of a contingency would require a minimum threshold as he understood it, the Director of the Exchange and Trade Relations Department said. Therefore, any deviation up to the threshold would quite likely require some adjustment of performance criteria, thus incorporating some adjustment. However, he considered that basic purpose of contingency financing was to assist the country in keeping its economic program on track, and not to assure the country of a given amount of financing irrespective of changes in external circumstances.

The Economic Counsellor said that, as he saw it, the purpose of a review was to determine two things: first, had the contingency actually occurred; and second, to the extent that it was indeed an external shock that had taken place, how should the performance criteria be modified? In view of the external shock, adjustment would be required, but the contingency financing provided the breathing space necessary for the country to continue with its program.

Mr. Sengupta remarked that the purpose of contingency financing was to assure a member country that the Fund would protect it as long as it followed a predetermined policy; if that policy was affected by certain exogenous factors, the Fund would stand by the member country. An example of that support would be an assurance that if a country liberalized imports, and the price of imports later increased, the Fund would finance the contingency beyond a certain threshold. While he could accept that there be a review to look into the question of whether action should be taken, that review should not be linked to the basic assurance of financing.

Mr. Ortiz commented that one of the objectives of a program was to provide assurances on the appropriate mix of adjustment and financing for a country in the case of an exogenous shock. That element was important in fixing the program's credibility. If there was any uncertainty regarding the level of future financing in the event of a shock, then the whole purpose of contingencies would be thwarted. For example, in the Mexican case, the basic role of the contingency element had been to provide assurances of financing of shocks up to a certain magnitude. Those assurances permitted the authorities to have some positive expectations regarding the sustainability of their adjustment.

The Chairman noted that while there would be cases in which access could be granted automatically, in general, it would be impossible to put together a contingency facility if a provision were not made for judgment at the time that the contingency materialized. The details of how that judgment would be implemented would be discussed at a later time, but the essential principle should be that, as he had set out in paragraph 5 of his statement, a review would take place, which could be expedited.

Mr. Sengupta suggested that contingency financing be made available as soon as the contingency materialized, with a subsequent review having a provision for repurchase in the case of overcompensation.

Mr. Kafka supported Mr. Sengupta's suggestion, because excessive caution in disbursing funds would come close to denying the logic of even a stand-by arrangement; if the Board wanted to be absolutely sure that there was never an excessive drawing, it would have to require a review before every drawing under the stand-by arrangement, as well as under the contingency mechanism.

Mr. Dallara suggested that Directors return to specific issues after the Interim Committee meeting in order to progress on other issues that were outstanding. For example, the issue of symmetry had not been decided upon. Perhaps the Board discussion on conditionality, which was scheduled for the following day, could be delayed until the following week in order to allow continued discussion on the external contingency mechanism.

Mr. Sengupta and Mr. Ortiz indicated their agreement with Mr. Dallara's suggestion.

The Chairman, after receiving indications from the Secretary and from the Deputy Managing Director that such a postponement would be feasible, suggested that the remainder of the current meeting and the subsequent meeting could be used to decide on the issues of automaticity and the link between contingency access and access to the associated arrangement.

Mr. de Groote said that, in the discussion on the linkage of contingency financing to access under the associated facility, the dimension of the country's financial needs had been overlooked. In the case of a country that had a stand-by arrangement which covered a large percentage of its financial needs, it would be unnecessary to grant that country the full contingency access all at once. On the other hand, a country could have financial needs that were not at all covered by the associated arrangement, in which case greater use of contingency financing might be needed. A possible solution would be that, if there were a consensus for establishing a link between contingency financing and access under the associated arrangement, that link would be implemented on a judgmental basis, taking into account the financing needs of the country. While he certainly wanted to ensure that a country with great financial needs was able to continue to implement its program, he did not wish to give a country whose needs were covered by a stand-by arrangement additional financing.

The Director of the Exchange and Trade Relations Department indicated that, while such a solution could be explored, the question of the adjustment/financing mix would require decisions as to whether adjustment could be made immediately and whether or how much additional financing was still required.

Mr. de Groote said that the general philosophy of the external contingency mechanism would be that a country would have access to financing only if it also adopted the appropriate additional policy measures. However, he was not discussing the general philosophy of the facility but simply exploring whether, if a link were made, it could be done in a way that took into account the financial needs of the country. That would not affect the general approach previously agreed to on adjustment.

Mr. Dallara said that, while he appreciated Mr. de Groote's point, there seemed to be a risk that taking into account financing needs without other considerations would not be fair to all members. Certainly, it could be noted that, in reaching a judgment on a case-by-case basis, one should take into account the member's particular circumstances, including the appropriate adjustment/financing mix, the financing needs, and its ability to repay obligations to the Fund.

The Chairman asked Executive Directors to indicate whether they preferred the first approach or the postscript solution, as set out in Annex I; how they would tranche access; and, if they selected the postscript solution, whether they would choose presentation a or b, as set out in Annex II.

Mr. Al-Assaf said that his tranching preference for the postscript solution would be 40 percent for the compensatory financing element, 30 percent for the fungible tranche, and 40 percent for the external contingency element, for a total of 110 percent.

Mr. Sengupta said that subject to a satisfactory solution on first tranche conditionality, he would support Mr. Al-Assaf's position.

Mr. Zecchini said that his authorities could go along with the 40/30/40 solution, depending on the interpretation of first tranche conditionality. In addition, they were not in favor of multiple phasing.

Mr. Massé said that his authorities would probably support a solution along the lines of 40/25/40. If the consensus were for a higher total access, they would still prefer that pattern, which would probably result in a solution of 40/30/40.

Mr. Posthumus said that he would support a solution of 50/33/0, which meant that up to 83 percent could be used for the compensatory financing element or, alternatively, 50 percent for compensatory financing and 33 percent for contingency financing.

Mr. Ortiz said that he could go along with Mr. Al-Assaf, Mr. Zecchini, and Mr. Sengupta on the 40/30/40 solution.

Mr. Marcel said that he would support total access of at least 110 percent, tranched 50/20/40.

Mr. Mawakani said that, while his authorities welcomed the proposal to create an external contingency mechanism, their preference was to have that mechanism separate from the compensatory financing facility. There appeared to be a consensus in the Board for an integration of the facilities, but because he represented countries that exported raw materials, he had difficulty in supporting a substantial reduction in compensatory financing access. Accordingly, for the postscript approach, his solution would be total access of 120 percent, divided 60/20/40. If it were necessary in order to achieve a consensus, he could, as a compromise, go along with the alternative presented by his colleagues--40/30/40. The compensatory financing facility was one which authorities could be certain about, since it had been in effect for 25 years, while the external contingency mechanism was new and perhaps should be set up on an experimental two-year basis. Therefore, compensatory financing access should not be reduced substantially.

Mr. Ovi said that he could not support any overlapping of financing, and therefore favored the first approach. He could accept some flexibility in the tranching as long as the member's choice was made at the outset within the overall access limits. That would call for less flexible interpretation of first tranche drawings under the compensatory financing facility and a lower ceiling for contingency financing. He would be in favor of maximum total access of 100 percent, with the member deciding on the tranching in advance.

Mr. Cassell said that his tranching preference would be 35/40/25.

Mr. Kafka indicated that he would support a tranching of 40/30/40, conditional on the settling of other issues.

Mr. Reddy said that, with Mr. Kafka's caveat, he also could go along with 40/30/40.

Mr. Goos said that his first preference would be along the lines of the proposal made by Mr. Posthumus, but he could support a solution of 40/20/40.

Mr. Yamazaki remarked that as his authorities would like the contingency element to be as large as possible, he would propose a solution of 35/20/45. In order to reach a consensus, he was prepared to accept the division of the 35 percent compensatory element into two tranches.

Mr. Chatah said that he would prefer alternative b of the postscript solution, with tranching of 40/30/40, but if it were important for Directors to have a presentation along the lines of alternative a, he could also accept that.

Mr. Feldman said that he had no preference between presentations a or b, and he could go along with tranching of 40/30/40, in accordance with the postscript solution.

Mr. Hubloue said that he could go along with the 40/30/40 proposal, with a slight preference for presentation b.

Mr. Dallara said that he could support Mr. Yamazaki's tranching solution of 35/20/45, and he had a very strong preference for presentation a. Part of his authorities' price for going to the postscript solution would be to divide the compensatory financing element into two tranches.

Mr. Jiang said that he preferred presentation b, with tranching of 40/30/40.

Mr. Abdallah said that he, too, preferred presentation b, with tranching of 40/30/40.

Mr. Rye said that he agreed with some other Directors that if the second approach were to be adopted, total access would consequently have to be reduced. Total access of 100 percent of quota was as high as his authorities could support. He was indifferent as to presentation a or b, but would obviously support the lower of the two sets of figures set out in the Managing Director's oral presentation. As far as tranching was concerned, he could support 35/25/40.

Mr. Salehkhou said that his position remained that the compensatory financing facility should be preserved with access of 83 percent of quota, and that the external contingency mechanism should be established as a separate facility.

Mr. Ovi added that, within the constraints of the Managing Director's postscript solution, he would support as low an overlap as possible, with a maximum total access of 100 percent. Therefore, Mr. Grosche's position of 40/20/40 was as close as he could find to his own preference.

The Chairman observed that there seemed to be a clear preference for the postscript solution, with presentation a, and he therefore requested Directors to concentrate their reflections on a solution of that kind. A good deal of progress had been made at the current meeting despite the number of questions that were still open. He suggested that the question of conditionality and tranching under the compensatory financing element be discussed at the following meeting, after which other questions, including the staff's definition of automaticity versus review, could be discussed.

The Executive Directors agreed to continue their discussion on the following day.

LEO VAN HOUTVEN
Secretary

Statement by the Managing Director on the Review of the Compensatory Financing Facility and Further Consideration of External Contingency Mechanisms
Executive Board Meeting 88/50
March 28, 1988

At its last meeting, the Interim Committee encouraged the Executive Board to complete its review of the compensatory financing facility before the next meeting of the Committee. At the Board's recent consideration of external contingency mechanisms (EBM/88/38, 3/11/88), I proposed that we return to the key outstanding operational issues and the main modalities of external contingency mechanisms before the April Interim Committee meeting. Taking account of Directors' views at our earlier meetings, this note makes some suggestions that might serve to help move us toward a consensus on both the review of the compensatory financing facility and the operational framework for external contingency mechanisms.

Two major themes have emerged in our discussions. First, considerable importance is attached to maintaining the essential features of the compensatory financing facility. Second, there appears to be broad support for the general principle that advance commitment of contingent Fund financing could help maintain the momentum of adjustment in programs that encounter adverse external shocks.

There has been broad agreement on certain technical aspects of the operation of the compensatory financing facility, including application of an upper projection limit and procedures to avoid overcompensation in successive drawings. On the broader issues of conditionality, access, and phasing, the central question is to reconcile views as to how the compensatory financing facility could continue to provide timely compensation for temporary export shortfalls while at the same time ensuring sufficient protection for the revolving nature of the Fund's resources.

There has also been a convergence of views on the basic features and technical aspects of the design of contingency mechanisms. These features include the need for an appropriate blend of adjustment and financing, symmetry, and a focus on major disturbances above a minimum threshold level involving external factors beyond the control of the authorities. There seems also to be significant support for coverage of unforeseen changes in world interest rates, but concern was expressed about the possible consequences for the liquidity of the Fund. For this reason, strong safeguards would be required. We will need to do further work on all these matters after the Interim Committee meeting.

On the key issue of possible operational structures for an external contingency mechanism, several alternatives have been proposed. The discussions so far would tend to suggest that attention now be focused on an approach that would combine compensatory and contingency elements into the framework of an expanded compensatory financing facility, in a manner that would provide distinctive roles for each of these two elements, and that would attach the contingency component to Fund-supported adjustment programs. Under this approach, compensatory financing facility provisions would continue to apply to past temporary and reversible shortfalls in export earnings (and excesses in cereal imports), while separate modalities would be worked out, within a basic framework agreed on by the Board, for contingent deviations in exports and other eligible current account components. I believe that there are two broad approaches which could achieve these objectives.

The main lines of the first approach could be:

(a) Overall access under the compensatory and contingency elements would be specified within the expanded compensatory financing facility framework, but the operation the two elements would be distinct. From our earlier discussions it appears that a consensus might be reached on an overall limit in the range of 100-120 percent of quota, divided approximately equally between the two elements.

(b) Within the compensatory financing facility element there would be, as at present, two tranches. The first tranche would be subject to the lower conditionality now specified under the guidelines on cooperation under the compensatory financing facility. The second tranche would be linked to approval or review of a Fund arrangement. In a situation where there were no balance of payments difficulties beyond the export shortfall itself, access could be made without tranching up to the present compensatory financing facility access limit. Provisions for the financing of excesses in the cost of cereal imports would be maintained as under the present cereal decision with appropriate adjustment of the quota limit attached to that decision.

(c) Provision for access under the contingency element would be made at the outset of appropriate Fund arrangements, and would create a presumption of availability of contingent financing up to specified amounts. Subject to the access limit, the amount to be committed in support of any single arrangement would need to be determined on a case-by-case basis, taking account of the usual considerations governing access in individual cases, such as the ability of the member to service its indebtedness to the Fund. This would suggest that the amount of contingent support be linked to the amcunt committed under the associated arrangement. For example, there could be a general guideline to the effect that maximum contingent access in a particular arrangement would be expected to be no more than 50 percent of the basic access under that arrangement. If an adverse shock was too large to be accommodated under such a provision, it would be best to rethink the basic framework of the adjustment and financing package, perhaps within the context of a new arrangement. Under such an approach any margin for the external contingency mechanism that was not utilized would become available for use with subsequent arrangements.

External contingency mechanisms could be provided in conjunction with stand-by or extended arrangements. They could also be made available for support of arrangements under the enhanced structural adjustment facility, provided that the terms associated with use of the Fund's ordinary resources were appropriate for the country's circumstances. As for the structural adjustment facility, the absence of phased disbursements and a scheduled opportunity for reviewing the arrangement would require some operational adaptations if an external contingency mechanism were to be fitted in satisfactorily.

The alternative approach is designed to provide member countries with a greater flexibility of choice. The modalities suggested under the first approach would also apply to the second, except insofar as they had to be modified to take into account the degree of choice offered to members.

The main lines of the second approach could be:

(a) A member, whose circumstances justified it, could draw up to 83 percent of quota under the compensatory element. Such drawings would be phased in three stages. The first tranche would be subject to the requirements of cooperation, as in the first approach; the second would become available on the approval of a stand-by or extended arrangement or an arrangement under the enhanced structural adjustment facility, or, as mentioned earlier, under the structural adjustment facility, if the appropriate operational adaptations can be agreed; and the third tranche would become available on the successful completion of the first review with the Fund. In such cases, the contingency element would be reduced to a range of 17-37 percent of quota.

(b) At the choice of a member, it could alternatively opt to draw up to, say, 33 percent of quota on the compensatory element, in which case the amounts available under the contingency element would lie within a range of, say,67-87 percent of quota subject to the same qualification noted earlier on actual access.

We shall under either alternative need to propose to Executive Directors procedures that will avoid the possibility of double compensation.

I would add as a postscript that in order to advance our search for consensus further we might also consider:

(1) Varying the second alternative so that (i) the maximum amount available under the compensatory element is reduced to 70 percent of quota, in which case the availability of the contingency element could be 30-40 percent of quota, and (ii) the maximum amount available under the contingency element would also be reduced to 70 percent of quota, in which case the availability of the compensatory element could be 30-40 percent of quota.

(2) Providing that the maximum amount of actual access available under the contingency element be set at a figure within the range of 50-60 percent of the basis access under the related arrangement.

Managing Director's Oral Presentation at an
Informal Meeting with Executive Directors on
Compensatory Financing Facility/External Contingency Mechanism
March 30, 1988

Possible outlines of a compensatory financing facility/external contingency mechanism framework around which a consensus may be reached:

1. Two alternative presentations for access could be considered:

		(Percent of quota)
a.	Overall access within	100-110
	amount available under CFF up to	35 (40)
	amount available under ECM up to	40 (45)
	amount available at the option of the member to supplement either element	25 (25)

b. Within an overall access limit of 100-110 percent of quota, maximum CFF access would be 60-65 percent of quota and maximum contingency access of 65-70 percent of quota, at the choice of the member.

2. Where there were no balance of payments difficulties beyond the export shortfall itself, compensatory access could be untranched up to 83 percent of quota.

3. Compensatory access would otherwise be in two tranches: the lower tranche at 35 percent of quota, and the upper tranche (up to 25-30 percent of quota). The upper tranche would be linked to approval or review of a Fund arrangement, as has been the current practice.

4. There would be no need for a change in the guidelines on the test of cooperation for the lower compensatory tranche, but in updating the application of these guidelines staff will ensure that full consideration is given to the circumstances of the members.

5. Provision for the external contingency mechanism would create a positive presumption of availability of contingent financing up to specified amounts. Contingent financing would be activated after completion of a review. Should a contingency materialize, management would automatically agree to starting ad hoc reviews. The amount of contingent support in a particular arrangement would be determined on a case-by-case basis and would be expected to be no more than 50-70 percent of the basic access under the arrangement.

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INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
Informal Session 88/2

10:00 a.m., April 1, 1988

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

Executive Directors	Alternate Executive Directors
A. Abdallah	
	C. Enoch
	Jiang H.
D. H. Dallara	
J. de Groote	J. Prader
A. Donoso	E. V. Feldman
	A. M. Othman
	M. B. Chatah, Temporary
	B. Goos
J. E. Ismael	
A. Kafka	J. Hospedales
M. Massé	D. McCormack
Mawakani Samba	C. V. Santos
	I. A. Al-Assaf
G. Ortiz	L. Filardo
J. Ovi	M. Fogelholm
H. Ploix	D. Marcel
G. A. Posthumus	G. P. J. Hogeweg
C. R. Rye	
G. Salehkhou	O. Kabbaj
A. K. Sengupta	
K. Yamazaki	S. Yoshikuni
S. Zecchini	

L. Van Houtven, Secretary and Counsellor
M. J. Primorac, Assistant

Also Present

Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; P. D. Brenner, G. G. Johnson, H. B. Junz, C. Puckahtikom. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; T. M. C. Asser. Research Department: J. A. Frenkel, Economic Counsellor and Director; D. A. DeRosa, N. M. Kaibni, B. E. Rourke. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: D. Williams, Deputy Treasurer; D. Gupta. Western Hemisphere Department: E. V. Clifton. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: P. E. Archibong, A. R. Ismael, Khong K. N., K.-H. Kleine, A. Ouanes, P. Péterfalvy, K. Yao. Assistants to Executive Directors: N. Adachi, J. R. N. Almeida, R. Comotto, E. C. Demaestri, F. El Fiky, S. K. Fayyad, V. J. Fernández, B. R. Fuleihan, M. A. Hammoudi, C. L. Haynes, M. Hepp, L. Hubloue, M. A. Kyhlberg, V. K. Malhotra, D. V. Nhien, C. Noriega, L. M. Piantini, S. Rebecchini, S. Rouai, E. L. Walker, Yang W.

1. FURTHER CONSIDERATION OF REVIEW OF THE COMPENSATORY FINANCING FACILITY, AND EXTERNAL CONTINGENCY MECHANISMS IN FUND ARRANGEMENTS

The Executive Directors continued from the previous meeting their discussion of staff papers on the compensatory financing facility (EBS/88/20, 2/3/88) and on external contingency mechanisms in Fund arrangements (EBS/88/30, 2/12/88 and Sup. 1, 2/26/88), together with a series of the Managing Director's concluding remarks and statements at EBM/88/31 (3/4/88), EBM/88/38 (3/11/88), EBM/88/50 (3/28/88), Informal Session 88/1 (3/31/88), and at an informal meeting with Executive Directors on March 30, 1988 (see Annex II of Informal Session 88/1, 3/31/88).

The Chairman proposed that the Board meet with the staff at an informal lunch following the current meeting in order to make additional progress toward a consensus. Accordingly, the current meeting would be concluded at 12:30 p.m.

The Executive Directors accepted the Chairman's proposal.

In his oral presentation at the informal meeting of March 30, the Chairman noted, he had suggested that for upper tranche access there would be a link to approval or review of a Fund arrangement as had been the current practice. However, the existing guidelines on compensatory financing facility conditionality did not make a rule of that practice, and accordingly the second sentence of paragraph 3 should be deleted. It was to be hoped that there would be a number of cases in which it would not be necessary to have approval or review of a Fund arrangement for access to the upper tranche. Then, in paragraph 4, it should be stated that there was no need for a change in the guidelines on the test of cooperation, without specifying the first or second tranche.

On the question of automaticity, logically, the notion of contingency suggested a procedure involving a degree of automaticity, the Chairman remarked. However, the Board was designing an ambitious scheme and, as the trustee of Fund resources, it had to be careful not to place those resources in a position of hazard. Those two concerns had to be reconciled by providing enough automaticity to boost the confidence of member countries while at the same time preserving the safety of the Fund resources. He would propose maintaining paragraph 5, but adding a paragraph suggesting that, at least on an experimental basis, automatic activation of contingency financing could be envisaged in cases in which it was possible to define in advance, as in the Mexican case, the nature of the links between contingent deviations, policy adjustment, and the financing package. A definition of that link was necessary in advance, as was the ability to define in advance any automatic adjustments in performance criteria that might be required. If that could be done, then the case would be similar to the Mexican one and automatic activation of contingent financing would be feasible. It went without saying that activation would require that the member be in compliance with its program.

Mr. Dallara indicated that he would have difficulty with the deletion of the concluding phrase to paragraph 3, since he considered that to be a legitimate codification of basic practice, which was consistent with the updating of the application of guidelines in the lower tranche. He understood that the upper tranche would generally be linked to approval or review of a program, in accordance with the upper tranche guidelines. First, the existence of a satisfactory payments position was required, apart from the effects of an export shortfall--a circumstance which was dealt with elsewhere and which was a separate proposition because the immediate availability of the upper tranche would not be denied in such a situation. Then, he guidelines specified that a member could gain access to the upper tranche if it adopted a program supported by a Fund arrangement; was already involved in and performing satisfactorily under a Fund arrangement; or when the member's current and prospective policies were such as to meet the criteria for use of Fund resources in the credit tranches.

Accordingly, it seemed entirely consistent with practice to retain the phrase that the Chairman had wanted to delete, Mr. Dallara said. An alternative would be to say that "the upper tranche would generally be linked to approval or review of a Fund arrangement, except where there was an otherwise satisfactory payments position or where circumstances suggested that the member could, in any case, meet the criteria for use of Fund resources in the credit tranches." While that might be repetitive of the guidelines, it was not inconsistent with them.

The Chairman pointed out that while, according to the guidelines, the conditions for upper tranche lending frequently implied that the country would be under a program, the guidelines also indicated that the adoption of an arrangement was not a prerequisite.

The Economic Counsellor and Director of the Research Department said that, in practice, the upper tranche had been available under any of the following conditions: first, the existence of a satisfactory balance of payments position other than the effects of the temporary shortfall; second, the existence of a Fund arrangement either approved simultaneously with the compensatory financing request or in effect and on track at the time of the request; and third, a judgment that current and prospective policies met the criteria for use of Fund resources in the credit tranches even though such use was not contemplated at the time of the compensatory financing request.

In practice, since 1983, 32 drawings had taken place in the upper tranche, of which 31 were in conjunction with a Fund arrangement, the Economic Counsellor noted. The Managing Director had stated that there would be no change in guidelines or practice, which would imply that the majority of upper tranche drawings would continue to be made in conjunction with a Fund arrangement.

Mr. Dallara said that it did not seem to pose a problem to say that the upper tranche would generally be linked to approval or review of a

Fund arrangement or to say that it would be linked to approval except in circumstances otherwise specified under the guidelines, since that, in effect, clarified the current practice. Either of those approaches would be fully consistent with the guidelines and would give some sense of what practice had been.

Mr. Posthumus suggested that the last phrase in paragraph 3 be deleted, with the addition of a sentence reading: "This second tranche would normally be linked to approval or review of Fund arrangements as before." Such a statement would reflect the situation as it was in practice, and he would have difficulty with leaving it out.

Mr. Goos stressed that since his authorities' willingness to accept a combined facility was based on the condition that there be no automaticity, he could not support any addition to the original text that would open up the possibility of such automaticity. Such clear-cut cases as the Mexican one could be handled very flexibly by the review procedure that he had in mind.

Mr. Ortiz said that his authorities wanted the greatest degree of automaticity possible to be built into the combined facility, since automaticity was inherent in the spirit of contingent financing. Countries should have a sense of the amounts they would be able to draw under contingent financing, and of how much additional adjustment would be required in the case of such contingency. A definition should be set at the inception of a program of how much the country in question could count on in the event of an exogenous shock. As long as contingency financing was activated when the country was in compliance with a Fund-supported program, the question of moral hazard was avoided.

The Chairman pointed out that even if a country had been in compliance with a program prior to an exogenous shock, that shock could be enough to require a review of the program in order to avoid a risk to the resources of the Fund.

Mr. Ortiz pointed out that such a risk could be avoided by specifying beforehand the maximum amount of contingency financing that a country could obtain. If the exogenous shock were large enough that the country required more than its maximum amount of financing, it would then be clear that a review was necessary.

The Chairman said that it would also be necessary to ascertain what type of adjustment would be required in the performance criteria of the program; contingent financing could not be granted without investigating that question. If the necessary adjustment could not be established in advance, then an ad hoc review was essential.

Mr. Dallara asked whether Mr. Ortiz wanted greater automaticity of activation or greater assurance with respect to the amount of financing available from the Fund. One could prespecify at the outset of a program the amount of contingency financing available in the event of exogenous shocks. He had sympathy for Mr. Goos's concerns that the activation of financing not be automatic. His own, and others' efforts to stress the symmetry between financing and adjustment were critical to the willingness of Mr. Goos's authorities to go along with the combined facility, and he would be reluctant to undermine the progress that had been achieved toward a consensus.

He doubted that either the Fund or the member country would be served if the Board attempted to prespecify adjustments in performance criteria, Mr. Dallara said. He understood the need to do so if automaticity was to be achieved, but it was not really possible to decide ex ante the circumstances that might surround an exogenous event. He could see no other way to assess a country's situation than to carry out a review--albeit a cursory review. For example, structural policy changes had been stressed of late, and there was no way to prespecify an acceleration or delay in trade liberalization if that was an important part of the package. Even in the Mexican case, there had been no prespecification of additional adjustment actions, but rather, a review had taken place.

Mr. Rye indicated that if an addition were made to paragraph 5 in the spirit of encapsulating existing practice, the same procedure should be applied to paragraph 3, so that both elements of the combined facility were treated consistently.

Mr. Zecchini said that he felt the deletion proposed by the Managing Director was fully warranted because of the assumptions repeatedly made by the Managing Director in his statements that he did not intend to change the guidelines. The phrases that he proposed to delete were inconsistent with the present guidelines, and therefore should indeed be omitted.

He did not agree with the proposals for adjustments in performance criteria on the occasion of exogenous contingencies, Mr. Zecchini continued. His understanding was that the contingency facility aimed to maintain the program on track for the limited period of time to which the performance criteria applied, and to provide the member country with an immediate [illegible] of financing in order to re-establish the desired mix between adjustment and financing. After that temporary financing, the country could, together with the Fund, consider extensive adjustment of the program based on whether or not the exogenous shock was reversible. The review should not be seen as an opportunity to readjust the entire program, but should merely estimate the amount and timing of the needed contingency financing. Automaticity would not provide more insurance to the country, which always had the assurance of coverage by the Fund. The question was merely when such contingency coverage would take place and how much financing would be granted.

While a "review" should be allowed, it should not necessarily give rise to a Board discussion, Mr. Zecchini remarked. A review could take place on a lapse of time basis for cases like that of Mexico. The conditions under which the contingency mechanism was to be triggered could be defined in detailed enough a fashion to leave little scope for judgmental evaluation of the size of the coverage. In the case of Mexico, there had been very little scope for flexibility in judgment, and symmetry had also been embedded in the arrangement. In such cases, the review could be approved on a lapse of time basis in as little as two days, thus encompassing some features of automaticity without explicitly incorporating automaticity in the guidelines.

The Chairman said that he generally agreed with Mr. Zecchini, while noting that the details on review procedures would have to be dealt with after the Interim Committee meeting; it seemed possible, however, that reviews could take place on a lapse of time basis. However, he begged to differ on Mr. Zecchini's point that a contingency facility was, by definition, automatic. If an external shock went beyond the minimum threshold, the presumption was that the situation was more serious. It was then of the essence of the contingency mechanism to introduce a blend of financing and adjustment; the element of adjustment could not be ruled out.

Mr. Zecchini said that while he did not rule out the possibility of adjustment, that was not consistent with the spirit of a contingency facility, since adjustment had to be developed over a longer period of time. The contingency mechanism should act as an immediate insurance policy, covering the shock immediately, with adjustments made subsequent to the crisis. The timing of the coverage and the degree of reversibility of the exogenous factor would influence the degree of adjustment necessary. For example, if, in the case of Mexico, contingency financing had been arranged when the price of oil had not yet reached its trough, the Fund could have assumed that the fall in the price of oil would be reversed, delaying contingency action, and the country would have fallen into arrears. There consequently would have been a disruption in the international payments system, and by the time additional adjustment had been arranged, the contingency financing would have been of little or no use.

The Director of the Exchange and Trade Relations Department observed that Mr. Zecchini was seeking an immediate injection of financing while allowing the member country time to consider its situation. However, as Mr. Zecchini himself had suggested, if the contingency was of a certain severity, neither the amounts available from the Fund nor those from other creditors would necessarily be adequate, resulting in the Fund releasing its resources in a situation of a financing shortfall. Another problem would soon be the difficult case of a contingency occurring soon before a review of the program or a performance test date. Then the Fund's resources would be released under the external contingency mechanism with the knowledge that the performance criteria governing the stand-by arrangement would soon be broken and that the arrangement would therefore soon be suspended. Those were two situations that should give the Board pause when considering automaticity of contingency financing. In the Mexican case, there had been a sensible provision for phased adjustment of relevant performance criteria.

Mr. Zecchini said that the Director's point was well taken, but his concerns could be taken care of in the context of the program review. The review implied in the context of contingency financing should not be confused with a program review.

The Chairman noted that there could be cases in which prudent activation of contingency financing would require adjustment of relevant performance criteria.

Mr. Sengupta said that it appeared the Chairman was suggesting that the performance criteria changes necessary to accommodate contingency financing be negotiated beforehand whenever the amount of financing and the necessary changes in the performance criteria could be worked out. It was not reasonable to ask a country, before it entered into a contingency arrangement, to accommodate within its program all contingency financing and all changes that might have to be made in the performance criteria. That was not to say that there should be no review; financing could be made available, and if it were decided after the review that adjustment was also necessary, that could then be worked out. If it was accepted that the contingency mechanism was essentially an insurance policy to keep the adjustment efforts of member countries on track, then some sort of automaticity had to be incorporated into the mechanism. If the exogenous shock were major enough, a review would be held, which might suggest that further adjustments were necessary, but it was not possible to prejudge that adjustment.

The Economic Counsellor said that, while it was indeed not possible to prespecify adjustment to contingencies, general possibilities could be set out in advance. On the issue of adjustment and financing, once a large exogenous shock took place, the previous performance criteria became no longer feasible, and there had to be a recognition of the fact. The adjustment profile would have to be changed, but its timing depended on the degree of the external shock's reversibility. Modifying the performance criteria did not necessarily imply immediate change in the program, but simply a recognition that the performance criteria were no longer feasible.

Mr. Ortiz explained that, in the Mexican case, all adjustments to performance criteria had been prespecified at the outset of the program, as well as the exact mixture of additional adjustment and financing, contingent upon movements in the oil price. Clearly, that could not easily be done in all cases. In the Mexican case, it had been arranged that if the average price of oil fell below a certain benchmark, contingency financing would automatically be activated to fully cover the shortfall for the first quarter. Contingency financing would thereafter cover a smaller proportion of the shortfall, thus incorporating the concept of additional adjustment. Of course, the Mexican case had been unique in that only one commodity was in question and the threshold prices could be established; that was an ideal situation for protecting resources in advance, but one that was not easily replicated. His point was that the Fund should come as close as possible to informing the country in advance what to expect in terms of the adjustment/financing mix in the event of an exogenous shock. If the member country did not have such guidelines in advance, it might be difficult to ask it, in the middle of a program, to suddenly and drastically change the profile of its adjustment path for the remainder of its program.

The Chairman noted that the more seriously the implications of a contingency mechanism and the adjustment/financing relationship were considered at the time of the program's negotiation, the better the results for the program in question. He therefore saw merit in including a paragraph that specified that relationship.

Mr. Kafka said that the Board was being placed in the dilemma of choosing between absolute security and risk taking. There had recently been a move toward privatization of public enterprises, which were sometimes inclined to take risks where they should not, and sometimes did not take enough risks; it was now time to "privatize" the Fund.

Mr. Yamazaki said that he associated himself with the views of Mr. Goos on the matter of automaticity.

Mrs. Ploix said that while she understood Mr. Goos's concerns, the reference to the Mexican case was very relevant, since it was an example of a case in which conditions were precise and there was no risk for judgmental considerations at a later date. In such a case, the decision to grant contingency financing was very clear cut. While Mr. Ortiz had noted that the Mexican case was very specific, most cases in which the conditions set out by the Chairman held--the link between additional financing needs and the relevant contingencies and the policy actions that would need to be phased in should the contingencies arise could be specified in advance--would be similar to the Mexican one, in which instance the Fund could be very precise and fix definite limits.

Mr. Donoso said that it was true that injecting resources when a country experienced a shortfall involved a certain risk, but the Fund should not give an absolute value to the avoidance of such risk. To give an extreme example, if a country was in compliance with its performance criteria but had not yet undergone a program review, the Fund would be taking a risk in granting a drawing under the external contingency mechanism--but that was an appropriate risk. There would be cases in which the Fund would have to take such risks and would be justified in doing so.

On the review of performance criteria, if an adjustment in those criteria was not made soon after an exogenous shock, the country would be obliged to adjust fully to the exogenous shock because it would still be expected to meet the original performance criteria, Mr. Donoso noted. Even if the country received contingency financing, it would have to undergo additional adjustment until the performance criteria were relaxed; accordingly, not advancing the review did not imply a relaxation of performance demands.

The external contingency facility would be most useful if a country could anticipate in advance its eligibility for contingency financing, Mr. Donoso indicated; if that automaticity were not guaranteed, the financing would become more like an assurance of a positive attitude toward resource augmentation after the next review, and not a facility that financed contingencies.

Mr. Enoch remarked that he endorsed the comment of the Economic Counsellor that a major exogenous shock would cause the initial performance targets to be out of date. He also agreed that by stating that more financing was necessary, one recognized that the original performance targets were not appropriate in the given circumstances.

He considered that reviews were necessary, Mr. Enoch said. The number of cases in which the consequences of all exogenous shocks could be decided in advance was probably rather limited. In any event, a review did not necessarily have to be a great deterrent to members. He hoped that the Board would be able to respond flexibly to a country's contingencies and conduct the review rapidly if that were necessary. Once the facility had been set up, with the maximum access limits established, and when the contingencies to be covered were known, it would be fairly easy for a country to calculate approximately what level of financing would be available, as was the case with any other Fund facility.

Mr. Dallara said that he perceived a consensus developing on two notions--a presumption of availability of contingency financing, combined with the need to find an appropriate blend of adjustment and financing. Indeed, those two basic elements had been captured in the Chairman's informal remarks at EBM/88/38 (3/15/88). More staff work might be desirable before going into further detail on the modalities of the external contingency mechanism.

The Chairman agreed that it would be appropriate to capture what might be a consensus on the particular cases in which additional automaticity could be injected. He then turned to the question of updating the application of guidelines, calling Directors' attention to his statement on the application of guidelines on cooperation at Informal Session 88/1 (3/31/88).

Mr. Kafka remarked that the terminology used in the Managing Director's statement was, by necessity, imprecise. The guidelines set out in 1983 did not contain any reference to Fund arrangements in connection with the lower compensatory tranche, but rather, the requirement of a Fund arrangement had been introduced by the staff. He did not see any assurance in the Managing Director's presentation that the guidelines on cooperation would be applied in liberal enough a fashion.

The Chairman noted that his statement had been an attempt to classify the possible cases with which the Fund could be faced, and he requested Executive Directors' benefit of the doubt in his attempts, with the staff, to effectively codify the guidelines.

The Economic Counsellor proceeded to give examples of countries that had fit each of the five cases outlined by the Managing Director in his statement on the application of guidelines on cooperation. For a country whose balance of payments imbalance went beyond the export shortfall, but that had a good record of cooperation and policy actions and intentions that were judged adequate, a first tranche drawing would be permitted without a Fund-supported arrangement, as had been the case for Fiji in 1985 and Indonesia in 1987.

When the balance of payments imbalances were large and policies were deficient or the record of cooperation was weak, the Fund required "reasonable assurance" that the imbalances would be addressed, for instance, as had been the case for Ethiopia in 1986, the Economic Counsellor said.

In more difficult cases, a Fund-supported arrangement might be required to provide the "reasonable assurance" that imbalances would be addressed, as had been the case for Zaïre in 1987, for example, the Economic Counsellor continued.

In some cases, the need for a Fund-supported program was evident, the country had a good past record, low exposure to the Fund, and negotiation in good spirit had begun toward a Fund-supported economic program with adequate progress toward external financing arrangements; an example of that had been Bangladesh in 1985, the Economic Counsellor went on.

Finally, in cases where the need for a Fund-supported program was evident, the balance of payments difficulties and economic imbalances were more severe, the past record of cooperation was weak, and policies were deficient, the Economic Counsellor indicated; drawings under the first tranche would be permitted only at the time of a Board approval of a program.

The five categories were not an academic exercise, but rather had been suggested by a conceptual categorization of the past five years' experience; they represented actual cases that had required the application of judgment, the Economic Counsellor concluded.

Mr. Posthumus questioned the appropriateness of reviving discussion of the pre-1983 conditionality; he could accept the Managing Director's statement. The first and second tranche discussed by the Managing Director in his statement were, in fact, subtranches of the existing first compensatory tranche, and as such he proposed that the statement regarding conditionality for the second tranche--"no change in guidelines or practices"--be replicated for the third tranche as well. The statement could then be inserted in the Chairman's statement to the Interim Committee.

Mr. Zecchini noted that the 1983 decision on guidelines on cooperation (Decision No. 7528-(83-140), adopted 9/14/83) made no reference to Fund-supported arrangements in the context of lower tranche conditionality.

Was there a difference between a country's adjustment program and a Fund-supported adjustment program? If so, perhaps that could be one of the features distinguishing the conditionality of the lower and upper tranches.

The staff representative from the Research Department said that the 1983 guidelines on cooperation attached more importance to the adjustment itself than to the form in which it was expressed, namely, whether it was in the form of a stand-by arrangement or in the form of adjustment by the country without Fund support. That policy was referred to in the upper tranche guidelines in the provision that "the member's policies are such as to qualify it for an arrangement in the credit tranches." There was no reference to an arrangement being required for the lower tranche. There was an indication that where there was a need for correction of policy, the Fund would provide assistance in the lower tranche only if it were reasonably assured by the efforts of the member, including its prior actions, that the member would be adopting policies corrective of its balance of payments difficulties.

Mr. Zecchini said that his authorities were not in favor of a subdivision of the lower compensatory financing tranche. Drawings on that tranche, as set out in the Managing Director's statement, made good use of Fund resources and met the criterion of determining a country's level of access according to the country's ability to repurchase its drawing. The optional tranche should be considered as the second compensatory tranche.

Mrs. Ploix said that she supported Mr. Zecchini's point that there should be little, if any, tranching of the first window of compensatory financing access; the conditionality of that window should be relaxed as a trade-off for the reduction in total access.

Mr. de Groote said that, while the classification of the various cases was useful, he was not sure that it was necessary to take a decision on those points. It would be sufficient to say that, as a matter of policy, management would continue to implement the 1983 guidelines in full consideration of existing practices. There was a danger in trying to transform an analysis of past cases into legal text; the correct approach was to continue to apply the guidelines with common sense and good judgment. Therefore, he would be in favor of a broad text that did not attempt to cover all possible cases.

Mr. Al-Assaf observed that the cases cited by the Economic Counsellor could fall into more than one classification group; that imprecision emphasized the need for judgment.

The Chairman observed that the five cases were more of a continuum than a set of clear-cut, compartmentalized decisions.

Mr. Rye said that he joined Mr. Posthumus in supporting subtranching. On the Managing Director's statement on the application of guidelines on conditionality, the most difficult case would be the second one, in which judgments were the most difficult and the possibility of the Fund's resources being put at risk was greatest. Could the staff say anything more concrete about the kinds of reasonable assurances that would be regarded as appropriate in those very difficult cases when a country's balance of payments imbalances were large, policies deficient, and cooperation weak?

The staff representative from the Research Department said that, in the case of Ethiopia in 1986, prior action had been required in order to provide the staff and management with the assurances referred to in the guidelines.

Mr. Kafka said that, in his earlier reference to "privatization" of the Fund, he had not meant to insinuate that the Fund should be more liberal with its resources, but had merely been pointing out that if the Board decided on no automaticity, it would be swinging too much in the direction of not risking enough. Also, he had not suggested that a return be made to the 1983 decision on conditionality, but rather, that the Board find language that, like the language in the 1983 decision, gave the Fund greater assurance of what it could and could not expect. Finally, he was not concerned about conditionality of compensatory financing, but rather, with its timeliness. Before the 1983 decision, compensatory financing had served as a useful bridging loan because it could be disbursed quickly, pending the negotiation of a stand-by arrangement. Such timeliness would be desirable in any combined facility.

Mr. Posthumus clarified that he had suggested that the Managing Director's oral presentation be combined with the statement on the application of guidelines on cooperation to form one paper. It was his understanding that the reference in the statement to first and second tranches was actually a reference to subtranches of the existing first tranche of compensatory financing.

The Chairman indicated that there was not presently any proposal to subdivide the first compensatory tranche.

Mr. Posthumus responded that, if that were the case, the entire statement on guidelines could be replaced by the sentence that the Chairman had proposed to delete from his oral presentation, and which read: "The upper tranche would be linked to approval or review of a Fund arrangement as has been the current practice."

The Chairman indicated that paragraph 3 of his oral presentation dealt with the question of tranching access to the compensatory element in the new facility. Once that had been discussed, Mr. Posthumus's point could be decided upon.

Mr. Sengupta said that while he had no doubt that the staff could find examples of each case set out in the Managing Director's statement on guidelines, those were reflective of a practice with which his authorities had serious disagreement. He could go along with the Chairman's statement that no change in guidelines or practices would be made. However, he considered that even the 1983 guidelines had not been properly implemented, particularly with respect to the first tranche. If there was no change made in the application of compensatory financing conditionality, then Directors were being asked to accept a lowering of total access to that facility without any improvement in its operations--a request with which he could not comply.

In the pre-1983 guidelines, it had been a clear condition that the Fund had to be satisfied that a shortfall would be made up and that a member would cooperate with the Fund in an effort to find appropriate policies, Mr. Sengupta continued. Such conditionality was elaborated upon in the 1983 decision on guidelines, which stated that only when the member's balance of payments policies were seriously deficient and its record of cooperation had been unsatisfactory would the Fund expect the country to take prior action and give reasonable assurance that its policies would be implemented. No mention was made of a Fund-supported arrangement. That interpretation of the conditionality had created serious problems for many members who would otherwise have come to the Fund sooner for compensatory financing.

While his authorities were willing to accept a compromise on total access to the compensatory financing facility and were willing to accept existing practices on conditionality for the second tranche, Mr. Sengupta said, they had to be assured that application of conditionality in the second tranche would be more liberal than currently was the case. The Chairman's statement on guidelines made the practice of the Fund become the rule; it should be made clear that the statement was simply a reflection of past cases. Some wording would have to be included in any statement to the Interim Committee to the effect that the application of the guidelines would be more liberal than had been the practice up to the present.

The Economic Counsellor said that his earlier reference to 31 of 32 cases having been linked to Fund-supported arrangements had been a reference to the upper tranche of the compensatory financing facility, and not the lower. In the lower tranche, 12 drawings had been made, of which 6 had been made by countries with Fund arrangements and 6 without. Of the 6 Fund-supported programs, 3 were under the structural adjustment facility. In sum, between 1979 and 1983, about 10 drawings had been made in the lower tranche with Fund-supported arrangements, and 32 without.

Mr. Sengupta observed that the proportion of drawings with a Fund-supported arrangement had increased significantly after 1983.

The Chairman pointed out that of the five cases set out in his statement on guidelines, four were cases in which drawings would be considered without Board approval of the program.

Mr. Kafka said that he understood the statement as indicating that in only two cases would a member country avoid the drawn out procedure of at least initiating a Fund-supported arrangement negotiation before drawing on the compensatory financing facility His concern was the timely availability of compensatory financing.

Mr. Dallara said that he had read the Chairman's statement with the idea that the basic compensatory financing window would be split into two tranches, and that the optional window, if used by the member for compensatory purposes, would in effect be a third tranche. It was particularly important to his authorities that such tranching occur if they were to reconsider their willingness to assure a somewhat more flexible application of the guidelines.

In the second case set out by the Chairman, a country with large payments imbalances, deficient policies, and a weak record of cooperation would not be required to have a Fund-supported program in order to draw on the first tranche, Mr. Dallara observed. That, to him, was a more flexible application than before, since there was no reference to prior actions or to entering, in good faith, negotiations toward a Fund-supported program.

He would prefer that the first three cases in the Chairman's statement, like the fourth, contain a reference to the country's exposure to the Fund, since the arrears problem was very relevant, Mr. Dallara indicated. Otherwise. the Fund would simply be acting on faith that the member would put into place appropriate policies. It was stipulated that when the policies were deficient, consistent with the guidelines, all that would be required was "reasonable assurance"--a position that made him uncomfortable.

He could support Mr. de Groote's suggestion that the entire statement on guidelines be dispensed with, simply stating that the Fund would apply the guidelines on conditionality in the light of existing practice, Mr. Dallara continued. He also had sympathy with Mr. Posthumus's suggestion to combine the statement and the Chairman's oral presentation, although he did not agree with the suggestion that an addition be made to the statement on guidelines with respect to the third tranche, since the optional tranche was to be disbursed in connection with a program review. As there were no existing practices for that type of tranche, it would not be appropriate to make reference to existing guidelines and practices.

He also had specific problems with the statement on guidelines, Mr. Dallara went on. In the first case--in which a country's balance of payments imbalance was beyond the export shortfall, but the country had a good record of cooperation, and policy actions and intentions were judged adequate--he would suggest the addition of the phrase "and exposure to the Fund is low." For the second case, in which balance of payments imbalances were large and the country's policies were judged deficient or the record of cooperation had been weak, he proposed that the requirement of prior actions be added. In the next case, in which a Fund-supported arrangement may be requested or required to provide the "reasonable assurance," four example cases were described. He would suggest a reference to cases in which the exposure to the Fund was high. The difference between the third category, to which he had just referred, and the fourth category was not clear.

While he would appreciate his suggestions being included, Mr. Dallara indicated that he could, with some discomfort, accept the statement as it stood if there was a consensus for that in the Board.

The Director of the Exchange and Trade Relations Department said that Mr. Dallara's suggestions about paying attention to the exposure to the Fund in the first and third cases would in fact apply to all transactions performed in the Fund, and could perhaps be summarized in one general sentence.

The Chairman pointed out that the reference to good faith was mentioned in the guidelines, and as such did not have to be repeated. However, the condition that a country have limited exposure to the Fund could be added. Prior action as a condition for the second case was also already included in the guidelines. On the third case, the examples that he had listed were illustrative but not limiting, and as such the example of a country with high exposure could be added, but that was not necessary.

Mr. Ismael said that his authorities attached importance to the quick disbursing nature of the compensatory financing facility, and felt that the 1983 decision on guidelines had excessively limited application of the decision on compensatory financing. The Chairman's formulation of five cases was merely a formalization of the current much-criticized practice, and was therefore difficult for his authorities to accept. In return for accepting the lower access of 40 percent for the first compensatory tranche, his authorities wanted a return to the pre-1983 practice of permitting drawings in the first tranche when there was reasonable assurance that corrective policies would be adopted. They did not want the first tranche to be further subdivided. He therefore supported the proposals of Mr. Kafka and Mr. Sengupta.

Mr. Zecchini said that he did not support the suggestion of Mr. Posthumus that the Chairman's statement on guidelines be incorporated in his statement to the Interim Committee, because the language used in the statement on guidelines departed significantly from the 1983 decision setting out the original lower tranche guidelines in which, as he understood it, there was no mention of Fund-supported programs as prerequisites of lower tranche conditionality. Accordingly, he would consider the Chairman's references to such programs in connection with first tranche conditionality as a sort of subspecification of the requirement of prior action. Any reference to Fund-supported programs in the Chairman's statement would have to be prefaced by such an explanation before he could accept its inclusion. Otherwise, the statement would represent a substantial change in the guidelines. While the reference to Fund-supported programs might have to be given as an example of the kind of action that was required prior to drawing on the first tranche, it had to be made clear that such prior action could also take other forms.

The Chairman pointed out that the guidelines for upper tranche conditionality did not make adoption of a Fund-supported arrangement a condition for drawing; in the same vein, the language of the guidelines on the lower tranche did not preclude a stand-by arrangement. His presentation of the application of guidelines was simply an attempt to outline the possible cases.

Mr. Zecchini said that there was a difference between upper and lower tranche conditionalities in the 1983 decision on the application of guidelines; there was an explicit reference to arrangements with the Fund for the upper tranche, but none for the lower tranche. Repeated references to arrangements with the Fund in connection with the lower tranche, as in the Chairman's statement, would result in lower tranche conditionality resembling upper tranche conditionality very closely. He would want the point added that prior action included, but did not exclusively take the form of a Fund-supported program.

Mr. Ortiz said that the wording of the decision regarding lower tranche conditionality did not preclude a Fund arrangement. However, it would seem awkward to specifically mention the adoption of such an arrangement as a condition for lower tranche access, since it was very explicitly stated that an arrangement with the Fund was not a prerequisite for upper tranche access. The staff representative from the Research Department had said that the spirit of the decision was that adjustment was required, but that that adjustment did not necessarily have to be Fund-supported. Accordingly, perhaps the Chairman could qualify his description of the more difficult lower tranche cases by stating that the Fund might require policies that would be consistent with those of a Fund arrangement.

The Chairman said that the reference to a Fund-supported program had been included because some Directors had had the wrong impression that he would require negotiation of an arrangement for all first tranche cases.

Mr. Chatah pointed out that a reference to low exposure to the Fund as a condition for lower tranche access might limit countries that had a good record and good intentions, but had an extended arrangement with the Fund, in which case exposure would be increased. He fully agreed with Mr. Zecchini and Mr. Ortiz on the distinction between adjustment in general and Fund-supported adjustment, and expected that the discussion would return to that subject. On Mr. Dallara's suggestion to state that the upper tranche would generally be linked to approval or review of a Fund arrangement, he did not consider it appropriate to codify practice in the sense of making it an expectation or a presumption.

The meeting was then adjourned so that Executive Directors could continue their discussion over an informal lunch, as previously agreed.

LEO VAN HOUTVEN
Secretary