

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
Informal Session 88/3

2:30 p.m., April 5, 1988

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

Executive Directors

A. Abdallah
F. Cassell

C. H. Dallara
J. de Groot
A. Donoso

J. E. Ismael
A. Kaffa
M. Massé
Mawakani Samba

G. Ortiz

H. Ploix

C. R. Rye
G. Salehkhoul
A. K. Sengupta
K. Yamazaki

Alternate Executive Directors

Jiang H.

J. Prader
E. V. Feldman
A. M. Othman
M. B. Chatah, Temporary
B. Goos
J. Reddy
J. Hospedales
D. McCormack
C. V. Santos
I. A. Al-Assaf
L. Filardo
M. Fogelholm
D. Marcel
G. P. J. Hogeweg

S. Yoshikuni
N. Kyriazidis

J. W. Lang, Jr., Acting Secretary
M. J. Primorac, Assistant

1. Further Consideration of Review of the Compensatory Financing Facility, and External Contingency Mechanisms in Fund Arrangements Page 3

Also Present

African Department: A. D. Quattara, Counsellor and Director; Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; G. G. Johnson, H. B. Junz, C. Puckahtikom, M. H. Rodlauer, B. C. Stuart. Legal Department: W. E. Holdex, Deputy General Counsel; T. M. C. Asser. Research Department: J. A. Frenkel, Economic Counsellor and Director; M. Goldstein, Deputy Director; E. Hernández-Catá, N. M. Kaibni, E. C. Meldau-Womack, R. Pownall, B. E. Rourke. Secretary's Department: C. Brachet, Deputy Secretary. Treasurer's Department: F. G. Laske, Treasurer; 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: E. Ayales, P. E. Archibong, W. N. Engert, A. G. A. Faria, A. R. Ismael, Khong K. N., K.-H. Kleine, A. Ouanes, P. D. Péroz, G. Pineau, D. C. Templeman, N. Toé, A. Vasudevan. Assistants to Executive Directors: N. Adachi, R. Comotto, E. C. Demaestri, S. K. Fayyad, V. J. Fernández, B. Fuleihan, S. Guribye, C. L. Haynes, M. Hepp, G. K. Hodges, L. Hubicue, J. M. Jones, M. A. Kyhlberg, V. K. Malhotra, C. Noriega, L. M. Piantini, S. Rebecchini, A. Rieffel, S. Rouai, C. C. A. van den Berg, 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 Informal Session 88/2 their consideration of staff papers on the compensatory financing facility (EBS/88/2C, 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), and EBM/88/50 (3/28/88).

The Chairman introduced into the record the following informal remarks summarizing the Board's discussion to date on the compensatory financing facility and external contingency mechanisms, which had been circulated to Directors on the previous day:

I have noted broad agreement in the following areas:

(1) On general principles, we have agreed that the essential features of the compensatory financing facility should be preserved; that contingent Fund financing could help maintain the momentum of adjustment programs against adverse external shocks; and that the basic features of contingency mechanisms should include an appropriate blend of adjustment and financing, symmetry, and a focus on disturbances above a minimum threshold level involving external factors beyond the control of authorities.

(2) On the operational framework, there has been broad support for an approach that would combine compensatory financing and external contingency mechanism elements, attaching the latter element to Fund-supported adjustment programs. On overall access, agreement might be found within the range of 100-110 percent of quota. The amount available under compensatory financing and external contingency mechanism elements would each be 40 percent of quota and an optional tranche to supplement either element would be 20-30 percent of quota.

(3) On the compensatory financing facility, the guidelines on cooperation approved by the Executive Board in 1983 would continue to apply to compensatory financing purchases. In applying the guidelines it would be the intention to ensure that purchases under the compensatory financing facility continue to provide timely compensation for export shortfalls while at the same time being accompanied by actions that would provide reasonable assurance of protection of the Fund's resources. The 40 percent of quota available for the compensatory financing facility would be drawn in two tranches, a lower and an upper. The considerations that would be taken into account in applying the guidelines on these two tranches in the light of evolving experience are set out in the appendix to these remarks. (See Appendix I.) If a member decided also to apply the optional

tranche to the compensatory financing facility, then that tranche would become available upon either approval or review of a program supported by the use of Fund resources or, in the absence of such a program, upon the Fund being satisfied that equivalent requirements had been met.

(4) On external contingency mechanisms, provision for an external contingency mechanism in a Fund arrangement would create a positive presumption of availability of contingent financing up to specified amounts. Contingent access in a particular arrangement would be set on a case-by-case basis, taking into account the member's financing needs and its capacity to meet its obligations to the Fund.

(5) On the question of automaticity versus reviews in external contingency mechanisms, to the extent possible, at the outset of the program efforts would be made to specify the link between additional financing needs and the relevant contingencies and the nature of the policy response that would need to be phased in should the contingencies arise. In instances where this could be done with sufficient precision, disbursement of contingent financing could proceed automatically once it had been ascertained that performance criteria had been observed for the relevant period of the arrangement. In the more usual case, where the precision required for such an automatic process could not be achieved, the authorities and the Fund would be carefully tracking developments. As soon as it appeared that the contingencies were arising, a review by the staff would take place with the aim of indicating to the Board as quickly as possible the amount of additional purchase that was justified, the extent to which performance criteria needed to be modified to reflect the effects of the relevant contingencies on policy variables, and the understandings that had been reached with the authorities on adaptations of policies. To the extent possible, Board procedures could be adapted (for example, through lapse-of-time approval procedures) in order to expedite disbursement.

It would be my intention after the Interim Committee meeting to ask the Executive Board to consider how our handling of compensatory financing facility cases might be expedited in ways consistent with the need to safeguard the Fund's resources.

The Chairman suggested that Executive Directors offer their preliminary observations on the informal remarks, which could then be discussed paragraph by paragraph.

Mr. Dallara said that he had begun to realize that there were certain areas on which it was critical that the Board reach some consensus prior to the Interim Committee meeting. In many of those areas, the question was not so much a matter of achieving further consensus as of encapsulating

the existing consensus. In other areas--for example, the question of automaticity versus reviews--it might not be absolutely essential to reach a detailed understanding prior to the Interim Committee meeting. In the light of those observations, he had prepared the following informal note in which he attempted to synthesize first, those areas in which he sensed the Board was either close to or at a consensus and second those areas that it might be most productive to delay considering until after the Interim Committee meeting.

Mr. Dallara made the following statement:

1. We have agreed to establish a combined facility involving compensatory and contingency financing, subject to agreement on specific operational issues.
2. On general principles, we have agreed that the essential features of the compensatory financing facility should be preserved; that contingent Fund financing could help maintain the momentum of adjustment programs against adverse external shocks; and that the basic features of contingency mechanisms should include an appropriate blend of adjustment and financing, symmetry, and a focus on disturbances above a minimum threshold level involving external factors beyond the control of authorities.
3. Total access to the facility would be 100-110 percent of quota divided into two main windows, one for compensatory financing and one for contingency financing. An optional tranche of 20 percent would be available to supplement either window.
4. The current guidelines on cooperation would continue to apply to all purchases under the compensatory window.
5. Where there is a satisfactory payments position apart from the shortfall, access would be available untranchéd up to the full compensatory window plus the optional window.
6. Where there is a payments imbalance that goes beyond the export shortfall, the compensatory window would be divided into two tranches, with a third optional tranche of 20 percent available as indicated above. In such cases, the guidelines would be applied as follows, paying due attention to the member's indebtedness to the Fund:
 - A. A lower tranche drawing would be permitted in the following circumstances:
 - (i) If a country has a good record of cooperation and its policy actions and intentions are judged generally

adequate. (The drawing would be available immediately, and there would be no requirement for an economic program or negotiations on a program.)

(ii) If payments imbalances are large and a country's policies are judged deficient or the record of cooperation weak, but a country adopted prior actions that would provide "reasonable assurance" that the member's balance of payments problem would be addressed or, in more difficult cases, the country would adopt a Fund arrangement to provide the "reasonable assurance," and the drawing would be available upon Board approval of the arrangement.

- B. Upper tranche: no change in guidelines of practices.
- C. Optional window (20 percent): it would be available upon program reviews.

7. There would be a positive presumption of availability of financing under the contingency window, within the context of an appropriate mix of adjustment and financing. Contingent access in a particular arrangement would be set on a case-by-case basis, taking into account the member's financing and adjustment needs and its capacity to meet its obligations to the Fund, but generally would not exceed 70 percent of the access under the associated basic arrangement.

Among the unresolved technical and operational issues that will require further work by the Board following the Interim Committee meeting are:

1. The access limits for the compensatory and contingency windows, and for the two tranches of the compensatory window.
2. Specification of exogenous variables to be generally applied to determine contingency financing.
3. Mechanisms of symmetry.
4. Level of threshold for activation of contingency financing.
5. Mechanisms for disbursement of contingency financing and determination of associated adjustment measures.
6. Extent and nature of coverage of contingency financing for interest rate developments.

Mr. Goos said that he broadly shared the view of Mr. Dallara that a number of issues needed further consideration before the Board could come to more specific conclusions. In particular, the paragraphs in the Chairman's informal remarks on automaticity and reviews were formulated in a manner that his authorities probably could not support. Paragraph (4), which dealt with access to the external contingency mechanism, was currently too broad for his authorities to accept. They would prefer to report to the Interim Committee on the progress that the Board had made so far, without necessarily going into great detail with regard to specific issues.

Mr. Salehkhon pointed out that he was not part of the agreement summarized in either Mr. Dallara's statement or the Chairman's informal remarks.

Mr. Mawakani said that while Directors were in agreement, as was stated in the Chairman's informal remarks, that the central features of the compensatory financing facility should be preserved and that the external contingency mechanism should shield Fund-supported programs from external contingencies in order to maintain the momentum of adjustment, his authorities found it very difficult to come to a compromise based on the informal remarks. Given the complexity of the issues at hand and the diversity of views, they considered that a more cautious approach would be preferable. Accordingly, for the time being, the Fund should retain the compensatory financing facility as it was and postpone all decisions with regard to the external contingency mechanism until after the Interim Committee meeting, when the Board would have more time to study in detail all the operational modalities. That position did not pre-empt the possibility of merging the two facilities at a later stage if the Board so wished.

The Chairman's informal remarks proposed a compensatory financing access limit of 40 percent--a reduction from 83 percent--and a lower tranche of 20 percent--a reduction from 50 percent, Mr. Mawakani noted. It would be difficult for his authorities to go along with that proposal.

Mr. Sengupta said that while he welcomed the introduction of an external contingency mechanism, his authorities could not accept the Chairman's informal remarks as they stood. Those who were concerned about preserving the compensatory financing facility had been presented with a reduction in access from 83 percent to 60 or 65 percent, with a reduction in the lower tranche from 50 percent to 20 or 25 percent. In exchange, they had been offered an external contingency mechanism whose modalities were still unclear. That type of trade-off was not acceptable to his authorities, who would prefer to maintain the current compensatory financing facility until after the Interim-Committee meeting.

While the positions outlined by the Chairman in his informal remarks did reflect agreements by Executive Directors, those agreements were subject to the Board reaching a consensus, Mr. Sengupta remarked. His authorities would welcome creation of the external contingency mechanism as a separate facility, allowing time to observe its operation before

considering whether it should be combined with the compensatory financing facility. He considered that the Chairman's informal remarks at the end of EBM/88/38 (3/11/88), together with his concluding remarks at EBM/88/31 (3/4/88) would be sufficient basis for the Managing Director's statement to the Interim Committee.

The Chairman indicated that he would base his presentation to the Interim Committee on the situation at the conclusion of the current meeting.

Mr. Ismael made the following statement:

In our efforts to arrive at an acceptable compromise, we have moved considerably from our preference for a separate external contingency mechanism to a combined facility with aggregate access of 120 percent. Later, we compromised further by indicating a willingness to accept an access limit of 110 percent of quota, provided that there is adequate liberalization in access to the first compensatory financing tranche, which we define as 40 percent of quota. I appreciate the Chairman's desire to reach a quick settlement, but it is equally important that the wide differences of view in several areas be recognized. Several elements of the Chairman's latest proposal are unacceptable to this chair, and we would reiterate our position as follows.

First, we would prefer an overall access of 120 percent of quota but, in any event, it should be no less than 110 percent of quota. I note that the majority in the Board supports an access limit of 110 percent, as well as a 40/30/40 split.

Second, my authorities cannot accept the 40 percent of quota available for the compensatory financing facility being split further into two tranches, given the already significant reduction in the compensatory financing component from the present 83 percent of quota. In my authorities' view, this split would imply a significant restriction in access compared with the existing limit of 50 percent of quota for the first compensatory financing tranche.

Third, the Chairman's previous formulation of untranching compensatory financing access up to 83 percent of quota in cases in which there are no balance of payments problems beyond the export shortfall is now missing from the package. We would like this element to be reintroduced.

Fourth, the Chairman's interpretation of the guidelines on cooperation with respect to the first compensatory financing tranche does not provide the liberalization in access that we require in exchange for our acceptance of a combined facility, a reduction in the compensatory financing first tranche, and a lower total access for compensatory financing. My authorities

consider that a request for a drawing on the first compensatory financing tranche would be presumed to satisfy the present guidelines if the export shortfall is of a short-term nature and largely attributable to circumstances beyond the member's control, and the member is willing to cooperate with the Fund in an effort to find appropriate solutions to its balance of payments problems. The exception would be if there were substantial indications that the member's record of cooperation in recent periods had been unsatisfactory, and that the existing policies were seriously deficient.

Therefore, I reiterate my strong support for a 40/30/40 solution, with the entire compensatory financing component of 40 percent of quota to be regarded as the first tranche, and the optional element of 30 percent of quota to be treated as the upper tranche. In cases in which the external payments difficulties are confined only to the export shortfall, there should be untranching access up to 83 percent of quota. I emphasize that this is the very minimum that my authorities can accept.

The Chairman noted that the existing 83 percent untranching access for those few cases in which export shortfalls were experienced with no balance of payments problems would be retained as part of his proposal, although the view of the Board was not unanimous on that subject.

Mr. Yamazaki urged Directors to move as far as possible toward a consensus so that a meaningful discussion could be undertaken by the Interim Committee without too much attention to small technical matters. His authorities attached great importance to the creation of a combined external contingency/compensatory financing facility with a substantial contingency component. While he had stated previously that he preferred tranching of 35/20/45, in the light of the discussion's development, he could adjust that position.

The compensatory financing element of the new facility should be safeguarded by appropriate conditionality, with a three tranche approach being preferable, Mr. Yamazaki said. He therefore supported the Chairman's proposal to divide the compensatory financing window into two tranches, with current conditionality being applied to the lower and upper tranches. He preferred that a case-by-case approach be taken to disbursement of contingency financing, although he could follow the view of the majority. He could not go along with the proposal to make automatic disbursements, and supported the original proposal that activation of the external contingency mechanism be made only through an ad hoc program review. However, that issue could be discussed after the Interim Committee meeting. In general, he could go along with Mr. Dallara's statement.

Mr. Cassell said that he had not expected that the full 83 percent of compensatory financing would still be made available to members without balance of payments difficulties beyond the export shortfall. He considered

that the current discussion had taken a sharp turn from that of previous meetings and felt that the Board should work to build on the attempts made by the Chairman and by Mr. Dallara at summarizing the consensus.

The Chairman noted that the 83 percent compensatory financing access would be granted only in exceptional cases, for which the Fund had few precedents. He concurred with Mr. Cassell's disappointment that Directors seemed unwilling to move from their current positions.

Mr. Cassell said that it was not the Chairman's reference to the exceptional cases of access to full 83 percent compensatory financing that had concerned him, but rather, his impression that a number of Directors wanted to return to the existing compensatory financing facility and consider the establishment of an external contingency mechanism as a separate entity, with the combination of the facility to be considered at a later date.

Mr. Ortiz said that he and some of his colleagues had firm views on some of the issues, but it was not accurate to characterize those positions as taking the consensus backward.

Mr. Dallara asked Mr. Ortiz to set out what he considered were the areas of consensus and the areas of differences. The note he had circulated to Directors did not set forward his own opinion, but rather was a genuine attempt to capture some of the areas of consensus. For that reason, he had intentionally not tried to specify within the overall access ceiling of 100-110 percent the precise size of each window, because there had not appeared to be a consensus on that subject. However, the lack of consensus on some particular issues was not the same as returning to a simple review of the compensatory financing facility, with the possibility of a contingency mechanism being considered alongside. Such an approach was totally out of the question for some Directors.

Mr. Rye indicated that his authorities did not consider that the compensatory financing facility should continue on the present basis with the external contingency mechanism being experimented with simultaneously. He had been prepared to work through the Chairman's informal remarks, paragraph by paragraph, with Directors in an attempt to see where further consensus could be reached, and he was disappointed that some Directors did not seem prepared to do so.

In the spirit of reducing the areas of disagreement, Mr. Rye said that it had been his understanding that there had been a consensus to preserve 83 percent untranching access to compensatory financing for those limited cases in which no balance of payments imbalance other than the export shortfall existed. However, Mr. Dallara's paragraph 5 appeared to run against that understanding.

Mr. Dallara said that that paragraph did not so much run against the understanding as it did not run quite far enough, because it was certainly consistent with the spirit of the Chairman's suggestion. His authorities

had no problem with the notion of maintaining full untranching compensatory access up to the maximum amount of the compensatory plus optional windows, nor did they have any difficulty with maintaining untranching access up to 83 percent if it were done through the appropriate windows. Discussions to date had centered around a facility whose total access would be in the range of 100-110 percent, with a compensatory window, a contingency window, and perhaps an optional window. The notion of granting 83 percent compensatory access posed a serious problem of consistency with the basic structure of the combined facility. He could supplement his suggestion in paragraph 5 by stating that contingency access up to, say, 20 percent could be made available without the country having a program, in similar circumstances to those for which 83 percent compensatory financing access was allowed, in order to retain a measure of consistency in the combined facility. He was willing to discuss that further, if there was still a basis to move ahead in discussing the Managing Director's informal remarks.

Mr. Fogelholm said that he, like Mr. Rye, had been prepared to work toward a consensus based on the Chairman's informal remarks. He also felt that the Board had regressed somewhat in its progress toward a consensus, and considered that it would be a loss for all members if no progress could be achieved at the current meeting.

The Chairman agreed that it was in the interest of all Directors to make the next Interim Committee meeting as productive as possible. If the current meeting were concluded immediately, he was concerned that the Interim Committee would not have the proper basis for a quick agreement. He suggested that recess be taken in order that he might sound out the precise position of individual Directors and ascertain whether or not there was a possibility of further negotiation. If not, then he would prepare his report to the Interim Committee on the basis of the present situation.

The review of the compensatory financing facility, which had to be made before the Interim Committee meeting, had not yet been completed, the Chairman observed; the action necessary in that respect could be decided after the recess, which would begin once those Directors who had already asked for the floor had spoken.

Mr. Hogeweg said that his chair was prepared to discuss the Chairman's informal remarks, although he had little to add to its previous statements other than the fact that his chair had always had a very favorable attitude toward the compensatory financing facility, and attached a great deal of importance to the views of the primary recipients of that facility.

His chair was very much concerned with the impact of the access limits to the facilities on the Fund's liquidity position, Mr. Hogeweg indicated. Therefore, the combined facility access should not exceed 100 percent of quota. The optional tranche should be rather limited in size--perhaps 20 percent. That would result in a tranching pattern of 40/20/40.

Mr. Sengupta remarked that it was not necessary to conclude discussion of a combined facility before the Interim Committee meeting. His authorities found it difficult to accept the fact that, in the present state of the international economy, the industrial countries would consider it necessary to substantially reduce compensatory financing access--from 83 percent to 60 percent. If the industrial countries considered that, regardless of the composition of the external contingency mechanism, compensatory financing access should be drastically reduced, they should make that clear. The trade-off being offered to the countries that used the compensatory financing facility was not attractive.

Mr. Kafka said that while he was grateful to the Chairman and to Mr. Dallara for the efforts they had made to bring before the Board a text that could be the basis for an agreement, he considered that the Board was far from such an agreement at the present time.

The Executive Directors agreed, at 3:25 p.m., to adjourn the discussion, which was resumed at 6:40 p.m.

The Chairman indicated that a dinner would be held for Executive Directors following the current meeting in order to facilitate a conclusion to the discussion. He reminded Directors that although it might not be explicit in his informal remarks, he did favor two windows--a compensatory financing window and a contingency window--within a combined and common facility.

Mr. Sengupta said that his first preference was to create a combined facility on the basis of discussions to date. However, if such an understanding could not be reached, he would not want to see the external contingency mechanism completely dismissed, which was why he proposed a separate trial external contingency mechanism.

The Chairman noted several points on which the Board's discussion should concentrate. First, a decision had to be made on the overall size of the facility, within the current agreement on a range of 100-110 percent. Directors of developing countries had made a strong case for tranching of 40/30/40, while others supported tranching of 40/20/40. If all the other issues were properly settled, perhaps the Board could propose to the Interim Committee an access of 105 percent. Second, the text on the application of guidelines would have to be decided upon. Third, there was the question of tranching. While the G-9 countries felt strongly that the 40 percent compensatory financing window should be available in one single tranche, to which guidelines for lower tranche cooperation would be applied, other Directors felt equally strongly that the 40 percent should be tranching, with greater conditionality on the upper tranche of the 40 percent compensatory window. He had included the concept of tranching the 40 percent in his informal remarks, considering that it worked toward a compromise, but it seemed that that might not be the case, and it was not essential for the protection of Fund resources to subdivide the compensatory window.

Executive Directors then had circulated to them the following redraft of the Chairman's statement on the application of guidelines on cooperation, which was appended to his informal remarks on the compensatory and contingency financing facility.

I would like to elaborate on my comments on how the guidelines on the test of cooperation would relate to the lower compensatory financing tranche, based on evolving experience. As I said there would be no need for a change in the letter of the guidelines but we would need to interpret them in a manner that both ensures timely access for the member and provides an adequate degree of protection for the Fund's resources.

A request would be presumed to satisfy the guidelines if the export shortfall were temporary and largely attributable to circumstances beyond the member's control, and the member was willing to cooperate with the Fund in an effort to find an appropriate solution to its balance of payments problems, unless there were substantial indications that the member's record of cooperation in recent periods had been unsatisfactory, or that its existing policies were seriously deficient. It will in all cases be important to pay due attention to the member's indebtedness to the Fund and its capacity to service its future debt obligations.

If a country has a good record of cooperation and its policy actions and intentions are judged generally adequate, the drawing would be available immediately.

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 prior actions that would provide "reasonable assurance" that policies corrective of the member's balance of payments problem would be adopted.

The Chairman noted that the redraft used the wording of Mr. Dallara's note (paragraph 6(A)(i)) in reference to compensatory financing conditionality for first category countries with a good record of cooperation. The new second paragraph reflected the proposed drafting set out in Mr. Ismael's statement.

Mr. Kafka observed that the conditions in the second and third paragraphs of the re-draft were repetitive, and therefore misleading. In addition, the last sentence of the second paragraph--which indicated that it would be important, in all cases, to pay attention to the member's indebtedness to the Fund in its capacity to service future debt obligations--was essentially a repetition of the condition that there should be no substantial indications that the member's record of cooperation in recent periods had been unsatisfactory, or that its existing policies

were seriously deficient. On the fourth paragraph, the first sentence once again repeated the conditions that already appeared in the second paragraph.

The Chairman indicated that, given the degree to which the Fund was currently suffering from arrears, it was important to make clear that the Fund would pay special attention to the situation of overdue obligations even though it might already have been mentioned implicitly. The second sentence of the fourth paragraph made it clear that prior actions would be necessary to provide the reasonable assurance that the Fund required in such difficult cases. On the question of countries' indebtedness to the Fund, it was not possible to establish a precise classification of countries, and a great deal of judgment would be needed, with the staff informing the Board in each case whether the indebtedness to the Fund was significant and whether the member's capacity to service future debt was questionable. The judgment would have to be made by the Executive Board. Accordingly, the reference to the debt situation and capacity to service debt obligations was essential.

The Director of the Exchange and Trade Relations Department suggested that the third paragraph of the text could be deleted, with the last few words "...the drawing would be available immediately" being moved to the first line of the second paragraph, the first sentence of which would then read: "a request would be presumed to satisfy the guidelines and the drawing would be made available immediately if the export shortfall were temporary..." To meet Mr. Kafka's second point, the first sentence of the final paragraph could be deleted, and the words "In such cases" inserted at the beginning of the second sentence, which would read: "In such cases, consistent with the guidelines...would be adopted." The revised sentence could then be moved and inserted before the penultimate sentence of the second paragraph.

Mr. Ortiz suggested that, the reference to a member's "indebtedness to the Fund" in the final sentence of the second paragraph be deleted, thus eliminating one of the judgmental aspects. It was not so much the indebtedness to the Fund as a country's capacity to service that debt that was important.

Mr. Chatah indicated that he supported Mr. Ortiz's suggestion.

Mr. Dallara said that while he was willing to work on the text on guidelines that Directors had before them, he did not consider it possible to find appropriate language without, at the same time, dealing with the question of the number of tranches into which access to the compensatory financing facility would be divided. He had no difficulty with the proposals by the Director of the Exchange and Trade Relations Department and by Mr. Ortiz. However, he did suggest that the word "substantial" be deleted from the first sentence of the second paragraph, since it excessively reduced conditionality. Also, the reference in the Chairman's previous draft to the most difficult cases was missing from the latest draft. As he understood it, those cases would be included under those

cases in which there were problems of cooperation. However, he considered that, for some of the particularly difficult cases, the Board should preserve the option of disbursing compensatory financing in conjunction with program approval.

The Chairman indicated that program approval could be one of the prior actions required for the more difficult cases.

Mr. Cassell observed that the first sentence of the second paragraph, as it had been redrafted, was very long, and should perhaps be divided. On the final paragraph, he had placed much emphasis on the reference to large balance of payments imbalances, and considered that such a reference had to be retained. Perhaps the reference to existing policies being seriously deficient would take into account the size of the imbalance, but that was not clear.

The Director of the Exchange and Trade Relations Department suggested that the first sentence of the second paragraph be divided by placing a period after "...balance of payments problems." The rest of the sentence could be preceded by "However, if...."

Mr. Kafka remarked, in response to Mr. Dallara's point, that the term "substantial indications" was an attempt to assure member countries who were denied immediate access to compensatory financing that the staff could defend its position.

Mr. Sengupta, in response to Mr. Cassell's points, agreed that a reference to the size of the balance of payments should be retained. On Mr. Dallara's point regarding "substantial indications," the term had to be qualified, since all members at some point had some degree of difficulties. Those difficulties had to be substantial or significant before they should affect a country's access to compensatory financing.

Mr. Dallara noted that, if the first sentence of paragraph 2 were divided into two sentences, some link had to be made between them to focus the reader's attention on the second sentence. The new first sentence, which ended "...balance of payments problems," should be completed by the phrase "except as provided for below." Otherwise, the sentence became a definitive statement that, no matter what the situation of the country, an immediate drawing would be available.

The Director of the Exchange and Trade Relations Department suggested that the second sentence of the second paragraph, which concluded "...policies were seriously deficient" could have added to it "...in relation to its balance of payments imbalances."

Mr. Goos said that the suggestion of the Director of the Exchange and Trade Relations Department did not make a specific enough reference to large imbalances.

Mr. Ortiz observed that a country's balance of payments imbalance was taken into account in the final sentence of the second paragraph, in which it was stated that attention would be paid to the member's capacity to service its future debt obligations. If a country had a large imbalance, that would affect its ability to repay the Fund.

Mr. Goos noted that it was inaccurate to make a specific reference to existing policies being seriously deficient in relation to the size of its balance of payments imbalances, because policies could be seriously deficient in many other respects.

Mr. Kafka suggested that the term "inter alia" precede the reference to the size of the balance of payments imbalances.

The Director of the Exchange and Trade Relations Department proposed that the reference to the size of a country's balance of payments imbalances could be widened by stating: "the size of its existing or prospective balance of payments imbalances."

Mr. Dallara said that he had difficulty with the elimination of a reference to large balance of payments imbalances and with the retention of the term "substantial indications." In addition, he could not accept the language as agreed, unless it was clear that compensatory access would be made available in three tranches. The absence of any reference to a program was clearly also a substantive problem for him, unless it was clear that there would be three tranches. While the Chairman had pointed out that prior actions included programs, it was important to him that a specific reference be included, particularly if there would be only two tranches.

Mr. Donoso proposed that the final sentence of paragraph 2 be made clearer by adding the phrase "...to the Fund" to the words "capacity to service its future debt obligations "

Mr. de Groote suggested that it would be preferable to state, in the first sentence of the second paragraph, "except as provided for below," instead of "except as discussed below."

Mr. Sengupta said that his authorities would find it difficult to accept subtranching of the 40 percent compensatory window, given the fact that they had already accepted a reduction in total access from 83 percent to 60 or 70 percent, particularly since it was not yet clear precisely how the external contingency mechanism would be operated.

Mr. Ortiz noted that it would be more consistent with the language of the guidelines to state, in the penultimate sentence, that the Fund would "expect prior actions" rather than "require prior actions."

The Chairman said that the debate over two or three compensatory tranches was a separate matter, and asked Directors to accept the text on the application of guidelines on cooperation subject to the outcome of the

rest of the negotiation. For the present, the text would be taken as it was, with the reservations of Mr. Dallara on the term "substantial indications," and on the concept of prior action--as opposed to specifically mentioning programs. The question of tranching would be discussed over dinner.

The Executive Directors concluded their discussion at 8:15 p.m., and moved to informal discussion over dinner.

LEO VAN HOUTVEN
Secretary

Application of Guidelines on CooperationLower Tranche

I would like to elaborate on my comments on how the guidelines on the test of cooperation would relate to the lower compensatory financing tranche as drawn from evolving experience.

As I said, there would be no need for a change in the letter of the guidelines, but we would need to interpret them in a manner that both ensures timely access for the member and provides an adequate degree of protection for the Fund's resources. In this respect, it will be important to pay due attention to the member's indebtedness to the Fund and its capacity to service its future debt obligations.

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 lower tranche drawing would of course be permitted.

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 prior actions that would provide "reasonable assurance" that policies corrective of the member's balance of payments problem would be addressed.

In some difficult cases, an economic program that could be supported by a Fund arrangement may be necessary 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, I outlined how we might respond in such cases in a timely way that would recognize different country circumstances. Let me elaborate on what I had in mind by reference to two types of cases:

a. In the first case, the country has a good record of cooperation, low Fund exposure, negotiations have begun in good spirit toward an adjustment program that could be supported by a Fund arrangement and adequate progress has been made toward external financing arrangements; in this case, management could recommend that the Board support a request for an immediate drawing under the lower tranche. In formulating its judgment, management would also take into account the balance between the impact that a delay in providing compensatory assistance--or no such assistance at all--may have on the progress of the negotiations and the risks associated with providing such assistance at an early stage of the discussion.

b. In the other case, the balance of payments difficulties and economic imbalances are more severe, the past record of cooperation is weak, and policies are deficient; hence, management would recommend supporting a drawing only at the time of Board approval of a Fund arrangement. Whether the drawing could be limited to the lower tranche or would encompass both tranches would be decided on a case-by-case basis.

Upper Tranche

No change in guidelines or practices.