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INTERNATIONAL MONETARY FUND

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M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	
F. Cassell	C. Enoch
	Jiang H.
C. H. Dallara	
J. de Groote	
A. Donoso	E. V. Feldman
	A. M. Othman
	M. B. Chatah, Temporary
G. Grosche	B. Goos
	J. Reddy
A. Kafka	J. Hospedales
M. Massé	D. McCormack
Mawakani Samba	C. V. Santos
	I. A. Al-Assaf
G. Ortiz	L. Filardo
	M. Fogelholm
H. Ploix	D. Marcel
	G. P. J. Hogeweg
C. R. Rye	
G. Salehkhou	
A. K. Sengupta	L. E. N. Fernando
K. Yamazaki	S. Yoshikuni
	N. Kyriazidis

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

Also Present

African Department: A. D. Ouattara, Counsellor and Director; A. Basu. European Department: M. Guitián, Deputy Director, L. J. Lipschitz. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; H. B. Junz, G. G. Johnson, C. Puckahtikom, B. C. Stuart. Legal Department: T. M. C. Asser, W. E. Holder. Research Department: J. A. Frenkel, Economic Counsellor and Director; N. M. Kaibni, E. C. Meldau-Womack, R. Pownall, B. E. Rourke. Treasurer's Department: G. Laske, Treasurer; D. Williams, Deputy Treasurer; D. Gupta. Western Hemisphere Department: S. T. Beza, Director. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: A. A. Agah, A. G. A. Faria, A. R. Ismael, Khong K. N., K.-H. Kleine, R. Morales, P. D. Péroz, M. Pétursson, D. C. Templeman, N. Toé, A. Vasudevan, Yang W. Assistants to Executive Directors: N. Adachi, F. E. R. Alfiler, J. R. N. Almeida, R. Comotto, E. C. Demaestri, Di W., S. K. Fayyad, V. J. Fernández, B. Fuleihan, S. Guribye, C. L. Haynes, M. Hepp, G. K. Hodges, L. [illegible]bloue, S. King, V. K. Malhotra, C. Noriega, W. K. Parmena, L. M. Piantini, S. Rebecchini, A. Rieffel, S. Rouai, C. C. A. van den Berg, E. L. Walker, R. Wenzel.

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 (IS/88/3, 4/4/88) their consideration of the Chairman's informal remarks at that meeting on the compensatory financing facility and external contingency mechanisms. They also had before them 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 Chairman'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), together with his informal remarks on the compensatory financing facility and external contingency mechanisms made at Informal Session 88/3, 4/5/88. The Chairman submitted the following redrafts of the appendix (on the application of guidelines on cooperation for the compensatory element) to his informal remarks on the compensatory financing facility and external contingency mechanisms and of paragraphs 4 and 5 of those remarks.

Application of the Guidelines on Cooperation for Compensatory Financing Facility Element - Redraft

I would like to elaborate on my comments on how the guidelines on the test of cooperation would relate to the compensatory financing facility element, 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.

Except as provided for below, a request by a member experiencing balance of payments difficulties that go beyond the export shortfall would be presumed to satisfy the guidelines and a drawing for the full amount of the compensatory financing facility element would be available immediately if the export shortfall were temporary, 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. On the other hand, if 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 in relation to the size of its existing or prospective payments imbalances, then, consistent with the guidelines, we would continue to expect prior actions that would provide "reasonable assurance" that policies corrective of the member's balance of payments problems would be adopted. In these circumstances, access to the compensatory financing facility element would be in two tranches. The first would be disbursed as soon as appropriate prior actions are taken. Disbursement of the second tranche would take place according to the present guidelines and practices relating to the upper compensatory financing tranche. It would generally be expected that when a program was in place the optional tranche would become available upon program review. It will be important in all cases to pay due attention to the member's capacity to service its debt obligations to the Fund.

Redraft of paragraphs 4 and 5 of the Chairman's informal remarks on the compensatory financing facility and external contingency mechanisms

4. On external contingency mechanisms, provision for an external contingency mechanism in a Fund arrangement would create a positive presumption of contingent financing for specified amounts which would be established on a case-by-case basis, taking into account the need for an appropriate mix of adjustment and financing and the member's capacity to meet its obligations to the Fund, and would not generally exceed 70 percent of the access under the associated basic arrangement.

5. As soon as it appeared that a specified contingency was arising, a review by the staff would be carried out and Executive Directors would be asked to decide whether an external contingency mechanism purchase was justified, the amount that was justified, the extent to which existing performance criteria might need to be modified, and the understandings that might need to be reached with the authorities on adaptation of policies. An attempt would be made, whenever possible, to specify at the outset of the program 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 such cases, the staff assessment could be expedited and Board procedures could be adapted so that disbursement could be made with as limited delay as was feasible. In all cases, disbursements would of course require observance of relevant performance criteria.

The Chairman then proposed that Directors begin by discussing the text on guidelines on cooperation for the compensatory element. He noted that the latest redraft incorporated the suggestion of Mr. Dallara that the first sentence of the second paragraph include the phrase "except as provided for below." It also incorporated Mr. Kafka's suggestion that reference be made to the size of a member's "existing or prospective payments imbalances." In addition, it provided for two tranches for members with good records of cooperation, and three tranches for more difficult cases.

Mr. Sengupta noted that the penultimate sentence indicated that disbursement of the second tranche would be considered on the basis of the strength of the program and actions undertaken by the authorities. However, it had been agreed that actions could include a program, and therefore the words "program and" should be deleted.

Mr. Dallara said that his understanding of the previous evening's discussion at dinner was that Directors had agreed that the second tranche would be disbursed on the basis of the existing upper tranche guidelines and practices; he considered that the penultimate sentence used new language, and requested that it be changed to make it explicit that the existing guidelines applied. In addition, there should be a clear understanding of the basis for disbursement of the optional tranche.

Mr. Kye supported Mr. Dallara's understanding of the previous evening's discussion--that disbursement of the second tranche be made on the basis of existing upper tranche guidelines and practices.

Mr. Kafka noted that his agreement to the text was conditional on the outcome of other outstanding issues.

The Chairman stressed that no Director was committed to accepting the entire package until the conclusion of the discussions.

Mr. Al Assaf said that the text as it currently stood implied that the compensatory financing element was composed of only 40 percent, divided into two tranches. Only in exceptional cases would the 40 percent be divided into two tranches; accordingly, the first 40 percent should be considered as the lower tranche, and the optional tranche, as the upper tranche.

The Chairman indicated that the compensatory financing facility would comprise two elements--the 40 percent window and the optional tranche. For those countries with a good record of cooperation with the Fund, the first tranche would be 40 percent, and the optional tranche would be made available on the conditionality of upper tranche guidelines. For members with a poorer record, the first 40 percent would be subtranched for the protection of the Fund's resources. To take account of such situations, the current text made reference to the first subtranche being disbursed as soon as appropriate actions were taken, and the second tranche being disbursed on the basis of the strength of the member's program and actions. The optional tranche would be disbursed with upper tranche conditionality, according to the guidelines.

Mr. Sengupta suggested that the text on guidelines be subtitled "lower tranche" in order to make it clear that only disbursement of the first 40 percent was being discussed.

The Chairman agreed that the purpose of the text on guidelines on cooperation could be clarified by deleting the current third sentence of paragraph 3 of his informal remarks, which read: "The 40 percent of quota available for the compensatory financing facility would be drawn in two tranches, a lower and an upper." It would be replaced by a sentence reading: "The application of the guidelines which would govern access to the 40 percent of quota under the compensatory financing facility element is set out in Appendix I."

Mr. Al-Assaf said that it should be made clear in the Chairman's statement to the Interim Committee that a country had the choice of using the optional tranche for either compensatory or contingency financing.

Mr. Dallara said that it would help him if the availability of the optional window were discussed. His understanding had been that for the second category of countries--those that had a poor record of cooperation--the optional window would be made available upon program review. But for the first category of countries--those with a good record of cooperation--he had understood that current upper tranche guidelines and practices would apply.

The Chairman noted that the optional tranche would be made available, for both categories of countries, on the basis of upper tranche guidelines.

Mr. Dallara repeated that he had considered that a program review would be necessary for access to the optional tranche for second category countries. He insisted that program review, and not merely program approval, was necessary. That was a fundamental problem.

Mr. Rye said that he agreed that, for second category countries, access to the upper tranche of the compensatory financing element should be based on current second tranche practices. There would be a few cases in which a program would not be required, but certainly when a program was required and access to the second tranche was triggered by program approval, the country's access to the optional tranche would be triggered by the first program review. No discussion had yet taken place on the conditionality for those cases which did not require program approval for the upper tranche of the compensatory financing element.

Mr. Goos said that he shared Mr. Dallara's understanding of the previous evening's discussion; he had also considered that disbursement of the optional tranche to second category countries would be conditional on successful completion of a program review. In addition, he agreed that access to the upper tranche of the compensatory financing window should be conditional upon approval of a Fund program.

Mr. Yamazaki and Mr. Ovi said that they, too, had the same understanding as Mr. Dallara of the previous evening's discussion.

Mr. Chatah said that his understanding had been that access to the lower tranche of the compensatory element would be conditional on prior action without a program; access to the second tranche of the compensatory element would require prior action that might necessitate a program; and access to the optional window would be governed by the current upper tranche guidelines.

The Chairman asked whether Directors could agree that, for first category countries, there would be two tranches--the 40 percent compensatory financing window and the optional window; and that for second category countries, there would be three tranches, with the subtranching of the 40 percent compensatory financing window being determined after the Interim Committee meeting.

Mr. Dallara said that he could not agree to that. The first tranche of compensatory access should be 20 percent. If that had not already been accepted, he wished that other Directors had made that clear before.

The Chairman indicated that the discussion would proceed on the understanding that tranching would be conducted as he had just set out, with the fact that some chairs could not go along with that being noted.

Mrs. Ploix said that she went along with the Managing Director's statement as it stood, and had understood that access to the optional tranche would be conditional on either program approval or program review.

Mr. Dallara remarked that he was surprised by the apparent difference of interpretation of the Board's informal agreement over dinner. He thought that there had been no disagreement on the need for a review, and asked what the views of the other Directors were.

Mr. Sengupta indicated that in supporting the Managing Director's proposal, he was accepting that there would be three tranches for compensatory financing access. The question was with respect to the language of conditionality, which should be taken up with the Interim Committee, and followed up on from a legal point of view. Based on a suggestion by the Chairman, he suggested that the sentence in the redrafted text on guidelines referring to disbursement of the second tranche be adjusted to read: "disbursement of the second tranche would be considered on the basis of the strength of the program <u>and/or</u> actions undertaken by the authorities."

Mr. Ortiz said that he had understood the agreement as being that, in effect, the second 20 percent of the compensatory financing window would be disbursed to second category countries with upper tranche conditionality. The problem was that there would then be no difference between the conditionality of the optional tranche and that of the upper tranche of the compensatory financing window.

Mr. de Groote noted that while there was not a difference in terms of conditionality, there was a difference in terms of phasing, in the sense that the optional tranche would be made available at the time of a program review--if the country had a program--or at the time of program approval--if the country did not already have a program.

Mr. Ortiz noted that such conditions could not be stated specifically because, according to the guidelines, it was not absolutely necessary to have a program for upper tranche conditionality. Although it was the case that 31 of 32 drawings under the compensatory financing facility had been made in the context of a program, that could not be spelled out without contradicting the guidelines.

Mr. Kafka suggested that it be stated that the optional tranche "generally" be disbursed after review of a program.

Mr. Dallara said that he could accept Mr. Kafka's suggestion to use the word "generally." He also considered that he could take care of Mr. Ortiz's difficulty by simply making it clear in the text that, for second category countries, the second tranche of the compensatory financing element would be subject to existing upper tranche guidelines and practices. As far as the optional tranche was concerned, that could be taken care of either through Mr. Kafka's suggestion to use the term "generally," or by referring to a program review while adding the language of the Chairman's informal remarks: "...or in the absence of such a program, upon the Fund being satisfied that equivalent requirements had been met." That would take care of the possibility that even for second category countries the optional window might not require a program.

Mr. Rye indicated that he could go along with the proposals of Mr. Dallara and Mr. Kafka.

Mr. Ortiz said that he could not accept the inclusion of a warning that the optional window would generally be disbursed on the basis of a program review, even though that might actually be the case.

Mr. Sengupta pointed out that the inclusion of the word "generally" was effectively changing the guidelines. He was willing to accept that that might be the actual practice, in which case referring to existing practices should be sufficient.

The Chairman asked whether Mr. Dallara could agree that conditionality for second category countries' access to the optional window be decided later on, subject to the fact that existing upper tranche guidelines and practices would apply.

Mr. Dallara said that the previous evening's agreement to have only two tranches for first category countries had been a trade-off for having a clear definition of three tranches for second category countries; it was important to him to clarify that definition. Since Mr. Ortiz had said that the Board should not specify that in all cases a program would be required, he had offered two alternatives: first, Mr. Kafka's approach of stating that a program review would generally be required, and second, to require a program review or, in the absence of such a program, upon the Fund being satisfied that equivalent requirements had been met.

Mr. Massé proposed that the Chairman's statement to the Interim Committee state: "The Board agreed that, in the case of second category countries, access to the optional tranche would generally be granted after a program review."

Mr. Sengupta indicated that he was not happy with the qualification "generally," which was too vague. He preferred Mr. Dallara's reference to the Chairman's informal remarks--that, in the absence of a program review, the Fund would have to be satisfied that equivalent requirements had been met. However, the original wording had referred to program approval or review; he did not understand why Mr. Dallara was insistent on dropping "program approval." As situations developed, there could be cases in which program approval would provide sufficient protection. Acceptance of the entire sentence would not change the spirit of the guidelines and would give the Fund sufficient protection.

Mr. Dallara agreed that the opportunity for a country to improve its situation from second category to first category should be retained. However, he could not accept the use of the phrase "approval or review." If management decided that a country was in the first category, then the optional window would become available upon program approval, as was the custom under current upper tranche guidelines and circumstances. However, if a country was a second category country, then it was by definition subject to the three tranche approach.

Mr. Goos said that his concern was that a second category country could, on the basis of a program approval, have full access to 60 percent compensatory financing. That would result in heavy front-loading of a program, with the compensatory financing resources disbursed at the beginning of the program being much higher than the resources provided by the stand-by arrangement. Therefore, his authorities considered that the disbursements for second category countries should be phased.

The Chairman indicated that it was not possible for a second category country to receive its full compensatory financing entitlement in one disbursement.

The Director of the Exchange and Trade Relations Department said that prior actions would qualify a second category country for access to the first tranche, program approval for access to the second tranche, and program review for access to the optional tranche. If a country did not already have a program in place, then program approval would qualify it for the optional tranche, since the delay until a program review was possible was about nine months. The customary prior actions on which the Fund would insist were such actions as an exchange rate change or a sharp move in interest rates.

Mr. Fogelholm observed that there appeared to be general agreement that the second tranche be made available under the present practices for upper tranche conditionality. If there was a possibility to draw upon Fund resources in the upper tranche without a program, then the possibility of access with the approval of a program should also be preserved. Certainly, there were very few such cases, but the possibility should be retained. The three tranches would still be preserved.

Mr. Dallara said that his proposal did retain the possibility for even second category countries to have access to the optional tranche without a program. However, his concern was not simply a question of preserving the three tranches, but one of the conditionalities associated with each tranche.

The Chairman observed that there was a disagreement on how the second tranche for second category countries would be disbursed. Some Directors considered that access could be granted upon either approval or review of a Fund-supported program or, in the absence of such a program, the Fund being satisfied that equivalent requirements had been met. Other Directors preferred the omission of the words "either approval or." First category countries would have access to the 40 percent lower tranche under lower tranche conditionality and to the optional upper tranche under upper tranche conditionality. That was his understanding of the discussion to date.

Mr. Dallara said that, if agreement were not reached on the fact that the optional tranche for second category countries required a review or the equivalent, the result would be to reopen issues elsewhere in the text.

The Chairman then proposed that discussion of the text on the external contingency mechanisms begin.

Mr. Donoso noted that the redraft of paragraphs 4 and 5 did not make clear that while a review would generally be required to activate an external contingency mechanism, there was the possibility that, with sufficient prespecification, no review would be necessary.

Mr. Kafka said that he agreed with Mr. Donoso's point.

The Director of the Exchange and Trade Relations Department observed that, in omitting the term "automaticity," the redraft no longer permitted a drawing on the external contingency mechanism without the case coming before the Board; that was at variance with the Mexican example.

Mr. Dallara suggested that a sentence be inserted after the first sentence of the second paragraph, reading: "Such reviews would normally be conducted within the context of a midterm program review, although in some cases it might be useful and appropriate to conduct an ad hoc review in order to expedite the process." Then, the following sentence should read: "In some exceptional cases, an attempt would be made to specify at the outset of the program the link between additional financing needs and the relevant contingencies and policies that would need to be phased in should the contingencies arise."

Mr. Goos said that he could accept Mr. Dallara's proposed changes, but he found the access limit of 70 percent of the access under the associated basic arrangement to be too high, and would prefer a figure of, say, 50 percent.

Mr. Yamazaki said that, for the sake of consensus, he could support the proposals of Mr. Dallara.

The Director of the Exchange and Trade Relations Department observed that the redraft as it now stood did not allow for the possibility of no review in exceptional cases, such as the Mexican case, although reviews could take place on a lapse of time basis.

Mr. Donoso suggested that a phrase be introduced to ensure the possibility that, when appropriate, lapse of time approval could expedite external contingency financing disbursement.

Mr. Dallara said that while he would not welcome such an insertion, he could go along with it if his other changes were accepted.

Mr. Cassell said that he agreed with Mr. Dallara that it would not be possible to preselect the relevant variables other than in very exceptional circumstances, and the text, as it now stood, reflected that reality.

Mr. Donoso suggested that a sentence be added, reading: "An attempt would be made to specify at the outset the link between additional financing needs and contingencies and the policy actions that a country would have to adopt should contingencies arise." Then financing could proceed once it had been ascertained that the performance criteria had been observed.

Mr. Dallara said that he was willing to consider approval on a lapse of time basis, but not a complete omission of any review.

Mr. Kafka noted that Mr. Donoso was trying to preserve the possibility of a second "Mexican case."

Mr. Rye remarked that it would be very regrettable if the principle of Board approval for disbursement of funds were discarded for the sake of expediting disbursement by only a few days.

Mr. Ortiz noted that, in effect, Board approval would be granted at the beginning of the program.

Mr. Rye said that the Board would not know at the beginning of a program whether, in fact, the external contingency mechanism would be activated, much less what the amount of the disbursement would be.

Mr. Donoso said that the situation he was discussing was that in which it was possible to specify in advance the amount to be disbursed and under which conditions that would be done. He would suggest that, after the phrase "An attempt would be made whenever possible to specify at the outset of the program..." the point be added that if specifications could be made with sufficient accuracy, disbursement would proceed once it had been ascertained that performance criteria had been observed for the period of the arrangement subject to compliance with the rest of the program. Then, the text would continue "...In such cases, the staff assessment could be expedited and Board procedures could be adopted so that disbursement could be made with as limited delay as was feasible."

Mr. Sengupta said that he saw considerable merit in Mr. Donoso's suggestion, since it made clear that the expedition of disbursements should only take place in those particular cases.

Mr. Yamazaki said that while he was not satisfied with the agreement on the conditionality of compensatory financing purchases for second category countries, he could go along with the proposal in the spirit of compromise. However, he wanted to make his position clear.

Mr. Dallara said that, at the current stage, he could not associate himself with any of the text on the application of guidelines on cooperation. His chair's acceptance of having only two tranches for first category countries was completely conditional on the fact that second category countries would have clearly specified conditionality for access to the third tranche.

The Chairman indicated that the staff would circulate a paper summarizing the status of Executive Directors' current positions as a reminder for the Board, to which it could return after the Interim Committee meeting. It would be clearly noted that there were a number of areas in which agreement had not been reached. He would report to the Interim Committee on the position of the Board, indicating that the review of the compensatory financing facility was almost completed.

The Board had broadly agreed to the preservation of the compensatory financing facility's essential features, the Chairman noted. Directors had agreed to create a combined facility to cover external contingencies, although specific aspects of modalities still had to be discussed further. The overall access of the combined facility would be between 100-110 percent of quota, with the optional tranche between 20-30 percent. There were two schools of thought in the Executive Board--those who preferred a predominance of the compensatory element and those who preferred a predominance of the contingency element. However, it did not appear that one group was stronger than the other, so he would suggest that the two elements be of a similar size, although the Interim Committee could, of course, take a different view. He hoped to find a conclusion to the remaining areas of contention after the Interim Committee meeting, and considered that a good deal of progress had been made.

Mr. Salehkhou said that he reserved his right to submit a statement for the record after seeing a final version of the Managing Director's statement to the Interim Committee.

Mr. Sengupta observed that, when the Chairman said that there was broad agreement that a combined facility should be created, it should be stated specifically that that agreement was conditional on agreement about the nature of the two facilities, especially with respect to the amount of access, conditionality of tranching, and the issue of automaticity. Broad agreement to the creation of the combined facility was conditional upon agreement on those three basic elements. His reading of the Executive Directors' positions was that a majority were in favor of the compensatory element being predominant.

The Executive Directors then adjourned their discussion of the review of the compensatory financing facility, and external contingency mechanisms in Fund arrangements.

LEO VAN HOUTVEN
Secretary