

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
Informal Session 88/5

3:00 p.m., April 7, 1988

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

Executive Directors

A. Abdallah
F. Cassell

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

J. E. Ismael
A. Kafka
M. Massé
Mwakani Samba

G. Ortiz

H. Ploix

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

Alternate Executive Directors

C. Enoch
Jiang H.

E. V. Feldman
M. B. Chatah, Temporary
B. Goos
J. Reddy
J. Hospedales
D. McCormack
C. V. Santos
I. A. Al-Assaf

M. Fogelholm
D. Marcel
G. P. J. Hogeweg

N. Kyiazidis

L. Van Houtven, Secretary and Counsellor
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. Ouattara, Counsellor and Director. European Department: M. Guitián, Deputy 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, B. E. Rourke. Legal Department: T. M. C. Asser, P. L. Francotte. Research Department: J. A. Frenkel, Economic Counsellor and Director; E. Hernández-Catá, N. M. Kaibni, E. C. Meldau-Womack, R. Pownall. Treasurer's Department: F. 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: P. E. Archibong, W. N. Engert, A. G. A. Faria, A. R. Ismael, Khong K. N., K.-H. Kleine, A. Ouanes, P. D. Pérez, P. Péterfalvy, M. Fétursson, D. C. Templeman, A. Vasudevan, J. E. Zeas. Assistants to Executive Directors: N. Adachi, J. R. N. Almeida, K. Comotto, E. C. Demaestri, S. K. Fayyad, V. J. Fernández, B. Fuleihan, J. Gold, S. Guribye, M. Hepp, G. K. Hodges, L. Hubloue, V. K. Malhotra, C. Noriega, L. M. Piantini, S. Rebecchini, S. Rouai, G. Schurr, N. Toé, C. C. A. van den Berg, E. L. Walker, R. Wenzel, Yang W.

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

The Executive Directors considered a revised version of the Managing Director's informal remarks on the compensatory financing facility and the external contingency mechanisms which read as follows:

I would intend that these informal remarks be provided to the members of the Interim Committee as background. Our recent discussions lead me to believe that there is 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 and contingency elements, attaching the contingency 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 and contingency elements would each be 40 percent of quota and an optional tranche to supplement either element at the choice of the member 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 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 providing reasonable assurance of protection of the Fund's resources. The application of the guidelines which would govern access to the 40 percent of quota under the compensatory element is set out in Appendix I. If a member decided also to apply the optional tranche to the compensatory element 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. It should be understood that where a member has a satisfactory balance of payments position except for the effect of the export shortfall, the member would continue to qualify for an outright purchase of 80 percent of quota.

(4) On the question of access to contingency financing, provision for such financing 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.

After 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 a contingency 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. 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. 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 the policy actions that would need to be phased in should the contingencies arise. Where this specification could be done with sufficient precision, disbursement of contingency financing could proceed once it had been ascertained that performance criteria had been observed for the relevant period of the arrangement. In such cases, the staff assessment could be expedited and, after the Board had been informed, disbursements would be made. In all cases, disbursements would of course require observance of relevant performance criteria.

It would be my intention after the Interim Committee meeting to ask the Executive Board to consider further the modalities and operational elements of external contingency mechanisms.

Application of the guidelines on cooperation for compensatory element

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

The Chairman said that he had accepted a suggestion by Mr. Kafka after the conclusion of IS/88/4 (4/6/88) to reconvene because it appeared that Executive Directors had been working since that meeting to reduce the areas of disagreement. Accordingly, the staff had worked with Executive Directors to revise his informal remarks at IS/88/3.

He proposed to add a sentence to the end of the latest version of his remarks, stating that a fair amount of work still remained to be done, the Chairman said. There were still a number of important matters that remained to be discussed, including the mechanism for symmetry and the extent and nature of coverage for interest rate developments. He also considered that it should be made more clear that the two elements-- compensatory and contingency--were to be combined into a single facility.

Mr. Salehkhon indicated that it was not his position that the two elements should be combined into a single facility.

The Director of the Exchange and Trade Relations Department outlined the points of difference between the original version of the Chairman's informal remarks and the revised version before Executive Directors.

The new introductory paragraph simply drew attention to the fact that the Chairman's informal remarks would be provided to the members of the Interim Committee as background material, the Director explained.

In paragraph (2), the point had been added that the compensatory and contingency elements would be combined into a single facility, the Director continued. That was not a change of substance, but rather a point of clarification.

In paragraph (3), the Director recalled that the original statement had made reference to purchases under the compensatory financing facility, "being accompanied by actions that would provide reasonable assurance...." The reference to those actions had been deleted on the basis of the argument put forward by a number of Executive Directors that actions would not, in all cases, be required. In any event, the phrase stood alone, without that qualification. At the end of section (3), it was stated that where a member had a satisfactory balance of payments position except for the effect of the export shortfall, it would continue to qualify for an outright purchase of 83 percent of quota.

At the beginning of paragraph (4), the Director noted that the original statement had referred to external contingency mechanisms, but on the suggestion of an Executive Director, the wording had been rephrased to read "on the question of access to contingency financing."

A number of changes had been made to the final paragraph, the Director indicated. Several of those changes reflected points made by Mr. Dallara at the most recent meeting on the subject, and seemed to be accepted by Executive Directors. The second, third, and fourth sentences in the latest version were all additions, replacing the fourth and fifth sentences of the original version. The first sentence of the original version had also been deleted, and the second sentence had been replaced by a much abbreviated sentence, which had become the fifth sentence, reading: "In such cases, the staff assessment could be expedited and, after the Board had been informed, disbursements would be made." The condition that performance criteria be observed was retained in the final sentence.

Based on a suggestion by the Chairman, the Director said, a new final sentence had been added, indicating that the Chairman would ask the Board to consider the modalities and operational elements of external contingency mechanisms after the Interim Committee meeting.

The revised version of the appendix stated that "disbursement of the second tranche would take place according to the present guidelines and practices relating to the upper compensatory tranche," the Director of the Exchange and Trade Relations Department indicated. The text of the appendix had been debated at some length at the previous informal session. Access to the optional tranche, which previously had been covered in paragraph (3) of the main text, was now dealt with in the penultimate sentence of the latest draft, which read: "it would generally be expected that when a program was in place the optional tranche would become available upon program review."

Mr. Kafka registered his general reservation that he could not commit himself to any one element before agreeing on the whole package.

The Chairman indicated that no Director was to feel bound by discussing one element at a time; the package would be agreed to as a whole.

Mr. Al-Assaf noted that the appendix as it stood gave the impression that first category countries--those with a good record of cooperation--would have access to the compensatory element in one tranche. A sentence should be inserted before the phrase "on the other hand" reading: "the optional tranche would become available upon either approval of a program or, in the absence of a program, upon the Fund being satisfied that the equivalent requirements had been met," in order to make it explicit that access would be made available in two tranches.

Mr. Dallara said that he did not want to delete the reference to a review.

Mr. Kafka proposed that the second paragraph of the appendix be divided into three paragraphs, with the splits occurring before "On the other hand" and before the final sentence. Then it would be absolutely clear that certain elements would affect only the second category countries, while the need to service one's debt obligations to the Fund applied to all members.

Mr. Dallara suggested that a sentence be added after the second sentence reading: "The optional tranche would generally become available according to the present guidelines and practices relating to the upper compensatory financing tranche."

Mr. Al-Assaf preferred that it be stated that current guidelines on cooperation for the upper tranche would apply to the optional tranche, without the word "generally" being used.

Mr. Dallara considered that the word "generally" might be used with reference to the availability of the upper tranche upon program approval.

Mr. Sengupta suggested that the sentence read: "The optional tranche would become available, as appropriate, in accordance with paragraph (3) of the main text."

Mr. Chatah noted that Mr. Dallara's suggestion to include a sentence on the first category countries simply incorporated the fact that, for the optional tranche, upper tranche conditionality applied. Mr. Sengupta's suggestion left open the possibility of a review. Accordingly, he preferred the proposal of Mr. Dallara.

Mr. Ortiz said that he could go along with Mr. Dallara's proposal that it be stated that access to the optional tranche for first category countries would be subject to upper tranche conditionality. There would also be need for a sentence stating that those resources would become

available upon program approval. That consideration was symmetric to the sentence that was being added for second category countries.

Mrs. Ploix supported Mr. Chatah in suggesting a reference to upper tranche conditionality, without the qualification of "generally."

Mr. de Groote said that, apart from the changes to the text on which all Directors agreed, he had been in favor of the Chairman's initial presentation. In that draft, it was clearly announced in paragraph (3) that the application of guidelines governing the first 40 percent of access was dealt with in the appendix, and then in the following sentence the optional tranche was dealt with. With the latest redraft, anything relating to the optional tranche would be included in the appendix. He considered it preferable to keep the subjects separate.

Mr. Sengupta indicated that he could accept a reference to upper tranche conditionality according to the guidelines, but not a reference to current practices; it was the practices with which he had difficulty, and which he hoped could be improved upon.

Mr. Dallara said that possibly Mr. Sengupta's basic formulation could be used, with the qualification "as appropriate." He asked whether Directors could accept his earlier proposal to eliminate the term "when a program was in place."

Mr. Sengupta indicated that he was only willing to accept deletion of that phrase in an effort to work toward compromise. The phrase being deleted did have significance--for example, for countries that were applying for the third tranche and were only just adopting a program.

Mrs. Ploix stated that she had reservations regarding the tranching of the compensatory financing access into three elements for second category countries.

Mr. Goos said that he still was concerned about the issue of automaticity, and had not had time to consult with his authorities on the reformulation as set out in paragraph (4). His preference would be to place the two sentences preceding the last one into brackets. While he appreciated the effort to present those cases in which automaticity might be allowed as a clear exception, he also knew that exceptions could, over time, become the rule. The current formulation involved a heavy degree of automaticity; one would only have to ascertain that the performance criteria had been observed for a country to gain access to contingency financing, after which the Board would only be informed. That raised the fundamental issue of whether or not the Board should always be involved in decisions on disbursement of resources.

The other issue was that merely observing performance criteria would not give sufficient assurance that the program had indeed been implemented as envisaged, nor did it give assurance that the prespecified contingency measures were being implemented, Mr. Goos continued. Accordingly, it

would help his authorities if a further condition could be added after the words "performance criteria had been observed for the relevant period of the arrangement," reading: "...and the agreed policy actions were taken." He also considered that the general limit on contingency financing of 70 percent of the access under the associated basic arrangement--referred to in the first part of paragraph (4)--was too high. He would prefer that that sentence be placed in brackets.

Mr. Kafka pointed out that Mr. Goos's addition was not necessary, since the performance criteria would not have been fulfilled if the required policy actions had not been taken.

Mr. Goos responded that the observance of performance criteria was not the only condition under Fund arrangements, which also included a number of other policy requirements.

Mr. Kafka said that if the Fund stated that not only did the performance criteria have to be observed but also other conditions, unnecessary complications would be introduced that would destroy the value of the contingency element, which had to have at least a potential element of automaticity. There were cases in which the conditions under which contingency financing would be activated could be clearly specified in advance.

Mr. Ortiz noted that the completion of a review was considered part of the performance criteria. It was a standard clause in any review that additional measures could be taken if it was felt that the program's objectives were not being met. Accordingly, there was a safeguard in that possibility of including additional measures.

When the response to a particular contingency had been prespecified at the outset of the program, a maximum amount of contingency financing would be set in advance, Mr. Ortiz observed. Therefore, if the contingency could not be met either by contingency financing or by the additional measures contemplated under the program then, of course, a different program would have to be implemented, because the performance criteria would not have been met.

The Chairman noted that the qualification that the disbursements would not be made until "after the Board had been informed" implied that enough time would be allowed for members of the Executive Board to react if they had difficulty with the disbursement. Accordingly, a Director could request a Board meeting if he considered it necessary.

Mr. Yamazaki said that he agreed with Mr. Goos's concerns on the clause stating that disbursements would occur "after the Board had been informed" and on the previous sentence, in which the observance of performance criteria was considered sufficient conditionality for disbursement. However, he could go along with the majority.

Mr. Rye indicated that while he had been concerned about the place of the Board in the disbursement of contingency financing, he was reassured by the Chairman's statement that sufficient notification would be allowed.

Mr. Goos said that he had also been somewhat reassured by the Chairman's statement, although it was not quite clear to him whether, if the Board was simply informed, it could actually stop the disbursement on the basis of its concerns. He also wondered what type of information would be provided to the Board--would it merely be the fact that the performance criteria had been observed, or would it be a more detailed statement on the actual economic situation of the member country?

The Chairman said that disbursement would be suspended during the period of delay in which the Board could react. The delay had to be brief--he would suggest two working days--but the Board did require grounds for reacting; he presumed that the staff would circulate a note with the basic elements of its judgment.

Mr. Dallara said that he, too, had been concerned about the paragraph under discussion, and was only very reluctantly prepared to accept the deletion of the reference to lapse of time Board approval. Mr. Goos was focusing on the distinction between the Board being informed and its taking a decision on a lapse of time basis, and he had a valid point in his concern over whether or not associated policy actions would be taken. However, in the interest of retaining the language as it stood, he had a question on Mr. Ortiz's understanding of that language. Directors had agreed that there should be an appropriate mix of adjustment and financing. If a member agreed in advance to take certain policy actions immediately following the development of a contingency, but did not take those actions, did Mr. Ortiz consider that the staff would be obligated to recommend disbursement?

Mr. Ortiz said that if it were in the original arrangement that a country would take policy actions apart from those included in the performance criteria--which would be unusual--then he would expect the country to take them. However, since the performance criteria would have been already modified, it would seem redundant to also require additional policy actions.

Mr. Dallara asked Mr. Goos whether, with such a statement on the record, he could perhaps go along with the language as it had been agreed.

Mr. Goos asked whether it would be possible to replace the phrase on informing the Board with an explicit statement that the Board would take a decision on a lapse of time basis as expeditiously as possible.

Mr. Hogeweg asked what the operational difference would be between those two options.

The Secretary stated that, inasmuch as the Board would require the time necessary for any individual Director to have the matter be placed on

the agenda, the actual difference between the Board being informed and taking a lapse of time decision was very small indeed.

Mr. Donoso said that he understood that in one case the Board was informed, while in the other case the Board was expected to take an active decision in order for disbursement to occur.

Mr. Goos repeated his concerns, pointing out that there could be a situation in which making disbursements only on the basis of performance criteria would not make sense. For example, if a country experienced a negative shock and an unexpected favorable development in the capital account at the same time, then it would have no balance of payments need, and contingency resources should not be disbursed.

The Board should at least ensure that the country had actually implemented all policies and not just those that were explicitly formulated in terms of performance criteria, Mr. Goos went on. For example, a country could have, as part of its program, the condition that it had to maintain positive real interest rates. If it did not adhere to that condition, and an external shock occurred, the money would nevertheless be disbursed, even though with a different kind of interest rate policy there would have been no balance of payments need.

However, he did not wish to prolong the discussion, and since it appeared that there was a majority in the Board willing to accept the wording as it now stood, he would no longer oppose it, Mr. Goos said. Once again, he expressed his clear reservations, and those of his authorities.

The Chairman said that he understood Mr. Goos's concerns, which would be taken care of, to some extent, by the second stage of discussions when operational decisions would be addressed.

Mr. Dallara indicated that his authorities had consistently expressed serious reservations on the question of allowing 83 percent access for members that had a satisfactory balance of payments position except for the effect of the export shortfall, considering that it seriously fractured the integrity of the windows. He understood that that issue had been important to Mrs. Ploix in terms of "preserving the essential features of the compensatory financing facility." However, he was somewhat concerned with her reservation--which had not been expressed before--on the notion of having three tranches for second category countries. He wondered whether she was prepared to accept that allowing the 83 percent access for classical shortfalls would be a trade-off for having three tranches.

Mrs. Ploix said that that decision would have to be left to her authorities. It simply seemed logical that if it was said in the first paragraph that the essential features of the compensatory financing facility should be preserved, the 83 percent access should be allowed in normal, or classical, cases. The reference had been included in earlier

summings up, but had somehow been dropped at some point. There were other issues on which she could not agree, such as the level of overall access.

Mr. Mwakani asked about the significance of the reference by the Chairman in the first sentence of his informal remarks to broad agreement in the following areas. If there was any commitment to that agreement, he would have to express his reservation on the tranching of the compensatory element.

The Chairman said that the reference to a broad agreement should be perceived as his own judgment, and he would ask Directors at the end of the current meeting whether they could recommend the package as it stood to their authorities. If they had to introduce limiting brackets, he would ask them to reduce as much as possible the scope of those brackets.

Mr. de Groote observed that great progress had been made in clarifying the agreement. However, an opportunity should be given to Directors to transmit the emerging consensus to their authorities. It should be agreed that, while there were still a number of general reservations on the package, it could still be presented to the Directors' authorities. The only major issue remaining to be discussed was the question of overall access. He was in favor of agreeing as soon as possible on what could be transmitted to the authorities so that they could begin studying the agreement.

On the question of overall access, there appeared to be a convergence around the range of 100-110 percent of quota, and Mr. de Groote suggested that the Chairman ask Directors for their readiness to accept a tranching of 40/25/40, for a total access of 105 percent. The Director could then show that the Board was in a position to propose fully rounded decisions to the Interim Committee. He himself could agree with that tranching, and proposed that a first round be taken on Directors' positions regarding total access, after which Directors could communicate to their authorities the broad package. If the figure could not be agreed upon at the current meeting, then Directors could reconvene the following day.

Mr. Dallara said that he was willing to consider such an approach if total access were the only issue to which the Board would return and no further review of the text would take place.

Mr. Massé suggested that an attempt be made to reach a consensus at the current meeting; he could accept a tranching of 40/25/40.

Mr. Abdallah, Mr. Jiang, Mr. Kafka, Mr. Ortiz, Mr. Sengupta, Mr. Fogelholm, and Mr. Al-Assaf said that they could agree with tranching of 40/25/40.

Mr. Ismael said that he could agree to such tranching, on the understanding that that was part of the whole package.

Mr. Dallara indicated that if his other colleagues were prepared to support tranching of 40/25/40 as part of a complete package, then he was prepared to strongly recommend it to his authorities.

Mr. Rye said that, on the basis of Mr. Dallara's statement, he could go along with tranching of 40/25/40.

Mr. Cassell said that he, in the same spirit, could support such tranching.

Mr. Yamazaki said that, since the Board was so close to a consensus, he could support such tranching on the condition that it be part of the whole package.

Mr. Mawakani remarked that, because the package included tranching of the compensatory element into three tranches, he had to maintain his reservation.

The Chairman noted that, while no Executive Directors had been briefed by their authorities to accept the package as it now stood, he had hoped that they could at least recommend it to their authorities.

Mr. Mawakani said that since the total access to the compensatory financing facility would be reduced, it would be difficult for him to accept the current compromise, but he would attempt to recommend to his authorities that they accept it.

Mr. Dallara said that it should be understood that no Executive Directors could definitively commit their Governments at the current stage; the question was whether they were prepared to recommend the package.

Mr. Donoso indicated that he could recommend the package to his authorities, although he already had indications that they would not follow some of his recommendations on the matter.

Mr. Cassell said that he was quite prepared to recommend the package to his authorities, although he was not certain that he could receive a response by the following day.

Mr. Kyriazidis said that he had quite serious difficulty with the entire package being proposed, after having consulted with his authorities. They maintained the position that had been expressed by his chair on April 1, and he could not associate himself with the package now being proposed.

Mrs. Ploix said that she had the same difficulties as Mr. Mawakani, but she could tell her authorities that the package was representative of a certain consensus in the Board and that she hoped that they would support it.

Mr. Goos said that, subject to the caveats expressed by other Directors, he would also recommend the package to his authorities.

The Chairman indicated that he would add to his report to the Interim Committee, especially for those Executive Directors who had special difficulties with accepting the package, that the Executive Directors had decided to recommend the package in their personal capacity.

Mr. Kyriazidis remarked that he could not, even in a personal capacity, recommend the package to his authorities, but he would make a communication to them.

Mr. Salehkhov said that he would try to faithfully communicate what had occurred in the Board, without any personal views.

Mr. Hogeweg said that, while his authorities had stated that they were not prepared to support access of more than 100 percent of quotas, in the spirit of compromise he was willing to communicate to them the progress of the meeting and to personally recommend the package to them. That in no way, of course, bound his authorities.

The Chairman said that he felt the statements of Executive Directors authorized him to tell the Interim Committee that there was very broad support for the package, including the size of the overall facility. It was in that spirit that he would report to the Interim Committee. He hoped that in the following days further agreement would be reached, based on communications between Directors and the authorities. He trusted that the reservations of Mr. Mwakani and Mrs. Floix on the question of tranching would be minimized before the Interim Committee met. The Directors would receive a clean copy of the agreed statement that evening, so that they could send it to their authorities (see Annex I). He congratulated Directors for their spirit of compromise and their courage in taking responsibility for the nuances in the package.

The Executive Directors then concluded for the time being their informal discussion of the compensatory financing facility and external contingency mechanisms in Fund arrangements.

LEO VAN HOUTVEN
Secretary

The Chairman's Informal Remarks on the
Compensatory Financing Facility and
External Contingency Mechanisms - Final Version

I would intend that these informal remarks be provided to the members of the Interim Committee as background. Our recent discussions lead me to believe that there is 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 and contingency elements into a single facility, attaching the contingency element to Fund-supported adjustment programs. On overall access, agreement might be found on a figure of 105 percent of quota. The amount available under the contingency and compensatory elements would each be 40 percent of quota and an optional tranche to supplement either element at the choice of the member would be 25 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 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 providing reasonable assurance of protection of the Fund's resources. The application of the guidelines which would govern access to the compensatory element is set out in the appendix. If a member decided also to apply the optional tranche to the compensatory element 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. It should be understood that where a member has a satisfactory balance of payments position except for the effect of the export shortfall, the member would continue to qualify for an outright purchase of 83 percent of quota.

(4) On the question of access to contingency financing, provision for such financing in a Fund arrangement would create a positive presumption of contingency 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.

After 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 a contingency purchase was justified, the amount that was justified, the extent to which existing performance criteria might need to be modified, and the understanding that might need to be reached with the authorities on adaptation of policies. 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. 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 the policy actions that would need to be phased in should the contingencies arise. Where this specification could be done with sufficient precision, disbursement of contingent financing could proceed once it had been ascertained that performance criteria had been observed for the relevant period of the arrangement. In such cases, the staff assessment could be expedited and, after the Board had been informed, disbursements would be made. In all cases, disbursements would of course require observance of relevant performance criteria.

There are still a number of important matters that remain to be discussed, including the mechanism for symmetry and the extent and nature of coverage for interest rate developments.

It would be my intention after the Interim Committee meeting to ask the Executive Board to consider further the modalities and operational elements of external contingency mechanisms.

Application of the Guidelines on Cooperation for the Compensatory Element

I would like to elaborate on my comments on how the guidelines on the test of cooperation would relate to the compensatory 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 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. The optional tranche would become available, as appropriate, in accordance with paragraph (3) of the main text.

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 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 tranche. It would generally be expected that in these cases 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.