

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
Informal Session 87/6 + Correction 1

3:00 p.m., November 13, 1987

R. D. Erb, Acting Chairman

Executive Directors

A. Donoso
M. Finiaish
G. Grosche
J. E. Ismael

M. Massé
Mwakani Samba

J. Ovi
H. Ploix
G. A. Posthumus

A. K. Sengupta
K. Yamazaki

Alternate Executive Directors

E. T. El Kogali
Jiang H.
M. K. Bush
J. Prader

J. Reddy
J. Hospedales
C. Enoch

P. D. Pérez, Temporary
V. J. Fernández, Temporary

G. P. J. Hogeweg
C.-Y. Lia
S. Kouai, Temporary
L. E. N. Fernando

N. Kyriazidis

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

1. Structural Adjustment Facility - Enhancement of
Resources - Proposed Financial Arrangements Page 3

Also Present

African Department: J. Artus. Asian Department: K. A. Al-Eyd. European Department: E. O. C. Brehmer. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; S. J. Anjaria, S. B. Brown, H. Hino, M. Nowak. External Relations Department: I. S. McDonald. Fiscal Affairs Department: E. S. Kreis. Legal Department: F. P. Gianviti, General Counsel; A. O. Liuksila, R. H. Munzberg. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, D. H. Brown, J. C. Corr, D. Gupta, D. V. Pritchett, B. B. Zavoico. Western Hemisphere Department: J. Ferrán, Deputy Director. Advisors to Executive Directors: M. B. Chatah, S. M. Hassan, G. Pineau, I. Puro, N. Toé. Assistants to Executive Directors: N. Adachi, R. Comotto, F. Di Mauro, W. N. Engert, S. K. Fayyad, G. K. Hodges, L. Hubloue, V. K. Malhotra, W. K. Parmena, S. Rebecchini, A. Rieffel, C. C. A. van den Berg, R. Wenzel, Yang W.

1. STRUCTURAL ADJUSTMENT FACILITY - ENHANCEMENT OF RESOURCES -
PROPOSED FINANCIAL ARRANGEMENTS

The Executive Directors continued from IS/87/5 (11/13/87) their consideration of a staff paper on proposed financial arrangements for the enhancement of the structural adjustment facility (EBS, 7/228, 10/29/87; and Sup. 1, 11/11/87).

Mr. Posthumus remarked that during the recent meeting of the Interim Committee, the Governor for the Netherlands had indicated that his "Government would strongly support a debt strategy being developed primarily for those debt-distressed, low-income countries whose adjustment efforts warrant exceptional debt relief and additional import financing." He had added that "with regard to an enhanced structural adjustment facility, the Dutch authorities would prefer to make a contribution in the form of cofinancing with the World Bank," assuming that "the enlargement of the structural adjustment facility will take place in the framework of Fund-Bank collaboration, and that adequate conditionality will be maintained."

His authorities were prepared to make available, in the framework of the enhanced facility, a grant to the joint Fund-Bank initiatives for debt-distressed countries, Mr. Posthumus continued. The grant, financed from the development assistance budget, should be channeled directly to eligible countries in the form of cofinancing with World Bank programs. Eligibility for a program under the structural adjustment facility on the basis of a policy framework paper would be one of the conditions of lending. He would not elaborate further on his authorities' proposed approach, because a final decision on the amount of the grant had not yet been taken. He would be discussing specific arrangements with the staff, and hoped that procedures could be worked out, subject to agreement by the Board. In sum, his authorities supported the policy, but a direct contribution to the Trust Fund was not being considered at the moment.

The proposed arrangements for financing a Trust for the enhancement of the structural adjustment facility were acceptable, with one exception, Mr. Posthumus commented. He had doubts regarding the provision of security against the residual risk, particularly the proposal to allow a borrower under the facility to borrow from the Fund's general resources in order to repay obligations to the Trust. The residual risk of nonpayment of the Trust's obligations might be small, according to the strong view of management, but it certainly existed. He wondered what was envisaged in the event that that risk materialized and generalized solutions, such as the one proposed, were not acceptable to the Board at that time. In that connection, a few issues were particularly relevant. Contributions to the initiative, but not to the Trust, in fact decreased the risk of nonpayment of obligations to, and therefore also by, the Trust. Thus, there was a question whether members whose contributions were not channeled through the Trust could be expected to carry a share of the residual risk of nonpayment by the Trust. That issue would be an even more difficult one for the Netherlands if the Fund's gold was pledged to cover the residual risk.

Mr. Donoso remarked that his authorities had indicated that their contributions would have to be finalized in the context of a broadly based regional participation and after commitments by the main participants had been made. He wondered whether the staff could indicate, in comparable terms, the commitments of both principal and the associated subsidy received to date, so that Directors could better inform their authorities of the progress that had been made.

Mr. Finaish said that he welcomed the progress that had been made in the mobilization of resources and development of financing arrangements for the enhancement of the structural adjustment facility. The staff paper provided a useful discussion of how claims on the Trust could be protected against risk and provided with an appropriate degree of liquidity. His constituency included both potential contributors and countries eligible to use the facility, and all of those countries supported the timely initiative to enhance the facility's resources and were following its progress with interest.

Although he had not yet received enough instructions from his authorities to allow him to comment on the specifics of the staff's proposals, he could say that the modalities of the enhancement, as well as possible contributions, were being considered by some of his authorities, Mr. Finaish added. As Directors were aware, creditor countries in his constituency had provided substantial assistance to low-income countries. Their aid relative to GDP had continued to be quite high despite the sharp drop in their income and other unfavorable developments in the region in recent years. He was encouraged by the present discussion and hoped that broad international support for the enhancement would materialize soon. It was important that the participation of major industrial countries in the enhancement should be commensurate with their weight in the international economy. In that regard, he had noted the remarks made by Mr. Abdallah and others about U.S. participation, as well as Mr. Dallara's statement that the United States had not closed the door on the initiative to help low-income countries.

Mr. Jiang remarked that he had some reservations on the use of the resources of the Special Disbursement Account to pay interest subsidies. In view of the nature and spirit of international cooperation underlying the enhanced structural adjustment facility, the lenders should, in principle, provide their own interest subsidy; neither the Fund's resources nor contributions from other countries should be used for that purpose.

Although the U.S. authorities were facing a difficult fiscal position, he hoped that they would be still able to find the ways and means to contribute to the enhancement of the structural adjustment facility, Mr. Jiang concluded.

The Director of the Exchange and Trade Relations Department observed that many comments had been made regarding the security provided for claims on the Trust, and the nuances were diverse. The staff would carefully

examine the record of the discussion and would contact Executive Directors bilaterally when considering the implications of their comments and redrafting the paper for formal consideration by the Board.

On other issues, discussions on bilateral lending were still at a general stage, the Director from the Exchange and Trade Relations Department commented. In the staff's view, the terms and conditions for bilateral lending should be as similar as possible to those for lending to the Trust. On the proposed interest rate on overdue obligations, the staff had not intended that users of the existing facility should be subject to a surcharge. Finally, the staff would consider further the point raised by Mr. Donoso regarding the implications of commitments to date for a broadly based participation in the enhancement of the facility.

The Deputy Treasurer, commenting on the media of payment, remarked that there were legal limitations with respect to the ability of the Trust to accept and hold SDRs; the staff would, however, look at possible techniques for accommodating payments in SDRs as well as in U.S. dollars. On the provisions for the voluntary transfer of claims on the Trust, the staff had not suggested that such transfers should be subject to any particular conditions. It was assumed that agreement on any conditions would normally be reached between the parties when the transfer was arranged. The timing would be decided by the transferees and would not be specified in the decisions to give effect to the enhancement of the structural adjustment facility.

The date proposed for the termination of commitments to lend to the Trust was discussed in the staff paper on access and monitoring procedures (EBS/87/230, 11/9/87; and Cor. 1, 11/16/87), which the Board would consider in the coming week, the Deputy Treasurer observed. The length of the needed commitment period for loans to the Trust would depend essentially on the disbursement period for loans by the Trust, which, in turn, would depend on the cutoff date for possible commitments by the Trust, the provisions related to the phasing of disbursements by the Trust, and any provision that the Board might wish to make for delays in disbursements under an agreed program. On the basis of its analysis, the staff was suggesting a common cutoff date for lenders' commitments of mid-1992.

The staff was not proposing to increase special charges on existing loans under the structural adjustment facility, but rather was raising the question of special charges for the Board's consideration, the Deputy Treasurer noted. The rationale underlying that question was that late payments on existing loans under the structural adjustment facility would effectively reduce the amounts that could be transferred to the Reserve. The same rationale applied to the proposal that overdue obligations to the enhanced facility should bear an SDR interest rate.

Several questions had been raised regarding the provision for variation in the Subsidy Account interest rate, the Deputy Treasurer recalled. While it was hoped that contributors would provide subsidies that were fully sufficient to ensure a lending rate of 0.5 percent, it was not

absolutely certain that the subsidization required could be achieved. The staff therefore had suggested that the situation should be kept under review and if a shortfall emerged--whether because of a shortfall in contributions or developments in interest rates--the first course of action would be to seek larger contributions for the Subsidy Account in order to achieve the targeted rate. In the event that the subsidy shortfall was not covered, some provision was needed for adjusting the rate of interest. That rate would be reviewed periodically, and any adjustment of the rate would require a simple majority of the voting power of the Executive Board.

The suggested provision for the Subsidy Account to borrow was a contingency provision, the Deputy Treasurer explained. Although it was not at all certain that the Subsidy Account would need to borrow, it was desirable to have the ability to do so built into the Instrument, so that, for example, if sufficient cash contributions to the Subsidy Account were not actually in hand at the time that a subsidy payment had to be made but firm subsidy commitments were in place, the Account could borrow either from another agency of a contributor or possibly another government on a short-term basis against the security of the commitment. Of course, any borrowing would have to be decided by the Executive Board. In the event there were such borrowing, the cost would have to be low or zero, because the Subsidy Account itself would not have the ability to absorb net borrowing costs without effectively eroding the Account.

The staff representative from the Legal Department remarked that in the event of a member's liquidity need owing to unfavorable developments in its reserves, it was assumed that the member would use its reserve tranche before having access to the Fund's general resources under Article V, Section 3(b)(ii). That was an assumption, not a prerequisite. A distinction was made between a balance of payments problem under Article V, Section 3(a) and developments in reserves under Article V, Section 3(b)(iii), as explained in the Commentary on the Proposed Amendment of the Articles of Agreement. For example, if a member required access to the Fund's general resources for the purpose of discharging a liability, then the safeguards for use of those resources would be related to the member's particular liquidity situation. In that context, a claim on the Trust was one element that would be taken into account as a safeguard for the Fund.

A question had been raised about the legality of transfers to the Reserve under Article V, Section 12(f), the staff representative recalled. As the purpose of the Trust was to provide additional balance of payments assistance to developing countries, and the transfer of resources to the Reserve was a necessary element to establishing the Trust, such transfer was consistent with the provisions of the Articles.

The inclusion of protected provisions, whereby some provisions of particular relevance were not subject to amendment by the Executive Board, was a usual practice for all Trust Instruments, the staff representative from the Legal Department explained. For example, since the provisions

on reserves were important to assure contributors regarding the security of their claims they were proposed to be excluded from further amendment at a later stage.

Mr. Sengupta remarked that the transfer of resources from the Special Disbursement Account to the Reserve should be examined carefully before a final decision was taken. The resources of that Account, which had been created as a result of profits from gold sales, were, according to the Commentary, particularly destined for the use of low-income developing countries. It was difficult to accept the staff's explanation that the transfer of the Account's resources to the Reserve to provide security for the claims of creditors in some sense fulfilled the requirements of Article V, Section 12(f). In that sense, nothing would prevent the retransfer of those resources to the General Account because the Fund would be making Special Disbursement Account resources available to the developed countries. That specific point was raised in the Commentary itself. It therefore was necessary to explain carefully how the transfer would directly help low-income countries.

The issue was one of interpretation, and was of major concern because some Directors had suggested that the sale of the Fund's gold would be used to subsidize interest payments, to provide security, and so on, Mr. Sengupta continued. However, according to the Fund's Articles, all profits from gold sales would have to go to the Special Disbursement Account. It was therefore important that, if it was agreed that some amount of the Account was to be transferred to the Reserve in order to provide security to creditors, the agreement should be clearly stated and formulated so that it did not go beyond the amount of \$2.7 billion. Indeed, an open-ended arrangement would be difficult to accept.

The Acting Chairman remarked that the staff would certainly reflect on those questions and return to them at the next discussion on the enhancement of the facility.

The staff representative from the Legal Department commented that the decisions to be presented to the Board would be precise with respect to the transfers to the Reserve. The staff paper on the decisions would explain fully the consistency of those decisions with provisions for the use of the Special Disbursement Account.

Mr. Sengupta noted that although it was true that the resources of the Special Disbursement Account could be transferred to the General Resources Account for immediate use, such use would have to be consistent with the purposes of the Fund. The Commentary clearly indicated that, in the event, the member's need, uniformity of treatment, and other issues related to balance of payments support would have to be carefully considered.

Mr. Posthumus commented that although management was convinced that the residual risk of nonpayment of the Trust's obligations was very small, no provision had been made for what should be done in the event

that such risk materialized. While some Directors had argued in favor of a pledge of the Fund's gold against the residual risk, others had expressed satisfaction with the proposals as they stood. He was concerned that if the issue was not resolved at the present stage, there was no guarantee that it could be resolved when the residual risk materialized in 10 or 12 years. In his view, it was important for the decisions being taken that a generalized solution to that particular contingency should be found.

The Director of the Exchange and Trade Relations Department remarked that it was impossible to envisage the range of options that might be available to the Board in 12 years' time. Circumstances could be wholly different. For instance, in the future the Fund might have the right to issue SDRs to itself. Because it would be unwise to commit the Board to any particular course of future action, the resolution of the question of residual risk had deliberately been left open. The staff would review that question in the light of Directors' comments and of further bilateral discussions with their offices.

Mr. Ovi asked what would be the nature of the Fund's commitment? Would it be a declaration of intent only?

The staff representative from the Legal Department remarked that the commitment was, in fact, a commitment by the Executive Board to consider all the possibilities available as the issues arose. It thus had a legal character with respect to the promise made, namely, to consider all the available alternatives.

The Director of the Exchange and Trade Relations Department commented that in addition to its legal character, the commitment would be, above all, a moral one on the part of Executive Directors. In the history of the Fund, Executive Directors had always taken the moral commitments of their predecessors with utmost seriousness, and it was assumed that that situation would continue.

The Acting Chairman made the following concluding remarks:

We have had a most interesting and productive informal discussion of the financial arrangements proposed for the enhancement of the structural adjustment facility. I think we now have greater clarity on key points that have engaged our attention over the past months, and a good basis to proceed to develop further the financial aspects of the enhancement.

Let me refer to some of these key points:

First, the security of lenders' claims on the Trust is a question of concern to most lenders.

I want to stress again management's view--a view expressed also by a number of speakers today--that the fundamental source

of security lies in the strength of the authorities' commitment to the programs to be financed. This will be a subject of our forthcoming discussion on considerations relating to access and monitoring procedures under an enhanced facility.

With respect to added security, the proposal for the establishment of a Reserve in the Trust is summarized on page 4 of EBS/87/228 (10/29/87). Almost all Directors agreed that the proposed elements of financing should be placed in the Reserve. There was also agreement that the Fund should undertake, in the unlikely event that the Reserve were to prove insufficient to meet the obligations of the Trust and if it appeared that any delay in payment by the Trust would be protracted, to consider fully and in good faith all such initiatives as might be necessary to assure full payment to lenders. We shall approach individual contributors so as to fully understand the concerns raised by some Directors and to determine how the requirements of all participants and the Fund can best be met.

Second, the liquidity associated with claims on the Trust is not a question to which all attach equal importance because of the various institutional arrangements envisaged by different lenders. For some of those who are concerned regarding the liquidity of their claims, the arrangements suggested by the staff do not yet fully meet their needs. To an extent, the proposed arrangements rely on mutual undertakings by the parties involved, and we will continue to explore the possibility for such arrangements among those whose authorities have expressed a preparedness to consider such undertakings. The staff will be working with Directors to help determine the provisions necessary to make such a mechanism operational.

Third, our discussion today has covered a large number of specific details regarding loan commitments; procedures for calls; maturity, interest, denomination; and the operations of the Subsidy Account. On the Subsidy Account, I hope that all potential contributors can see their way to providing the grant component of their contribution in a flexible manner that will permit us to deal with possible fluctuations in the interest rates to be paid on some of the loans to be provided. We have noted Directors' comments on all these issues and will carefully take them into account in the preparation of specific documentation for the Board's subsequent consideration and approval. I should say, however, that the framework for the Trust's financial operations, as put forward in the staff paper, appears generally satisfactory both to the Board and to the individual lenders.

On November 20, we will discuss the companion paper on considerations relating to access and monitoring procedures under the enhanced facility. Shortly thereafter, the staff intends to issue further material, as may be needed, including,

if possible, early drafts of decisions and instruments necessary to give effect to the enhancement. The staff will also begin to work with potential contributors on the form of loan agreements that, within the basic principles indicated today, meet the individual needs of those contributors. All those issues will be further considered by the Executive Board in December.

LEO VAN HOUTVEN
Secretary