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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 93/45

10:00 a.m., April 2, 1993

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

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
T. C. Dawson	
	J. Prader
E. A. Evans	A. M. Tetangco, Jr.
	J. A. Solheim
H. Fukui	
	L. E. N. Fernando
J. E. Ismael	
D. Kaeser	
	G. Bindley-Taylor, Temporary
	A. V. Mozhin
	J. Papadakis
J.-P. Landau	P. Bonzom, Temporary
	J. M. Burdiel, Temporary
A. Mirakhor	
L. J. Mwananshiku	
D. Peretz	
G. A. Posthumus	
C. V. Santos	
S. Schoenberg	B. Esdar
A. S. Shaalan	Y. Y. Mohammed
	K. J. Langdon, Temporary
	Wei B.
	M. Estela

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

Also Present

IBRD: F. Choudhri, Development Policy Group. African Department: M. Touré, Counsellor and Director; G. E. Gondwe, Deputy Director; C. Brachet, J. A. Clement, R. L. Sharer. Central Asia Department: O. J. Evans, C. B. Mulder. European I Department: S. Oberg. European II Department: T. Shikado. External Relations Department: D. R. Hawley, R. W. Russell. Fiscal Affairs Department: J. A. Daniel. Legal Department: R. H. Munzberg, Deputy General Counsel. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; A. Basu, M. E. Edo, P. H. Mathieu, M. A. Pinon-Farah, J. Pujol, C. Puckahtikom, K. Thugghe, E. van der Mensbrugghe. Secretary's Department: A. Jbili. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; J. E. Blalock, K. Boese, E. Decarli, S. Fennell, D. Gupta, S. T. Lurie, M. A. Wattleworth. Western Hemisphere Department: B. C. Stuart. Personal Assistant to the Managing Director: G. R. Saunders. Special Advisor to the Managing Director: P. R. Narvekar. Advisors to Executive Directors: J. O. Aderibigbe, M. B. Chatah, R. F. Cippa, S. K. Fayyad, B. R. Fuleihan, J. M. Jones, N. Mancebo, E. Martínez-Alas, P. A. Merino, M. J. Mojarrad, M. Nakagawa, A. Raza, B. A. Sarr, Yang X. Assistants to Executive Directors: H. M. Al-Atrash, S. Al-Huseini, C. D. Cuong, R. Ferrillo, A. Galicia, M. E. Hansen, K. M. Heinonen, J. Jonas, R. Kibria, É. Kotova, G. J. Matthews, S. Narube, S. K. Regmi, S. Rouai, S. Shimizu, F. A. Sorokos, T. P. Thomas, R. Thorne, V. Y. Verjbitski.

1. UNAUTHORIZED DISCLOSURE OF INFORMATION

The Chairman stated that he had been distressed to learn that morning that the press had been given a fairly accurate report of the Executive Board discussion on the proposed facility to assist economies in transition (EBM/93/44, 4/1/93). The press had not made the appropriate references to the proposed facility's strong relationship to the implementation of policies, however, which therefore gave the public an incorrect idea about the tenor of the discussion. The wording that had been used in the Board describing the facility had appeared in the press as well, however, and from other clues in the report it was clear that someone who had attended the Board meeting had spoken to the press afterwards. That distressed him greatly. He would have wished to have been given the opportunity to provide the press with a straightforward statement about the proposed facility as soon as the Board had completed its work on it.

Mr. Fukui said that the question of a facility to assist countries in transition was a tricky one which needed to be discussed in depth and explained convincingly to the public. There should be no misunderstanding about the Fund's aims in creating such a facility. In that sense, he disliked informal leaks of the kind that had obviously just occurred. That notwithstanding, he trusted that at some point the Fund would give a clear explanation of its intentions, after the Board had discussed the issues thoroughly and had actually taken a decision.

The Chairman replied that he agreed completely with Mr. Fukui. The Fund's credibility was at stake, and further explanation of the details of the facility and the Fund's aims would be crucial. However, before that could be done, he would wish to have a better idea as to the consensus on the character of the facility as it developed in the Board. The Fund needed to send a single clear message; the leak had served to muddy the waters and confuse things, in his view. He intended to make a brief statement on the basic elements of the facility on which there was general agreement. More information would be provided to the press once the Board had agreed on the exact modalities of the facility.

Mr. Peretz remarked that he shared the Chairman's distress about leaks, which seemed to be getting worse. On the previous day, there had been three separate leaks of the paper on the world economic outlook. He was wondering what to do about the leak of the Board meeting on the special facility to assist members in transition. As an Executive Director, he would volunteer to make inquiries in his own office and with his authorities to see if there was any possibility that any of the leaks had originated there, and he would report to the Chairman on the results. He would suggest that his colleagues do the same.

Mr. Esdar said that he shared the Chairman's disappointment and concern. He believed that Mr. Peretz's suggestion was a very good one. Executive Directors were being placed in the strange situation of being informed only after their own authorities--or the press--were informed, a situation that was untenable, in his view.

The Directors concluded their discussion of the unauthorized disclosure of information.

2. OPERATIONAL MODALITIES AND FUNDING ALTERNATIVES FOR AN ESAF SUCCESSOR - PRELIMINARY CONSIDERATIONS

Executive Directors considered a staff paper on preliminary considerations relating to the operational modalities and funding alternatives for an ESAF successor (EBS/93/32, 2/26/93).

The Chairman commented that it was interesting--and in certain ways, symbolic--that the Board was turning to the issue of an ESAF successor after having had discussed only on the preceding day how to support reform, stabilization, and transformation in an important part of the world that, while not poorest part of the world, nevertheless faced important problems. The poorest countries in the world faced similar problems, and he had no doubt that the Executive Board would demonstrate similar commitment, imagination, and drive in dealing with the poorest as it had in dealing with the countries in transition in Eastern and Central Europe and the former Soviet Union.

Mr. Fernando made the following statement:

> The recent review of experience under programs supported by the ESAF, even though applying to a limited number of cases, revealed a picture of modest but overall improvement in economic conditions. Statistically significant achievements were noted mainly in the macroeconomic area. Unless supported by strong structural policy reforms, these achievements would prove fragile and unsustainable in the years ahead. In most instances, economic growth performance was below potential and many structural reforms are aimed at removing growth constraints and eliminating resource use inefficiencies. Concurrently, a stronger savings and investment effort is needed to add to existing productive resources in order to provide the basis for sustained per capita income growth and eventual graduation from low-income status.
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> Reform of the financial sector and reform of public enterprises are two vital areas that have lagged behind macroeconomic stabilization. Reform in one cannot hold without concomitant reform in the other. Coordinated action is required to preserve the won earlier macroeconomic gains. The recent review recognized that ESAF-supported programs to date had made it clear that structural reform and institution building took time and required sustained effort. The experience of formerly centrally planned economies in coping with the transition to a market environment

brings home more forcefully the iceberg-like feature of structural reform--only the tip is visible at first.

One half of the countries under ESAF programs have not registered progress toward external viability. The current external environment facing adjusting countries is in many ways more unfavorable than at the time the ESAF was launched. Commodity prices have remained depressed in the third year of an economic downturn in industrial countries. ESAF-eligible countries face a debt burden that is still rising: debt as a percentage of exports and services increased from 310 percent in 1985, to 340 percent in 1990. In the context of inadequate progress in reducing the debt burden, we welcome the Paris Club's readiness at this point to consider a reduction of the stock of debt after a suitable period of adjustment. The Fund should retain its leadership in overseeing members' macroeconomic performance, and to this end, it should be involved in giving timely policy advice and technical assistance. Fund financial inputs should be an integral part of this involvement, tailored, of course, to program strength and financial needs, and with due allowance for total exposure in individual cases. Reduction of the debt burden in the context of multi-year Fund programs will improve the quality of Fund claims on the debtor members. Debt-reduction operations from the mid-1990s should strengthen the external finances in good time for meeting maturing obligations under the current ESAF, which are expected to peak around 2002.

The central role for the Fund in the economic agenda for ESAF-eligible countries continues to be a major political and economic imperative. This received endorsement by the Interim Committee at its meeting in September 1992, and has attracted broad support within the Executive Board on many occasions. Active consideration should be given for funding the successor facility through the General Resources Account (GRA). There are several reasons for this. First, as the staff notes, it will obviate the need to seek additional external resources as well as a reserve backing to guarantee the claims of creditors; second, the prospective disbursements are unlikely to strain the Fund's liquidity position, in particular if some of the major countries that have initiated program discussions obtain commitments under the present ESAF; and third, the liquidity position would be under continuing review, and an early warning should sound if pressures develop.

Like the ESAF, a high degree of concessionality should be an integral feature of the successor arrangement. An important objective is to lower the debt and debt-service burden of the recipient country, and Fund credit should not be part of the problem. Given that the maturity period for loans is at most ten years, the burden of delivering on concessionality is on the rate of charge. At a time when official bilateral creditors are enhancing concessionality by increasing the grant component in official assistance, the Fund should not send a conflicting signal by reducing the present concessionality in lending to ESAF-eligible countries. This is not a new concept for the Fund, if the deep historical roots of the rate of charge are reviewed, or the more explicit instances beginning with the 1975 Oil Facility Subsidy Account. The Group of Seven, in its July 1992 communique, and the Executive Board earlier this month, fully endorsed concessional financing to low-income countries.

The question of the interest subsidy--its funding, rate structure, and application--is common to all funding options identified in the staff paper. The rate of interest should be a uniform 0.5 percent for all eligible users. The case for tiering is unclear and raises complex issues. Applying the higher rate to those judged more creditworthy could penalize those members that followed prudent debt policies. Besides, creditworthiness may improve over the program period, and capturing part of this dividend would raise difficult operational issues. Moreover, even at a tiering level of 0.5 percent and 4.0 percent, the amount saved is only SDR 0.5 million out of a total of SDR 3.3 billion. We do not favor tiering.

Under the GRA option, it is important to ensure that resources available under the current ESAF are fully committed. However, we would seek a clarification as to the level of commitments that can be subsidized at the 0.5 percent rate. In light of the delays in commitments and disbursements of ESAF Trust loans, a longer period has elapsed during which the subsidy account could have been augmented through higher investment earnings on donations, as well as on loans made available by contributors at below market rates. However, we notice that for over two years, the level of commitments that can be financed at 0.5 percent has remained unchanged, at SDR 4.7 billion. Every effort should be made to utilize in full not only the SDR 5.15 billion in the Trust, but also the additional SDR 0.3 billion offered by Japan for on-lending at 0.5 percent.

In financing the subsidy, we should avoid tampering with major issues of Fund policy and practices. Thus, we would not favor gold sales for this purpose, nor can we de-link the SDR interest rate from market rates to derive a lower rate of charge. Furthermore, the rate of charge on ordinary resources has to deliver on income targets and is additionally burdened with deferred payments. These raise questions far beyond that of determining a concessional element in Fund charges.

Voluntary contributions will have to be the primary means for financing the interest subsidy in the early years. This can be supplemented by investment income from the SDR 600 million in the Special Disbursement Account (SDA) that is yet uncommitted on SAF loans. The simulation exercises conducted by the staff indicate a reserves cover that is many times the maturing obligations. Financing prospects for later years may be constructed on the basis of retransfers from the ESAF Trust Reserve Account back to the SDA, once outstanding obligations in the ESAF Trust Loan Account are fully covered. Given the cautious approach to program approval and close monitoring, we are confident that defaults could be avoided, and that this point could be reached by 1999. Precision is impossible in these estimates, but we do note that the assumptions underlying them are conservative. It follows that we do not favor the termination either of the SAF or the SDA.

The GRA option is attractive, as it does not raise the issue of funding or of a reserves back-up. On the latter aspect, the staff has presented a plausible scenario under which the Reserve Account provides adequate security for the current ESAF, as well as a successor of SDR 6 billion funded from external resources. We note further that additional to this, the Fund has provided assurances as to the safety of creditor claims, including a gold pledge specifically targeting disbursement to those currently in arrears to the Fund. If initial reactions of present contributors to the ESAF Trust to these considerations are favorable, the staff should be encouraged to explore funding sources to expand the current ESAF Trust or to set up a new trust. An update of such negotiations, if we decide to explore this option, should be provided at mid-year.

We note that operational modalities of the successor facility have evolved on the basis of continuous monitoring of program performance. At each annual review, including the one earlier this month, the Board has had the opportunity to introduce modifications to program design, conditionality and monitoring. The recent review laid stress on consolidated public sector accounts with a view to identifying more accurately the source and size of financial imbalances. Noting the still substantial weaknesses in administrative capacities in low-income countries, the staff was asked to explore ways to link more closely program design with plans for technical assistance. We agree that current operational modalities, including conditionality, phasing, and monitoring, may continue into the successor facility.

Elaborating on his statement, Mr. Fernando said that he had expressed a preference for the option of funding a successor facility from the General Resources Account of the Fund. The creation of a proposed systemic transformation facility would clearly have implications for the Fund's liquidity, particularly in the light of the kind of conditionality that was likely to be associated with the first disbursements under the new facility. He would nevertheless wish to maintain his initial proposals regarding the financing of an ESAF successor.

Mr. Landau made the following statement:

I fully welcome this first opportunity to discuss in detail the operational modalities and the funding alternatives for an ESAF successor. We certainly have some crucial issues to resolve within the next few weeks in order to have the successor facility fully operational in December 1993.

I will address first the rationale for such a successor; second, the operational modalities for the successor; and third, the funding alternatives. On the two latter issues--and in particular with respect to the third--some of my comments will be unavoidably of a preliminary nature. Indeed, the main objective of the Board should be to try and reach a sensible consensus as soon as possible on the most practical ways to finance the continuation of the Fund's support to adjustment and reform efforts in the poorest members of the institution.

I fully concur with the staff that the initial rationale for the ESAF remains fully relevant in 1993. Our recent review of ESAF programs has concluded once again, and very clearly, that experience under the ESAF has been generally favorable, and that such a concessional facility provides the Fund with an excellent vehicle for addressing the specific problem of a large number of Fund member countries. Also, the staff paper points to the fact that the current external environment is even weaker than it was in 1987. At the same time, however, we can take comfort from the fact that our next efforts will probably prove even more efficient than the previous ones, because the consensus in favor of Fund-proposed policies has grown in these countries, and we have gained valuable experience under the ESAF that will help to strengthen the results of the successor facility.

It is thus fully within the Fund's mandate to continue an approach that has enabled it to help members address their balance of payments problems and improve their macroeconomic policies, and that has allowed the Fund to play its catalytic role by giving confidence to other members of the international community, thus ensuring the needed increase in net transfers to these countries.

As the need for a successor facility is well established, we must address the question of its operational modalities. I fully agree with the staff that, considering the generally successful experience under the ESAF, it is reasonable to retain most, if not all, of its basic operational features. I will thus focus mainly on the time frame, the eligibility criteria, conditionality, the interest rate, and the access policy.

Regarding the time frame for commitments, we should emphasize the need to embark early on the road toward adjustment and reform. At the same time, past experience shows that good preparation is a factor in the success of programs. Thus, given the limited administrative capacities in a number of eligible countries, a medium-term perspective is needed for the commitment period as well.

This leads this chair to suggest that more consideration be given to a commitment period of from four to five years, which would obviate the need to come back too soon to the question of extensions.

We have noted the arguments concerning the seven currently eligible countries with GDP per capita substantially higher than the cutoff figure for International Development Association (IDA) loan eligibility. On balance, we believe that the continuing vulnerability of those economies, their small share in terms of quotas, and the general advantage of not reopening such a delicate issue, might argue in favor of maintaining those countries on the eligibility list.

I fully concur with the staff that the current already relatively high level of conditionality should be maintained. There is certainly room for focusing more precisely on certain areas, in light of the recent experience. I refer in particular to the situation of the overall public sector and to the adequate provision of technical assistance. At the same time, during our recent review of the ESAF, it appeared that increased reliance on prior actions would be at odds with the limited implementation capacities of many of these countries and could prove generally counterproductive. I would be extremely reluctant to take that avenue.

I reiterate this chair's interest in considering further associating the successor facility with simple contingency planning and financing. I could insist on the need for simplicity and for augmentation, the latter of which seems a prerequisite if the successor facility is to be made sufficiently attractive.

With regard to the interest rate to be applied to loans under the new successor programs, there is clearly a potential tension between, on the one hand, the wish of some for a transition toward market rates, and, on the other hand, the adverse effect for many of the borrowing countries--as the staff stresses correctly--of imposing interest rates above 0.5 percent per annum. On balance, we tend to share the latter view. In addition, we agree with the staff that any attempt at tiering would be a difficult, complicated, and highly judgmental exercise, especially in a context characterized by data deficiencies. We would thus advocate the continuation of the present interest rate--which also has the advantage of not having raised major repayment problems so far.

I fully agree with the staff that the current ESAF access limits, as updated after the Ninth General Review of Quotas, could be retained. I have noted that those access limits can be accommodated irrespective of the funding method.

On the question of access to the successor for past ESAF users, I would note, first, that one of the main conclusions of our review of ESAF experience is that the time needed for adjustment and reform in those countries was initially seriously underestimated. We should thus not fall again into counterproductive overoptimism and assume too lightly, and against all the evidence, that some ESAF beneficiaries will not need further concessional financing from the Fund. Second, I would have strong doubts about any attempt to define specific lower access limits for past ESAF users. Such a rigid approach would be contrary to the need to adapt our intervention to the specific circumstances of each country. In fact, our general policy of access already--and correctly--provides for differentiated access, not only according to the needs and policies of the country, but also according to its past use of the Fund's facilities. I believe that this is the correct approach to the problem.

Regarding funding alternatives for an ESAF successor, any estimate of amounts needed is bound to be a subject for discussion, and I have taken note of the two methods used by the staff. It is already significant that both methods yield results of similar orders of magnitude. I also find it especially relevant to assume that, in the weaker external environment of the next few years, the Fund will be led to continue to provide the same small but catalytic proportion of the prospective resources needed--namely, about 4 percent. Therefore, the amount of SDR 6 billion is as good a basis as any--and indeed, probably the best basis--for our consideration of funding alternatives.

Given, on the one hand, the obvious need for continued concessional Fund financing and, on the other hand, the budgetary constraints of potential contributors, it would seem sensible that we look at the various options with an open mind, and with a view to determining how much each one of these options can contribute.

In light of these general considerations, we need to keep an open mind on financing through the General Resources Account (GRA) or through a trust fund. I am attracted by the substantial advantages of the former approach. As stressed by the staff, such an approach, for which there is a precedent in Fund history, would help to streamline our facilities. As stressed by the staff, the impact on the liquidity position of financing through the GRA is estimated to be no more than 3 basis points, and, in terms of the Fund's risk exposure, the difference between the GRA and the trust fund option is one of the degree of directness in the end, as the Fund's general resources are exposed indirectly even under the trust fund option. Finally, the GRA option might be the most appealing to those contributors facing the hardest budgetary constraints. Such an approach would not only eliminate the need to provide capital and the related security, but it also reduces the amount required for subsidies, owing to the slightly shorter grace period. Anyway, we would like to keep an open mind about this. If substantial contributions were available to finance the successor under a trust fund facility, we would be prepared to consider that option as well. That would also help in the transition from the present facility to the new one. We could also envisage financing through a combination of both the GRA and a trust fund if such a formula could be proved practicable. I would welcome some comments by the staff in this regard.

The question of financing sources should also be considered with an open mind. Various sources could potentially help reach the required amount of about SDR 6 billion, either as a complement to, or substitute for, national contributions. In this regard, I would like to elaborate briefly first on the question of funds potentially available in the current Reserve Account or in the Special Disbursement Account (SDA), and, second, on the question of gold.

I fully agree with the staff that use of the excess amount of revenues accumulating in the Reserve Account after 1999, and of the income from the SDA that is currently being transferred to the Reserve Account, should be considered for funding the successor and the successor's subsidy account.

I would also suggest that current and future contributors to the ESAF and/or its successor give further consideration to the degree of security that they feel they need for their current and future contributions. As the staff has stressed, the historical track record of concessional facilities does not show a particularly high level of nonpayment. I have noted in this regard that the level of nonpayment of Trust Fund loans was no greater than 6 percent. That being said, I wonder whether it is excessively conservative to expect a direct guarantee of the order of 100 percent of resources made available. Under a slightly more realistic assumption regarding the guarantee, therefore, there might be some room for providing additional contributions to the successor.

In the same vein, we would be prepared to study the contribution that could be made--admittedly on a smaller scale--of using the proceeds of sales of a minor part of the Fund's stock of gold to finance the successor facility, as was done for the financing of Trust Fund loans.

I would not like to end this review of the methods that this chair could be prepared to consider without mentioning the possibility--which could merit further study--of asking current ESAF contributors to extend their loans, which might sometimes be easier than providing new budgetary contributions. There is also the larger, but relevant, issue of the SDR allocation. The use of the excess funds available in the Reserve Account, in the SDA, and current ESAF reflows could, in combination, help substantially in financing the new facility.

I would like to recall some crucial arguments that were made during our recent review of the ESAF. Concessional Fund financing is an excellent channel for helping the poorest members of this institution to continue their progress toward adjustment and reform. It is at the same time money that enhances the favorable influence of the Fund, and it is money that is spent efficiently. Given the catalytic character of this Fund financing, it can even be argued that ESAF-type support constitutes excellent leverage that enhances the efficiency of bilateral transfers to these countries. Finding the ways and means to continue such a useful kind of involvement would allow the Fund to continue providing the poorest countries in the world community with what Mr. Arora so appropriately calls a "ray of hope." Both this leverage and this ray of hope are very much needed in these difficult times.

Mr. Ismael made the following statement:

The modalities of the ESAF evolved to a generally satisfactory extent during the facility's five-year existence. We should aim at keeping these modalities simple, concise, and operationally transparent. At the same time, we should offer adequate safeguards to the objectives of both the facility and of the Fund in general. I am content to retain these core modalities in the ESAF's successor.

I endorse the view that the duration of the ESAF successor should not be too short. We now have the benefit of hindsight in the operation of the present ESAF, and experience tells us that, in almost all cases, reforms take more time than originally anticipated. I therefore agree with the staff that a three-year commitment is reasonable. I believe that the shortness of the original 18-month commitment period of the present ESAF, and the fact that the commitment period was extended repeatedly to four years, were unfortunate characteristics, as the inherent uncertainty may have prompted countries to embrace programs hastily in order to meet the deadline. In our discussion on the effectiveness of the ESAF, many Directors also stressed the importance of adequate prerequisites, such as institutional strengthening and manpower training, which could be tackled more effectively through a mix of technical assistance and policy advice prior to program implementation. Again, hindsight tells us that it takes time to build a strong foundation, and adequate provision should be made for this, especially for newly eligible members. Perhaps the new facility could be made available for five years--until the end of 1998--even though the use of resources would remain limited to three years.

I agree that the eligibility criteria, qualifications, and access limits under the successor facility should remain largely unchanged from those of the present ESAF, although I would like to see more attention given to social issues and to public sector reforms in the design of programs. The distinction that is made in the access limits as between newly eligible members and those previously eligible should be abolished under the successor arrangement, as such a distinction no longer serves any effective purpose. Members that have already used the facility should still be eligible to use the successor facility, but only when further substantial structural reforms are needed. What is more important, the access limits should doubtless reflect the reduced reliance on exceptional finance of such members.

The idea of interest rate tiering has merit only to the extent that it would reduce the subsidy cost of the facility. Now that Fund-wide objectives have a substantial structural content, and since exceptional financing is necessary to support the adjustment effort in order to play this critical catalytic role, the only discrimination between eligible countries should be on the basis of country exposure and prolonged use of Fund resources. On the one hand, the tiering of interest rates does not satisfy either of those criteria. On the other hand, lower access limits for better-performing members, and the fixed three-year commitment, do satisfy those criteria. It does not seem logical to penalize with higher interest rates those members that have endured painful reforms. Moreover, the decision to assign countries to a certain interest rate tier is a judgmental one that may be hard to defend on a subjective basis; such subjective discrimination should be avoided in any case. In this connection, the interest rate of the successor facility should be kept at the current rate of 0.5 percent, in order to maintain consistency and so as not to penalize newly eligible members for joining the Fund only recently.

Regarding funding alternatives for the ESAF successor, the current structure of the ESAF has served adequately, and I could go along with continuing the present arrangement. However, the three sets of accounts have involved a complex procedural structure, with the associated high cost of administration. A simple, lean, and efficient system would naturally be preferred. There is much to be said for integrating the facility into the operations of the ordinary resources of the Fund. Doing so would have no significant impact on the Fund's liquidity, and the provisions of the new ESAF could thereby be streamlined and included within those of other Fund facilities under the GRA--with those of the extended Fund facility, in particular. This is a natural progression. In this manner, the uncertainty attached to resource availability would be removed, the facility could become operational without delay, and administrative costs would be reduced. I therefore support the alternative suggestion that the successor to the ESAF be funded from the GRA. Understandably, an interest subsidy account would be necessary under the GRA, and I wish to support the staff's recommendations for the funding of such an account. In this regard, it is important to keep in mind that there is no concessional element of the facility within the GRA, as the subsidy differential will be covered from the external subsidy account.

However, the facility should be completely autonomous, in both its operations and its modalities, within the GRA, with adequate medium-term budget appropriations. Moreover, in the event of an overall constraint on access to Fund liquidity, access to the ESAF successor should not be curtailed ahead of access to other facilities in the GRA; rather, restrictions on access should apply equitably to all the various facilities under the GRA.

I agree that the conditionality of the present ESAF, and the staff's recommendations regarding phasing and the monitoring procedures, should be carried over to the ESAF successor.

Mr. Fukui made the following statement:

Regarding the duration of the successor facility, my authorities believe that, because the successor will need to be temporary, it will need to incorporate provisions to prevent prolonged use of the facility, and to encourage graduation from it. These provisions could include, inter alia, a more explicit definition of the temporary nature of the facility, through the application of a stricter policy regarding the commitment period and the program period. Also, a distinction could be made between past ESAF users and non-ESAF users. Past users should accept the disadvantage of having more limited access to the new facility than those that have not used ESAF resources. If this more limited access cannot satisfy the financial needs of a past ESAF user, a blending of ESAF resources with ordinary resources should be recommended. Another option in this regard would be to charge a higher interest rate to past ESAF users.

There should be some reward for those countries that have committed themselves to, or are implementing, stronger adjustment efforts. I understand that the current individual access policy includes elements of differentiation between program countries according to the strength of their adjustment, but I would suggest that this merit system be more transparent and explicit. One option could be to allow a country with a good track record during the initial year of an arrangement to request a higher level of access to the ESAF successor than originally envisaged for the following year. I would be interested in the staff's comments on the merits of this approach.

Another important element that must be taken into account in the consideration of merit is the country's good relationship with creditors--a "non-default" requirement. The faithful servicing of a country's external debt obligations is most crucial to the maintenance of a good relationship with official or private creditors, and, most important of all, it is the quickest way for a country to return to the international financial community and to restore external viability. Countries with a good track record on debt servicing should be rewarded properly. I believe that these elements should be incorporated in the design of an ESAF successor.

Reducing unproductive expenditures--typically, military expenditures--thus promoting a more productive use of resources, remains an urgent and challenging task for developing countries. The world is still far from peace and harmony, and we are witnessing unfortunate setbacks in some regions, but a general consensus has emerged that military expenditure should be cut back. The Japanese Government adopted last year its so-called Official Development Assistance Charter, which clearly provides that full attention should be paid to the issue of military expenditure.

The Fund should do what it can within its mandate, and an ESAF successor should also incorporate this strategy. We would suggest that the Fund should--at least--intensify its monitoring of military expenditures, as well as of other unproductive expenditures. Board papers on requests for arrangements under the ESAF successor and reviews of programs should cover issues of military expenditure and its macroeconomic implications. Furthermore, attempts could be made to link military expenditure to program conditionality. I would request the staff to respond to our suggestion.

At the board review of the experience with the ESAF, the need for technical assistance to improve the basic data and administrative capacity and to help institution building was widely emphasized. We therefore want to integrate technical assistance more closely into arrangements under the ESAF successor, and in a more timely fashion. In light of the limited resources and absorptive capacity of recipient countries, it would be necessary to target in the policy framework paper process areas in which technical assistance is most needed. The Fund and the Bank should then cooperate closely and in a timely manner in implementing technical assistance. The necessary technical assistance would be effective if it could be provided either before the start of a program, or at an early stage of the program. My authorities are more than willing to intensify this process through the Japanese administered account for technical assistance, or through any other available vehicle.

Another key element for the success of a program is the firm political commitment of the authorities to implement the necessary reforms and adjustment measures. We know that the political area is often beyond the control of the government, but this should not discourage the Fund from seeking stronger political commitment. Rather, the Fund could sometimes play a catalytic role in gathering political momentum for the reform. In some cases, greater use of prior actions and benchmarks could be useful in facilitating reforms involving legislative initiative. At the same time, much deeper involvement by the authorities in the formulation of a reform program, resulting in a sense of ownership of the program--as Mr. Ismael said at the last review--would help strengthen the authorities' political commitment. Deeper involvement by the authorities would make the programs better reflect the particular conditions of a country.

I do not see any reason to change the level of conditionality under the ESAF successor. The integrity of conditionality, which has proven to be effective under the present ESAF, should be firmly maintained. We discussed the desirable components of ESAF conditionality at the last ESAF review, and I do not wish to repeat them. For emphasis, I would just mention two points. First, in view of the basic character of the ESAF successor, structural reform needs to be emphasized more. In particular, attention should be paid to establishing a financial system under which needed resources will be channelled to viable small and medium-size enterprises, which show the most active and promising economic growth prospects. Second, since a country's external viability and domestic economic performance depend heavily on export performance, more attention should be paid to initiatives that would expand and diversify exports. Close cooperation with the Bank on structural policy through the policy framework paper process is indispensable.

Programs should be focused more on restoring external viability and bringing about a graduation from the ESAF successor within a three-year period.

This leads me to the issue of the temporary nature of the new facility. I can go along with the staff's suggestion regarding the commitment period and the program period. A clear message needs to be sent to possible borrowers that there is a time limit on the facility, and that extraordinary adjustment efforts must be made by borrowers within that time limit.

The interest rate level should also be examined in light of the temporary nature of the new facility. The Fund has provided concessional resources with an interest rate of 0.5 percent for a relatively long time--since the Trust Fund. I am afraid that if the Fund created a new facility carrying an interest rate of 0.5 percent, it would give the impression that such a concessional facility would continue forever. Given its temporary nature, we should pave the way to gradually phasing out the concessional facility, and we should make it clear that the ESAF successor is a step toward the use of GRA resources. Raising the interest rate above 0.5 percent would serve this purpose.

Of course, the level of the interest rate would depend on the amount of subsidy contributions, and we should take into account the fact that the prospects of contributions from industrial countries are not necessarily bright, given persistently difficult fiscal situations.

I note with interest the two-tier interest rate system suggested by the staff. Even though there would be some practical problems, such as a moral hazard for those who could enjoy a lower interest rate, I believe that the suggestion merits further consideration.

With respect to funding alternatives for an ESAF successor, we prefer to have an ESAF Trust structure, rather than to use GRA resources. On the one hand, under an ESAF Trust structure, the transition from the ESAF to an ESAF successor might be much easier. In addition, the Trust structure is suited to responding flexibly to donor requirements--including Japan's--in contributing to the new facility. On the other hand, resorting to GRA resources would increase the Fund's risk exposure and would not be recommended, especially taking into account the present uncertain world economy, including the massive transitions of centrally planned economies.

As under the ESAF, it would be absolutely necessary to safeguard lenders' claims under a new ESAF Trust structure. For this purpose, continuing and expanding the current ESAF Trust would be preferable.

With respect to the use of gold, we should not forget that the Fund's holdings of gold constitute the Fund's financial strength. I therefore would not recommend using gold to create an ESAF successor.

I can go along with the staff's suggestion regarding eligibility and access policy. I would suggest, however, that past ESAF users have a lower level of access to the facility.

The current interest rate is simply too low, and it cannot be justified. I would appreciate it if the staff could give us their thoughts about the appropriate level for the interest rate. It should be kept in mind that large contributions should not necessarily be expected from industrial countries with difficult fiscal situations.

The Trust Fund is preferable for the Japanese funds that would be mobilized. It is absolutely indispensable that the burden of mobilizing contributions to the new facility be shared fairly. We would like to see equitable burden sharing based on an objective and transparent formula.

The Chairman remarked that the Japanese administered account for supporting technical assistance would be of great importance to the ESAF-eligible countries.

Mr. Fernando commented that the assessment of economic and financial policies should take into account, and should aim at reducing, unproductive expenditures, including military expenditures to the extent that they fell into that category. Like Mr. Fukui, he believed that such expenditures should be scrutinized closely. At the same time, such scrutiny should apply not only in the context of countries requesting access to ESAF resources, but also to the Fund's entire membership.

Mr. Landau said that the issue of access of past ESAF users to the successor was a complex one, as the concerns raised by Mr. Fukui demonstrated. The proposal to blend concessional ESAF resources with resources subject to a higher nonconcessional rate of interest would imply that interest rates would be tiered on the basis of whether or not the country had used ESAF resources in the past, which did not appear to be a sound basis for doing so. In any case, he would be against tiering of interest rates.

The question of the country's track record should not be overlooked, Mr. Landau pointed out. A country might not have had access to the present ESAF because it might not have been able to maintain a sufficiently strong program. There were other countries--users of the ESAF--that had maintained excellent track records. It would be paradoxical to refuse access to the ESAF successor to those countries that had maintained good track records under the current ESAF, and which continued to require concessional support from the Fund, while allowing access to the successor by those countries that had been unable to prepare programs strong enough to benefit from the present ESAF.

Mr. Fukui responded that he agreed with Mr. Fernando that unproductive expenditures were an issue not just for ESAF-eligible countries, but for the Fund's entire membership. Nevertheless, it should be a particular issue in the context of the extension by the Fund of concessional resources to countries. Because those resources were concessional, the Fund had to do what it could to ensure that they were used most productively and efficiently.

Regarding Mr. Landau's observations, Mr. Fukui went on, his concern was that the Fund provide the appropriate incentives, under any new ESAF, for countries to graduate from the use of such a concessional facility. The ESAF or its successor could not become a permanent facility, so graduation from it would be inevitable at some point in any case. Either by way of incentives or penalties, the Fund needed to create an impetus to countries to graduate. His own preference would be to focus on incentives, rather than on penalties.

Mr. Mirakhor said that he had been interested in Mr. Fukui's idea of increasing interest rates in order to motivate countries to graduate from ESAF use. From the previous Board discussion on the ESAF, his impression had been that the system of incentives and penalties already built into ESAF programs was sufficiently strong to ensure the graduation of countries from the use of the ESAF. In one particular instance, the incentive system, as well as the political catalytic role of the Fund, had served to encourage the country to graduate, and to graduate early. That being said, the graduation argument was not a strong one for raising interest rates on ESAF resources, in his view. Perhaps the staff could comment on whether or not the present incentive system needed to be strengthened by adding more penalties to encourage countries to graduate.

Mr. Dawson said that his authorities had taken to heart Mr. Fernando's comments about the need to deal evenhandedly with military expenditures. He wondered whether Mr. Fukui might consider countries' relative fiscal positions as an objective criterion upon which to base a sharing of the burden of the cost of an ESAF successor.

Mr. Dawson then made the following statement:

> The staff paper presents a number of complex and interrelated issues on which my authorities are still formulating their views. Therefore, my remarks will be brief, and they reflect preliminary reactions to the various alternatives under consideration.
>
> As I indicated in the recent ESAF review, we are convinced of the need for Fund policy advice and financial support in low-income countries, and we believe that the existing ESAF Trust has provided a good vehicle for extending this assistance.

Accordingly, we agree on the need to establish a successor facility to continue these efforts.

As to the size, structure, and degree of concessionality of a successor facility, we believe that the membership will have to be pragmatic. As the Board is well aware, U.S. budget constraints call into question the United States' ability to make any contributions that would require new appropriations. My sense is that some other past contributors may be in similar positions.

From this perspective, we recognize that funding an ESAF successor through the GRA, with a separate subsidy account, could facilitate its financing. However, we have a clear preference for maintaining the existing ESAF structure--either through the continuation of the existing facility, or the establishment of a new Trust. As the staff paper points out, this structure has accommodated a variety of forms of contributions in the past. It is also a structure with which our governments and legislatures are already familiar. Indeed, from my authorities' perspective, the ESAF Trust route may well also be preferable if U.S. consent to the use of GRA resources required U.S. Congressional approval--as it appears it does.

I suspect that the size of the facility will be driven by the structure of the new ESAF and the availability of contributions, and that these considerations will, in turn, largely determine the concessionality of the facility. If fewer concessional resources are available, some tiering may be desirable, and indeed, even unavoidable. At the same time, we have some sympathy with the view that there should be some differentiation among countries according to their debt-service capacity. We would like to return to this issue once we have a clearer idea of the amount of available financing.

With regard to other modalities, such as phasing and monitoring, we agree that the operations of the successor facility should be modeled, by and large, on practices of the existing ESAF Trust, while we continue our efforts at the same time to improve upon them. In this connection, we concur on the need to monitor structural measures more systematically and to sharpen the medium-term structural orientation of ESAF programs.

Mr. Solheim made the following statement:

The staff paper provides a good basis for our further deliberations on an ESAF successor. In general, a credible ESAF successor arrangement is likely to increase the possibility of an additional external transfer of resources to the developing countries. At this stage, we are prepared to give some preliminary views as to the need, scope, and modalities of a possible future ESAF successor. However, several issues will have to be explored before a more concrete stance can be taken--among them, the financing of the arrangement. Until these issues are resolved satisfactorily, we maintain a general reservation with respect to our contribution.

We see several merits in the establishment of an ESAF successor. In spite of the considerable progress some countries have made under the existing ESAF, there is a widespread need for further macroeconomic adjustment and reform in the low-income countries. Such policies should be combined with external financial support on concessional terms, given the difficult debt situation and the weak external environment confronting these countries. We agree that a continuation of the reforms could turn out to be more effective, considering that a greater general receptivity to comprehensive market-based reforms has developed lately in countries supported by ESAF arrangements. Moreover, we note that credible ESAF arrangements and World Bank arrangements have catalyzed substantial financial support over the last years. It is very important that an ESAF successor contribute to a continuation of this process.

Bearing in mind the scope and nature of the problems in the poor countries, there is a need for intensified cooperation between the Fund and the World Bank. Both institutions need to be involved financially in these countries to obtain the best possible economic results and the strongest catalytic effects on financing from other sources. We concur with the staff's view that program design could be strengthened by a more simultaneous approach to structural reforms in the two institutions than is the case at present.

As to the alternatives suggested for a funding structure, we strongly prefer the Trust Fund model as compared with the GRA version. Such a model would be less of a burden on the Fund's liquidity situation over the coming years. Also, the Fund's role should be limited as much as possible to that of a trustee with regard to concessional balance of payments financing. The staff appears to play down the difference between the use of a Trust and the use of GRA resources in terms of the effects on Fund exposure. In our view, important differences might emerge in practice if the Fund is exposed directly, rather than indirectly.

The structure of the operational modalities should be kept broadly unchanged, so as to avoid encouraging arbitrage between the new and the existing arrangement and--perhaps--forestalling difficulties in negotiations with the lenders and the contributors to the existing arrangement. However, some minor adjustments in the modality structure should not be totally excluded from the start of the discussion.

A repayment period of the order of ten years for the new facility could be desirable, bearing in mind the difficult debt situation in the low-income countries.

A possible new arrangement should be designed in such a way as to keep the degree of conditionality broadly unchanged. However, program design could include contingency elements and social dimensions to protect vulnerable groups. For the program to have the intended effects, and in order to achieve viable and sustainable solutions, we believe that it is essential to increase technical assistance for building administrative capacity on policy formulation and implementation. The Fund also has an important role to play in identifying appropriate areas for technical assistance provided by institutions and donor countries.

It is difficult to assess the potential demand for an ESAF successor, but we can concur with the staff's view that it might be of the order of SDR 6 billion.

The aim should remain to obtain a lending rate of 0.5 percent for the poor and indebted countries. We see some merit in seeking differentiation as to the degree of subsidization, as discussed in the paper. However, a number of practical problems remain to be solved under such an approach.

We note the positive attitude to an ESAF successor that was signalled at the Munich summit meeting last summer. We assume that this implies major financial support from the summit participants. We take it for granted that broad participation and fair burden-sharing, with regard both to loan funding and subsidies, would apply. I share the views expressed by Mr. Fukui on this question.

Mr. Shaalan made the following statement:

The staff paper makes a strong case for an ESAF successor. Indeed, for the reasons mentioned by the staff, the initial rationale for establishing the ESAF remains at least as relevant today. What is perhaps most important, the cash-flow situations in many ESAF-eligible members remains very tight, and the international mechanisms that have been introduced to assist in easing the external resource constraint confronting these countries continue to envisage an important role for the Fund in the process. In these circumstances, it is important for the Fund to maintain beyond November 1993 its ability to assist its poorer members through a facility that, like the ESAF, is well-suited to their problems and needs.

Regarding some of the operational issues raised in the paper, the suggested time frame of three years for commitments appears to be reasonable, but I could go along with a longer period, particularly in light of the slower than envisaged pace of utilization under the ESAF. It is hoped that this time frame will prove adequate for concluding arrangements with potential users, including those members currently in arrears to the Fund.

I see no compelling reason at this time to exclude from the eligibility list the seven countries identified in the staff paper as having relatively high per capita incomes. For one thing, IDA eligibility had guided, if not determined, SAF/ESAF eligibility, and the members in question remain IDA-eligible. Moreover, as a practical matter, possible use of the resources of an ESAF successor by those members would have hardly any implications to speak of for the resource requirements of the successor facility. We also take note of the staff's comment that, in the time that has elapsed since the eligibility list was last expanded, and on the basis of updated information on per capita incomes, no additional countries appear to satisfy the considerations that guided the last expansion of eligibility. This matter should be revisited at such time as the Board may consider a possible expansion of the list to include countries in the area of the former Soviet Union. The possibility that such a broadening of the scope of consideration might entail significant implications for the resource requirements should not be a reason not to do so. I would ask the staff about the prospects of incorporating purchasing power parity conversion factors in a possible further consideration of eligibility.

We agree with the staff's view regarding the criteria for qualification for assistance under an ESAF successor, and in particular, with its views regarding the adequacy of reserves as a gauge for assessing balance of payments need. We support the proposed retention of the approach used in assessing the presence of a protracted balance of payments problem, which was agreed when the SAF was established in 1986. I would note that, in practice, assessments of "protractedness" have conformed to the majority view expressed at the 1987 review of the SAF; namely, that, a priori, a low-income country with a balance of payments need satisfies this criterion.

We agree with the staff's proposal on access limits, access in individual cases, and average access. We also agree that there would be no justification under an ESAF successor for maintenance of the present distinction vis-à-vis access between the originally eligible and the newly eligible countries. Finally, the possibility of access augmentation should be maintained.

We are in agreement with the staff's analysis of the overall resource requirements, and we support its proposal regarding the basic terms governing commitments, disbursements, maturities, and the interest rate to be charged. As regards the possibility of differentiation in the degree of subsidization, while I do not question the rationale for drawing a distinction between the "needy and needier" within the group of low-income countries, I harbor considerable doubt as to the practicability of drawing such a distinction. First, as noted by the staff, there would seem to be no one specific grouping that can be viewed unequivocally as objectively superior. Second, the staff's analysis--albeit illustrative--would seem to suggest that it may not be feasible to realize significant savings in the amount of required subsidies without a substantial differentiation in the degree of subsidization, or the charging of a rate of interest that is significantly higher than 0.5 percent on loans to the needier countries in the group. Using a blend of GRA and ESAF-type resources could alleviate this concern, but there would still be the practical issue of how to group the countries on the basis of broadly acceptable objective criteria. Therefore, on balance, I would favor maintaining all eligible members in a single group, and charging a uniform rate of interest that is as close as possible to 0.5 percent--that is, as under the current ESAF.

We have no strong views regarding the two main options presented by the staff for the funding alternatives. The amount and type of subsidy and concessional loan contributions from member countries should determine which of the two options would be more feasible, as we do not find any of the misgivings that may be associated with either of the two options sufficiently significant to warrant its elimination from further consideration. Perhaps the most important difference between the two options lies in the possibility of using internal resources to reduce, mainly under the GRA option, the amount of subsidy contributions that needs to be sought from members. That would be an especially significant difference if it does not appear that the $3.3 billion in subsidy contributions currently projected would be forthcoming. But it should be recognized that utilizing the internal resources in question would imply a commensurately significant reduction in the Fund's future ability to use Special Disbursement Account (SDA) resources to extend concessional loans or support concessional lending.

We are in broad agreement with what the staff says about the operational modalities of an ESAF successor. Regarding the fate of the SAF, we would favor retaining the facility for use by eligible members, which means that it would be essentially--although not exclusively--a source of funding for arrangements with members now in arrears to the Fund. The interest income on the uncommitted resources of the facility could be used in the meantime as a contribution to the subsidy account of the ESAF successor.

Ms. Langdon made the following statement:

At the earlier Board discussion, this chair joined most others in assessing positively the experience under the ESAF. The key issues for today's discussion are the rationale for a concessional facility; the size and operational modalities of an ESAF successor; and the funding alternatives.

The staff's arguments on the issue of the rationale for an ESAF successor are valid. However, at this stage, my authorities are not in a position either to support or reject the idea of an ESAF successor. We would emphasize, however, that broad financial support among the donors and creditors and fair burden sharing would be important prerequisites for our participation.

Assuming that there is broad agreement in favor of an ESAF successor, my authorities have certain preferences with regard to its characteristics. With regard to its time frame, we would emphasize the temporary nature of the facility and the need to signal the importance of timely adoption of reform programs, so as to move away from temporary reliance on concessional Fund assistance. Thus, we support the staff suggestion of a three-year period for commitments.

We endorse maintaining the current eligibility list. Only countries with strong balance of payments need and a commitment to significant adjustment should qualify. Current or past ESAF users that have made significant progress and are not facing a need for exceptional assistance should not request new arrangements.

Access limits would depend on the amount of resources available. Individual access should be differentiated according to the strength of policies, financing need, and past use of resources. For countries that have already used the ESAF, lower access and strong adjustment requirements would signal the need to phase out reliance on concessional Fund support. We concur with the staff that current conditionality standards should be maintained, along with existing program monitoring procedures.

Regarding the size of the facility, my authorities view the staff's estimates of resource requirements as higher than might be warranted for the period of operation of a new facility, given that the pace of commitments under the current ESAF has been slower than expected. In particular, it is difficult to imagine that some countries with protracted arrears will be able to sort out their domestic political situations and adopt and then complete a rights accumulation program in time to make use of a new facility.

In the same vein, if some ESAF resources remain uncommitted at the time of the commencement of a new facility, those resources could be retained for use under the new facility, potentially reducing the total amount required. The SAF could also be concluded and the small amount of SDA resources transferred to the ESAF Trust Reserve Account.

We do not have strong views concerning tiering, but the simpler approach--as the staff suggests--might be to raise the interest rate to 1.5 percent, or to some other level.

With regard to the two funding alternatives presented by the staff, we prefer, on balance, the enlargement and extension of the existing ESAF Trust. The main advantages of this approach are, first, that the temporary nature of Fund concessional financing would be reinforced, and ESAF operations would be kept separate from the Fund's ordinary resources; second, full utilization of current ESAF resources would be assured, and a smoother transition from the old facility to the new would be facilitated.

Mr. Peretz made the following statement:

My authorities see a strong continuing need for a successor to the ESAF, as many other speakers have observed this morning. The process of macroeconomic and structural adjustment in low-income countries cannot be left partly completed. What is important above all is the Fund's continuing role in providing advice on macroeconomic policy. The paper clearly explains the importance at present of the existence of a Fund-approved stabilization program, together with a Fund- and World Bank-approved adjustment strategy, as the central part of what is a network of bilateral and other multilateral assistance to the poorest countries. It is hard to see how this process could continue without a successor Fund facility, and a successor facility that offers concessional resources. If we were not to have a successor to ESAF, then the whole strategy would have to be rethought, and the relative roles of the different institutions in offering macroeconomic policy advice to the poorest countries would also have to be rethought. I do not favor that.

We should be realistic about the time frame of an ESAF successor. However much we all hope that the successor will be strictly time limited, and will resolve a temporary problem for low-income countries, we must recognize the reality that the Fund, like others, is going to have to stay involved for as long as it takes, and for some countries, that may well take some time.

Given the pace of ESAF agreements to date, I would be most surprised if as much as SDR 2 billion a year were, in practice, committed under a new facility. While a short time limit may indeed help to emphasize the urgency of the need for reform, I am concerned that it could also create the temptation to compromise on standards of conditionality. Nor do I see much purpose in setting deadlines that, from the outset, would seem likely to have to be extended. I could thus support a longer time limit for commitments than 1996. I would also be interested in staff comments about whether it really is realistic to expect commitments of as much as SDR 2 billion a year.

I agree that the current list of eligible countries is about right. In particular, I support retention on the list of the small island economies, given their special vulnerability. Of course, we must consider the eligibility of new members based on any revisions of estimates of their per capita income, just as we were able to add, for example, Albania and Mongolia to the list in the recent past. Qualification standards for a successor facility should be similar to those for ESAF. Where there really is no balance of payments need, then I would favor a similar arrangement to post-ESAF monitoring arrangements, so that the Fund's role in the network of assistance to the poorest countries can be preserved. However, I would stress in this case that it is important for Fund involvement to be just as close as it would have been had Fund resources been committed.

I agree with the staff that broadly similar rules on access levels to those under the present ESAF could be retained, both in terms of average and individual country access. The final answer on this, however, will have to await firmer information on the amount of financing available for a successor facility. Individual access levels should take into account past access to ESAF, as the staff suggests, in the same way as access to GRA resources takes account of existing use. How great an adjustment is needed on this account will require further, rather careful, thought.

I have no problem with the general orientation of conditionality described in the paper. I have much sympathy for Mr. Fukui's comments about unproductive public expenditure. I also support Mr. Landau's ideas about contingency mechanisms. During the earlier review of the ESAF, I noted that there was widespread interest in the Board in making both conditionality and access more contingent on subsequent exogenous developments. I hope that this can be addressed in the successor facility, and I agree that it should be addressed in a way that is simple and transparent. I also agree with Mr. Fukui about the key importance of cooperating very closely with the World Bank on structural elements of programs. Retention of the flexibility to extend a program for a fourth annual arrangement seems appropriate, provided that the country concerned has a strong record of performance. However, we should think carefully before agreeing to extend facilities where they have gone off track in the past.

I favor retaining the SAF for the time being. The remaining resources, which are only small and therefore could not make much contribution to funding a successor, should remain available for those members in arrears that are continuing to cooperate with the Fund. Similarly, the potential access of members in arrears to subsidized resources should probably be preserved under the successor. However, I wonder whether it is realistic to allow in our estimates for noncooperating countries in arrears. What difference would it make to expected access and cost if this particular category of potential--but unlikely--users were dropped from the estimates? Perhaps the staff could comment on that.

It is clearly not possible to come to any firm decisions about the level of subsidization of the successor facility before we know the amount of financing. The possibility of tiered rates of charge is an interesting idea, not so much because of the potential cost savings, but--what is more important--because it makes the discontinuity between those eligible for subsidized resources and those that are not less abrupt. I would oppose any tiering as a way of distinguishing between countries that have had past access and new beneficiaries, for the same reasons as Mr. Landau. I recognize that classification of countries by need involves difficult choices, and that per capita income data are neither timely nor very accurate. I would note that even deciding what group of countries is eligible involves difficult decisions; so it is a decision of the same nature to differentiate between those that are eligible. A tiering of interest rates would also open the way to graduation, because, as per capita income increases, then countries might move from one level of subsidy to a lesser one, and then finally out of the arrangement altogether. I would not want to discard that possibility at this stage. Also, there are arguments for setting a slightly higher rate of charge overall--or a slightly higher minimum rate if there were a tiering of rates of charge. I believe that the rate of 0.5 percent is the lowest interest rate currently available to borrowing countries from any of the various multilateral or bilateral concessional loan facilities available to the poorest countries, but perhaps the staff could confirm that. If that is the case, moving from 0.5 percent to 1 percent could be considered, for example.

My authorities have no strong preferences about the alternative structures for the funding of the successor facility. Like Mr. Landau, I am personally attracted to the use of GRA resources, but in the end, we can support whatever alternative is best able to mobilize sufficient financing, and which proves to be the simplest to administer.

Regarding bilateral contributions, as Mr. Dawson pointed out, many donor countries face very tight fiscal positions, with aid budgets under great pressure. In the circumstances, it is important that all avenues for financing be explored thoroughly, especially those that would avoid direct bilateral public expenditure contributions. We also need to look again carefully at the cost and disbursement estimates. We may have to consider a combination of several different sources of financing. For example, I would not want to see gold sales ruled out at this stage without further and fuller consideration of it, although I recognize that the scope for such sales would be limited by the need to maintain the risk capital of the Fund at a time of exceptional risks for the Fund in other areas of its activities. We should be thinking about a range of different sources of financing that, when added together, might produce what was needed.

It would be useful to have a sensitivity analysis of the capital and subsidy needs of the ESAF successor. I have mentioned some of the factors already, such as estimates of likely disbursements, the inclusion of provisions for all arrears cases, and the level of the rate of charge. Mr. Landau has raised the question of the level of required reserves for a Trust Fund. Finally, I am conscious that the assumed future levels of world interest rates may well be over pessimistic in the current estimate. I would like to see some further work on these subjects before we come back to the question of an ESAF successor again.

Mr. Posthumus made the following statement:

I support a continuation and enlargement of the current ESAF Trust, or the establishment of a new Trust as the basis of a successor facility. However, I will not support financing of a successor facility from the General Resources Account of the Fund. Fund resources, by their very nature and according to the Articles of Agreement, are to be used to solve balance of payments problems with adequate safeguards for the temporary use of the general resources. All the ESAF countries, however, are confronted with prolonged balance of payments problems of a structural character; indeed, this is a requirement to qualify for an ESAF-supported program.

The message of the staff paper is that the external environment facing ESAF-eligible countries today is much more difficult than it was in the mid-1980s, that external positions even of those countries that have had ESAF arrangements remain fragile, and that the adjustment process is far from complete, all of which suggest the continuing need for exceptional balance of payments support and structural reforms. ESAF conditionality is not the same as upper credit tranche conditionality--one of the reasons behind the decision to establish Trust Fund financing for the ESAF six years ago. ESAF funding out of the GRA would cause an undue deterioration in the quality of outstanding Fund credit, as was the position of Executive Directors in 1987. This was also the position of some lenders to the ESAF Trust in 1987. These lenders were more concerned about the security of their loans to the ESAF Trust than about the security of GRA resources, and the Fund then agreed to allay their concerns by providing assurances. I remember vividly how uncomfortable I felt about what was happening at the time. The staff now seems to say that the GRA was exposed anyway, so why not expose it again, and directly.

It is stated that the issue of ensuring adequate reserves arises only if an ESAF successor takes the form of a Trust, not if it is financed from the GRA. However, the risks attached to the credits would not be lower if the ESAF were funded from the GRA. By arguing that no additional reserves are needed, the staff implies that it is more important that ESAF creditors have appropriate assurances for repayments of their loans than that the creditors of the Fund itself have such assurances. This approach is unacceptable, the more so in view of the doubts we expressed on earlier occasions about the adequacy of the Fund's precautionary balances.

Moreover, financing an ESAF successor from the GRA would be at variance with the principle of nondiscrimination, because--unlike the other Fund facilities--the ESAF is open only to a group of member states with per capita incomes below a specified amount. The Articles of Agreement specify that concessional assistance to these countries is possible by drawing on the Special Disbursement Account (Article V, Section 12(f)).

To prevent an inappropriate use of Fund resources, it was decided in 1987 to look for donor financing of the ESAF. There is no reason to view this matter differently now. An additional argument is that the low per capita income criterion has been applied in one or two cases--Nepal, in particular--as the qualification for eligibility for an ESAF loan, even though there was no balance of payments need. This will certainly occur again, because some of my colleagues will argue that countries with no balance of payments need should not be penalized by not having access to the ESAF.

It is stated that funding from the GRA would permit some streamlining of Fund facilities, by integrating the ESAF successor into the extended Fund facility. However, the character of the two facilities is quite different. For those of us who feel that the extended Fund facility is itself already a facility that makes possible the prolonged use of Fund resources, the argument that it should be streamlined by incorporating into it interest subsidized Fund resources--obviously leading to even more prolonged use of Fund resources--is not very convincing.

The staff estimates that the effect of GRA financing on the liquidity ratio would be modestly negative. This is apparent, as the staff had assumed in its most recent projections that there would not be an ESAF successor and that therefore the ESAF-eligible countries would instead use the Fund's general resources. However, the argument in favor of the ESAF is that the countries concerned cannot afford to use the general resources at regular rates of charge. How can the staff make projections for the use of Fund resources--which the countries concerned cannot afford, and which was the reason for instituting the ESAF in the first place? In addition, should we not do everything we can to prevent the liquidity ratio from dropping to 33 percent to 49 percent by the end of 1995? The chance that the Fund will be able to obtain another increase in quotas by 1995 is nil, and will remain so for many years after 1995.

We acknowledge the fact that it might be difficult to accumulate total donor contributions of the order of SDR 6 billion for the new facility, and SDR 3.3 billion for the subsidy account. However, these estimates seem to be rather high, for several reasons. First, the estimates exceed the amounts available under the existing ESAF. Second, the Fund has already had difficulty extending ESAF credits over the past six years, while the time envisaged for the ESAF successor is only three years. Third, it can be expected that present ESAF resources would not be used entirely, so that the amount left over could be used for an ESAF successor. Fourth, Fund financing as a share of the total financing needs of the countries concerned was 3.7 percent in the period 1987-1992, and is estimated at 4.3 percent in the period 1993-1999. This is an increase in the share of Fund financing of 16 percent, or SDR 1 billion of the estimated SDR 6 billion. Moreover, the staff's suggestion to tier the concessional interest rate would reduce the donor contributions that would be needed. The tiering of access limits could also be considered, which would ensure that, with a smaller amount of available resources, sufficient financing would still be available for the most difficult cases. For the three-year period for which the ESAF successor is being requested, the estimated amounts could probably be halved: the absorptive capacity of these countries will be insufficient, and--what is most likely--the Fund would not be able to commit SDR 6 billion in a three-year period.

Mr. Burdiel made the following statement:

The review of experience under ESAF-supported arrangements showed the important contribution of these arrangements to promoting growth, improving the balance of payments, and fostering structural reforms in the member countries with the lowest per capita incomes.

It is also clear that many ESAF-eligible countries still have an important agenda of structural reform before them, and that external viability has not been achieved in many cases. This difficult situation is reinforced by an adverse external environment that is very different from that of 1986 and 1987, the time the SAF and ESAF were established. External demand for the exports of these countries is weak, reflecting the economic slowdown in industrial countries, and low prices for primary commodities can be expected to continue for some time. Moreover, a further deterioration of the terms of trade can occur in many of the ESAF-eligible countries.

Under these circumstances, concessional financing will be crucial to achieving economic growth and external viability in coming years. Taking into account the catalytic role of the Fund in increasing concessional capital inflows, and the successful experience in many cases in implementing comprehensive macroeconomic and structural reform programs under the ESAF, there is little doubt about the appropriateness of adopting an ESAF successor.

There is broad agreement that the ESAF has provided an effective mechanism for Fund involvement in low-income countries. The ESAF has proved to be an instrument well-suited to the needs and problems of low-income countries. Given that the ESAF's operational modalities have been modified and streamlined several times, according to the experience obtained from the implementation of ESAF programs, we agree with the staff that it would be reasonable to retain the basic operational orientation of the ESAF under any successor.

Concerning the time frame of a successor, I agree with the suggested period of three years for commitments, as it will provide a sufficient period of time for adopting the reform programs and carrying out eventually and prior restructuring, if it is required. At the same time, it establishes a time limit for gaining access to the facility, encouraging the authorities' reform efforts. In this regard, the provision of timely Fund technical assistance, when necessary, seems to be very relevant.

Countries eligible for an ESAF successor should be those now eligible for the current ESAF. Any expansion of the number of eligible countries should take place according to the criteria established on the occasion of the amendment of the list of ESAF-eligible members--namely, per capita income and IDA eligibility--on a case-by-case basis, as was the Board's procedure previously.

The inclusion in the list of ESAF-eligible countries of the seven countries with relatively high per capita incomes and inherently vulnerable external positions would be inappropriate, given their per capita income levels. That particular variable is precisely the most relevant criteria for determining ESAF eligibility. Were such an expansion of the list to take place under that criterion, the rationale for adopting an ESAF successor would be unclear, and some of its operational modalities inconsistent. Those factors come to light when the staff proposes a tiering of interest rates--with a wide range of from 0.5 percent to 4.0 percent--as a means of resolving the inconsistency of such differences in income levels. Relaxing the eligibility criteria on the basis of per capita GDP would be inconsistent with the rationale for the highly concessional terms of the facility and, therefore, its strict definition, and would thus open the ESAF successor to any member with a vulnerable position, making it similar to other Fund facilities.

As under the ESAF, prolonged balance of payments problems, hand in hand with committed efforts by the eligible country to improve substantially and consistently its external position, should be the relevant qualifications for assistance under the ESAF successor. The policy framework paper, the three-year period of annual arrangements, and the midterm reviews have all proved to be efficient instruments, and should thus be made mandatory.

The unchanged qualification for assistance raises the question of those current or past ESAF users that still have an important agenda of structural reform before them, and which have not achieved external viability. It can be expected that those countries would request access to the new facility. The access policy under the ESAF, which was reviewed in July and November 1992, combined with the above-mentioned instruments, should be flexible enough to deal with these cases. As usual, the access level should be determined by the authorities' commitment to reform policies, in addition to the financing need and the past use of Fund resources.

The financial terms of the current ESAF related to maturity and interest rates should be maintained. In particular, the interest rate should be kept as close as possible to 0.5 percent. Given the principle of uniformity of treatment, the same interest rate should be charged to all eligible countries. I am not sure that a tiering of interest rates would be appropriate for differentiating between countries. The above-mentioned access policy is flexible enough to do that. Only when eligible countries with significantly higher levels of income are introduced into the scenario should other differentiating instruments--such as a tiering of interest rates--be required. Eligibility should be restricted to low-income countries, thus avoiding the distorting problems introduced by allowing countries with significant higher income levels access to the facility. The financial assistance that those countries deserve can and should be obtained from a different facility.

The staff paper focuses on two of three funding alternatives. Although the GRA alternative would have some advantages in terms of availability of resources and streamlining of Fund facilities, it does not seem to fit with the special requirements of the ESAF successor. Concessional financing is a particular characteristic demanding, for the time being, a specific facility for proper financial intermediation. Moreover, in spite of the small impact on the liquidity position of the Fund of the use of the GRA, a Trust Fund alternative would help to dispel concerns about extensive and/or prolonged use of Fund resources by some members.

There would be a larger pool of resources for financing low-income countries under a Trust Fund alternative. The type, origin, flow, and destination of the resources made available for that financing would not distort the general financing purposes and facilities of the Fund, and would contribute implicitly to an enlargement of the available resources for those general financing purposes. Furthermore, there would be a smoother transition between facilities, and the resources already committed to the ESAF Trust would be fully utilized.

In principle, an extension of the current ESAF Trust is preferable to the establishment of a new one, but I would leave the complicated question of the administrative issues concerned to the staff's best judgment in that regard. I consider the coverage provided by the current Reserve Account to be adequate for the time being to cover the additional liabilities of the Trust. However, I would expect to have the opportunity to review this issue in the event of unexpected developments.

The adverse external environment confronting low-income countries has been noted. Industrial countries are also being affected by an economic slowdown. The economic climate of 1993 is not--unfortunately--that of 1987. Unemployment is rising. At the same time, very tight fiscal policies are required. This raises some concern about the contributions to the ESAF successor. This concern notwithstanding, I still consider the Trust Fund option more convenient than the GRA option. However, I would like to suggest that all available resources retransferred to the SDA from the current ESAF Reserve Account, as well as the currently uncommitted SDA balances, be earmarked for interest subsidies.

The funding of the ESAF successor is the most difficult issue. The guiding criteria should be simplicity of management and fairness to the membership at large. It seems that the Trust Fund option would be the most convenient solution, provided that enough resources are committed. I expect that they will be, and that the ESAF successor will be on track before December 1993.

Mr. Kaeser made the following statement:

This chair supports the continuation of the ESAF, as the original rationale for it remains valid in the present economic environment. It is imperative that the Fund provide long-term financing to poor countries with protracted balance of payments problems, on a strongly concessional--and strongly conditional--basis. In spite of some shortcomings, the ESAF has proved to be rather successful: countries with ESAF arrangements in place have, on average, improved their economic performance and balance of payments position. This facility has provided the Fund with a convenient vehicle for supporting reforms in low-income countries. At the same time, it has highlighted the Fund's catalytic role and allowed those countries to benefit from increased official transfers and capital inflows.

I would like to stress that simplicity should guide our approach to the operational modalities of an ESAF successor. As experience with the compensatory and contingency financing facility has shown, it is not advisable to define in too much detail the modalities for implementing a facility. In this respect, we should avoid suggesting any further complication of the present ESAF, such as the tiering of interest rates or any discrimination with respect to eligibility. Although I can understand the economic rationale behind most of these proposals, I fear that their introduction would reduce the efficiency of the facility--without even mentioning the problems that could arise in terms of equality of treatment and moral hazard.

I agree that the current criteria for eligibility--per capita income and IDA eligibility--as well as the possibility of expanding the eligibility list on a case-by-case basis should be retained. I am disappointed by the insufficient treatment in the staff paper of the problematic countries of the former Soviet Union. While those countries will have the possibility of drawing on the temporary facility for countries in transition experiencing a systemic shock, the access limits and the rate of charge envisaged under that facility are much less generous that those of the ESAF. A strong case can be made for opening the ESAF to the states of the former Soviet Union that are IDA-eligible, and this chair will press for that. I believe that Mr. Shaalan has expressed the same opinion.

Regarding access to the ESAF successor, I support the rule simplification proposed by the staff that is aimed at eliminating the present distinction in access as between originally eligible and newly eligible countries.

I do not suggest that those countries that have already used the ESAF be strictly excluded from using the new facility. However, I would like to emphasize that the use of this facility should be temporary, and that any prolonged use of Fund resources should be discouraged.

I have no firm position on the access limits. In this respect, I tend to put the emphasis on the conditions for using ESAF resources, rather than on the maximum amounts available. The Fund's support under the ESAF should be provided in an amount sufficient to be relevant, and in order to help catalyze support from other sources. As already mentioned by other Directors, there is a strong rationale for phasing out access, but we should not penalize good behavior. The same argument applies to the tiering of interest rates, with the differentiation of the degree of subsidization. I am against these proposals, as they introduce substantive and conceptual complications, contain large judgmental elements, and their efficiency will be seriously compromised by data deficiencies.

Given the importance that we attach to the funding of the new facility, we are relatively open minded about how the financing can be secured. The case for the Trust Fund option has been eloquently presented by different Directors. The Trust Fund option enables the development aid and structural reform components of the ESAF to be stressed. It also allows donors to exercise a stronger influence on the functioning of the facility. However, there are also some arguments for the GRA option. The fact that it is being suggested that the facility be renewed shows that it is becoming a durable tool of the Fund's policy. Moreover, the facility is relatively modest in size, compared with the size of the Fund and its uncommitted resources--which surpassed SDR 50 billion as of the end of February 1993. It also needs to be borne in mind that the new facility to assist the economies in transition would be funded through the GRA. Also, the budgetary situation of the main participants in the existing ESAF is not good enough to allow the new ESAF to be funded through the budget, and it is by no means sure that the resources allocated to the new ESAF will be additional to current official development assistance resources. Having said that, we are ready to join any consensus--but in this respect we would be less imaginative than some previous speakers.

Mr. Bindley-Taylor made the following statement:

We welcome this discussion on what we perceive to be one of the most important issues facing the Fund, namely, the maintenance of its ability to play a catalytic role in the economies of some of its poorest members. While it is true that not all that was expected of ESAF programs has materialized, there is adequate evidence to suggest that, in the absence of the ESAF, almost all of the countries with ESAF programs would have been worse off economically.

In looking at an ESAF successor, our major emphasis is on the preservation of the substance of the existing facility. We will then address the issue of the facility's structure. Of critical importance are the issues of eligibility, qualification, the time frame of assistance, access policy and conditionality, and the concessionality of the facility.

The criterion for ESAF eligibility so far has been a mixture of the per capita income operational cutoff for IDA eligibility and the Fund's judgment. This has proved quite appropriate, and we see no reason to deviate from this path. The staff has suggested that the number of ESAF-eligible countries could be increased. First, there is the case of a few countries with high per capita incomes that remain IDA-eligible, which have small Fund quotas, and the economies of which are clearly vulnerable. Second, there is the case of several of the states of the former Soviet Union, which, over time and in light of revisions in their estimated GNPs, may qualify as ESAF-eligible countries in the future. In keeping with past practice, we can decide on eligibility for members of either group on a case-by-case basis. However, we note that while reference has been made to expanding eligibility, no reference has been made to expanding the resources available for the ESAF.

A protracted balance of payments problem, combined with a commitment by the member to address its imbalances, as expressed in a policy framework paper, is at present the benchmark for qualifying for assistance under the ESAF. We agree with the staff that this should remain so, as should the current time frame of three years for commitments under any successor facility.

We should retain the access limits that currently apply under the ESAF in any successor facility, as the present access limits have proven adequate to meet the potential needs of the eligible members. We therefore do not agree with suggestions that seek to differentiate access on the basis of past usage of ESAF resources. Annual phasing, quarterly benchmarks, and semi-annual performance criteria should be retained, for they have provided a good monitoring system in the past. As such, we see no need to consider quarterly phasing, as suggested by the staff. With respect to conditionality, the emphasis on structural reform must remain at the heart of these programs, as past experience indicates that structural reform is vital to the attainment of balance of payments viability and growth in these countries. We agree with other Directors that some form of contingency mechanism should be built into these programs. However, in light of our past experience with contingency mechanisms, emphasis on any such measures in ESAF programs must be on simplicity in both design and implementation. What is more important, it is the financial terms of the ESAF, with respect to both the interest rate charged and the repayment period, that were crucial to making the facility an attractive and viable proposition to our poorest members. We must preserve both, and this chair is thoroughly opposed to any suggestion--however well intentioned--to tier the interest rate charged.

We now turn to the issues of transition and the possible structure of an ESAF successor. With respect to the transition from the old to a new facility, we would expect that existing SAF and ESAF arrangements would run their course, and that, after November 1993, all new ESAF arrangements would take place under the ESAF successor.

There seem at present to be no new demands for SAF-supported programs, and the remaining balances in the SDA represent mainly the undrawn balances of those SAF- and ESAF-eligible countries currently in arrears. We would prefer to leave these resources available for those countries to finance their adjustment programs after they have successfully completed rights accumulation programs. The alternative, which is to terminate the SAF and transfer the unused SDA resources to the ESAF Reserve Account, appears neither very useful nor attractive. In the interim, investment income from uncommitted SDA resources could be used to strengthen the subsidy of the successor of the current ESAF Trust.

The use of GRA resources to finance the successor, combined with an interest subsidy account, would seem to be the least operationally complex of all the options. Of course, we could have taken that route in 1987 at the time the ESAF was first launched. However, the arguments raised then concerning the Fund's role in so-called "development issues," the subsidization of use of Fund resources, and the preference for using GRA resources for short-term financing as against prolonged use have never been adequately resolved. The possibility of reaching a consensus to follow this route is therefore far from assured.

As a result, our preference to enlarge the current ESAF Trust. While this is not an optimal solution, it looks like the least messy. The disadvantage of the present system seems to lie mainly in the complexity of the differing arrangements between ESAF lenders and the Trust. Moreover, in the context of the legal structure of the Trust, certain amendments require the consent of all contributors. We are uncertain as to how, and in what ways, the staff, together with donors, can simplify the procedure for providing resources to the ESAF Trust Loan Account, but we urge them to explore all possible opportunities to achieve this.

The issue of whether the Reserve Account would provide adequate coverage for additional liabilities seems to be neither pressing nor worrisome. By 1999, and assuming no arrears, reserves are projected to begin to exceed claims on the current Trust. Even at a default level of 50 percent of obligations falling due, the Reserve Account would equal outstanding obligations by the year 2002. Once this crossover point is reached, the excess resources would return to the SDA, and could form the reserve account for the ESAF successor. However, the need for a separate reserve account is eliminated if the ESAF successor takes the form of an expansion of the current Trust. Given such an expansion, and even assuming an extremely high level of nonpayment, the reserve account would remain just sufficient to meet all the Trust's obligations. We therefore endorse the approach of having the successor take the form of an expansion of the existing ESAF Trust.

Mr. Santos made the following statement:

At our last Board review of experience under ESAF-supported arrangements, we recognized the effectiveness and the important role that the ESAF has played in removing impediments to growth and improving resource allocation in eligible countries. At that meeting, a broad consensus emerged in favor of continuing the Fund's concessional assistance to low-income countries in the form of an ESAF successor. It was made clear that while important progress has been achieved toward medium-term balance of payments viability in some cases, many of the ESAF-eligible countries that have availed themselves of the facility have fared less well on some structural issues, particularly in financial and public enterprise sector reforms, as well as social reforms. We therefore agree with Mr. Fernando that the need for the Fund to play a central role in the economic agenda for these countries continues to be a major political and economic imperative. In this regard, and as stated on previous occasions, we would have favored a longer time frame for the successor--or even making it permanent--as the appropriate course of action in order to address some of the major problems relating to debt and structural adjustment. Nevertheless, we believe that a temporary facility can be effective if it is supplemented with further enhanced debt concessions, more aid effectiveness, and the implementation of policies both in industrial and developing countries that are conducive to a global economic recovery.

We keep an open mind on the issue of the funding alternatives presented in the staff paper, provided that enough resources are mobilized to make the ESAF successor an effective instrument. However, we are attracted to funding the new ESAF through the GRA, which seems to be the most operationally effective option, given its efficiency and ease of operation. The staff elaborates extensively on the advantages of this funding option, and I need not dwell on them. I will add that in adopting the GRA option, the perception that the Fund is prepared to commit its own resources in support of its low-income members would only enhance confidence in these countries in their reform process. We realize that, under the GRA option, contributions from donors will be needed to fund an interest subsidy account. Resources for this purpose could be generated from the various sources identified by the staff in the paper. If the required voluntary contributions are not forthcoming, all avenues of financing should be explored, including the sale of a minor part of the Fund's gold holdings.

The concessionality of the ESAF is one of its critical features, and it should remain unchanged for all eligible countries. I would like to associate myself with those speakers who do not favor any tiering of interest rates for the new facility.

The basic operational orientation of the present ESAF, which has been adapted through the experience gained over the years, has proved adequate to address the various difficult operational issues that emerged, and has therefore helped countries implementing ESAF-supported arrangements to cope with unforeseen exceptional developments. We believe that the current operational modalities of the ESAF can be retained in the successor facility.

With regard to the time frame of an ESAF successor, we can agree to retain the three-year commitment period for the ESAF successor. We agree also that eligibility should not be denied to any low-income member that meets the qualifications for assistance under the present ESAF. However, at the time of expansion of eligibility, resource requirements will need to be reassessed so as to ensure that the level of access is not reduced for those already eligible. We recognize the difficulties that the staff faced in projecting the aggregate financing needs for ESAF-eligible countries. A potential lending volume of about SDR 6 billion, with a subsidy of from SDR 2 billion to SDR 3.3 billion, can be considered at this stage as a first order of estimation of the amount necessary to avoid diminishing substantially the effectiveness of the Fund's assistance to these countries.

We have no difficulty retaining the present access limits, and we agree that we can do away with the special provision on access for the newly eligible countries, as the association of the ESAF with the SAF will no longer be relevant. However, individual access will need to continue to be based on the usual criteria, without regard to past use of the facility.

We agree that, during the transition to the ESAF successor, current ESAF arrangements should run their course, and that no provision for parallel access during the transition period should be envisaged. We also agree that after November 1993, all new arrangements would be approved under the ESAF successor. We believe that the availability of SAF resources for countries in arrears should be preserved, in order to allow the Fund to respond to the expected large financing needs of these countries once they clear their arrears. However, pending the successful completion of the right accumulation programs, it seems appropriate that interest earnings on SDA balances be used as a Fund contribution to the subsidy account of an ESAF successor.

We agree that overall conditionality standards under an ESAF successor should remain similar to those under the present ESAF. However, conditionality should remain pragmatic and take account of the more complex nature of the remaining structural reforms that these countries will be undertaking.

We agree that phasing and monitoring procedures under the present ESAF should be retained for the ESAF successor. We do not support the proposed quarterly phasing and further tightening of performance criteria, which are not in line with the structural orientation of the ESAF.

The recent review of ESAF-supported arrangements has provided us with the opportunity to better focus our conditionality and program design on key priority areas that could accelerate progress toward the achievement of the program objectives.

The protection of programs from unexpected adverse shocks should be made more systematic under the new ESAF successor through a simple contingency mechanism.

Comprehensive technical assistance at an early stage could play an important role in rebuilding institutions, improving public sector and debt data, as well as national accounts and financial sectors statistics. The new ESAF should draw extensively on the experience of the coordinated interagency technical assistance provided to some Eastern European countries. In the interim period, the Fund will nevertheless need to consolidate the progress made in assisting these countries. It has to be understood, however, that institutional bottlenecks, although constraining, should not in any case result in delaying the provision of much-needed financial assistance to ESAF-eligible countries.

The Fund will also need to pay greater attention to the social impact of the measures, and it will need to incorporate social safety nets in economic reform programs. Data needed to better assess the impact of policies will need to be improved as a matter of urgency.

Mr. Esdar made the following statement:

As my authorities have not yet come to a definite decision to support an ESAF successor, I will limit my remarks to matters of principle. Let me point out, first of all, that the ESAF was established as a temporary special facility. My Government has made it clear that its contribution to this temporary facility would have the character of a one-time action, and that no further contributions could be expected. However, my authorities endorse the views expressed by the G-7 Summit leaders in Munich and by the Interim and Development Committees, and they are still considering whether an ESAF follow-up facility might be appropriate and, if so, in what way this could be done.

Notwithstanding, and without prejudicing the outcome of, these considerations, any facility must maintain and adequately reflect the temporary character of the ESAF. We therefore would strongly advise against the use of the Fund's general resources to finance an ESAF successor, as such an approach could lead to the wrong impression that the ESAF was going to become a permanent facility, and that the Fund is shifting its emphasis more in the direction of development financing. The Fund's credits are refinanced by short-term central bank resources, which are incompatible with the more long-term orientation of ESAF credits. In this regard, I fully agree with Mr. Posthumus's remarks. I would also advise against opening a Pandora's box by considering sales of some of the Fund's gold holdings to finance an ESAF successor.

A number of questions need to be answered before a final decision can be reached. First, I believe that the staff overestimates the financing and subsidy needs in the framework of an ESAF successor. We should not consider it a forgone conclusion that a possible ESAF successor will have the same access limits as the current ESAF. It should also be borne in mind that a retention of ESAF access limits, combined with a uniform application of the limits to all eligible members, would lead to a considerable increase in the access of the newly eligible ESAF countries, thus allowing them to use a considerable amount of the ESAF successor--probably as much as 30 percent. Therefore, I feel strongly that a reduction in access limits would not only better reflect the temporary character of the ESAF successor, but would also correspond to the scarcity of resources to finance this facility, which must be taken realistically into consideration. The temporary character of the facility should be further underscored by a gradual phasing out of average access over the envisaged three-year disbursement period--that is, starting with 40 percent in the first program year, followed by 30 percent in the second year, and ending with 20 percent in the third year.

Second, concerning the proposed financial terms, a definite decision about the level of the basic interest rate can only be made after the amount of the available subsidies is known. However, I wonder whether it is necessary to aim at an interest rate of 0.5 percent from the outset, which is even somewhat below the IDA rates. The staff has made an interesting proposal in this regard--implying a tiering of interest rates. That proposal should be examined further. A gradual increase in interest rates could also be considered, starting, for example, with a rate of 2.5 percent in the first year and ending with 4.5 percent in the last year. Such a phasing-in to more market-oriented interest rates would be justified, as the Fund expects the debtor country to make considerable progress toward establishing normal financial relations with its external creditors under the Fund-supported arrangement.

Third, the proposed eligibility criteria for the ESAF successor should be reviewed. For example, we could consider limiting eligibility to the so-called IDA only countries, and exclude the so-called blend countries that qualify for regular World Bank loans in view of their maintained or regained creditworthiness. Another possibility would be to exclude those 17 countries listed in the staff paper that, in the staff's view, are better able to cope with credit on market terms than the poorer countries.

All of these proposals deserve consideration, and I would therefore ask the staff to discuss them in more detail in a follow-up paper. In this context, an analysis of the consequences of these proposals for the financing and subsidy needs of an ESAF successor--by way of illustrative calculations--would be especially interesting. The staff could base those calculations on three different assumptions: first, a limited reduction of the expected average access to 90 percent of quota, instead of 110 percent of quota; second, a greater reduction in expected average access combined with a gradual phasing out of the average access, by limiting--for example--the annual average access to 30 percent, 20 percent, and 10 percent of quota for the first, second, and third program years, respectively; and third, an increase in the minimum interest rate to at least 1.5 percent, combined with a tiering of interest rates and a gradual increase in the interest rates. This could imply an interest rate structure of 1.5 percent, 2.5 percent, and 3.5 percent.

Although it is too early to discuss the operational modalities of a possible ESAF successor in any detail, the results of the recent review of the ESAF should be taken into account in designing any successor facility. In this regard, it is especially important to aim more directly at balance of payments viability, the improvement of administrative capacity, the strengthening of fiscal adjustment efforts, and an intensification of adjustment efforts in the areas of public enterprise reform and bank restructuring. In general, more frequent use of prior actions in crucial policy areas should be envisaged. I also support the conclusions and recommendations of the Chairman's summing up of the Board's discussion in March 1993 on the review of the current ESAF.

I would like to stress that the security of lenders' claims on the ESAF Loan Account must not be impaired by the establishment of an ESAF successor.

Mr. Al-Tuwaijri made the following statement:

During our recent review of experience of ESAF-supported arrangements, I endorsed the staff's key conclusion that the ESAF has provided a channel for Fund involvement in low-income countries that is well suited to their problems and needs. Moreover, I sympathize with some of the concerns regarding the appropriateness of Fund involvement in concessional financing of members with long-term development financing needs that cannot be satisfied through adjustment programs of limited duration. However, I believe that recourse to ESAF-type arrangements was probably unavoidable, and I share the staff's view that the initial rationale for the ESAF remains valid.

Consequently, there appears to be a need for the Fund to continue its current involvement with ESAF-eligible members for another well-specified period of time. Nevertheless, the Fund should not embark on a path leading to the permanent establishment of a concessional window for low-income countries in need of long-term development financing. Hence, I place considerable importance on the Fund's "arm's length" relationship with the ESAF. Therefore, any ESAF successor should be designed along lines similar to the current ESAF. Indeed, the proposal to fund the successor facility through the use of GRA resources, with subsidies from an administered subsidy account, may create the perception that the Fund's provision of long-term concessional resources has become a permanent feature of its activities. Hence, I support the continuation of the present ESAF Trust structure, with a preference for establishing a new Trust rather than expanding and extending the current ESAF Trust.

In this regard, a new Trust would provide the possibility--albeit unlikely--of simplifying some of the ESAF borrowing arrangements. More significantly, a new Trust would avoid compromising in any way the security of the current ESAF loans and would obviate the need to consult with all ESAF lenders prior to the expansion of the loan account. However, I recognize that this will require further examination by the staff, and I look forward to a more detailed exposition in the future.

This being said, the ESAF successor should retain the basic operational modalities of the current ESAF. Therefore, I can go along with maintaining the same time frame, qualification, conditionality, program monitoring, access policy, and financial terms as in the current ESAF. Here, I believe that the staff's current treatment of balance of payments need appears warranted. The maintenance of the current access policy, financial terms, and overall size of the facility will depend crucially on the availability of resources, and they may need to be adjusted in light of the progress made with respect to contributions to the loan and subsidy accounts.

I agree with the staff that it does not seem necessary to expand eligibility to use ESAF-type resources at this time. Also, I do not see a compelling reason at this stage to make ineligible the seven small island economies, as long as they remain IDA-eligible. With respect to members not currently ESAF-eligible, I agree that the Board may want to pay due regard to major changes in per capita income data, and that it should look favorably on the request of members to become ESAF-eligible if circumstances warrant. While the poorest members of the former Soviet Union are obvious candidates for a future expansion of the eligibility list, such a potential expansion should not be restricted only to these countries. Indeed, there may be several other members with highly tentative per capita income estimates that could qualify equally well for ESAF resources once more reliable estimates become available.

Mr. Mwananshiku made the following statement:

The case for an ESAF successor has been well documented by the staff. Its essence is twofold. The first is that although some progress has been made under the existing facility--as revealed in the recent review of experience under the SAF- and ESAF-supported programs--critical problems of adjustment in low-income developing countries remain and--in some areas--have even worsened. Of particular concern was the failure by a large number of countries to achieve external viability despite the great efforts made in implementing strong adjustment policies, including the liberalization of trade, commodity pricing and marketing, and the exchange system. Equally of concern is the fact that, even where countries have embarked on structural reforms, those reforms have not yet been completed, and the beneficial effects of reform have therefore not begun to show.

The second consideration supporting an ESAF successor is that a good number of ESAF-eligible countries have not yet even started implementing reform programs. As the staff correctly points out, these countries face serious macroeconomic imbalances and structural distortions that need to be addressed if noninflationary growth and external viability are to be achieved.

In the circumstances, taking into account the persistent hostile external environment characterized by an adverse terms of trade and external debt problems, and bearing in mind the catalytic role of the ESAF in mobilizing additional resources, including debt relief and technical assistance that is suited to the present condition of low-income countries, we believe that the Fund should continue to support strong and comprehensive adjustment programs under an ESAF-type concessional window. Timely establishment of an ESAF successor is therefore warranted and would be consistent with the calls by the Group of Seven major industrial countries and the Interim Committee last year for the Fund to pursue this course.

In this respect, we note that the operation of the existing ESAF facility has evolved since its establishment, and the modalities have been modified and fine-tuned for enhanced effectiveness. The experience gained so far, including the mechanism for international cooperation that has evolved for mobilizing support for strong adjustment efforts in ESAF countries, therefore constitutes an invaluable asset upon which a successor facility should build. In this regard, we support the staff proposal that the essential features of the ESAF's operational orientation should be retained under its successor. The modalities would be guided largely by the source of the facility's funding.

With regard to the funding, the staff has provided two alternatives: the use of GRA resources, or the continuation of the present Trust Fund system. In our view, the use of GRA resources with an interest subsidy account is a more appropriate way of funding a successor facility. The reasons given by the staff in support of this option are strong and acceptable to us.

However, if the consensus is for the use of the Trust Fund, we can go along with it as well, as it also has a number of advantages, as indicated by the staff. The difficulties associated with this option can be addressed if creditors would show the necessary understanding and cooperation with the Fund to simplify the existing--somewhat cumbersome--borrowing arrangements.

With regard to the other operational issues, we support, in principle, a three-year commitment period, as proposed by the staff. However, experience under the current facility suggests that a period of three years is perhaps too short, especially taking into account the evolving political environment in many of the eligible countries. For this reason, the Board should stand ready to consider an extension if it becomes necessary. Similarly, consideration should be given to extending country arrangements under a successor facility beyond the three years proposed. In making this suggestion, I am taking into account a fact that has long been recognized by the Fund--that the problems facing most, if not all, of these countries are structural in nature, and that they do not lend themselves to easy and speedy solutions.

We are in favor of an automatic extension of eligibility to all existing ESAF-eligible countries. Past use of the ESAF should not be a barrier to eligibility for the successor facility. We also agree that qualifications for assistance under a successor facility should remain the same as under the current ESAF. Moreover, we share the staff's view that some mechanism should be created to enable countries undertaking rights accumulation programs to have access to the resources of the new facility or to other, similar, resources at the end of their programs.

The present access restrictions applicable to newly eligible members should be lifted under a successor facility. The access policy should itself continue to be applied flexibly to assist needy members in coping with the impact of shocks. It follows that contingency financing should be accepted as part of the operational features of the successor facility, as experience has shown that the ESAF countries are vulnerable to shocks.

The retention of the existing basic terms of loans under the ESAF successor is preferred. Specifically, we are in favor of keeping the maturity term of 5 1/2 to 10 years, and a uniform interest rate that would be kept as close as possible to 0.5 percent for all eligible members. The proposal to tier interest rates if resources for the subsidy are inadequate is therefore not supported, because of the potential problems it would create. As the staff rightly observed, the criteria for ranking countries are difficult to apply objectively because of conceptual complications and the large judgmental element and data difficulties involved. Judgments based on such criteria would clearly be misleading and would put at risk the Fund's commitment to the principle of equal treatment. In this regard, we would like to appeal to the donor community to come forward and support the subsidization of interest to ensure the continuation of a concessional facility.

We agree that the current conditionality standard should be broadly maintained, but we would add that a more critical appraisal of the adjustment strategy against the overall objectives that are set should be conducted more frequently. What comes readily to mind is the difficulty of attaining external viability and export diversification in many countries that have adopted programs supported by the ESAF. While the major cause of the unsatisfactory external sector performance has been rightly identified as the persistent terms of trade losses--over which these countries have no control--the staff seems to suggest that the solution lies partly in the further strengthening of the adjustment effort. This raises some concern that the emphasis has been misplaced. In our view, while programs should remain strong and comprehensive under the successor facility, for their successful implementation, the strengthening and sequencing of policies should give due consideration to resource availability, as well as institutional and administrative capacity.

Mr. Mirakhor made the following statement:

During the recent Board review of the experience under ESAF-supported programs, there was a general agreement that this facility has been helpful in promoting macroeconomic adjustment and structural reforms in low-income countries. It is also clear from the staff paper that the agenda of reforms in these countries is far from completed, in view of the mixed results achieved in the area of external viability. In addition, with the persistence of a difficult external environment and the continued need for exceptional financing by low-income countries, the justification for the ESAF at the time of its introduction remains valid and warrants the Fund's specific involvement in low-income countries through an ESAF-type facility. Moreover, a commitment by the Fund and donor countries to maintain their support for low-income countries will send a strong signal about the interest of the international community in the plight of these countries, which is particularly important at this juncture, when the focus of attention has been directed to the states of the former Soviet Union. With this in mind, we can support the general principles outlined by the staff regarding future relations between the Fund and low-income countries in the period after November 1993--the cutoff date under the current ESAF mechanism.

With respect to the time frame for an ESAF successor, our preference is to allow for a commitment period exceeding the three years proposed by the staff. First, given the complexity of the problems and the deep-seated structural distortions existing in low-income countries, we believe that the proposed period is too short to allow for concrete results to emerge from the broad array of adjustment efforts. Second, we note that, after more than five years of experience, the totality of the resources available for ESAF has not been committed. We believe that this has much to do with the limited time span allowed for in the program. A longer commitment period will also facilitate technical and administrative preparedness and will continue to offer a window of opportunity for countries in protracted arrears, as well as to potential newly ESAF-eligible countries.

Our experience shows that a longer period of time is needed. In the case of Ghana, for example, a fourth year could have been very useful, because even when Ghana graduated, the authorities opted for enhanced surveillance in the fourth year because they believed that the Fund's intense involvement in their continued adjustment was essential. Therefore, we endorse the views of those Directors who have recommended the lengthening of the commitment period.

With respect to eligibility, qualification, and access policy, we can support the current guidelines, including the consideration of a possible expansion of the eligibility list on a case-by-case basis. We also agree with the staff's suggestion to eliminate the distinction in access as between originally eligible and newly eligible members.

I agree with Mr. Landau that we should try to revisit the conditionality guidelines, not in order to soften them, but to simplify them; without weakening the program, we have to try to avoid fine-tuning. We also endorse the idea of building into the program some degree of feedback to allow for target resetting when the assumptions or external conditions change.

In considering an ESAF successor and the rate of interest on use of its resources, it is important to bear in mind the Fund's experience with the compensatory financing facility--experience that we should try not to repeat. In redesigning the compensatory financing facility, the nature of a mechanism that had proven its usefulness to member countries was changed unnecessarily, and the simplicity for the Fund of the facility's operational modalities was destroyed as well. It is generally recognized that the main characteristic of the ESAF--which is also the major element of its attractiveness to low-income countries--is its concessionality. The proposal to raise the interest rate, even for some of the eligible countries, should be evaluated in light of the staff's conclusion that, for many eligible countries, cash flow situations are expected to remain tight, with a continued need for other exceptional financing. In addition, it is difficult to appreciate the rationale behind the proposal, particularly at a time when the general level of interest rates is declining. According to the staff estimates, nominal and real long-term interest rates in the Group of Seven major industrial countries fell by more than 2 percentage points between the mid-1980s and 1990-92. While the low-income countries have not benefitted from this reduction, as their access to financing on market-related terms is either limited or nonexistent, the general reduction in global interest rates has helped lower the level of subsidy contributions that would be needed from donors. Moreover, we are concerned about the additional operational difficulties that would have to be introduced if interest rates were to be tiered. Those difficulties need to be considered in the light of the fact that, according to the staff's estimates, the savings to be realized from tiering will be small, as pointed out by Mr. Fernando as well. We therefore strongly support the idea--expressed by many Directors--that there is no justification for changing the rate now charged on the use of ESAF resources.

I wonder whether other financing alternatives in addition to those mentioned by Mr. Landau should not be considered. One example is the Belgian proposal--some kind of redistribution scheme for an administrative account managed by the Fund. Another alternative would be to agree to set aside a portion of any new allocation of SDRs to finance in part the ESAF successor.

The latter alternative can have a number of advantages. First, it could reduce the perception of moral hazard, to which Mr. Kaeser has alluded. Second, low-income countries would have a channel through which to invest directly in the financing of the concessionality element of financial support needed to launch their adjustment effort. Third, it would allow for greater and more extended burden sharing; and fourth, it would reduce--albeit indirectly--the subsidy element in the rate of charge.

We concur with the staff proposal regarding the transition to an ESAF successor, and we can also support retaining program monitoring standards. We prefer to maintain the SAF as long as the rights approach is available to countries in arrears.

Mr. Bonzom stated that his chair shared Mr. Mirakhor's views about the helpfulness of studying further the redistribution of an SDR allocation in the context of the financing of the ESAF successor.

Mr. Prader made the following statement:

Our chair can support the establishment of an ESAF successor because, more often than not, ESAF programs have played a useful role in bringing about adjustment, growth, and structural reform. This implies that an ESAF successor should contain two major complementary elements of the original ESAF: a high degree of concessionality, possibly aiming at a 0.5 percent interest rate, and a high degree of conditionality. Nevertheless, my authorities also believe that an ESAF successor would provide an opportunity to improve on the original ESAF, in the sense expressed by Mr. Dawson during the last ESAF review and by Mr. Fukui today--namely, that more attention could be paid to the preconditions for a successful adjustment strategy, especially in the political, institutional, and administrative spheres. I therefore favor the integration of technical assistance into the ESAF. I trust that future discussions will provide room for further reflections on ways of improving the ESAF facility. Possible contributions to a successor ESAF from members of my constituency would seem to be very sensitive to the impression that a large number of donors would participate in the burden-sharing effort, and not just those countries with obvious historical and economic ties to the Fund's poorest member countries. I obviously share Mr. Solheim's remarks on this point.

The staff paper raises a number of questions, and I would like to comment on two of them. The first is whether the financing for ESAF successor programs should be integrated into the GRA, or come from resources outside the GRA. On this issue, the potential donor members of our constituency remain split. While one of our potential donors would prefer the GRA option, the other two likely donors would participate only under the ESAF Trust option. I will therefore abstain from rehashing the arguments used by my authorities for and against the use of the GRA. Personally speaking, I share Mr. Posthumus's recollection of the 1987 discussion, and I think that we should not regress enough to lose the common ground we reached at that time. The alternative of financing an ESAF successor through the sale of Fund gold is rejected by my authorities. My Belgian authorities have come up an alternative that would make the ESAF successor altogether unnecessary--an SDR allocation linked to an appropriate redistribution scheme. It goes without saying that they would also support Mr. Mirakhor's proposal for using part of an SDR allocation to finance the ESAF successor.

The second question concerns the tiering of interest rates. Speaking for all members of our constituency, I am not ready to support an additional fine-tuning of concessional assistance beyond the criterion of ESAF eligibility. The Fund should be guided by basic principles in providing concessional assistance, and the most important of these should be equal treatment of all members. The invention of ever more sophisticated eligibility criteria and ever more subtle varieties of concessionality makes it ever more difficult to keep this principle in sight.

By the same token, however, there is an expectation that ESAF funds will be used only by eligible countries experiencing balance of payments difficulties that have no access to other sources of financing their reform programs.

I would also agree with Mr. Esdar's wish that we not lose sight of the goal of keeping the ESAF a temporary facility. Without necessarily having recourse to a tiering of interest rates, I also support Mr. Fukui's proposal to introduce mechanisms--such as graduation incentives--in order to prevent the ESAF from becoming a permanent facility.

Mr. Papadakis made the following statement:

The rationale for establishing the ESAF remains at least as relevant today as it was in 1987. Given the currently difficult external environment for low-income countries, it has become even more urgent today to place their adjustment efforts in a medium-term perspective, with emphasis on structural reforms and institution building to support strong macroeconomic policies. The Fund's involvement in this procedure, under appropriate conditionality, is within the Fund's mandate and responsibility. At the same time, the role of the Fund should remain mainly catalytic, complementary, and--above all--temporary. Such involvement should not, and under certain conditions, would not, imply any change in the monetary character of the Fund. It should not substitute for the role expected from other participants in the network of international support to low-income countries. The existence of an ESAF successor and its operational modalities should not create moral hazards that could delay members' graduation from the use of concessional Fund resources.

With respect to the time frame of any successor facility, the suggested period of three years seems to be a realistic compromise between apparently conflicting considerations: on the one hand, the need for timely adoption of reform programs and, on the other, the thorough preparation of such programs to improve their efficiency and effectiveness. Like Mr. Shaalan, I hope that this could prove to be a sufficient period to allow for a better picture to emerge for the group of members with rights accumulation programs. A longer period might be considered if it were to enhance the role and effectiveness of the facility. There seems to be no urgent need to change the existing criteria on eligibility. For possible new candidates, the matter could be revisited at some later stage, after a clearer picture has emerged about the ESAF successor's resource requirements as against the available resources. With respect to qualification, the criteria for financial assistance under the ESAF successor should be the same as under the current ESAF, that is, protracted balance of payments financing needs and a credible commitment by the member, as evidenced in a policy framework paper, to correct the situation in a comprehensive and sustainable manner. The assessment of members' compliance with the qualifying criteria should continue to be made on a case-by-case basis.

With respect to access, the average and the highest access recorded so far under the current ESAF may raise the question as to whether some reduction in maximum access limits would be advisable. The existing criteria for differentiating access in individual cases should be maintained. For reasons of equality of treatment, there should be no prior distinction between members eligible for support under an ESAF successor other than in accordance with the set criteria, including the outstanding use of Fund credit and the member's record in using Fund resources in the past. It might be useful to explore the possibility of incorporating a criterion relating to a country's ability to proceed quickly to structural reform and institution building. Such an ability could justify extra support through concessional resources if it proved technical feasible to incorporate a relevant, transparent, and workable criterion in that regard.

The potential contributors in our constituency would like to remain open regarding the funding of the successor facility. They can understand and appreciate the advantages of an ESAF-type arrangement, the concerns about the Fund's liquidity, and the need to maintain as far as possible the short-term and revolving character of GRA resources. At the same time, however, there are additional considerations that need to be weighed. Funding the successor arrangement through the GRA seems to be more flexible, transparent, and equitable in spreading the implied burden. It also seems to be a more realistic option in a period during which many of the potential contributors will themselves be undergoing difficult fiscal and structural adjustments to secure conditions of longer-lasting noninflationary growth. Under the GRA funding alternative, lengthy consultations with contributors would be avoided, while under the ESAF-type alternative, lengthy legislative processes could be required in some cases for approving the additional amounts needed in the national budgets. Under the GRA option, lengthy discussions with contributors on subsidies or the adequacy of reserves would also be minimized. For the Fund, the GRA funding option could thus simplify the process of administering the facility, which has been cumbersome and costly at times in the past in terms of human resources, owing to the need for different arrangements with the various lenders.

In actively considering the GRA option, ways should be sought to help defray charges on the Fund's general resources. Increasing the Fund's contribution to the subsidy account would facilitate and simplify the consultations with other contributors to that account. The tiering of subsidies--although attractive in that the subsidy funding needs would be smaller--would be inconsistent with the central objectives of the facility, and could have undesirable effects. I was attracted by Mr. Fukui's suggestion to tier subsidies or interest rates according to the record of performance, if a technical way can be found to develop such an incentive. It would seem advisable to investigate further all other potential sources of financing the subsidy account. Liquidity and security issues should be monitored closely and reassessed regularly.

Mr. Wei made the following statement:

Like previous speakers, we welcome today's discussion of the paper on the operational modalities and funding alternatives for an ESAF successor.

In the recent discussion of the review of countries' experiences under ESAF-supported arrangements, it became clear that a number of countries had succeeded in correcting their economic imbalances and had laid the foundation for healthy economic growth. However, because the economies of these countries are all agriculture based or primary product dependent, their economic growth is unavoidably vulnerable to the weather and price fluctuations on international markets. Their reform efforts need continuous support from the international community under concessional terms. In this respect, we fully share the staff's view that the external environment for ESAF-eligible countries in the early part of this decade has unfortunately deteriorated, as the industrial countries have undergone a difficult period of very slow growth. According to the staff's calculations, the terms of trade of ESAF-eligible countries have declined by 25 percent cumulatively between the mid-1980s and 1990-92. Their balance of payments positions are still fragile and need time to be addressed. As we all recognize, given the difficulties confronting these countries, that they have to rely on concessional assistance in order to continue their adjustment efforts to achieve sustainable economic growth. The Fund's ESAF has been a useful instrument in assisting the low-income countries. Given that the rationale for establishing the ESAF is still pertinent today, we firmly believe that the Fund has an obligation and a responsibility to support these countries with an ESAF successor.

With respect to the funding alternatives for an ESAF successor, we can support the first option, that is, to establish a new ESAF Trust by seeking additional contributions from donors and creditors in the form of grants or loans, if firm commitments are secured. However, as the fully subsidized resources in the current ESAF trust would be exhausted by end-November 1993 if the ESAF arrangements currently under discussion with members were concluded, and in the event that sufficient new resources from donors and creditors to establish a new ESAF Trust could not be mobilized, we would support funding the ESAF successor through the GRA, for the reasons given by the staff in the paper. Regarding the liquidity ratio, we would emphasize that, when considering the Tenth General Review of Quotas, we should take account of the projected 3 percent decline in the liquidity ratio, although this will have a relatively small impact on the liquidity position of the Fund.

The degree of concessionality under the ESAF successor should be the same as under the ESAF--that is, the rate of interest should be a uniform 0.5 percent for all eligible ESAF countries, in the light of the difficulties borne by the low-income countries, and in particular their heavy debt burdens.

We agree with the staff that the access limits for the ESAF successor should be broadly the same as the present maximum limits under the current ESAF.

We support retaining on the list of ESAF-eligible countries the seven small island countries noted in the staff paper, as long as they continue to be eligible for IDA resources. We associate ourselves with the staff view that the essential features of the operational modalities of the current ESAF remain valid for the ESAF successor. However, we emphasize that no additional conditionalities should be added to the ESAF successor.

The ESAF-eligible countries are proceeding with their structural reforms and macroeconomic adjustment, and they thus deserve concessional financial assistance from the international community, including from the Fund. The ESAF successor will play an active and catalytic role in assisting these countries in overcoming their difficulties--in particular in their external accounts--to enable their economies to grow on a sustainable basis. Like Mr. Mwananshiku, we urge the donors to redouble their efforts to find an early resolution of the ESAF successor issue.

Mr. Evans made the following statement:

I continue not to favor concessional financing by the Fund, and the specific reservations that some of my authorities have regarding Fund lending at concessional rates of interest are well known. Nevertheless, as it is clear that there is majority support for an ESAF successor, I will concentrate my intervention on the financing and operational issues involved.

We favor the GRA funding approach, primarily for the reasons given in the staff paper. However, we also see a significant advantage in drawing a clear distinction, both conceptually and in practice, between program issues and funding issues. I note in that regard that the Director of the Policy Development and Review Department has reminded me, more than once, that there is absolutely no difference in conditionality between programs under the ESAF and programs under the extended Fund facility. Moreover, ESAF programs do nothing that programs under the extended Fund facility cannot do. This is clearly correct, and I trust that we shall never hear the staff, or management, or the Board argue that the type of programs appropriate to a given member country should depend on the rate of charge applied to its purchases. On that basis, as far as programs are concerned, we should no longer have ESAF programs per se in our successor arrangements, but only programs under the extended Fund facility, with or without concessional financing. Eligibility requirements would attach to the concessionality, not to the program. There are several advantages in making this clean break, both in simplifying our program arrangements and members' understanding of them, but also in allowing us to consider the nature and spread of concessionality in its own right without consideration of program matters. In doing so, many of the problems referred to by Directors today would simply disappear. I would appreciate staff comments on this point.

We are proposing an extension of ESAF-type funding arrangements at the same time as we are considering a new facility for countries in transition. In both cases, we are looking at extended repurchase periods and high-risk situations. Both elements impinge upon the revolving nature of Fund resources. I believe that the staff needs to look further at the liquidity implications of this combination of events.

When I last spoke on the issue of an ESAF successor, I agreed with other Directors that it was clearly the case that comprehensive reform programs yield greater success than do partial programs, and that low-income countries have a need for highly concessional financing. However, I suggested that the staff may wish to consider whether or not it was desirable or useful for the Fund to make the link between these two propositions, which is what concessional lending by the Fund attempts to do.

The staff paper briefly attempts to establish the case for the Fund's role in making this link between concessional financing and comprehensive programs, but it does not do so convincingly. The main reason given in the paper for the Fund's making this link is that the very difficult debt burdens of many ESAF-eligible countries would mean that Fund financial involvement should be at a concessional rate of interest. This argument ignores the catalytic role of comprehensive Fund-supported programs that is well recognized elsewhere in the paper. The Fund's contribution to the total financing needs of countries using ESAF resources--at just 4 percent of the total between 1987-1991--is negligible in terms of their overall requirements, and the interest subsidy component of Fund assistance is even more negligible. What is important is that the comprehensive reform program tied to the use of ESAF resources unleashes substantial assistance from donors.

This is not to say that the loans provided by the Fund to countries using the ESAF are not in addition to what would otherwise be available, for, given the conditionality of the loans, clearly they are; but I do not accept the suggestion that the assistance provided in the form of a concessional rate of interest is in addition to external assistance that would otherwise be available.

With respect to the financing of an ESAF successor, I agree that the gold sale alternative can be put aside. Of the two remaining alternatives--an ESAF-type trust arrangement or use of the GRA--I believe that the GRA is the better option. Under this option, potential problems associated with mobilizing loan resources, including complications associated with a plethora of different donor agreements, would be obviated. Concerns over explicit insurance for donors in case of loan defaults would also not arise. Also, there are likely to be efficiency gains from effectively integrating the extended Fund facility and the ESAF successor.

While some may see the implications for the Fund's liquidity position as a problem, in reality it would appear that the GRA could easily handle the amounts expected to be involved. Nevertheless, one aspect of the liquidity issue that is not considered in the staff paper is the potential impact on the revolving nature of the Fund's general resources. The issue here is whether or not the use of the GRA for longer-term commitments under an ESAF successor would disturb significantly the balance between shorter-term and longer-term commitments from the GRA. In the latest financial year, the value of shorter-term commitments from the GRA was more than double that of longer-term commitments under extended arrangements. Funding an ESAF successor through the GRA could lead to a significant lengthening of the maturity structure of the Fund's total commitments. The potential implications of this, such as reducing the capacity of the Fund to quickly mobilize resources, are not addressed in the paper. Overall, the liquidity issue may be something of a distraction because of the methods available to the Fund to increase its own liquidity, but the staff may like to comment on the maturity issue.

The staff paper raises two potential problems with changing from the current Trust to using the GRA: the possibility of arbitrage between facilities, and difficulties in making the transition from the ESAF Trust to the use of the GRA. However, these two problems can be largely overcome if the interest rate under the GRA option is set at 0.5 percent, and if the operational differences between the ESAF and its successor are minimized.

I agree with much of what the staff has written about other of the issues of the operational modalities and on the emphasis needed within ESAF-type programs. I would particularly like to stress that firm financial discipline must be the central feature of economic programs under the ESAF successor. There is also a clear need to encourage national authorities to design programs that will accelerate progress toward external viability.

A central conclusion of the recent review of experience with ESAF-supported arrangements was that a lack of administrative capacity had been a severe constraint on the implementation of ESAF programs. We should use the opportunity afforded by moving to the ESAF successor to try and correct this problem. Of course, we should ensure that at least a basic level of administrative capacity is in existence before the Board approves a program. In addition, the focus of support provided by the Fund under ESAF successor arrangements could shift more toward technical assistance. Given the already strong demand for Fund technical assistance, the Fund's role in enhancing the assistance provided to ESAF-eligible countries might be properly restricted to one of coordination.

Mr. Estela made the following statement:

I will focus on the desirability of an ESAF successor, the operational modalities of such a facility, and the financial considerations.

The question of the desirability of a successor facility has already been alluded to by Directors in the previous discussion of the ESAF. We support the continuation of a temporary concessional facility that aims not only at achieving macroeconomic stability in low-income countries facing severe disequilibria, but also at eliminating structural rigidities that hamper both stability and growth prospects. While the performance of countries with ESAF arrangements has not been unequivocally positive, it is clear that it has been generally encouraging, even when that performance was affected by adverse exogenous factors.

With regard to the operational modalities of the successor facility, we agree with the proposal to follow current practices with respect to eligibility, conditionality, monitoring, access, and phasing.

Regarding the financing of the successor arrangement, the staff has clearly indicated the trade-offs involved in following an ESAF-type arrangement, either through the existing ESAF Trust or a new trust, or by funding the facility through the GRA. Two among the various issues involved stand out: first, the source of financing for the facility, and second, the implications for the transition period.

Certain principles should be considered in assessing these issues. The first is the simplification of Fund operations and facilities, which has received support from the Board and the staff in the past. The second is that the proposed changes should not have adverse spill-over effects on other users of Fund credit. This implies, inter alia, no increases in the rate of charge, which is already quite high. The third is that the concessional facility should be viewed as temporary in nature, and mechanisms should be included for the graduation of countries. One possibility that merits attention is the tiering of interest rates. The fourth is that the proposed changes should minimize disruptions in current and prospective programs. Thus, issues of the transition should be kept in mind when deciding on the ultimate structure of the successor facility.

With these considerations in mind, we favor the continuation of the current ESAF Trust as the best way to meet these principles. Keeping the operational modalities as close to current practices as possible will virtually eliminate transitional problems. Moreover, the temporary nature of the facility could be spelled out clearly with a definite time frame, which will encourage countries to implement adjustment measures at an early stage. In addition, the existing Reserve Account could be utilized for current and future arrangements. While Fund arrangements will not be simplified, neither would they be made more complicated, which would be the case under a new ESAF-type trust or with the use of GRA resources.

If this route is followed, the challenge will be raising the funds to finance the facility. The staff has already identified some possible sources of Fund contributions. As to the remainder, we note the constructive communique of the Group of Seven major industrial countries of July 1992, and we can only hope that this will be followed by concrete actions.

The Director of the Policy Development and Review Department stated that, with respect to the operational modalities of an ESAF successor, there appeared to be a fairly strong consensus in the Board about the need to build administrative capacity, to cooperate with other institutions--especially with the World Bank--in providing technical assistance at an early stage to assure that the prerequisites for program implementation were in place, and to design a mechanism to take account of so-called simple contingencies. The staff would prepare another paper for the Board's consideration that explored in greater depth the program design and conditionality issues that had been identified. While that paper was being prepared, the staff would pursue further the issues concerning the funding of the facility and its operations with individual Executive Directors and with prospective donor countries.

There was no substantive difference, in terms of program content, between the conditionality attached to programs under the ESAF and that attached to programs under the extended Fund facility, as Mr. Evans had observed, the Director agreed, as the aim of programs under both facilities was the restoration of external viability and sustainable growth. There were differences, nevertheless, in terms of the aggressiveness of the targets for external viability. The target for a program benefitting from the support of the Fund's general resources should be the restoration of viability broadly within the program period. The guidelines for programs supported by the ESAF specified that substantial progress toward external viability should be made within the program period, and that, as a minimum requirement, the rescheduling of debt interest payments cease at the end of the program period. There was also the formal requirement under ESAF-supported arrangements that a policy framework paper be prepared, which was not necessary under an extended arrangement, even though, as had been the case in two Eastern European countries, a medium-term framework paper had been formulated in collaboration with the Bank as part of an extended arrangement, which had proven particularly useful in those cases. That practice could be applied in principle to other extended arrangements as well, if needed.

The staff's estimations of a funding requirement of about SDR 6 billion for an ESAF successor were based on the global financing needs of the ESAF-eligible countries, as derived from the world economic outlook projections of the likely situation of those countries, as well as the Fund's share in the financing of those countries, the latter of which would amount to between 3.7 percent and 4.3 percent of the total financing required, the Director explained. The likely needs were projected over the course of the prospective ESAF period--of perhaps five to six years. While, as Mr. Posthumus had pointed out, there was a difference in the outturn depending on the exact assumption of the percentage of the total financing needs that the Fund would finance, the difference was clearly within a reasonable margin of error for a projection that looked that far out into the future. Other factors that had been taken into account in the projections were the likelihood that individual countries would request ESAF financing--a country-by-country assessment made in consultation with the area departments--and the likely amount of financing that would be requested. That was not to say that the estimates were not subject to a good deal of prediction error. There were similar difficulties in the assumptions about the time frame of the new facility, and about how the financing would be disbursed--that is, in equal annual tranches, or in some other way. Such judgments had been based partly on the staff's past experience with ESAF programs, but they were more difficult to make for countries that had not used the ESAF in the past, but which might be expected to request access to the successor.

The accuracy of the staff's projections for the ESAF had not been good, however, the Director acknowledged. Proof of that was the fact that the original ESAF had had to be extended several times beyond its originally anticipated 18-month commitment period. One of the reasons the record had not been good was that it had been severely affected by the pace of progress towards program conclusion with a few large countries. In fact, while it was expected that all of the fully subsidized resources of the current ESAF--about SDR 4.7 billion--would be utilized by the November 30, 1993 cutoff date, that expectation hinged on the assumption that negotiations on an ESAF arrangement would advance rapidly with a number of very large countries, and be concluded successfully. Taking those elements into consideration, the pace of disbursements of SDR 6 billion would be similarly difficult to predict. It could also not be presumed that disbursements would be in equal annual tranches over the three-year period of the arrangement; the staff paper had opened up the possibility of some flexibility in the pace of commitment.

There was even more room for debate about the amount of subsidies that would be needed, the Director continued. While the target of SDR 3.3 billion for subsidies, on an as-needed basis, would not be affected significantly by different disbursement patterns, it would be affected on a present value basis, in that the longer the period over which commitments and disbursements were made, the lower the present value would be for a given discount and market interest rate. The market interest rate itself affected the estimates subsidies in an important way. The staff had used a rate of 7.6 percent--the average relevant SDR rate over the preceding five years, but the current SDR interest rate was much lower. The forward SDR interest rate under current exchange rates was presently about 6.6 percent. Each 1 percentage point reduction in the interest rate reduced the required subsidy amount by about SDR 500 million. If commitments were made in the three-year period from 1994 through 1996, then disbursements would be made until two-and-a-half to three years beyond 1996--up to 1999--and repayments would be made until 2009. Interest rate projections over such a long period were obviously subject to very large margins of error.

There had been little support among Directors for interest rate tiering, the Director recalled, although there had been a bit more flexibility about the base rate. The strong sense of the Board would seem to be to keep the base rate at 0.5 percent for as long as the resources could be mobilized to support that rate.

Another factor that could affect the calculations was the treatment of countries in arrears to the Fund, the Director of the Policy Development and Review Department concluded. Within the total of SDR 6 billion, the staff had factored in about SDR 1 billion for the countries in protracted arrears that had not yet entered into any form of cooperative arrangement with the Fund. There was a question as to whether or not resources should be raised and earmarked for those countries in the ESAF successor, to be used by them at such time as they came to cooperative arrangements with the Fund, such as through a rights accumulation program. The staff would want to take into account as well, in any estimates of the total amount of resources needed, the amount of resources that might be taken up by countries that had already begun to cooperate with the Fund, or were undertaking rights accumulation programs, upon the conclusion of those arrangements.

The Executive Directors agreed to continue their discussion in the afternoon.

APPROVED: November 3, 1993

LEO VAN HOUTVEN
Secretary