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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 95/85

10:00 a.m., September 12, 1995

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Executive Board Attendance

M. Camdessus, Chairman
S. Fischer, Acting Chairman
A. D. Ouattara, Deputy Managing Director

Executive Directors

A. A. Al-Tuwaijri

M.-A. Autheman
J. Bergo
E. Srejber

I. Clark

H. Evans
K. P. Geethakrishnan

D. Kaeser
A. Kafka
W. Kiekens
Y.-M. T. Koissy
G. Lanciotti

K. Lissakers

H. Mesaki
A. Mirakhor
C. Saito
S. Schoenberg

D. V. Tulin
E. L. Waterman
J. de Beaufort Wijnholds
Zhang M.

Alternate Executive Directors

S. Al-Huseini, Temporary
D. Desruelle, Temporary

V. J. Fernández
J. Guzmán-Calafell, Temporary
G. F. Murphy
T. Berrihun, Temporary
J. Shields
W. Hettiarachchi
L. M. Cheong
H. Kaufmann, Temporary

J. Prader
H. A. Barro Chambrier
N. Coumbis
M. Giulimondi, Temporary
B. S. Newman
M. W. Ryan, Temporary
T. Oya, Temporary

A. G. Zoccali
B. Esdar
Y. Y. Mohammed
A. V. Mozhin
J.-H. Kang
O. Havrylyshyn
Wei B.
Huang X., Temporary

L. Van Houtven, Secretary and Counsellor
R. Bradshaw, Assistant
D. M. Rajnes, Assistant

Also Present

IBRD: P. Garg, Europe and Central Asia Regional Office. Central Asia Department: Y.-R. Kim. European II Department: J. Odling-Smee, Director; E. Brau, Deputy Director; A. Gagales, L. Hansen, A. Knöbl, A. K. Lahari, H. R. Lorie, G. Shabsigh, M. Shadman-Valavi, H. J. G. Trines. External Relations Department: G. Hacche, C. Hellemaa, P.-M. Falcone. Fiscal Affairs Department: P. S. Heller, A. Jaeger, I. C. Lienert. IMF Institute: G. C. Dahl. Legal Department: W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; J. L. Hagan, Jr., R. B. Leckow. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; D. N. Lachman, Deputy Director; L. D. Everaert, N. L. Happe, K. J. Langdon, A. K. McGuirk, J. K. Wakeman-Linn. Research Department: M. Mussa, Economic Counsellor and Director; R. D. Haas. Secretary's Department: A. Mountford, W. S. Tseng. Southeast Asia and Pacific Department: G. Oestreicher. Treasurer's Department: G. Wittich, Deputy Treasurer; J. E. Blalock, J. C. Corr, L. U. Ecevit, K. M. Kenney, G. S. Markosov, M. I. Otker. Western Hemisphere Department: C. M. Loser, Director; A. S. Linde. Office of the Managing Director; S. Sugisaki, Special Advisor; G. R. Saunders, Personal Assistant, J. Quick, Personal Assistant Designate; Advisors to Executive Directors: B. Andersen, P. Cailleteau, R. F. Cippa, S. S. Farid, S. K. Fayyad, T. K. Gaspard, H. Golriz, R. Kannan, J. C. Martinez Oliva, S. O'Connor, J.-C. Obame, A. V. Vernikov. Assistants to Executive Directors: P. I. Botoucharov, A. G. Cathcart, D. Daco, J. C. Estrella, A. Galicia, C. M. Gonzalez, A. Guennewich, O. Himani, G. H. Huisman, P. Jilek, K. Kpetigo, G. A. Kyriacou, B. M. Lvin, T. Lwin, J. A. K. Munthali, M. V. Nikitsenka, N. Prasad, G. P. Ramdas, S. Rouai, S. Simonsen, V. Trivedi, E. Zamalloa, Zheng H., Zubir bin Abdullah.

1. EMERGENCY FINANCING MECHANISM

The Executive Directors considered a staff paper on emergency procedures to provide rapid assistance to a member facing an exceptional crisis in its external accounts (SM/95/216, 8/22/95).

Mr. Clark made the following statement:

> I wish to commend the staff on producing a concise, yet comprehensive, statement, which clearly documents the objectives and properties of the proposed mechanism. I was especially pleased that the following three basic desirable features were so explicitly stated:
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> First, the mechanism entails exceptional procedures that would facilitate the rapid approval of Fund assistance while assuring the conditionality necessary to warrant that support;
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> Second, the mechanism involves no new financing programs but could, on occasion, involve exceptional levels of access to Fund resources and exceptional phasing in the disbursement of those resources; and,
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> Third, the mechanism is not a guarantee against sovereign default or for the replenishment of sustained large capital outflows but is instead a method of supporting the quick implementation of corrective policies aimed at avoiding chronic financial deterioration.
>
> The procedures outlined for the emergency financing mechanism (EFM) are really not new procedures; they are a formalization of existing procedures, which were employed most recently to assist Mexico. This has both positive and negative connotations. The procedures did work reasonably well in the case of Mexico given the absence of warning, experience and criteria at that time and, consequently, formulate a reasonable basis for more formal procedures.
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> On the other hand, the criteria under which the mechanism can be activated and the process of deciding on activation are probably still too vague to satisfy many of the concerns voiced at the time of the Mexican crisis. It is not clear, for example, if exceptional circumstances refer to exceptions to country-specific historical trends or exceptions to the general stability conditions for the global financial system. At a minimum, activation should be considered only if the spillover effects from the initial shock in a member are assessed as potentially imposing substantial damage on the payments position of another country or if the initial financial or economic

shock, itself, is global in nature so that several members are severely affected.

I agree that there can be no absolutely precise definition for exceptional circumstances and that an ad hoc, case-by-case assessment must prevail. But, in an institution that has rules to define eligibility for various types of assistance to ensure evenhandedness and to prevent abuse, such a departure from normal practice, while consistent with exceptional circumstances, requires careful consideration. I do agree, however, that the advantage of a case-by-case assessment is the strength that it can impart on the 'no guarantee' property and the effect that it may have on minimizing moral hazard problems.

I also recognize that judgments about the severity of a negative event at its inception are difficult to make. I was struck, therefore, by the statement that "...the Executive Board would be notified immediately of the activation of the EFM procedure," which implies that the decision to activate has already been taken by management and that the Board would be involved only in deciding the modalities of any supporting financial assistance. This places the Board in the unenviable position of either endorsing substantial support or running the risk of deepening the crisis through disagreement. The staff document also asserts that "...early involvement and high frequency briefing of the Executive Board would be the centerpiece of the procedures facilitating a rapid Fund response...." On this basis, it would be inconceivable that management would make a decision to activate the EFM without first informally seeking the views of the Board. Nevertheless, the role of the Board regarding the formal decision to activate will be an important decision for us to make.

Another striking point in the document referred to the Mexican arrangement in which the Board decision to approve an exceptional financial program was taken within six days of the completion of negotiations but that the negotiations themselves took about six weeks. This suggests that in some cases procedural bottleneck would not be the decision to activate the EFM or to approve the financing but the negotiations.

The speed of the Fund's response depends clearly on the member's readiness to negotiate, its willingness to take immediately the necessary policy actions, and the member's past performance with respect to Fund surveillance. The surveillance performance relates less to the Fund's willingness to provide assistance than to capacity to do so quickly. The onus is on the member to report in a consistent, accurate and timely fashion in accordance with the strengthened surveillance policies of the Fund. Moreover, a member that has implemented

Fund advice in the past is more likely to understand its premises and perceive its benefits. Required additional policy actions are likely to be less severe than otherwise and more readily accepted and implemented.

Effective surveillance activities will also reduce the frequency of activation of the EFM as well as improve procedural speed. The use of an effective early warning system based on strengthened data reporting procedures would allow the staff to prepare a contingency plans for member countries facing potential problems. If the early warning procedures are sufficiently effective, no emergency would arise and the EFM would not be needed. The EFM would be reserved, as it should, for those truly exceptional occasions where an economic or financial emergency occurs with no advance warning.

In conclusion, I would note that the viability of the EFM as a rapid response mechanism to emergency situations depends critically on its use as a truly exceptional procedure, which is reinforced by the proposals for strengthened surveillance activities of the Fund. While the key to speed of response may be embedded in the negotiation procedures, the responsibility for improvement in this procedure rests largely with individual members. The key to activation rests in the judgment of exceptional circumstances and a consensus for action. Finally, I will emphasize that the EFM cannot be a backstop to consistently bad policy formulation. Ultimately, there are no painless financial rescues.

Mr. Kiekens made the following statement:

The proposed emergency financing mechanism addresses some of the drawbacks of today's globalized capital markets, which although they are improving the world's resource allocation, are at the same time exposing members' balance of payments positions to the effects of increased market volatility. Stronger surveillance will doubtless reduce the frequency of sudden and disruptive capital outflows, but cannot realistically be expected to put an end to the possibility of financial crises. The Fund must thus be ready to assist member countries to react rapidly to such crises by attacking their underlying causes. This means shortening the Fund's own reaction time by having at its permanent disposal up-to-date, accurate information about the economic situation of its members and by devising quicker negotiation and approval procedures and prearranged concertation mechanisms. Clarifying and elaborating the procedures to be followed will go far to eliminate uncertainties about how to respond to a crisis. I can broadly agree with the staff's general considerations and with the way it spells out the purposes of, and conditions for activation of procedures for providing urgent financial assistance to members. Useful as this contribution is, however, it needs to be further elaborated.

The staff presents the EFM as an exceptional procedure which would not create an "entitlement." The EFM would only be activated in case of a crisis in a member's external accounts--or in case of the threat of one--which requires an immediate response from the Fund to contain the damage. The staff hardly explains further the notion of an emergency, whose identification would be based primarily on the judgment of the Managing Director.

In principle, every situation where a member is confronted with the need to adjust its policies to deal with imbalances in its external accounts calls for quick policy adjustment in order to limit, or prevent, further damage, and hence represents an emergency. The fact that sometimes the economy concerned is a small one and the chances that delays in policy adjustment or financial support will damage its trading partners and the rest of the world are rather limited cannot justify undue delay in the Fund's financial support. The primary responsibility for determining whether financial support is urgently needed lies with the member affected, just as it is that member's primary responsibility to decide on and to implement rapid measures, including prior actions, of sufficient strength to forestall or deal with a crisis. In other words, any member willing and able to decide quickly on such policies is "entitled" to receive the Fund's financial support without any avoidable delay on the part of the staff, Management, or Board, in assessing the situation and the appropriateness of the program.

It being understood that the degree of urgency depends on the individual characteristics of each case, the EFM does not involve a set of rules that are qualitatively different from the procedures which should normally be followed.

In the staff's proposal, "early involvement and high frequency briefings of the Executive Board would be the centerpiece of the procedures facilitating a rapid Fund response." To that end, the Executive Board would be immediately "notified," apparently orally, of the activation of an EFM, and of the nature of the emergency and the essential elements of discussions about the proposed arrangements. Besides written documentation describing the current economic situation, the Executive Board would be "briefed" regularly on the progress of the negotiations and other relevant elements.

Here again, I consider that the Board's involvement should include, but not be limited to, these exceptional so-called emergency procedures. The Board should be involved each time the use of Fund resources is being discussed between a member and the staff, as well as during a review of an arrangement already in place, whenever its viewpoint can be useful for the guidance of Management and the member concerned in their negotiations. There is no compelling reason why the Board's involvement should become qualitatively different depending on the degree of urgency of a request for access to Fund resources.

The Board should also have a role less passive than is suggested by the words "notifications" and "briefings." A more active exchange of views is warranted. The Board, which must ultimately approve the conditions for access to Fund resources, would give guidance to Management and the member concerned whenever this can further understanding between the negotiating parties, or when it is less certain that the projected basic features of the program are in line with the standing policies of the Board.

In view of the long-standing practice under which the Board has delegated far-reaching authority to the staff and Management to negotiate understandings about the conditions for the use of Fund resources, the Board must certainly observe restraint and must respect the objective and "technical" character of the negotiations. Management should, however, respect the limits of its delegated authority and avoid taking to itself the Board's responsibilities, particularly when the case is not clear-cut.

I share the staff's view that the Board's involvement in EFMs requires the maintenance of strict confidentiality. This is valid for all parties involved. Management should therefore not inform the press, particularly during negotiations, about its assessment of the economic situation and the key parameters of the arrangement, without having obtained the informed consent of the member concerned and of the Board.

The staff rightly stresses that the existence of an EFM must not increase "moral hazard." To avoid this, it may be justified, when publicly confirming the Fund's readiness to apply emergency financing mechanism, to note explicitly that the Fund does not provide guarantees of any kind against sovereign default and is continuing to studying measures to limit its financial involvement while preserving market discipline.

Finally, I agree that there is no need to create new Fund facilities, and that the issue here is to clarify procedures, and where necessary to elaborate new ones, aimed at ensuring that every member receives the Fund's financial support fast enough to prevent the damage that would be inflicted by undue delay. I reiterate, however, my position that just as with the staff's proposals on the Fund's financing of currency stabilization funds, we must further examine how to make the present arrangements more flexible. In particular, when access to Fund resources is approved in order to finance members' balance of payments needs arising from a sudden reversal of capital flows--of course within the limitations of Article VI--the term of the Fund's financing will probably be of shorter duration than in case of balance of payments needs stemming from a deficit in the current account, a case where adjustment often requires structural reforms. Determined implementation of strong policies can rapidly stem a crisis of the capital account and reverse capital flows.

I therefore suggest that we examine further whether the prevailing rules should not be modified to adjust the terms of the Fund's financing to match the specific features of the supported program and the time interval likely needed to regain a viable balance of payments position.

Mr. Bergo made the following statement:

In addition to being commendable short, and yet comprehensive and concise, as Mr. Clark rightly mention in his statement, the staff paper for today's discussion provides a good overview of all the major issues relevant for discussing the feasibility of establishing an emergency financing mechanism.

Let me begin by saying that I find the proposed approach to be reasonable, and that it is a useful basis for the Managing Directors report to the Interim Committee. However, we should keep in mind that our mandate from the Interim Committee is somewhat broader, namely to consider how the Fund can better assist members in coping with sudden market disturbances. This has a bearing on almost all the policy issues currently under consideration, where the procedures to follow in emergency situations are only one but, of course, a very important element.

Consequently, I find it difficult to comment on the suggested EFM without touching upon other aspects related to how we can strengthen the Fund's ability to assist members in coping with sudden market disturbances more generally.

As with other emergencies we should of course do our utmost in minimizing the risk of their occurrence. Here the main responsibility rests largely with individual members and should continue to do so. It is evident that today's increasingly integrated and agile capital markets have provided scope for capital movements of an unprecedented size, but this development has also greatly increased the efficiency of our economies and has provided a positive market discipline on the policies pursued. Thus, the premium put on stability-oriented macroeconomic policies has provided a strong and welcome incentive "to keep your own house in order." When it comes to the role of the Fund, I find that our primary responsibility should be to assist member countries' own efforts in the prevention, to the extent possible, of crisis situations from occurring. In this connection the key is, of course, strengthened Fund surveillance. In particular, I find it appropriate to repeat the necessity to improve the transparency and rapid availability of high-quality data to the Fund and the markets also in this connection. Thus, an important lesson from recent developments is that the lack of timely information increases the uncertainty and may cause significant and sudden shifts in market sentiments when the information is finally released. Furthermore, in its prevention activities, and in providing a good base for a rapid response by the Fund if needed, I would find it appropriate if the Article IV discussions lead to a broad agreement on the main policy measures to be taken by a member country if key assumptions for the economic policies should depart importantly from earlier expectations. Thus, increased contingency planning, in particular in countries identified in the surveillance process as potentially at risk, would be important to contain the need for Fund financing.

Realistically it is, however, important to bear in mind that even with increased emphasis on the preventive efforts, crises will most likely occur from time to time, and where in some instances rapid response and appropriate financing from the Fund could be crucial. Before commenting on how to ensure rapidness in the Fund's response, allow me to dwell a little on some other aspects of the EFM. I agree with the staff and would underline that the establishment of an EFM should in no way create an "entitlement," and I found it very useful that the paper emphasizes a number of important safeguards, including the need for the Fund's financing role to remain catalytic; that it should be avoided that the Fund provide or convey the impression that it is providing guarantees of any kind against sovereign default; and that the Fund may not finance "large or sustained capital outflows," even though this may be difficult evaluating in advance, especially at very short notice. Moreover, it is essential that any Fund financing occurs only in the context of strong front-loaded economic policy measures aiming at effectively and rapidly reestablishing market confidence. I fully agree with the proposal to address emergency situations within existing Fund facilities. I also found it helpful that the staff paper mention that there could well be emergencies facing members that called for a very rapid response by the Fund that could be handled adequately within the usual access limits. Furthermore, I find it essential that new procedure under no circumstances should be interpreted as if the Fund's policy concerning access limits has been changed. The exceptional circumstances clause should still be invoked only in truly exceptional circumstances. I also agree with the staff that no formal links should be established between the EFM and activation of any borrowing agreements.

While all these necessary safeguards generally are mentioned by the staff, they, nevertheless, deserves emphasis, especially in order to be able to strike a right balance between adjustment and financing. I have stressed the conditionality aspect, not because I neglect the usefulness of financing, but since we need to be realistic with regard to what the Fund's financial resources can and should achieve in a world with huge capital movements.

Let me now turn to the suggested general procedures of an EFM. The key operational aspects of such procedures are by no means easily established and especially care must be taken to ensure that new procedures in themselves does not lead to easier access to financial support from the Fund. Mr. Clark mentions in his statement that the procedures outlined are really not new procedures, but a formalization of existing procedures employed most recently to assist Mexico. Without intending to reopen the debate on the Mexican case, I would like to stress that the procedures in that case should not be a reference for future cases. Rather the Mexican case underscored the need for more clear and transparent procedures. While I welcome the intention to brief the Executive Board when the EFM procedures are activated, and on a regular basis throughout the process, I would be concerned if this ends up being only a one-way communication. While I consider it natural that the initiative rests with the management, I would find it appropriate to have the Board more actively involved at a very early stage as well as during the process. I note that Mr. Clark and Mr. Kiekens have similar concerns, and for our future discussions I would like to invite the staff to consider how it can be ensured that the views of this Board is taken into account by the staff and management and communicated to the authorities concerned as well.

In a situation where a potentially very damaging crisis is brewing it would be essential that the negotiated policy adjustment and financing package is in fact approved, and by consensus. Thus, while in normal circumstances I fully understand and respect management's wish to finalize negotiations on a comprehensive and coherent package before presenting it to the Board, I think that when operating under EFM procedures management would be well advised to take on board the views of the Board on what can be acceptable and, especially what is not acceptable before finalizing the negotiations. While we have ample evidence that in ordinary program negotiations some delay would not necessarily have devastating effects, making it possible for the Board to ask for more time or to have certain elements renegotiated, presumably in EFM cases we could not.

Moreover, I find it important that other multilateral institutions that may be invited to join in the financing of the member's program, is being informed and involved from the very beginning of the process. Of course strict confidentiality will be essential. The information provided to the Board should include the likely impact on the Fund's liquidity. Furthermore, I would like to mention that one piece of information that should not be forgotten is timely and transparent information on possible consequences for the designation plan and the operational budget, since the financing of the drawings may have a not negligible impact on the composition of creditor central banks' reserves. Finally, a speedy response by the Fund should not take place at the detriment of formulating sufficiently strong policies. Let me add that I fully agree with the staff that the member's past cooperation with the Fund, in particular its record of reporting and responding to the Fund's policy advice, would have a strong bearing on the speed with which the Fund itself could assess the situation and agree on necessary corrective measures. Here I found Mr. Clark's observation, that in some cases procedural bottlenecks might not be the decision to activate the EFM or to approve the financing but the negotiations with the authorities concerned, to be very well taken.

In conclusion, I agree that we need better and more transparent procedures for early Fund involvement in emergency situations. The staff proposal forms a good basis for formulating such procedures, but some additional considerations on the appropriate role of the Executive Board will be necessary, and the safeguards must be spelled out very explicitly.

The Director of the Policy Development and Review Department remarked that Directors had made several inquiries about the relationship between the proposed emergency financing mechanism and the short-term financing facility (discussed at EBM/94/104, 11/30/94). The latter had been intended to assist members who were experiencing very short-term balance of payments or exchange market pressures, despite satisfactory economic policies and prospects. It would have been a new facility with its own rules, conditionality, and access limits, and perhaps with different maturities and a different rate of charge than other facilities. It would also have had some degree of automaticity, on which two options had been suggested. First, the facility could have operated like a line of credit, pre-approved on the basis of the Article IV consultation process, and would have been available to a member for a fixed period of time, such as six months. Second, the facility could have required Board approval for the member to make a purchase, even if the member had been judged eligible already to make purchases under the facility by the Article IV consultation process. With both options, there had been a tradeoff between the need to provide confidence to members about the availability of Fund resources and the need to safeguard those resources. The Board had not gone so far as to favor either option for establishing a short-term financing facility.

The 1994 staff paper on establishing a possible short-term financing facility (EBS/94/193, 9/26/94) had also noted a completely different means of establishing such a facility, based on current facilities but with different procedures, the Director recalled. In fact, the Chairman had observed in the last paragraph of his concluding remarks (BUFF/94/112, 12/8/94) on the discussion on such a facility that: "I observe that, in the above paragraphs, I have referred more frequently to a facility than to streamlining of our present procedures and instruments. Let me assure you that I am not making a final decision here on what is the best avenue to go." Several events since then--including the Mexican crisis--had shown that streamlining procedures under existing facilities, particularly stand-by arrangements, could usefully assist members with short-term balance of payments problems, despite satisfactory policies and prospects. That was the origin of the current proposal for an emergency financing mechanism.

The EFM would not be a new facility, but a means of dealing with members' difficulties requiring a very rapid reaction and support from the Fund, the Director stated. The updated procedures under the EFM would still be linked with the Article IV surveillance process, given that the extent to which the Fund could react rapidly was a function of the extent to which it had had a close dialogue with a member; indeed, rapid Fund support required tight surveillance beforehand.

The language in the staff paper should have read that the Board would be notified immediately of management and the staff's "intent" to activate the EFM procedure, the Director emphasized. Management would require the Board's support.

The Chairman reiterated the Director's last point. The original language in the paper that the Board would be notified of the activation of EFM procedures was unfortunate, and he thus understood the difficulties of Mr. Clark, Mr. Kiekens, and Mr. Bergo. Activation of the EFM first required a consensus in the Board for the Fund to be able to act decisively, if need be.

Mr. Clark commented that he had thought initially that the Board would make a formal decision to activate the EFM, but he was less sure at present that that would be the appropriate path to take. As the precise rules for the Board's role with the EFM--which Directors would agree--would last for some time, it was an important issue. He wished to hear other Directors' views before taking a position on that matter.

The Chairman observed that Mr. Clark had agreed that what was vital was to establish a consensus between management, staff, the Board, and the member concerned on the appropriate action to be taken in the event of short-term balance of payments pressures. He differed somewhat, however, with Mr. Clark's view that a member that had implemented Fund advice in the past was more likely to understand its premises, to perceive its benefits, and to implement a Fund-supported program. Experience indicated that members could suffer from adjustment "fatigue," making some of them behave imprudently or think that they could pursue unsustainable policies without having to resort to the Fund.

Mr. Bergo stated that the Board should not only be deeply involved in the activation of the EFM, but also in negotiations with the member, which would differ from those with members seeking access to the Fund's ordinary resources. As damaging crises could be in prospect for a member seeking support under the EFM, it would be essential that the Board provide staff and management with feedback on what would and would not be acceptable in an EFM-supported program; and, by consensus, the Board should have to approve the negotiated adjustment and financing package. It would be highly detrimental to the country concerned if a situation arose in which the Board disagreed with the negotiated program.

Mr. Mirakhor made the following statement:

> We support the establishment of an emergency financing mechanism. The statements by Mr. Bergo, Mr. Clark and Mr. Kiekens have addressed the importance of the strengthened surveillance with emphasis on transparency and quality of data as preventive measures. Therefore, I will not cover the same ground. I have a few comments relating to the conceptual and operational aspects of the proposed mechanism.
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> I am looking forward to staff response to Mr. Kiekens's concerns regarding the notion of entitlement. One would think that by virtue of membership, all countries are entitled to the use of Fund resources. Certain facilities, by nature of their specific design, may exclude some members from their use but this has more to do with eligibility criteria and should not, in principle, have a bearing on entitlement. If the emphasis on entitlement is intended to underline the importance of management and the Board's role in determining access and activation, then all Fund facilities are subject to the same stipulation.

I take note of the Director of the Policy Development and Review Department's explanations this morning. Like Mr. Kiekens and Mr. Clark, I had some concerns regarding the role of the Executive Board. I understand from the Director of the Policy Development and Review Department that the paper will be revised to indicate involvement of the Board before the activation. This would bring the procedure close to that followed in the case of Mexico. I recall that the Board was involved, albeit informally, within hours after management became fully apprised of the extent of the crisis.

It should, however, be stressed that the speed of response must be the feature that operationally distinguishes this mechanism from other facilities.

Mr. Clark raises an important issue regarding the criteria for activation. While deliberate vagueness has the benefit of investing the mechanism with flexibility, further clarification may be helpful. At least, attempts should be made to specify whether the EFM is meant to deal only with crisis situations with regional or global spillover effects and whether the perceived magnitude of these effects are to have a bearing on management and Board judgment regarding activation. Moreover, it is important to clarify whether the function of EFM can be characterized as that of a lender of last resort in case of crisis with regional or global impact. Finally, the Director of the Policy Development and Review Department this morning clarified the difference between EFM and short-term facility. It would also be helpful to clarify the relationship between EFM and operations under the exceptional circumstances clause.

Finally, the paper suggests that most of the operational features of the Fund support under the EFM, including access and phasing, would be tailored to the size and nature of each case. This raises difficulties in projecting use of Fund's resources under EFM. Under these circumstances, staff's comment on how Fund's liquidity position and financing needs is assessed will be helpful.

The Chairman commented that it would be difficult to predict the impact of exceptional use of the EFM on the Fund's liquidity position. The Fund's task, in any event, was to prevent members from having recourse to the EFM in the first place; but if recourse were necessary, the institution should have sufficient resources to provide financing under it. Supplementary lines of credit and the General Arrangements to Borrow should be tailored to allow the Fund to face any contingencies with sufficient liquidity to enable it to lend under the EFM. However, the Fund should not provide any guarantees regarding possible financing under the EFM, but needed to ensure that there was some uncertainty in the minds of policymakers.

Mr. Kafka made the following statement:

We welcome this discussion of a possible emergency financing mechanism. It is understood that this is not a new window but a new procedure for using our existing windows in an emergency. The main practical problem which we face is to combine speed of reaction with security for our resources which we are to make available. One should not underrate either the necessity or the difficulty of bringing about this combination. There are obviously various ways of accomplishing this objective. One of them is an idea which our chair has mentioned on several occasions when we were discussing the Systemic Transformation Facility, i.e., asking the recipient or other members to provide the Fund with a guarantee or collateral. The idea found no support in the Board. Another possibility which we have mentioned in the past, would be to encourage all member countries including those that do not need arrangements to negotiate them, nevertheless, just in case an emergency occurred. But this idea also seemed to find no support and does present major difficulties.

In the absence of such new departures, we are in general agreement with the staff proposals. Although we have shown that we can act rapidly and on a very major scale when necessary, it is certainly desirable that the procedures under which we do so should be spelled out to some extent. We should not, however, want to spell them out in too much detail because every emergency is sui generis.

It should be understood that the acceptance by the Fund of an emergency financing arrangement does not provide any guarantee of Fund support or exceptional access. Certainly, we would not want to give an impression that we are guaranteeing private or official creditors against sovereign defaults. Our Articles do not allow us to finance large or sustained capital outflows which may be the immediate cause of an emergency balance of payments problem. It is not clear how effective a procedure would be which did not allow us to finance such capital outflows. Certainly, if we are to liberalize capital movements effectively we may eventually come up against this problem. It is also clear to us that the Fund's role should as far as possible remain catalytic. Yet this may not always be possible.

The great difficulty of an emergency financing procedure is how to combine speed of reaction by the Fund with safety for our resources. A continuing and close dialogue between the Fund and the country applying for emergency assistance is a condition. Such a dialogue would enable the Fund to be at all times amply informed about economic developments in a country applying for emergency assistance and, as the staff correctly mentions, in countries which may suffer from contagion effects. Beyond dialogue, one should agree that the country applying for emergency assistance should be prepared at the same time to take action prior to the completion of any negotiation. It should be stressed, however, that if an emergency mechanism or procedure is to be effective, the Fund will not be able to insist that such "prior" action should be of the precisely defined kind which we usually understand by that expression.

Regarding the detailed procedures spelled out on pages 5-6 of the paper.

We agree with the first indented paragraph.

The second indented paragraph speaks of readiness to engage immediately in accelerated negotiations with the prospect of early agreement and adoption of adequate measures. This is, perhaps, too vague, though I have no immediate suggestion.

We have no problems with indented paragraphs 3-7 or with the suggestion for review.

We agree at this point there is no need to discuss the financing mechanism. Fortunately, the Fund appears to have adequate resources to meet at least one or two emergencies of major scope. But the healthiest way of approaching this matter would be an early decision on an adequate quota increase and supplementary financing mechanisms. Obviously, much more discussion will be necessary.

One practical point. We have now, finally, decided to number paragraphs--for ease of reference. I think that unnumbered indented subparagraphs and unnumbered bullet points are also a bit unhelpful.

Mr. Mesaki said that his authorities attached the utmost importance to the current discussion. He believed that the Board should address four issues: whether it should establish substantive--not just procedural--guidelines on an EFM to help guide management, including conditions for activation of, access to, and phasing of an EFM, and on procedures for the Board's involvement; whether the proposed procedural guidelines would ensure sufficient Board involvement in the decision-making process; how to define the appropriate relationship between an enlarged General Arrangements to Borrow (GAB), the Board, and the EFM; and how to ensure that the EFM was immune from moral hazard.

The staff paper described possible substantive guidelines for an EFM only abstractly, yet explained in great detail procedural aspects of an EFM, Mr. Mesaki observed. While it seemed as if the staff had preferred to leave many of the substantive matters to management to decide, he would have preferred the opposite approach.

As he had emphasized at the Board discussion on the role of the Fund (EBM/95/75, 8/2/95), the Fund's response to the Mexican crisis should be regarded as exceptional, Mr. Mesaki recalled. It was crucial that the Fund establish well-defined rules to regulate the use of an exceptional clause to deal with other similar cases in the future. While it could be argued that those rules would not be necessary, given that the staff's proposed procedural guidelines for an EFM would ensure that the Board had sole and final authority to decide on substantive matters--such as access and phasing in individual cases--it would be unrealistic for the Board to overrule management's proposals for specific cases under the EFM, given the likely impact on financial markets, as had happened in the case of Mexico. While it could be argued that strict rules were unnecessary, as, inter alia, access and phasing should be decided flexibly on a case-by-case basis, he still believed that it would be necessary to formulate substantive guidelines to preserve the Fund's catalytic role and to ensure that recourse to the exceptional clause remained truly exceptional. He urged the staff to prepare more specific proposals on substantive matters, including on access limits under the EFM, and the limit on up-front phasing.

He could support the staff's proposed procedural guidelines, which paid due regard to the Board's decision-making role under the EFM, Mr. Mesaki stated. He also supported the staff's intention not to establish any formal link between the EFM and the GAB, as that would help to ensure quick disbursal under the EFM.

While the Fund's response to the Mexican crisis had turned out to be successful, he was concerned--like many other Directors had been at the discussion on the role of the Fund--that it might have produced a moral hazard that had delayed needed tightening of macroeconomic policy in other countries, Mr. Mesaki considered. The current staff paper had considered the matter properly. He supported the staff's point, for example, that "it would not be the purpose of the Fund, in establishing and EFM or otherwise, to provide or convey the impression that it was providing guarantees of any kind against sovereign default." However, the staff should go further and consider seriously how to make that concern operational within the EFM. Perhaps more favorable treatment under the EFM should be granted to the members that were cooperating with the Fund under enhanced surveillance, or who were submitting sufficient data on a timely basis. He agreed with the staff that, "...the member's past cooperation with the Fund, in particular, its record of reporting and responding to the Fund's policy advice in the context of regular consultations and continuing surveillance, would have a strong bearing on the speed with which the Fund itself could assess the situation and agree on necessary corrective measures." Nonetheless, the staff should take a more systematic approach to that question, defining more clearly past cooperation, and connecting it more clearly with favorable treatment under an EFM. He hoped that the staff could submit specific proposals to that end as soon as possible.

The staff and the Board should continue to make every effort to reach early agreement on the establishment of an EFM, Mr. Mesaki emphasized. He agreed with the staff that, if Directors were in broad agreement with the proposed approach, the Managing Director could report that to the Interim Committee, taking into account the Board's guidelines.

Mr. Schoenberg made the following statement:

In our assessment, the paper presented by the staff for today's discussion brings back a certain amount of soberness and realism to this institution contemplating how to respond to members facing financial emergencies. We certainly welcome that. In line with the organization of the staff paper I will also deal in turn first with the conceptual considerations regarding an EFM and then with its main operating rules.

First, the general considerations governing an EFM outlined by the staff are partly acceptable and partly need modifications and interpretations in our view. We agree with the staff, in particular, that:

an EFM should be designed as a speeded-up procedure in the context of the existing facilities, access limits and conditionality rules of the Fund;

the establishment of an EFM would in no way create an "entitlement" or a guarantee to access or to extraordinary high access limits irrespective of the concrete circumstances involved;

a rapid activation of the procedures could only be expected if a member has prior to that fully fulfilled its information and cooperation obligations vis-à-vis the Fund and is prepared to take the necessary adjustment measures;

no formal links are being proposed between the emergency procedures and the activation of any existing or additional borrowing arrangements in favor of the Fund.

We would, however, attribute a different emphasis with respect to the following aspects:

The procedures followed in the case of Mexico should not be seen as an example for the desirable degree of flexibility of the Fund and even less as a model for dealing with similar cases in the future; Mexico must remain the exception, not become the rule;

accordingly, the main concern should not be to avoid introducing rules which could constitute limits to the flexibility of the Fund's response to emergencies; the first priority must rather be to minimize the moral hazard risks involved with such operations even if this requires somewhat more complex operating rules; so, I support Mr. Mesaki's views on the need of having clear rules for the issues discussed by him.

And most important: decisions on activating the EFM should not be governed primarily by considerations over the potential implications of a financial crisis for the member country immediately affected. The main objective must rather be to deal with potentially destabilizing spillover effects if those effects could develop into a systemic risk.

The emphasis on systemic risks is important because if the new mechanism would be available to any country in any kind of trouble in the financial markets the combination of potentially higher access and stronger frontloading than under the regular Fund facilities might well have counterproductive effects and, unlike Mr. Mirakhor, we would not see the Fund as a general lender of last resort. Such a prospect might lure member countries into an impression of false security, thereby inducing them to delay adjustment measures and contributing to make a crisis eventually appear more severe than it truly is.

Second, on the general procedures that would constitute an emergency financing mechanism I have the following observations.

In our view the decision to initiate the emergency procedures should be taken, in principle, by this Board. This should be the case because of both the potential amounts of resources and the potential front-loading of the disbursements involved which would contribute a new dimension of risk for the Fund and because of the inevitably very much prejudicing character of a decision to launch the EFM process. I recognize, however, that the Board, at this stage will be probably at a disadvantage compared to staff and management with respect to the ability to form a quick judgement on the situation facing a member coming under market pressures. I would be very interested to hear the views of my colleagues on this issue. We would consider it necessary, in any case, for management to consult closely though informally with Directors before launching the procedure. And those consultations should also give Directors the chance to get some feedback from their authorities before advising management how they evaluate a specific situation. Like Mr. Clark, however, a procedure under which the Board would be only notified of an activation of the EFM would be insufficient. We would also expect in such a situation that, unlike in the Mexican case, management would refrain from any public comments which would prejudge the

Board's final decision, and that, unlike in the Mexican events, the key features of a proposed program, like access and phasing, would remain unchanged until the Board's final decision.

Regarding conditionality, the main objective of a program approved under the EFM must be to reestablish market confidence. A strong conditionality would be the major prerequisite for achieving this objective. Therefore, some minimum conditionality requirements should be incorporated in the operating procedures. Such minimum requirements to be fulfilled by borrowers should include the establishment of realistic exchange rate and real interest rate levels and convincing steps towards rapid fiscal consolidation.

The Fund should make use of any conceivable possibility to keep its risk within manageable proportions. One way for achieving this could be, indeed, to draw other lenders into the operation, if that would not compromise the preferred creditor status of the Fund. Another option would be for the Fund to ask for a collateral security as pursuant to Art. V, Section 4 of the Articles of Agreement. We would also expect a country to use its own reserves first before drawing on the Fund. Finally, we would expect a stop to further drawings and early repurchases as soon as the financial situation of a country concerned improves.

Third, as for the financing aspects the staff observes that any supplementary borrowing arrangements in favor of the Fund should be sufficiently large and that the Fund should be assured of their availability. It would be difficult for me to imagine a procedure under which a Fund decision on financial support under the EFM would at the same time activate the GAB. I would rather expect the GAB participants to reserve the option not to participate in the EFM financing or to provide lesser amounts than requested.

The Chairman commented that he agreed with Mr. Schoenberg that notification to the Board of EFM activation would be meaningful only if Directors could consult quickly with their authorities. Nonetheless, speed was of the essence, to enable the Fund to indicate that it stood ready to act.

He recalled that GAB members clearly had the sovereign legal right not to follow the recommendation of a Managing Director to activate the GAB, the Chairman added.

Mr. Mohammed made the following statement:

I am in broad agreement with the proposals by the staff on the basic elements of a possible emergency financing mechanism.

I support accommodating this new emergency mechanism within existing Fund facilities in the credit tranches and possibly in the form of a modification of an existing extended arrangement. We should avoid any further proliferation of facilities.

The conditions proposed by the staff, under which the Fund could consider the activation of procedures for the use of an emergency facility, are sensible. The staff is also right to stress that the centerpiece of the procedures facilitating a rapid Fund response should be early involvement and high frequency briefing of the Executive Board. Given the emergency and exceptional nature of this financing as well as the higher degree of risk to the Fund that it may involve, it will be important to have the Executive Board on board as early as possible in the process, and the clarification provided by the Director of the Policy Development and Review Department at the outset is helpful.

One last comment. I do not believe that activation of EFM procedures should require a judgment on the existence of systemic or spillover effects. We would be opposed to making activation conditional upon such a judgment.

Mr. Kaeser made the following statement:

I welcome this opportunity to discuss the issue of an emergency financing mechanism on the basis of a short but comprehensive staff paper. As the creation of an emergency financing mechanism raises still many questions, I would have preferred to have today's discussion in a more informal setting. In any case, it would not be in the tradition of this house to rush to a decision on a subject that has not been debated at length.

Let me say at the outset that this chair does not dispute the idea that in the new environment characterized by the globalization of the financial markets the Fund might have to depart from cautious and well-tried practices and procedures in order to give a timely and appropriate answer to an emerging crisis.

It should also go without saying that the Fund in close cooperation with the member concerned would have done the utmost to prevent the emergence of a crisis. At least two lessons can be drawn from the Mexican crisis. Firstly, timely and accurate publication of important macroeconomic and financial data, as well as strengthened Fund surveillance, play an important role in reducing not only the possibility, but also the magnitude of a crisis. Secondly, the ability of a country to weather selling pressures in financial markets depends largely on sound economic policies and a strong financial position. This once again underscores the importance of implementing sound economic policies and of strengthening prudential supervision over the financial markets. As the case may be, the Fund should also be ready to accept an unorthodox solution. For instance, emerging countries fighting still high inflation and having to keep their interest rates at a level likely to attract capital from abroad, should be allowed to resort to temporary controls on the inflows.

The blueprint provided by the staff let open different crucial issues.

First, in spite of the staff's arguments, we remain unconvinced that the moral hazard issue has been exaggerated. The staff affirms that a major reason for creating the emergency mechanism consists of the need to give members confidence, but then they go on to state that there is no guarantee that the procedure would be activated in every case. However, since confidence can only be created by assuring the members that, under precise conditions, the Fund would indeed intervene, it would seem very difficult to distinguish such assurance from a guarantee.

The existence of an emergency financing mechanism also increases the likelihood of irresponsible behavior on the part of investors involved in these countries by giving them the impression that, as in the case of Mexico, foreign-currency-denominated liabilities of sovereign governments are always risk free. After all, if it was necessary to bail out investors in the case of Mexico, why would this not also be necessary if a similar crisis took place in another country of systemic importance? Admittedly, moral hazard cannot be entirely avoided, but the Fund should in no case finance large and sustained capital outflows.

Second, front-loading loans would certainly reduce both the incentives of the member in crisis to fulfill the associated conditionality and the degree to which the Fund would be able to enforce that conditionality. This, and the availability of extraordinarily large amounts of money, would carry considerable risks for the Fund's resources.

The risks associated with front-loading loans could be partly reduced by requesting bold prior actions from the borrowing countries. But I remember how difficult it was to tailor a suitable program for Mexico: the Mexican program had to be strengthened twice to fit with the situation of this country.

If the Fund is extending front-loaded loans, it should at least have the possibility to request earlier repayment and to impose higher charges if the drawing goes beyond certain limits. But the imposition of higher charges and of earlier repayment are--if I am well informed--not possible in the framework of a simple mechanism. They can only be introduced in the framework of a new facility.

Third, it is very difficult to judge on short notice whether or not a given crisis poses systemic risks or whether the balance of payment imbalance concerned is only temporary, or if it will persist until fundamental changes are made in economic policy.

In other words, because we would depart from well tried and cautious practices, resorting to emergency procedures bear a high risk of what can be called institutional failure. If the Fund is given exceptional power to handle exceptional situations, the right balance has to be established between these powers and the control under which the Fund has to operate.

The Director of the Policy Development and Review Department made it clear that the activation of the EFM would not be decided by the management. Nevertheless, the idea that strict confidentiality could be maintained after the outburst of a crisis is not realistic: on the contrary, the management will be put under pressure by the media and will have to speak to calm down the market. In such circumstances, the role of the Board would become purely formal.

To reduce the risk of institutional failure, tight control has to be exerted on the activation of the EFM. As we discussed the role of the Fund, I suggested that the risk of institutional failure could be reduced by introducing new rules or by resorting to special voting procedures. As it seems that special majorities cannot be requested for votes on Fund credits, we should try to define as precisely as possible the circumstances under which the EFM can be activated, but this task will not be easy. On the one hand, broad rules would prove useless, on the other, narrow ones will be too rigid.

Another option that could be considered would be to merge the EFM with the new borrowing arrangement. Nobody here thinks that the EFM will have to be activated to accommodate problems arising, let's say in St. Kitts and Nevis. The EFM will be activated to face a systemic crisis triggered by a large country, and this will have serious implications for the liquidity of the Fund. The new borrowing arrangement, the necessity of which has been stressed by many members, should provide resources to the Fund in special circumstances. A systemic crisis would represent the special circumstances called for the activation of the new borrowing arrangement. Merging the EFM and the new borrowing arrangement would therefore make sense and would have the advantage to force the Fund to hear a second opinion.

In any case, it would be difficult for this chair to support an EFM established along the line of the staff blueprint. The activation of the mechanism should leave less discretion to the Fund. There should be provision for an early repayment of front-loaded loans and the Fund should ask for higher charges if the drawing goes beyond certain limits.

Mr. Evans said that the staff paper was concise and well-focused. It was appropriate that the paper had begun by referring to strengthened surveillance, which was the Fund's top priority, and the means for avoiding crises and resort to the proposed financing mechanism. While he agreed with much of the paper, he also supported the comments of most Directors who had favored a more active role for the Board in the process and more emphasis on making the process a truly exceptional one. He shared Mr. Schoenberg's concern that consultation with the Board needed to be informal, and that management should not preempt Board decisions by making announcements, as in the case of Mexico, that made it almost impossible for the Board to take a contrary view.

The call at the Halifax summit for an emergency financing mechanism derived from dissatisfaction with the process by which the stand-by arrangement for Mexico had been handled earlier in 1995, Mr. Evans continued. Considering the size and speed of the arrangement, there had been insufficient consultation with the Board, and substantial last-minute changes had been made to the proposed arrangement. Accordingly, the heads of governments had seen a need for a new procedure. But there had been another concern as well--the need for an assurance that the Fund had sufficient resources, available at short notice for large arrangements.

The paper only went some way toward addressing the issues, Mr. Evans considered. While Mr. Mesaki wished to have all the details of the new mechanism spelled out precisely, especially regarding exceptional circumstances, it was unlikely that the Fund could, in practice, define such exceptional circumstances too precisely before they arose.

He welcomed the Director of the Policy Development and Review Department's clarification of procedures for notifying the Board, Mr. Evans said. However, he would have preferred that a formal Board procedure be instituted, such as a requirement that the Board vote on activation of an emergency financing mechanism. In any event, there had to be consultation with Executive Directors. He hoped that activation of an EFM could be based on a consensus in the Board following a proposal by the Managing Director. While it might not be possible to require more than a formal majority to approve activation of the EFM as Mr. Kaeser had suggested, the idea of activating the mechanism only by consensus was worth consideration.

Like other Directors, he believed that the use of the EFM should not become the norm for approving arrangements, Mr. Evans stated. With the advent of an EFM, many finance ministers might be tempted to claim that their own countries' cases were urgent, and to complain that the normal three-week circulation period of papers on requests for arrangements was excessive. The Fund thus had to make it clear that the EFM was truly exceptional, and was not just a matter of the financial stability of the member concerned; it should point out that activation of the EFM required that a member's balance of payments problems entailed the significant likelihood of contagion or systemic effects that would result in significant or special costs for other countries.

Previous speakers had referred to the risks of moral hazard, Mr. Evans noted. If the EFM were to be truly exceptional, one could not consider the mechanism as a facility for making the Fund into a lender of last resort; there had to be no risk that countries would seek to trigger use of the mechanism purely to obtain earlier financing than was usually possible from the Fund. The staff could usefully comment on one idea that had some intuitive merit, namely, that the level of conditionality required to activate the EFM should be higher than under regular Fund-supported programs or, in other words, that there should be greater assurance that the programs would be successful. In cases involving higher than average access--and thus greater risks to the Fund--the institution perhaps needed to be more confident of success than in normal cases. While it might be claimed that all Fund-supported programs had strong conditionality attached to them, some programs, indeed, were stronger than others.

Another means of highlighting that the EFM was truly exceptional would be to apply a higher rate of charge to the EFM than to other Fund resources, Mr. Evans suggested. It would be useful if there could be some presumption, if not legal requirement, for early repayment of EFM resources.

The staff paper had proposed that there be a 48- or 72-hour period between the circulation of staff papers and the Board discussion, Mr. Evans observed, although it might be preferable to specify the required period as two or three complete working days to avoid the difficulty of Directors contacting their authorities on weekends.

While the Chairman had noted that use of the EFM might be so exceptional that it could not be included in staff projections on the future use of Fund resources, Mr. Evans said, that question would have to be considered further. The GAB would certainly have a role to play in it, and the Fund would have to ensure that the conditions and procedures of the EFM would be compatible with the GAB.

Regarding financing of the EFM, Mr. Evans concluded, the Chairman had commented that the Fund had a long tradition of ensuring that it had sufficient liquidity to enable it to continue to lend--including in exceptional circumstances--and to be permanently liquid in its relations with central banks, with perhaps a 70 percent liquidity ratio indicating the need for a quota increase. Regarding the GAB, however, the Fund should not burden GAB members with the impossible task of quantifying every six months the risk of having to activate the GAB, a calculation that would also entail a moral hazard in indicating that the Fund was preparing to resort to exceptional lending. To the contrary, the Fund's working hypothesis should be that exceptional circumstances should not arise; indeed, during Board discussions on access policy, management and staff had consistently sought to limit recourse to the exceptional circumstances clause of the Articles. Exceptional circumstances had to remain truly exceptional, a point that should animate the Board's discussion of financing of the EFM--although the Fund should stand ready and be able to act if required.

Mr. Wijnholds made the following statement:

> I welcome the procedures elaborated by the staff to strengthen the Fund's ability to respond to financial emergencies rapidly--but not over-hastily. While I can support most of the staff's proposals and am in broad agreement with the statements of Messrs. Clark, Kiekens, Bergo and some other speakers, but have some specific remarks to make for emphasis. I first wish to discuss the EFM and the issue of moral hazard. The EFM should leave considerable uncertainty on the amount of financial support that is available in case of financial crisis. In this context, the current proposal has two important features. First, like others, I would stress the fact that the EFM is not in any manner a financing facility; the EFM procedure should not make access to Fund credit greater or easier--only quicker. Indeed, emergencies facing members that call for rapid responses can, in many instances, be handled adequately within the usual access limits. Nevertheless, it is possible that, in specific emergency situations, frontloading and exceptionally high levels of access to Fund resources will be needed. The Chairman has just spoken on this matter, and I endorse his view that these circumstances should be truly exceptional. Being only a procedure, the EFM cannot, and should not, imply more regular use of the exceptional circumstances clause. A second feature of the EFM that is intended to minimize moral hazard is

that the mechanism is not intended to convey the impression that the Fund will provide guarantees against sovereign default, a point that I am gratified to see that the staff has covered. It is essential that this message be communicated clearly to the public, so that all parties concerned are sufficiently aware of it.

I can accept the staff's definition of an emergency situation as one in which "...a member was faced with an exceptional situation threatening its financial stability... [requiring] a rapid Fund response in support of strong policies... to forestall or contain the damage." I prefer a criterion like this to any reference to systemic risk, as there is no consensus on what the latter concept means in practice. I realize that some colleagues may consider the staff's definition to be somewhat broad, but whatever definition is chosen, there will always be a strong judgmental element involved in deciding on whether an emergency exists, and whether spillover effects are likely too occur.

Programs that are designed quickly are likely to be somewhat less solid than programs designed in more normal circumstances, even if the quality of the member's past cooperation with the Fund and its record of reporting is high. Thus, I join Mr. Evans in noting that one would expect that the staff would err on the side of caution in designing programs under the EFM, favoring strong conditionality and, where relevant, including prior actions. In addition, there should be scope for the Fund to modify the program at its first review, in light of the reaction to the markets to the initial policy response. In some cases, the authorities will have to be prepared to "tighten their belt" further, which underscores the importance of one of the conditions for activation of the EFM, namely, the member's readiness to take early and sufficiently strong measures.

I would welcome the staff's comment on the possibility for an early repurchase obligation rather than a presumption, in the event that the drawing members' situation improves dramatically. I stress that the EFM procedure can function properly only if the Board is regularly debriefed and consulted throughout the whole process, particularly on the level and phasing of access. This has been discussed at length already, and I sympathize with the remarks made by the first few speakers. I appreciate the clarification of the Director of the Policy Development and Review Department and of the Chairman, particularly the introduction of the word "intent."

Mr. Guzmán-Calafell made the following statement:

The growing integration of the world economy, the increased importance of capital movements, and technological developments in the financial sector, among other factors, have substantially accentuated the potential of sudden disruptions to the balance of payments of individual countries. As the limitations of private market solutions for these problems have been evidenced, a widespread agreement has emerged on the need for a more efficient involvement of the Fund to cope with them. In this context, the proposal to establish an emergency financing mechanism within the Fund is highly welcome.

The Fund has to evolve and adapt to the changing characteristics of the world economy and to the challenges this implies. Recent events in Mexico have illustrated the importance of a swift response by the Fund with substantial amounts of resources to economic difficulties under certain circumstances. It is clear that in the absence of a bold reaction by the Fund to the Mexican crisis, the costs for both the country and the world economy would have been far higher.

But the Fund's involvement in emergency situations must not rely on an ad hoc approach. The definition of general rules and a conceptual framework is required to allow its participation to be more efficient. It is to be expected, on the other hand, that the existence of an institutionalized procedure for the provision of emergency assistance would by itself contribute to the stability of the world economy, by strengthening market confidence on the capability of the Fund to deal with crisis situations.

Since I am in broad agreement with the proposals contained in the paper prepared by the staff, I will limit my remarks to a few observations on some of the key features of the EFM.

Let me start with the issue of timing. The success of any attempt to overcome a balance of payments problem that threatens to set in motion a crisis is very closely linked to the speed with which the country in question is able to obtain financial support. In fact, a direct relationship exists between the time devoted to obtain the support, on the one hand, and the amount of financial resources required and the risks to which these resources are subject, on the other.

The recent agreement with Mexico has shown the capacity of the Fund to reduce the time invested in the provision of financial assistance. It would be expected that with the existence of formal procedures for Fund support in emergency situations, as those that the EFM would imply, the time frame can be reduced even further. This is an objective we should aim at, since in some cases even a period as that involved in the completion of the financial package for Mexico may prove to be too long.

Access is another central element of the EFM. In this area, both the Executive Board and management must adhere to an open minded pragmatic approach, to ensure that financing is provided on the basis of need. This will in some cases imply appeal to the exceptional circumstances clause, as well as the availability of a substantial portion of these resources up front. In this respect, it is important to be aware that underfinancing an economic program or unduly spreading out access to Fund support would both undermine the possibilities of success of the program and increase the risks to the Fund.

With respect to other aspects of the proposal, I would like to make the following observations:

First, I agree that support under the EFM must be provided only to those countries willing to start immediately negotiations leading to the implementation of a strong program of economic adjustment. It is also clear that a good record of reporting to the Fund will facilitate the assessment of the situation and the negotiation process, and consequently, allow an increased speed of response.

Second, we must not be unduly concerned with the so-called moral hazard problem. As the staff points out, the EFM does not guarantee neither Fund support nor unusual access. I would add that a moral hazard argument linked to the EFM would be in a sense tantamount to saying that the existence of stand by arrangements fosters balance of payments crisis.

Third, use of the EFM must be evenhanded and therefore available to all Fund members under conditions as those described in the report. The EFM represents an opportunity to enhance the efficiency of the support provided by the Fund which must remain open to all member countries.

Fourth, I fully agree with the staff that by supporting strong programs of adjustment the EFM can contribute substantially to deter or reverse capital outflows. The recent experience of Mexico can be used as a point of reference in this regard.

Finally, I wish to note that the proposal to establish an emergency financing mechanism underlines once again the need for a sizable and early increase of quotas under the eleventh review.

Mr. Mozhin remarked that he broadly agreed with the approach proposed by the staff, particularly its view that emergency situations should be addressed through exceptional procedures, not through establishing new facilities. The Fund, in fact, had been able to deal with the Mexican crisis on the basis of its existing facilities--although in the Mexican case, many Directors had not been entirely satisfied with the procedures adopted, because the existing procedures had not explicitly provided for rapid approval of Fund support. Therefore, the staff's current approach, based on formalizing the procedures employed in the Mexican case, seemed appropriate.

Despite the staff's reasonable approach, there remained a major risk of creating a moral hazard with the proposed EFM, Mr. Mozhin considered. Perhaps it was not surprising--although regrettable--that the proposed EFM had been labeled already as a "bailout fund" for irresponsible sovereign borrowers. While it might not be easy to persuade observers that it was not the intention of the Fund to create an entitlement that would provide a guarantee against sovereign default, it would, however, be helpful if the Board could make further progress in its discussion on the establishment of a debt adjustment facility. It was important to ensure that the Fund was prepared to deal with either type of financial crisis, by providing emergency financing or by initiating debt adjustment procedures. As long as it was discussing emergency situations only, it would not be necessary for the Fund to formulate strict country eligibility criteria. Yet, he fully supported the point that a member's past cooperation with the Fund, particularly its record of reporting and responding to the Fund's policy advice in regular consultations, should play a central role in the Board's decision-making process. He wondered whether the staff could clarify the further steps that would be necessary for the Fund to establish an EFM.

Mr. Lanciotti made the following statement:

> I find the excellent document before us a useful starting point for our discussion and a suitable response to the request by the Interim Committee, last Spring, to consider how the Fund might help members to face sudden market turbulence.
>
> As far as the procedural elements are involved, while I am in agreement that the EFM should be used only in circumstances which might originate a crisis in a member's external accounts requiring an immediate response by the Fund, I would like to stress that the strongest emphasis should be placed on the need to identify promptly such cases, before the gravity of a crisis requires a large scale intervention. This requires that the process of surveillance be allowed to work properly, and that our expertise in providing the appropriate assessment of the situation be reinforced.
>
> The conditional element in providing the Fund's assistance under EFM is crucial. A strong commitment to implement the necessary corrective measure must precede the activation of the

EFM. This will confer the necessary credibility to the arrangement, thereby helping to restore the appropriate conditions for and orderly management of the crisis, and the following recovery.

A basic element proposed for the strategy to cope with the crisis, is the immediate notification to the Board of the activation of the procedure, and the provision of all the basic elements for the discussion of the issue by the Executive Board. I would like to point out that, the exceptionality of the circumstances to be judged, the possible upfront provision of Fund financial assistance and the relatively large amount likely to be involved, warrant, more than a notification, rather a prior consultation by management with the Board in order to create the consensus ex ante that is advisable in these cases. I feel reassured by the clarification given by the Director of the Policy Development and Review Department this morning, and by the Chairman's comment, on this point. I also agree that the confidential element is crucial in such circumstances, and I would insist on the necessity to have the strictest level of confidentiality at that preliminary stages.

Continuous updating by the staff on the issues under consideration is a basic element for a decision by the Board, both in terms of reporting on the member's current economic situation, and in providing background information on the details of the program and its impact on the Fund.

Let me add that I endorse the points, recalled in the paper and raised in the past, also by this chair, in connection with the discussions on the role of the Fund. In particular, I agree that avoiding the problem of the moral hazard is crucial, which involves that the decision about whether or not to activate the policy, and the size of the financial support should be based on a number of considerations, and not on any form of automaticity. I am also convinced that the EFM should not be aimed at financing "large and sustained" capital flows, which would be in contrast with the Article VI, Section 1, but at restoring sound fundamentals, in order to reverse such flows.

Mr. Al-Tuwaijri made the following statement:

The paper before us today confirms that the Fund has the instruments and necessary flexibility to cope rapidly with financial crises. The emergency financing mechanism being proposed entails a formalization and elaboration of procedures to be employed in the case of a financial crisis affecting a member country. While the proposed mechanism has certain merits, a number of issues need to be further discussed and clarified:

First, the definition of an emergency is no doubt problematic. Most countries that request a Fund program are experiencing financial crises. Thus, the activation of the mechanism can require a considerable degree of judgment. Here, I shared the view of other Directors who stressed that it is important that the activation takes place following consultation with the Board, and I am reassured by comments of the Director of the Policy Development and Review Department and yourself this morning. Furthermore, while I understand that it will be difficult to elaborate objective criteria for the activation of the mechanism, such criteria will narrow the scope of this mechanism to the truly emergency situations.

Second, the emergency financing mechanism must respect the access policies of the Fund. At the same time, emergency situations may require high access. In the circumstances, it will be important that the magnitude of potential access is discussed by the Board at a very early stage in the process. Board members must also have sufficient time to consult with their authorities regarding the potential access level.

Third, it is perfectly understandable that a country experiencing a crises would like to see markets calmed through the announcement of a potential Fund program, including, in particular, the magnitude of the potential access. Nevertheless, any such announcement should only be made following Board discussion. It is critical that the Board not be in a position of discussing a program after public announcement of potential access.

Mr. Waterman said that the Board needed to accept that crises would occur, despite better reporting and monitoring. He thus had been a strong supporter of the need for the Fund to move quickly in exceptional circumstances, and he supported the idea of an EFM--although the modalities of it were vital. Support under an EFM was potentially of a high-risk nature, and there were problems of moral hazard. While the Fund could learn from the Mexican experience, that should not be seen as a model.

The focus of an EFM should be on those members heavily exposed to shifts in financial market sentiment, in particular those who were exposed to large volumes of portfolio capital movements, Mr. Waterman considered. Within that group, access to an EFM should be limited to cases in which there were significant spillover effects, as Mr. Clark and other speakers had argued. An EFM should certainly not aim at providing additional support to countries in transition or other developing countries that were not fully integrated into global capital markets, and which did not experience large flows of portfolio capital. Financing for that group of countries could be handled using existing Fund facilities.

The procedures established under an EFM should aim to allow the Fund to act quickly given the speed of reaction in capital markets, Mr. Waterman stated, while ensuring that a number of other requirements were met, including sufficient conditionality and prior actions. Mr. Evans had made a good point, which other speakers had noted, that the Fund should perhaps institute stronger conditionality for cases supported under an EFM, given their greater risks and the greater potential size of Fund lending. Like other speakers, he also placed considerable weight on there being adequate consultations with the Board by staff and management. Nevertheless, as a large degree of judgment was necessary in crisis situations, the procedures laid out under an EFM had to find an appropriate balance between the need for managerial discretion and for rapid action by the Fund, while ensuring that the Board was consulted, kept well informed, and its decision-making role respected.

He agreed with Mr. Schoenberg and other speakers regarding public statements by management in crises before the Board had considered the crises, Mr. Waterman indicated. He did not place a great deal of value on general statements of support; in crises, the Fund's detailed response needed to be considered carefully before it made any public statements, as did issues of financing and the possible link of the EFM to any activation of the GAB. Given the nature of an EFM and the potential risks involved, the relationship between management and Board needed to be defined clearly; thus he welcomed the clarification by the Director of the Policy Development and Review Department, and the Chairman's endorsement, of the decision-making process in the event of a crisis. But as Mr. Evans had noted, Mr. Mesaki might have wished to take that process further than might be possible in practice. In the final analysis, a good working relationship between management and the Board would be vital in crises.

While the Board had emphasized its informal discussions on country matters, Mr. Waterman observed, those were of limited value, because they did not highlight potential problems clearly enough, and were becoming routine. Executive Directors should recognize that it was difficult for area departments to comment as frankly as they might wish to, particularly when they had good working relationships with the countries concerned; indeed, there was a conflict between having a good working relationship with a country--which was useful in itself--and the need to grapple frankly with issues as they emerged in some of those countries. The Board should consider holding sessions on country matters that were more informal than at present, with only management and a few staff present. Perhaps the Policy Development and Review Department could play a more central role in that process of identifying potential problems.

Mr. Koissy made the following statement:

First of all, let me reiterate the support of this chair for this mechanism which is designed to assist member countries to cope with financial emergencies.

The increasing openness and globalization of the goods and financial markets, while contributing to economic efficiency, also carry with them the possibility of greater volatility of capital flows, which can have adverse effects domestically and spillover destabilizing effects outside the country. Therefore, it is desirable for the Fund to strengthen its ability to assist members in meeting such financial emergencies. Overall, we find the outline of the paper regarding the basic elements of a possible EFM as broadly appropriate.

Since the paper does not, at this stage, raise technical issues, but rather deals with principles and procedural aspects, some of which have already been applied in the Mexican case, and being in broad agreement with previous speakers I will limit myself to a few points.

On the identification of an emergency case requiring an immediate response from the Fund, we can go along with the proposal that initiative should be left to management.

Indeed, assuming that the improved surveillance and reporting procedures within the Fund are effective, management's task with respect to this issue could be facilitated. However, to ensure the effectiveness of the mechanism, it has to be quick-disbursing and front-loaded. Also, while conditionality should be rather strict, it should be limited in number so as to avoid prolonged negotiations which would defeat the whole purpose of the mechanism.

Regarding the conditions for activation of the EFM, we can also go along with the staff's proposals, especially as regards the need to inform regularly the Executive Board on economic and financial developments in the country case, as well as on the progress of negotiations and the key elements of the program. In this regard, we cannot but agree with the staff that: "early involvement and high frequency briefing of the Executive Board would be the centerpiece of the procedures facilitating a rapid Fund response." In this connection, like Mr. Clark, we would recommend that the Executive Board be involved in each of the different phases of the process leading to the approval of an EFM. The clarification given earlier by the Director of the Policy Development and Review Department on the activation of an EFM and your own observations to that effect are very reassuring.

In sum, we believe that the staff paper, as it stands, serves its purpose and could form a basis for a good discussion among our Ministers during the next Interim Committee meeting, especially on some other aspects such as the financing of that mechanism which appears somewhat unclear at the moment.

Mrs. Cheong made the following statement:

The staff has provided a concise paper for today's discussion on the proposed establishment of an emergency financing mechanism. I am in broad agreement with the staff's views on the general considerations and purpose of an EFM. In particular, I support the proposal that the EFM should focus on procedures to expedite Fund support in exceptional cases. Although the proposal emanated from the Go Halifax meeting, it is also timely for the Board to examine more unorthodox ways of doing things as stated by Mr. Kaeser. I share some of the views expressed by Directors; let me address specific areas where there are some of difference in views.

On the issue that establishment of an EFM should not be perceived as creation of an "entitlement" to avoid any "moral hazard" problem, I feel that the fear of the Fund having a lender of "last resort" character may be overblown. No country would like to use Fund resources unless it is in very dire straits. The staff paper has assumed that the EFM creates moral hazard problems and suggests that the decision to activate the EFM will depend to a large degree on judgment, based on the merits of each case. It seems then, that in trying to ensure that the Fund does not assume the role of a "lender of last resort," we are moving to the other extreme. The middle road would be to maintain a fine balance between the need to restrict activation of the EFM to emergency cases and the need to ensure evenhanded Fund treatment. This could only be achieved through some broad definitions of emergency situations, as this could mean differently from the Fund's view and the view of an individual country. As Mr. Evans pointed out that all Ministers of Finance would view their respective cases as most urgent. Learning from difficulties faced during the approval process for Mexico, we should also have some criteria to conclude the presence of contagion effects. Similarly, exceptional circumstances requiring larger access to resources should also be broadly defined. In this sense, the EFM will be more meaningful when procedures are transparent. Difficulties can arise when there are no guidelines, among others, on the definition of emergency assistance, sources of financing, permissible access limits to seeking assistance, amount available from other sources and timing of drawdown. Lack of more explicit procedures will lead us to the same situation of divided views that occurred recently. At the same time, to provide flexibility, I can go along with very broad guidelines in order not to tie the hands of management too much, to save time and expedite assistance to members.

As it stands, the Fund staff has only addressed an EFM within the Fund.

Circumstances where access amounts are unduly large requiring the need to fall back on other borrowing arrangements, have not been discussed, beyond recommending compatible procedures for activation of Fund resources and resources of borrowing arrangements. The related issue of financing is an important ingredient to setting procedures. At this juncture, I am not so sure that there should not be any link with GAB as stated by Mr. Mesaki, Mr. Schoenberg and other Directors. Of course I cannot comment on the existing GAB, but in the new GAB, the pros and cons of this link should be assessed.

Past experience tells us that in dealing with a crisis situation, it is preferable to be over-prepared than to be caught "short" at the critical moment. In cases where the access required is large and the Fund has liquidity problems, emergency procedures for rapid approval of Fund support would be futile if there is no corresponding mechanism for equally rapid mobilization of the required funds from other sources. In such cases, there could be advantages to set up formal links between the EFM and activation of borrowing arrangements. The staff themselves recognized (on paragraph 1, page 7) that "the conditions and procedures for activation of supplementary borrowing arrangements should be compatible with EFM procedures and the need for rapid Fund action." The issue is then to ensure such compatible procedures and that the participants of borrowing arrangements would also make decisions and release funds in the same time span as the Fund Executive Board.

In this regard, the staff should explore the possibility of varying the procedures in activating the EFMs based on the sources of funding. Such different procedures would be employed in varying circumstances. I can think of three different circumstances:

First, when the EFM only involves use of Fund resources;

Second, when the EFM involves use of Fund resources, but resources from other borrowing arrangements would be useful. Here, procedures for use of other resources should be compatible with procedures for release of funds under other borrowing arrangements;

Third, when the Fund has liquidity problems and the EFM involves use of the Fund and other sources. Here, an explicit link between use of Fund resources and other borrowed resources is required to ensure that activation of Fund resources leads to automatic access to other borrowed resources.

The last situation is only workable if borrowing arrangements are tied to the EFM of the Fund in a legally binding manner. The major drawback of this link is that when views are divided, contributors to the borrowing arrangement can also block access to Fund resources.

While I can appreciate the need to maintain strict confidentiality in the event of a crisis, I wonder if it might not be useful to assess inclusion of procedures to forewarn those member countries which are likely to face contagion effects, so that the central banks would be in the market early to avert sharp movements in their exchange rates and avoid large use of foreign exchange reserves. This is particularly important to check the spread of market over-reaction to an essentially isolated crisis. In such a process of instituting some kind of "early warning system," the need for Fund support to deal with contagion cases will also be minimized.

Finally, I am quite perplexed on the need for higher conditionality requirements raised by many Directors. This Chair has always viewed that all Fund programs should have high or strong conditionality. Under the existing stand-by arrangement or enhanced structural adjustment facility (ESAF) programs, there is already the side effects of massive unemployment and other social implications of adjustment. I wonder how much hardship do we want in exchange for Fund assistance. One cannot presume that risks to Fund resources will be greater when these funds are released under EFM procedures compared with funds released under the usual stand-by arrangement or ESAF procedures.

Mr. Evans pointed out that, as one of the Directors who favored stronger conditionality under an EFM than under regular Fund facilities, he did not equate program strength with the degree of economic hardship in a member; indeed, there was evidence in a number of cases indicating that it was lack of program strength that was responsible for economic hardship.

He had some sympathy for Mrs. Cheong's view that Fund borrowing arrangements with other lenders should be considered with an EFM, to provide greater assurance to potential users that financing would be available in the rare cases in which it was required, Mr. Evans said. He hoped that Indonesia would play an important part in the expansion of the GAB.

Mrs. Cheong indicated that, in fact, four members of her constituency had been identified by the staff as possible contributors to an expanded GAB. Those members would consider with open minds a request to participate in an expanded GAB, but their final decision would be based on whether there were appropriate terms and conditions.

The Chairman observed that negotiations on an expanded GAB were at a preliminary stage. That being said, he did not think that there was a strong rationale for formally linking an EFM and the GAB, even though that would reassure potential--albeit exceptional--users of an EFM that exceptional financing could be available. More important, however, was the need to ensure that the Fund's financing windows for contingencies were as large as possible, in line with changing developments in the world economy; hence, his wish to double the size of the GAB. He also hoped that the new GAB would be more flexible than the existing one, which was why the staff had circulated a paper on establishing supplementary lines of credit (EBS/95/129, 8/2/95). His predecessor as Governor of the Banque de France, Mr. Baumgartner, had established in 1960 a list of the possible first contributors to the GAB--a list that had changed greatly in subsequent decades, given changes in the world economy. If the Fund were to be relevant, it was vital that Fund financing mechanisms be flexible, adapting to the world economy.

Mr. Mirakhor indicated that he agreed with Mrs. Cheong that concerns about moral hazard had been overblown: it would be unreasonable to think that countries would literally precipitate crises--thus damage themselves--in order to use Fund resources. However, he wondered whether linking the EFM and the GAB would not trigger a moral hazard, making the Fund a lender of last resort, through the EFM.

Mrs. Cheong clarified that she had not suggested that a link between the EFM and the GAB should be a close one, but simply that the staff should study the pros and cons of linking the use of Fund resources with other borrowing arrangements. The only situation in which the Fund would link an EFM and the GAB would be one in which there was a shortage of Fund liquidity, and the financing requirements in a crisis were substantial. In those cases, there might be systemic risks, meaning that the issue of whether GAB participants would be willing to have their funds used by the Fund's general membership would have to be considered as well.

The Chairman noted that it was not essential to resolve those issues for the Board to decide on the principles and key features of an EFM. The issue of linking the GAB and an EFM could be left to the discussion on the enlarged GAB and supplementary lines of credit.

Mr. Saito made the following statement:

> I share the broad thrust of the outline presented in the staff paper containing basic elements of an emergency financing mechanism, the circumstances for activation, as well as the procedures to facilitate a rapid response by the Fund to emerging financial crises.
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> There is in our view a compelling need in the new environment of increased globalization and integration of goods and capital markets to reinforce the proposals for strengthened surveillance by ensuring that the Fund is in a position to respond quickly and on a sufficient scale to financial emergencies, to avoid contagion or to provide an additional

dimension of confidence to members and to the international monetary system in exceptional circumstances.

The proposed features for an EFM, when accompanied by a meaningful and ongoing policy dialogue between the member and the Fund, and its readiness to take measures to deal with the nature of the problem to forestall or revert a crisis, serve to dispel the notion that the existence of such a mechanism would generate "moral hazard." Moreover, as noted by Mr. Clark, effective surveillance activities will also reduce the frequency of activation of the EFM as well as improve procedural speed. The Fund's involvement in countries traditionally reliant on private markets, however, should remain catalytic and not preclude the development of parallel facilities for the provision of short-term liquidity with other institutions, including private ones, to reinforce prudential margins. While agreeing that the EFM cannot be a backstop to consistently bad policy formulation, the additional confidence provided by swap and contingency credit lines among OECD countries also should not be underestimated.

As to the general procedures suggested, I fully agree that management's initial judgment regarding an exceptional situation threatening a member's financial stability should trigger the intent to activate the mechanism and that to be effective the Fund's response in support of strong policies must be quick and involve the Executive Board at an early stage. Similarly, I consider it important that use of EFM procedures not be linked exclusively to exceptional levels of access or phasing, and that the activation of supplementary borrowing arrangements under the GAB and/or other suitable arrangements depend on the liquidity position of the Fund. Over time, quotas should strike an appropriate balance between the potential need and supply of conditional resources of the membership.

Ms. Lissakers made the following statement:

In considering the Fund's financial role, we must strike a balance between providing assurance of support to members, and the moral hazard that such assurances might encourage unwise policies by a government or unwise decisions by international lenders and investors. As we have noted in previous discussions on the role of the Fund, this is an issue which the Fund has confronted since its inception and the Executive Board deals with on an almost daily basis. Today, however, the stakes have become considerably larger as the interdependence of our economies has grown and the size and speed of capital flows have greatly increased.

We would agree with the broad outlines of the approach suggested by the staff although we believe that the role of the Executive Board is inadequately defined and the financing issues left too indeterminate.

First, we see no need to create a new facility and would prefer to rely on improved procedures in order to avoid any perceptions of entitlement or automaticity in the provision of emergency financing. We are skeptical that the conditions under which emergency financing will be provided and the scale of access to Fund resources can be defined precisely in advance. Nevertheless, we do believe that recourse to emergency procedures should be rare events, involving primarily serious threats to the stability of the system. This could involve either the traditional concept of a systemic threat to the payments system or a broader set of circumstances such as a serious problem of contagion that could lead to disruption of the world economy or of a specific region.

Second, the member should be required to implement the Fund's highest standards of conditionality. In particular, the Fund's willingness to provide substantial financing up-front must be met by the members willingness to take tough measures at the outset involving all elements of policies: fiscal, monetary and structural. The members' prior relationship with the Fund will also be relevant, both in providing assurances of cooperation as well as the necessary information on which to render judgments regarding the nature of the crisis and the necessary corrective measures. Finally, we would reiterate our earlier suggestion that interest charges should reflect the higher risks which the Fund is undertaking by the levying of a risk premium in cases involving emergency financing. Similarly, we would support the staff's proposal for additional commitments regarding early repurchase. We do not, however, believe that the Fund should seek additional collateral, which would raise doubts about its preferred creditor status.

Third, the procedures for Executive Board involvement must also balance the requirements for speed against the need for adequate consultation. This is perhaps the area which fueled the most controversy during the Mexican crisis. The Board must be consulted and involved in key decisions before they are set in stone, especially in circumstances where the Fund will be providing substantial up-front disbursements on an expedited basis. This would help to avoid possible misperceptions in the market regarding Board unity, enhance management's ability to negotiate with a potential borrower and facilitate expedited decisions when a program is brought to the Board for final action.

Fourth, the balance which is being sought on other elements of an EFM will also be necessary with regard to financing issues. We understand management's interest in retaining full discretion on the means of financing but believe it is undesirable to jeopardize the Fund's ability to meet "normal" balance of payments requirements by committing a large share of the Fund's resources to emergency situations or to plan large increases in the Fund's permanent resources to deal with situations that are by definition extraordinary. At the same time, an automatic linkage between the EFM and borrowing arrangements is unnecessary if sufficient resources are available to meet both normal and emergency financing requirements. The current GAB seeks to reach a balance between these competing considerations. We believe that further consideration is necessary to determine whether the current GAB provisions need to be modified in light of the purposes and procedures for an EFM which may differ from the GAB. We are not in a position at present to reach a definitive conclusion on this issue.

Mr. Mirakhor asked, regarding Ms. Lissakers's suggestion for higher rates of charge on emergency financing, whether the phenomenon of credit rationing and adverse selection had a role to play in Fund lending. His point related to the well-known phenomenon in finance theory that if one raised the rate of interest--particularly on fixed rate contracts--one might encourage risky borrowers to seek to borrow, given that they would be willing to pay the higher rate. Raising the rates of charge might create the moral hazard that Directors wished to avoid.

Mr. Autheman commented that Fund charges were agreed on a cooperative basis. The Fund was already charging low interest rates for long periods; and in the case of exceptional drawings on Fund resources, it would make sense to signal to potential borrowing members that exceptional financing could be available--at a small premium.

Ms. Lissakers suggested that, if normal access limits were to be exceeded, it would be useful to consider levying higher charges on such exceptional borrowing.

Mr. Kaeser said that he agreed with Mr. Autheman. The Fund should not refinance members' borrowing in capital markets with lower than market rates; hence, it would be reasonable to raise Fund charges, which would also serve to reduce the risk of moral hazard.

Mr. Mirakhor remarked that it was his understanding that Ms. Lissakers had argued in the past that the Fund should charge different rates for different classes of borrowers with varying degrees of risk, but it seemed that she currently wished to increase charges only on members who might, in exceptional cases, access an EFM.

Ms. Lissakers responded that she favored uniformity of treatment across the membership, not differentiation of charges according to the member. If any member, regardless of its circumstances, exceeded the access limits, the degree to which it did so should be charged at a higher rate than normal borrowing within those limits. The risk premium would be the same for all members who might borrow above the access limits.

Mr. Schoenberg commented that he agreed with Mr. Kaeser that higher charges for exceptionally high borrowing would be the appropriate counterpart to the higher risks that the Fund would face in agreeing to such borrowing, and also a means of reducing the risk of moral hazard. It was typical--even in the case of financing the purchase of a house--for a borrower to face higher interest rates the larger was the borrowed amount.

Mr. Mirakhor replied that that was why he had posed his question: finance theory indicated that higher rates of charge would not reduce the risk of moral hazard, but, in fact, increase it, by encouraging riskier borrowers to enter the capital market, given that they were willing to pay the higher rates for access to the funds.

The Chairman noted that he agreed that riskier borrowers took advantage of higher rates to borrow more than they could otherwise do, but the issue could not be solved in the current discussion on an EFM. Ms. Lissakers's important suggestion regarding all Fund resources could be considered at another Board discussion.

Mr. Zhang made the following statement:

> After several rounds of discussions on the role of the Fund in the changing world economy, especially in coping with emerging financial crises, I welcome this opportunity to concentrate today's discussions on the issue of an EFM and appreciate the staff's well-organized paper. I am in broad agreement with the establishment of an EFM and would like to illustrate some points on the principles rather than the details of EFM procedures.
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> In regard to sources of an EFM, since the Fund is a quota-based organization, this chair is of the view that financing of an EFM should basically be from quota resources. Regarding the issue of the connection of an EFM and the GAB, it is my view that the GAB or Fund borrowing from member countries should be used only when quota resources are insufficient to cope with the crisis. In this connection we strongly urge management to quicken the process of completing the eleventh quota review and welcome an increase in quotas sufficient to guarantee the operation of the Fund, particularly in providing financial assistance to members when they have an emergent need.

As to whether an EFM is a facility or procedure, in line with my first point, I join others in supporting the EFM as a procedure rather than a facility. This procedure will speed the decision-making process in granting member countries purchases from the existing facilities. In this connection, I appreciate the measures listed in the staff's report.

On criteria for accessibility, an appropriate judgment as to whether the crisis is serious enough to call for the Fund's immediate reaction is of crucial importance, so that EFM procedures will not be overextended to problems which could be tackled with the Fund's existing financing facilities.

Second, this chair is of the view that an EFM must be accessible to all member countries when they are confronted with emergency financial situations, irrespective of whether or not it will have a global impact. While a financial crisis with global implications should call for our immediate reaction to remedy, it is also the responsibility of the Fund, as an international cooperative organization, to devote its attention to countries in crises which might not have global implications so that these crises can be contained before they destabilize the country concerned.

Third, on the cooperative role assumed for member countries in crisis, we do not see reason for the overemphasis on past performance in data reporting and other such matters, because this might override the importance of basing the activation of EFM procedures on the nature of the crisis and the response measures from it. I do not think anybody will disagree with this point: the fire department's first reaction on receiving an alarm is to send its firemen to the burning house as soon as possible and not to wait for the owner's performance record over the past decade.

As regards supervision of EFM procedures, in order to guarantee an appropriate reaction from the Fund to a crisis country under an EFM, a supervisory mechanism should surely be designed. In this connection, we welcome the staff's proposal to frequently brief the Executive Board on the developments of EFM procedures in crisis countries. However, I would like to add at this point that the supervisory role of the Board on the appropriateness of Fund reaction should also be emphasized.

An access limit should be clearly defined for an EFM, however in order for the Fund to play a meaningful role in assisting members to overcome the crisis, substantial higher access should be considered, especially for those exceptional cases.

Concerning repurchases under an EFM, in order to avoid or limit overdue obligations to the Fund and guarantee the smooth operation of Fund liquidity, an early repurchase should be encouraged once the country's situation is normalized.

Finally, like Mr. Mirakhor, I oppose the idea that the Fund should impose an extra charge on the recipient member when it draws additional financial resources in an exceptional case.

Mr. Autheman made the following statement:

I am in broad agreement with the approach followed by the staff, since it meets my three fundamental requirements: no new facility, standard rules of access, and standard conditionality. I will therefore address some issues following Mr. Mesaki's agenda.

Some Directors have suggested that this emergency financing mechanism should be limited to cases of a systemic character. I share the view expressed by Mr. Wijnholds that it is very difficult to agree upon the definition of a systemic risk, and I think that what is at stake is the need for the Fund to be able to react with the appropriate speed to crises which may result from the growth and integration of global capital markets. So, I would rather place more emphasis on that aspect.

Second, to activate an emergency procedure, we must be confident that we have reached a broad understanding with the country, since this activation will signal to the country the willingness of the Fund to provide rapid support. Of course, we must not guarantee this support, but we should give some confidence to the country that we will be in a position to support it rapidly.

As far as the involvement of the Board in the procedure is concerned, I welcome the Director of the Policy Development and Review Department's comment and would insist on the substance of the consultation process. The purpose of this consultation is to take stock of the existence of a broad support in the Board.

One specific issue must be considered: possible public announcements by management. I am not referring to a general announcement of cooperation between the Fund and the country; but any announcement which could be related to the substance of a program would need more than Board consultation but some form of approval in order to prevent a situation where announcements would have been made by management but where Board members would find it difficult to support them.

On the link with GAB, I agree that there should be no rigid link, but I remember that we opened this negotiation on the extension of the GAB in order to support this new standing procedure. In my view, there are cases where the emergency financing mechanism will not call for any specific financing, but there can be cases where it would call for special borrowing. In these cases, the link will exist. I share Mr. Kaeser's point that, in these cases, we need to have a consistent qualified majority.

Finally, on the issue of moral hazard, let me limit myself to two observations. First, I am not sure that the name we are considering, "emergency financing mechanism," is the right one. As Mr. Mozhin said, it can lead to the misunderstanding that we are ready to provide high support in many cases. In fact, what we are discussing is an emergency procedure. We should consider calling a spade a spade. Second, while taking note of Mr. Mirakhor's concern about the possible negative impact of premium charges, I think it is proper to send the signal that we are reluctant to provide exceptional support and that we continue to intend not to use exceptional circumstances more than two or three times a century.

Mr. Wijnholds commented that he agreed that it would be worthwhile to find a more neutral term for the proposed procedure than emergency financing mechanism, which could create confusion.

Mr. Evans suggested that "emergency financing procedure" might be a more appropriate term.

Ms. Lissakers said that she agreed with that suggestion, which was more accurate than emergency financing mechanism, which had caused some misunderstanding regarding its purpose.

The Chairman indicated that he would prefer an even simpler term, "emergency procedure." In any event, the word "financing" should not be used.

Mr. Berrihun said that the new global environment, marked by large and, at times, volatile capital movements had important implications for the Fund's financial size and activities. It necessitated that the Fund establish improved mechanisms for averting sudden and unexpected economic crises stemming from shifts in capital flows.

The Fund, however, did not need to create another financing facility to assist members in crises, Mr. Berrihun considered. Emergency situations could be dealt with through existing Fund facilities; indeed, when the Eleventh General Quota Review was completed, the Fund would be in a position to cope with emergencies more effectively than at present. Until that time, and even thereafter, close monitoring and review of the Fund's liquidity position should be continued to enable the institution to determine in good time the amount of supplementary resources that it might require under the GAB.

He broadly agreed with the staff's proposals to accelerate management and the Board's decision-making procedures, and thereby allow faster access to Fund resources, Mr. Berrihun stated. Many of the conditions listed in the staff paper for activation of the procedures would provide the good safeguards needed, given that there were potentially higher risks associated with emergency financing. Yet it was not clear how the Fund would respond to requests from members who had not been particularly cooperative in providing information, for example, and who did not have a good track record, but whose financial crisis had systemic implications. There might also be members who might hesitate in seeking Fund support, choosing a wait-and-see attitude, even though the crisis that they were facing could result in substantial spillovers. He asked how the Fund would handle such cases.

Mr. Geethakrishnan remarked that neither the staff paper nor the discussion had clarified the rationale for proposing an EFM. The new mechanism had been proposed in response to the Fund's experience with the Mexican crisis, which had not been handled using normal procedures, given the suddenness with which the crisis had emerged. On December 20, 1994, the Acting Chairman had informed the Board that the authorities were to widen the peso's exchange rate band; but no one had expected that a crisis would break the very next day. Not only had the Mexican crisis broken suddenly, but it had also involved unprecedentedly large volumes of finance, very high access to Fund resources, and most important, the recognition that the Fund alone could not support Mexico, but required the support of other sources (including the United States, Canada, and the Bank for International Settlements), with the expectation that a domino effect or systemic crisis might otherwise result.

He disagreed with speakers who had said that the six weeks that it took to negotiate the Fund-supported program had been too long, because one had to keep in mind that there had been other parties involved in a cooperative effort, as well as the Fund and Mexico, Mr. Geethakrishnan observed. He commended the Fund for the speed and manner in which it had responded.

The Halifax summit had proposed an EFM, given the Group of Seven's concern that, if other crises such as the Mexican one were to occur, the existing financing mechanisms in the international community might prove to be insufficient, Mr. Geethakrishnan continued. The summit had not focused on financing of ESAF, stand-by, or extended arrangements, for example. In any event, the staff had gone to great lengths to state that any decisions regarding key parameters, including access and phasing, under the EFM would be taken in consultation with the Executive Board's existing procedures, and that the EFM procedure "may or may not" be associated with exceptional access to Fund resources.

While several criteria would have to be met before the EFM could be activated, Mr. Geethakrishnan observed, he did not believe that they were new. First, access to the EFM would be possible only in circumstances that threatened to give rise to a crisis in a member's external accounts. In any event, one should keep in mind that members did not request access to Fund resources--under the ESAF, stand-by, or extended arrangement, for example--lightly, given that none of them wished to be subject to conditionality if they could avoid it. Second, a member seeking access to the EFM would have to be ready to adopt an accelerated program immediately; yet that was not unusual, given that no member, in a crisis, had a choice but to agree to all of the measures specified. Third, the member would have to accept strong conditionality; yet all borrowing members, in any event, had to accept conditionality.

In fact, the only unique feature in the staff's proposals was to shorten the period for Board consideration of requests for Fund resources, from 21 days to 3 or 4 days, Mr. Geethakrishnan pointed out. Even so, the Board had dealt with a number of cases during the previous two years in which the standard circulation period had been reduced, down to 10-12 days in some cases, such as, perhaps, for Russia. If shortening the circulation period was the gist of the staff's proposals, extensive Board discussion on the current paper was unnecessary and the procedure did not have to be dignified with the name, emergency financing mechanism.

An EFM had been proposed to deal with cases that would have systemic effects, requiring such large access--perhaps 600 to 700 percent of quota--that the Fund would need the support of outside agencies, Mr. Geethakrishnan stated. Those would not necessarily include the GAB; in the Mexican crisis, the United States, Canada, and the Bank for International Settlements had pledged their support, but not the GAB. The Fund could activate an EFM if it believed a crisis would have systemic effects, the amount of financing required was so large that the institution required external support, and if conditionality could be high. In any event, if the Fund really wished to deal with crises in addition to that in Mexico, it would have to realize that it needed much larger financing than it alone could provide. Only then would the Board have to discuss the GAB and supplementary lines of credit.

In the case of Mexico, the Fund had handled the crisis in the best possible manner within existing procedures, Mr. Geethakrishnan considered. If the Board had been involved in the negotiations from the first day of the crisis under a procedure dignified as the EFM, it would have been the surest means of dooming the discussions. Current procedures should not be changed, other than by making a simple decision to shorten the circulation period of papers on requests for Fund resources from 21 days to 3-4 days, in the case of crises.

Mr. Mesaki commented that he would prefer that the name ~~of the~~ EFM remain, given that the purpose of the mechanism would be unclear without the term "financing;" moreover, the name had been agreed by the heads of state at the Halifax summit.

Mr. Geethakrishnan responded that the EFM would then refer only to a shortening of the circulation period for staff papers on requests for use of Fund resources.

Ms. Lissakers added that, upon further reflection, she agreed with Mr. Mesaki: the choice of the name, EFM, by the heads of state should be respected. Perhaps the issue of naming should be left to the Interim Committee.

Mr. Autheman said that he recognized Mr. Mesaki's concern, but agreed with Ms. Lissakers that the Interim Committee should perhaps decide on a name for the EFM.

The Director of the Policy Development and Review Department noted that Executive Directors had differing views on whether to link the proposed EFM and the GAB. It was conceivable, although unlikely, that there could be emergencies in which members would not require exceptional access that would call into question the Fund's liquidity, thus implying that no link would be required. Alternatively, there could be situations in which the Fund's liquidity required the institution to seek financing from other sources, even if those situations were not emergencies, but simply involved large countries drawing on Fund resources, which had to be supplemented by GAB resources. Thus, there could be situations in which the EFM could be required and not the GAB, and vice versa. But even if the EFM and the GAB were not to be linked formally, it was vital over the next few months that an enlarged GAB and supplementary credit lines be made compatible with agreed EFM procedures.

The problem of moral hazard could not be eliminated entirely, the Director considered, whenever mechanisms were used to assist countries, financial institutions--via deposit insurance--or central banks judged "too big to fail," or even to assist individuals. While Mr. Mozhin had noted that some observers considered an EFM a "bailout fund" for irresponsible sovereign borrowers, one had to consider that various parties would be involved in the process--the countries, the markets, and the Fund. First, there were the countries. In light of the Mexican case, it would be hard to argue that any member would risk the kind of market reaction or invite the kind of adjustment process that Mexico had had to endure to obtain exceptional Fund financing. Rather, the opposite was the case: in a number of cases, including in which there had been some threat of contagion, the Mexican episode had reinforced the view that the market was a disciplinary mechanism on economic policies, so that a number of countries had adopted firmer policies as a result. The exceptional support for Mexico had not resulted in a moral hazard, given the real pain involved in the subsequent Mexican adjustment, which was clear to observers.

Second, one had to consider an EFM in light of the markets, the Director remarked. The markets had not likely suffered losses in aggregate in the case of Mexico, as holders of short-term and other maturing instruments in the banking system and markets had recouped their investments. That was not to say that individuals who had exited the market at various points had not suffered large losses, however. Overall, the result had probably been akin to that in a zero-sum game, given that some investors had made large gains as the prices of those instruments had recovered and the tesobonos had been honored--not to mention the enormous price volatility in the equity and Brady bond markets. While interest rate spreads facing market access countries in the wake of the Mexican crisis had increased greatly, they had since declined, but not to below their pre-Mexican crisis level. The international support for Mexico, therefore, had not substantially altered markets' perceptions of the risk involved in financing countries.

Third, as for the Fund, it had to be clear that an EFM would provide no guarantees against sovereign losses by market lenders, and that rapid assistance by the Fund had to be based on improved surveillance, the Director emphasized. The staff had sought to stress as strongly as possible, as had a number of Executive Directors, that the extent to which the Fund would be in a position to respond rapidly to a particular member would depend on the extent to which the institution understood that member's situation, which, in turn, depended on the quality of the dialogue with the member under surveillance. Thus, there was a burden both on the country and the Fund to ensure that the surveillance process was as robust as possible, to enable the staff, management, and the Board to react quickly to changes in a country's circumstances.

While some speakers had called for more specific guidelines on the nature of emergencies and the procedures to respond to them, other speakers had noted that the situations would be truly exceptional, the Director pointed out. Indeed, Mr. Autheman had said that the EFM should not have to be used more than two to three times a century. The consultation process with the Board was intended to allow the latter to decide whether a case truly needed exceptional support; and while Ms. Cheong's language about finding that fine balance had been appropriate, it was--almost by definition--difficult to define what would be exceptional, given diverse country circumstances. For example, in the 1994 paper on a short-term financing facility (EBS/94/193, 9/26/94), the staff had attempted to specify various criteria for access to such a facility; access figures of 100 and 300 percent of quota had been mentioned in either the paper or the subsequent Board discussion (EBM/94/104, 11/30/94), with much analytical basis to them. While the staff had considered various countries' reactions to specific market pressures and the financing required, and several indicators, the latter had given varying results depending on the specific nature of the situation that was being examined. The staff had thus hesitated to specify narrow guidelines on, for example, access and frontloading.

An EFM should be available to any member that had experienced an external financial crisis requiring an immediate response, the Director considered. It was difficult to imagine crises in some countries that would not affect other similar countries, given the nature of market reactions. He was reminded in that regard of one of Ms. Lissakers's comments during a Board discussion on Mexico: she had related her conversation with market participants, who had indicated that, with Mexico in trouble, they would consider liquidating their positions in Hungary. While that kind of market reaction was perhaps inevitable to some extent, the purpose of an EFM would be to forestall such contagion or spillovers from any given country during a crisis. The Fund would therefore have to strike a delicate balance between deciding whether or not there was a threat of contagion, and whether it could act under an EFM before there was evidence of such contagion.

An EFM would not create an "entitlement" or a presumption of automatic Fund support in the event of a crisis, and was by no means a guarantee of sovereign risk, the Director stressed. Moreover, an EFM would not duplicate the exceptional circumstances clause of the Articles; it was simply an emergency procedure, which might, or might not, involve exceptional access.

The Deputy General Counsel said that the Fund could levy higher charges on members with greater use or higher access to Fund resources, provided that the charges were uniform. It would be possible to use another reference rate than the current SDR interest rate in setting the rate of charge--which was the same for all facilities--and/or to levy differentiated charges. For the Fund to do the latter, the Board would have to agree to return to the previous system of charging separate rates.

Before the Second Amendment of the Articles, the rate of charge increased under different schedules in accordance with the maturity and amount of outstanding purchases, the Deputy General Counsel recalled. That approach was no longer relevant given that the Fund currently had fixed repurchase periods, and thus no longer needed the trigger points under the old system for consulting with a member on a repurchase schedule. Shortly after the Second Amendment came into effect, a higher rate of charge was instituted for all Fund holdings of members' currencies above 200 percent of quota, given the Fund's intention to introduce the Supplementary Financing Facility shortly thereafter, which had higher access and was based on borrowed resources.

As it would be possible to levy higher rates of charge on higher access to Fund resources, the question then became why the Fund should do so, the Deputy General Counsel remarked. The motivation for that might be that the Board considered that greater use of its resources exposed the Fund to greater risks, which brought the discussion back to the question of risk assessment. It was clear that, given that charges would have to be applied uniformly, assessments of the risk of substantial Fund lending could not be done on a case-by-case basis. A higher charge, while conceivable, would not be a substitute for adequate safeguards and appropriate conditionality on the use of Fund resources.

An alternative to levying higher charges would be for the Fund to require a member to provide collateral in cases of use of Fund resources above 200 percent of currency holdings, which could take the form of regular payments to the Fund, to be returned to the member when it made a repurchase, the Deputy General Counsel pointed out. In that case, the amount of collateral required would necessitate case-by-case risk assessments. In any event, the issue of higher charges on higher access could not be agreed in the current discussion on an EFM, but was an issue of more general application.

The staff paper had indicated that, where drawings had been made after activation of an EFM and the member's policies had succeeded in settling the situation and reversing exchange market pressures--i.e., reversing the flow of capital--there would be a presumption that the member would make early repurchases, the Deputy General Counsel noted. The staff's intent had not been to require early repurchases or to establish an expectation (in accordance with the guidelines on early repurchases in Article V, Section 7(b)) but a voluntary repurchase that the member could make as soon as it was in a position to do so (in accordance with Section 7(a)). Of course, given that outstanding purchases were subject to Fund charges, there was an additional incentive for the member to make early repurchases.

As noted at the previous year's discussion on a short-term financing facility (EBM/94/104, 11/30/94), if the Fund wished to shorten the repurchase period, it would have to establish a new facility, given that any shortening of repurchase periods would have to be done on a uniform basis, applying to all purchases made under a facility, the Deputy General Counsel explained. It would be possible to create an individual repurchase obligation based on Article V, Section 4, pursuant to which the Fund might require collateral or other safeguards, which could apply under a currency stabilization fund, for instance.

Mr. Mirakhor commented that the staff's use of the word "entitlement" might connote nonuniform treatment of members, which the Fund should seek to avoid. He wondered why the word "eligible" had not been used instead of "entitlement," given that the former was used for other facilities, including the ESAF, which would not imply an entitlement to the EFM just as it did not to the ESAF.

The Director of the Policy Development and Review Department explained that one of the reasons why the staff had chosen the term "entitlement" was to counter some of the inaccurate reporting in the press regarding the implications of an EFM. The staff wished to inform markets that, while all members would be eligible for the EFM, the mechanism would not be available to any member simply by virtue of the fact that that member might be in crisis. The key issues were the member's policy response as market pressures developed, and its willingness to consult with the Fund.

Not all potential Fund borrowers required quick reaction from the Fund, the Director noted. Many of the countries, instead, needed to show that they were serious about adopting adjustment and reform measures that the market, and perhaps donors, regarded as necessary. Conditionality under an EFM would not necessarily be stronger, but would be tailored in line with the amount of resources available to the Fund to lend and policy fundamentals, such as the need to address an imbalance in the budget and in the external accounts; but it might be the case that observers judged that a country's fundamentals were sound, although the country was still threatened by an outside source. In that case, additional conditionality--including large interest rates increases, perhaps, and exchange rate action--might be required to restore market confidence.

Short-term interest rates were used to calculate charges for Fund lending, the Director added. With a normal upward sloping yield curve, the Fund was, in a sense, intermediating: there was a margin between what the Fund was charging the borrowing country and what the term structure of interest rates would perhaps suggest was an appropriate charge. In any event, in a cooperative international organization, there were externalities involved. One of the reasons for accepting that margin was the understanding that all members and the world economy would benefit if each country followed good policies, and adjusted those policies when they went off track. Given that the Fund not only levied charges, but also imposed conditionality, its lending was not comparable to market lending per se. In any event, it was not clear whether an increase in charges above a certain level of Fund holdings of a member's currency would increase the risk of moral hazard. Given that an EFM would only be activated in situations in which a member was threatened with substantial and highly volatile market pressures, minor interest rate differentials would not be relevant; the markets would likely require interest rate increases well in excess of what the Fund would consider even a special charge.

Mr. Geethakrishnan commented that, as an EFM was intended to deal only with a few cases a century, the mechanism had to be defined more clearly to indicate that notions of collateral, increased conditionality, and charges for extraordinary access would apply to a few select cases only. In any event, sudden "crises," such as the Mexican one, were possible only if the member in question had not taken the Fund into its confidence at an early stage of its difficulties.

Ms. Lissakers considered that any situation requiring the Fund to invoke an EFM would probably involve not only rapid support but also substantial support, following a sudden shock in financial markets, for example, which unduly affected a member. It would be hard to imagine a situation in which both speed and size of a member's resource needs would not be operative; hence, it was relevant to consider whether to levy higher charges on extraordinary access.

The Deputy General Counsel responded that he agreed that the issue of charges was relevant to the current discussion, but that it also went beyond an EFM to the more general question of the use of Fund resources. As charges had to be uniform, one had to find a uniform criterion for their determination; "exceptional access" was not such a criterion. The level of Fund holdings of a member's currency in relation to quota could be such a criterion, although the Board would have to decide at what access levels the Fund should consider imposing special charges.

Mr. Mirakhor pointed out that the risk of moral hazard would not be reduced by levying higher charges; only higher conditionality and strengthened surveillance would reduce that risk.

Mr. Evans indicated that he agreed with Ms. Lissakers that some combination of speed and size of resources would be involved when an EFM was activated. In its guidelines for an EFM, he hoped that the staff would link more clearly resource size and program strength: as the staff might not have sufficient time to make all necessary inquiries of the authorities, it would be preferable that the agreed program be strong.

The Chairman agreed that it would be worth reiterating in the guidelines for an EFM the cardinal principle of the Fund that the stronger a program, the stronger the financing could be.

The Director of the Policy Development and Review Department commented that he agreed that an emergency situation would likely require relatively large support and that, to some extent, the resource needs would also depend on how quickly an imminent crisis was addressed.

The Chairman made the following summing up:

> Directors welcomed the opportunity to consider the elements of a proposed "emergency financing mechanism" which would strengthen the ability of the Fund to respond rapidly in support of members facing a crisis in their external accounts and seeking Fund assistance. Although the wording "emergency financing mechanism" suggests a more ambitious purpose, Directors in fact considered that the topic under discussion was an emergency procedure rather than a new financing mechanism.
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> Directors agreed that the essence of an emergency financing mechanism was to provide for exceptional procedures that, in the event a member faced a crisis, would facilitate rapid approval of Fund support while assuring the conditionality necessary to warrant such support. In this connection, Directors generally agreed that there was not necessarily a link between exceptional procedures to facilitate a rapid response on the part of the Fund, on the one hand, and exceptional access, or the need for supplementary financing, on the other. However, Directors noted that, in addition to a rapid response to an emergency, the Fund may need to provide potentially large and front-loaded access, which possibly would imply the need to call upon supplementary resources. Issues related to possible expansion of the GAB and/or the supplementary borrowing

arrangements, and their modalities and criteria for activation, remain open for further consideration, and we may need to return to the question of linkages to the EFM as those discussions evolve. For the moment, however, I believe there is broad agreement among Directors on the main aspects of what would constitute emergency procedures.

While noting the staff's assurances regarding "moral hazard" and other issues raised during the Board discussion of the role of the Fund in August, most Directors stressed the importance of ensuring that the use of the emergency procedures would be limited to truly exceptional circumstances and that the Fund's role, in the context of such use, would remain catalytic. Further, use of emergency procedures would not be a guarantee against sovereign default. With regard to the key features of these emergency procedures, many Directors underscored the critical importance of strengthened Fund surveillance, and close cooperation between the Fund and the members, in order to help avoid a financial crisis and to facilitate a rapid response should a crisis occur. In that context, it was stressed by several Directors that it was a member's responsibility to come to the Fund early with a strong and comprehensive economic program in order to prevent a potential crisis from emerging and to limit the cost of repair.

There was very broad support for the circumstances and conditions under which emergency financing procedures could be initiated, and for the procedures themselves, as suggested and clarified by the staff. Some Directors expressed concern about the lack of objective criteria to identify in advance what kind of financial crisis would require and warrant a rapid Fund response, but others noted that it would be difficult to define beforehand the characteristics that would constitute such a crisis. A number of Directors would prefer to limit the use of emergency procedures to situations involving significant spillover or contagion effects, but most noted that such an approach would unduly restrict the availability of emergency procedures. Some Directors pointed to the lack of consensus on the meaning, in particular, of the concept of systemic effects.

In their comments, a number of Directors have emphasized the importance of continuous and substantive involvement of the Executive Board in the utilization of emergency procedures. I fully agree and have assured you that management would inform the Board immediately of its intention to activate the emergency procedures. Close communication and consultation would be maintained throughout the process, about which I will have more to say later in this summing up, and I agree on the importance of ensuring early and broad-based support in any activation of emergency procedures.

With reference to the specific elements of emergency procedures, I would list them as follows so that there is clarity for members, the staff, management, and the Board.

The emergency procedures would be expected to be used only in rare circumstances that represented or threatened to give rise to a crisis in a member's external accounts requiring immediate response from the Fund. Identification of such an emergency would be based on an initial judgment by management, in consultation with the Executive Board, that the member was faced with a truly exceptional situation threatening its financial stability, and that a rapid Fund response in support of strong policies was needed to forestall or to contain significant damage to the country itself or to the international monetary system, it being understood that the potential for spillover effects would be an important element of the Board's final judgment.

The conditions for activation of emergency procedures would include the readiness of the member to engage immediately in accelerated negotiations with the Fund, with the prospect of early agreement on--and implementation of--measures sufficiently strong to address the problem. Prior actions normally would be expected. The member's past cooperation with the Fund, in particular its record of reporting and responding to the Fund's policy advice in the context of regular consultations and continuing surveillance, would have a strong bearing on the speed with which the Fund itself could assess the situation and agree on necessary corrective measures. Our important operating principle--the stronger the program, the stronger the Fund's support--would also apply here.

The Executive Board would be informed immediately by management of the intention to activate emergency procedures, the nature of the emergency and the initial outlines of the planned responses by the member and the Fund, and the likely timetable for Executive Board discussion of a proposed arrangement. Strict confidentiality would need to be maintained, and public statements should be careful not to prejudge the Board's exercise of its responsibility to take the final decision.

A short written report would be circulated to the Executive Board as soon as feasible, describing the member's current economic situation.

During the negotiations with the member, the Executive Board would be briefed regularly on economic and financial developments, the progress of negotiations, the likely key parameters of the program (including the level and phasing of access), the likely impact on the Fund's liquidity and the possible need to activate borrowing arrangements, and any changes in the initially envisaged timetable for Executive Board discussion of the arrangement. These briefings would provide the Board with opportunity to give guidance to management and the staff on the country's policies and the contemplated Fund assistance.

In instances where support from other creditors is likely to be important, consultations with key creditors would be initiated at the outset of the emergency. The Executive Board would be informed of relevant developments in this area, in the context of the regular informal briefings.

Once agreement had been reached on a program, documents would be circulated as soon as possible. The staff would aim to do this within, say, five days. The Executive Board would be prepared to consider the request for an arrangement as early as 48 to 72 hours after circulation of the documentation. Decisions regarding key parameters, including access and phasing, would be taken in the context of the Executive Board's consideration of the arrangement, in accordance with the existing rules and practices of the Fund.

The early involvement and high frequency briefing of the Executive Board would be a centerpiece of the procedures facilitating a rapid Fund response. Similarly, after approval of the arrangement, and during a period of very close monitoring by the staff to allow early and continuing assessment of the effectiveness of the member's policy response, the Executive Board would continue to be involved closely in monitoring progress until the emergency was definitively resolved. In most cases, it could be expected that the full review of the initial policy response and the reaction of markets to these policies would be conducted within one to two months of the approval of the arrangement, with the aim of allowing modifications to policies as necessary in light of the evolving situation.

Directors agreed that there would be an understanding, rather than a legal obligation, that the member would make early repurchase of the resources made available under emergency procedures, provided the member overcame its crisis quickly.

I conclude from today's meeting that Directors agree that we should strengthen the Fund's ability to act quickly in crisis situations. Directors have endorsed the broad outlines of the proposed features of what could constitute emergency procedures. I will plan to report to the Interim Committee on this basis. Of course, there are issues related to supplementary financing arrangements still under discussion, and we will consider any implications of such arrangements for the emergency financing mechanism in due course.

Ms. Lissakers said that she hoped that exceptional circumstances would be better defined. In the summing up, the phrase "truly exceptional circumstances"--which might arise a few times a century, in Mr. Autheman's words--was inconsistent with the phrasing that an EFM would be activated "in circumstances that represented or threatened to give rise to a crisis in a member's external accounts requiring an immediate response from the Fund," which would seem to include most of the cases that came before the Board. The description of exceptional circumstances did not cover what the U.S. authorities had had in mind at the Halifax summit. She hoped that either exceptional circumstances would be defined, or that the word "truly" would be dropped.

The Chairman observed that, intellectually, the Board would agree with Ms. Lissakers's general point that it would be difficult in a world of integrated financial markets to maintain order without creating a moral hazard. The current phrasing, however, represented the consensus in the Board. In any event, the words had already been added to the summing up that "...the potential for spillover effects would be an important element of the Board's final judgment" in deciding whether to activate an EFM in an exceptional situation.

2. REPUBLIC OF BELARUS - 1995 ARTICLE IV CONSULTATION; AND STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1995 Article IV consultation with the Republic of Belarus and its request for a 12-month stand-by arrangement in an amount equivalent to SDR 196.28 million (EBS/95/128, 8/2/95; and Sup. 1, 9/11/95). They also had before them a background paper on recent economic developments in the Republic of Belarus (SM/95/194, 8/11/95).

The Acting Chairman noted that Executive Directors would have also seen the statement by the staff, circulated as BUFF/95/85, which had been considered by the Board on August 23, 1996 during an informal session on the Republic of Belarus.

Mr. Kiekens made the following statement:

> The solidity of the turnaround in economic adjustment and structural reform can best be judged by examining the policy measures which the authorities are implementing. An austerity budget, combined with tight monetary policy and restructuring of the real sector, will bring macroeconomic stability and create solid and adequate structures for a market economy. And in fact, the set of monetary and fiscal targets and structural benchmarks seem make Belarus' program appropriately strong.

The Belarussian authorities have asked us to confirm to the Board their strong commitment to adhere to their program in support of which a stand-by arrangement is requested. The Government is steadily working to strengthen its implementation capacity. The authorities fully realize that immense efforts will be required for its implementation, but are confident that support by the Fund and the international community will be very helpful, in particular in boosting the confidence of the population in the results of the difficult measures that are currently being implemented. They are grateful for the support already given by bilateral donors, and to the staff, which has done excellent work in the preparation of the program. They also hope for continuation of the constructive dialogue with the Fund, which will help to ensure its successful implementation.

Previous attempts by the Government of Belarus to reach an agreement with the Fund have failed because of factors over which the authorities had little or no control: first, because the financial assurances from the donor countries to cover the balance of payments gap were not yet in place; and second, because the monetary effects of the unexpectedly large inflow of foreign currencies into the country was anticipated neither by the staff in their projections, nor by the Belarussian authorities who were not technically prepared to neutralize the inflow. This inflow of foreign currencies, which was attracted by high domestic interest rates on deposits from both Russia and the industrial countries, forced the National Bank of the Republic of Belarus to intervene in the exchange market to prevent a rapid appreciation of the national currency from hurting local exporters.

These central bank interventions, combined with the measures undertaken by the Government to liberalize prices, especially utility prices, created inflationary pressures. Notwithstanding this difficult environment, very positive results have been achieved so far, and the Government has implemented all of the agreed prior actions.

The monthly inflation rate has fallen from 39.2 percent in January to 3.4 percent in May and 2.5 percent in June. The 5 percent monthly inflation targeted for the middle of the year has thus already been reached during the spring. Although the inflation rate increased briefly during July, to 5.2 percent due to a sharp rise in utility prices, it had fallen again to 3.4 percent during the first three weeks of August.

Belarus has also lived up to the excellent track record for fiscal performance which it been able to maintain during the whole period of transition. The budget deficit has actually never exceeded 4.5 percent of GDP. At the end of July the deficit was 3.2 percent of GDP. The Government has pursued a tight fiscal policy and adhered strictly to the ceilings set under the second STF program for financing the general government deficit through the banking system.

The continued contraction of output and the associated losses of tax revenues have made the budget situation increasingly difficult, but so far the Government has rigorously observed the parameters and quantitative indicators used for keeping the budget deficit within the agreed limits.

Recent statistics on tax collection confirm this assessment. For example, during the first half of the year, actual budgetary revenues exceeded projected revenues by 3.2 percent of GDP. This outcome was made possible by the comprehensive reformation of the national tax system, including introduction of new administrative and economic incentives to pay taxes on time, a broadening of the tax base, and the elimination of tax exemptions.

Although it was difficult to do in an inflationary environment, the level of the minimum wage has been held constant since March 1995, and the authorities have persuaded the Federation of Trade Unions of Belarus to sign an agreement supporting continuation of this policy.

In order to keep the budget balanced during the second half of 1995, the Government has taken additional measures on both the revenue and expenditure sides. In particular, it has decided to eliminate the income tax exemptions for military personnel, to broaden the base of the special wage tax aimed at defraying the costs of overcoming the Chernobyl disaster, to increase excise taxes, and to introduce transit fees for transport traffic passing through Belarussian territory.

In July, utility prices were raised to cover 60 percent of the costs, and further raises will be implemented in accordance with the program. In order to enable the most vulnerable groups of the population to pay these additional costs, the Government is actively working to adjust and better target the social security system.

Implementation of all these policies should reduce total outlays in the 1995 state budget by 4 percentage points below their 1994 level. In order to offset a possible shortfall in budgetary revenues, the Government has targeted, as a contingency measure, certain budget items, mainly subsidies, for further spending cuts.

A portion of the deficit equivalent to 2 percent of GDP will be covered by the issuance of state securities and foreign financing. To this end, the Ministry of Finance began in March to hold monthly auctions of short-term state bonds.

Turning now to monetary policy, the central bank has so far implemented a tight policy and is committed to continue this stance in order to bring inflation down to 1 percent a month by the end of the year. Interest rates were, and will continue to be kept positive, based on past inflation and prospects for the immediate future, taking into account developments on the foreign exchange market.

A special feature of the Belarussian program is that the authorities have accepted, in addition to the traditional targets of a ceiling for net domestic assets and a floor for the net foreign reserves of the central bank, performance criteria limiting the cumulative increase of the monetary base as well as of the net domestic assets of the banking system. This particularly stringent commitment with respect to monetary aggregates as an intermediate objective of monetary policy came, to a certain extent, in conflict with the authorities' exchange rate policy aimed at keeping the nominal exchange rate vis-à-vis the dollar relatively stable in order to preserve the competitiveness of the export sector. As shown in Chart 4, the Belarussian rubel appreciated in real terms substantially vis-à-vis the dollar and the Russian ruble, which made the authorities reluctant to let the exchange rate appreciate in nominal terms. The central bank was thus forced to sterilize massive foreign capital inflows at a cost that was high due to the nominal interest differential between the domestic and foreign currencies.

Due to seasonal patterns, a slight overshooting of reserve money above the target appeared during the summer months. End-July reserve money stood at 5.432 trillion rubels against a target of 5.296 trillion rubels for end-September 1995. Although the central bank was making a gradual reduction of this monetary aggregate in order to reach the end-September target, this strategy was substantially accelerated after this overshooting led the Fund management to refuse, on August 23, to recommend Board approval of Belarus' request for a stand-by arrangement. As mentioned in the staff's supplementary report of September 8, the central bank in the period from August 25 to August 31, reduced its reserve money by about 861 billion rubels to 4.658 trillion rubels, 12 percent below the end-September target.

The Belarussian authorities have thus demonstrated their determination and ability to implement the measures necessary to strictly adhere to what is without any doubt one of the most rigorous commitments undertaken by a member in conducting a monetary policy aimed at containing monetary aggregates.

Looking forward, the Belarussian authorities will closely monitor the appropriateness of their monetary and exchange rate policies in light of all relevant factors, including the evolution of similar policies in its major trading partners. They are confident of having a constructive dialogue on this issue with the staff, and are interested in Directors' opinions on this issue.

The central bank has not only implemented a tight monetary policy, it has also substantially changed its policy instruments. Directed credits were gradually replaced by credit auctions covering almost 50 percent of its credit to commercial banks. The central bank has also begun issuing its own securities, which are sold at auction. Its credit to the agricultural sector has been entirely eliminated. This year's harvest campaign was financed exclusively through the commercial banking system on the basis of market principles and within the ceiling agreed with the Fund on the expansion of the net domestic assets of the banking system.

Steps have also been taken to strengthen bank supervision regulations governing capital adequacy, solvency and loan loss provisioning. One commercial bank was recently closed because of its insolvency. Another one is under the consideration to follow suit.

The stabilization measures are complemented by structural reforms aimed at comprehensively restructuring the enterprise sector and further improving the investment climate. The Presidential Edict of March 3, 1995 on "Measures to Improve the Reform of State Property" defined the priorities for a program of broad-scale transformation of state enterprises into joint stock companies of the open type, and empowered the Ministry of Finance and other relevant ministries to begin the transfer of property in accordance with existing legislation. The 1995 privatization program is to privatize, within the period of one year, about 50 percent of the fixed capital of all enterprises, except for a few strategic enterprises of rather limited economic importance, whose privatization is prohibited by law. A majority of the Belarussian population has already applied for vouchers enabling them to participate in these mass privatization schemes. A total of 11.4 percent of these vouchers have already been exchanged for shares of enterprise stock. The privatization of land has also begun. The legislation provides for transferring plots of land to legal entities, including foreign ones.

It is the hope and expectation of our authorities that successful completion of the stand-by program will encourage the financial markets to more actively participate in the process by which the Belarussian economy is becoming a part of the world's market economy.

Mr. Tulin made the following statement:

I have long awaited this discussion because, as was commonly agreed in January 1995, the Belarussian program deserves support in the framework of the stand-by arrangement with this Institution. In January, this chair strongly commended the authorities for the bold commencement of the agreed program, even in the absence of our ultimate stand-by arrangement blessing. Despite some deviations and even worrisome, though relatively minor policy turnarounds, the authorities have managed to maintain the major thrust of reform. These deviations could be, perhaps, more easily understood if viewed in the context of an extremely extended process of legislature elections and unresolved issues of expected external financing. By the same token, higher inflation in the first months of 1995 may have reflected the true level of the eliminated distortions rather than actual policy slippages.

The authorities have not wasted these seven months. They were able significantly to improve public confidence in the now streamlined national monetary and financial system. This confidence was clearly evidenced by the unprecedented shift in currency preferences and, subsequently, in the rise of the National Bank of the Republic of Belarus's foreign reserves, albeit from a very low level. Such a shift appears to be based upon a rather healthy foundation since it has not been translated into a rising inflation rate. I understand that velocity measurement remains quite tricky owing to rather unreliable GDP statistics, but inflation dynamics should be viewed as proof of a steady velocity decline. Strong fiscal consolidation was, certainly, instrumental in achieving these results. I am glad to commend the authorities for keeping so far a very low budget deficit level, particularly by the standards of a transition economy.

Some recent developments in the foreign trade area are also very encouraging. Having substantially simplified and streamlined trade regulations, including tariff protection, the authorities prompted enterprises to expand and rationalize their export activities.

All in all, I see the measures implemented so far as strong evidence of the authorities' commitment to reform. The program they are presenting today envisages further strengthening and continuation of their efforts in the right direction, and, thus, should be fully supported.

When I turn to some particular program issues, it becomes obvious that all recent positive developments have forced the authorities to seriously consider their medium and long-term policy options as opposed to the most immediate ones with which they seem until recently to have been preoccupied.

Clearly, the issue of the appropriate monetary and exchange policies is among the most controversial, and I expect that the staff will explain to us in more detail what the present view of the authorities is, and what pros and cons were considered during the consultations. For example, in the same paragraph--on page 6 of the staff report--it is stated that the authorities "strongly supported the stabilization of the nominal exchange rate" and, at the same time, "are expected to depart" from this policy. Is it that the loss of competitiveness risk is already so high, wages so rigid, and the danger of systemic fiscal imbalances so imminent as to compromise any possible exchange rate anchor policy? The staff's deliberations on this question will be much welcome. I appreciate the high level of the authorities' responsiveness to the staff's concern, as demonstrated by their swift and decisive moves aimed at bringing monetary aggregates back to the program levels. One can wonder, nevertheless, whether unsterilized capital inflows--which were largely responsible for disappointing monetary data as of end of July, and for one more delay of our discussion--could have reversed automatically without all the dramatic policy measures. Some evidence of such behavior is indicated by the staff.

I welcome the authorities' cautious and rather balanced approach toward banking regulation. Their adherence to the achievement and maintenance of positive real interest rates deserves to be strongly commended; the high level of the commercial banks' free reserves with the National Bank of the Republic of Belarus--at least as of end of June--may reflect not only the shallowness of the domestic financial market, but much needed prudence on the part of banks. I am also pleased to see that this chair's January recommendation to unify reserve requirements and to use such an exercise as a sterilization measure has been successfully implemented.

It is rather fiscal developments, quite successful so far, that might unravel the reform. Therefore, I was very glad to learn that most of the tax exemptions have now been eliminated, outlays have been strictly checked--in line with cash revenues--and even substantial contingency reserves are set aside in the budget. Nevertheless, future challenges are many. Although the relatively small size and homogeneity of the country have seemingly allowed the authorities to avoid involvement in complicated issues of fiscal federalism with all its budget consequences, some reform measures in the most immediate future may expose new fiscal weaknesses. Structural reform leads to the erosion of state controls over existing enterprises and the proliferation of new ones, and the relative buoyancy of tax receipts may in part be reflecting the previous inflation of profits. Hence, there is absolutely no room for complacency, particularly if the recent surge in tax arrears is taken into account. In this respect, I would like to know if the staff expect social expenditures to soar in the wake of the reduction in subsidies (including effective subsidization stemming from the energy payments arrears), as happened in some other transition economies. Another issue of interest is related to a very important and bold measure, envisaged in the program, namely, a substantial rise in the cost recovery ratio of housing and household utilities fees. The collection rate of 97 percent, as reported by the staff in yesterday's supplement to the staff report, represents a spectacular success. Do the authorities foresee any difficulties in collecting these payments, particularly in the winter season? What is a realistic level of enforcement?

Finally, a few words about some aspects of bilateral relations between Russia and Belarus, that are so pertinent in the context of program financing. It is known that my authorities agreed to continue disbursement of state credits to Belarus as well as to provide additional resources under the Chernobyl-related programs.

Apart from this, as reiterated in the staff report, there also exists the still unresolved problem of arrears on gas payments owed to the Russian Gazprom company. As of the end of 1994 these arrears reached an amount of US$397 million, and, furthermore, in the first seven months of 1995 they increased up to the cumulative amount of $460 million. As one can see from the supplement to the staff report, a worrisome accumulation of arrears took place in August, too.

I have been instructed by my authorities to inform the Board that the Russian government stands ready to urge the Gazprom joint-stock company to reschedule the arrears accumulated by the end of 1994 on favorable terms and in such a manner that would be fully consistent with the economic program before us. At the same time the Belarussian authorities will be requested to formally guarantee the rescheduled part of the debt. Such a request is motivated by an imperfect credit history of the Belarussian state company Beltransgaz through which gas deliveries from Russia have been contracted. It is also based on the assessment of the financial standing of Beltransgaz which may not allow the company to service its debt without financial support from the Government. Moreover, in my authorities' view, it is the Government that effectively bears responsibility for the current financial difficulties of the Beltransgaz since this company was legally compelled to domestically resell imported gas at prices far below the border price it paid--or agreed to pay--to the Russian counterpart without any compensation from the budget.

The remaining part of the arrears (to the amount of approximately US$63 million) is to be repaid until the end of 1995 and after the cut-off date to be agreed upon Belarus is supposed to be current on its payments for natural gas.

The two governments have recently started negotiations on debt rescheduling. My authorities believe that their traditional friends and business partners will demonstrate a cooperative approach to the solution of the debt problem without which the economic program of Belarus under the stand-by arrangement would not win our support. My authorities will closely monitor the evolution of the debt problem during the stand-by arrangement period and will stay in contact with the Fund on this important issue.

With these concluding remarks let me on behalf of my authorities once again support the proposed decisions--including the absolutely justified front-loading of financial assistance--and wish the Belarussian authorities every success in their bold efforts in implementing the program.

Mr. Esdar made the following statement:

Belarus is only at the beginning of the transition process. Progress made so far has been somewhat limited by comparison with other transformation countries. Therefore, I very much welcome the commitment of the authorities of Belarus toward accelerated reforms and especially the strong support for the transformation program announced by the President. My support for this Fund-supported adjustment program is based on the expectation that the authorities remain determined to implement the program as agreed.

It was crucial to correct the monetary deviations immediately. A false start would have undermined an otherwise convincing program. Based on the spirit of trust, Germany and other donors are providing the necessary financial support to close the financing gap. In my view, the program correctly addresses the roots of the macroeconomic imbalances as well as structural problems. Therefore, I can endorse the staff appraisal and the agreed program. However, I must stress that the projected large financing gaps in the medium term demand the implementation of strong adjustment policies well beyond the period of this program. In this respect, the planned increase in domestic savings, as well as ambitious structural measures, play a crucial role in creating an environment attractive to foreign investors, which also includes a strong commitment to an open, market-oriented economy.

In the area of fiscal policy, I strongly support the staff's recommendation that the authorities fully adhere to the budgetary objectives. I especially welcome the contingencies provided for in the budget, since experience shows that very frequently revenues fall short of expectations while expenditures tend to exceed planned levels. Wage policy has to play a crucial role, given the magnitude of the public sector in the economy.

In respect of monetary policy, the program correctly stresses the importance of controlling money supply and maintaining positive real interest rates. Accelerating structural reforms in the financial sector would help enhance the effectiveness of monetary policy. The objectives should be to control money supply with indirect monetary instruments and to refrain from directing credit supply in favor of certain sectors of the economy. Hence, I strongly support the staff's recommendation to phase out subsidized credit to the agricultural sector. Furthermore, I would like to caution the central bank of Belarus against on-lending of the drawings under the stand-by program without adequate sterilization. It is a relatively large amount in comparison with reserve money, and would otherwise cause liquidity to balloon and counteract any anti-inflationary efforts.

I endorse the staff's recommendation to follow a more flexible exchange rate policy. The intention of the authorities to stabilize the nominal exchange rate would not only limit the effectiveness of monetary policy, but would also put undue burden on the still-weak reserve position. Besides this, I have some doubts whether it would be possible to define an equilibrium exchange rate at this early stage.

Macroeconomic stabilization policies, however, will fully bear fruit only if supplemented by bold market-oriented structural reform. This at least was the lesson learned from other transition economies. In my view, the program correctly addresses the most crucial areas, such as privatization, bankruptcy regulations, banking reform and supervision, as well as reducing interenterprise arrears. With respect to the latter, I especially welcome the commitment of the authorities to refrain from bailing out nonviable companies and the intention to set up clear incentives for enterprises to eliminate outstanding debt. The respective policies and instruments should be implemented as soon as possible, especially in view of the quite alarming fact that about 80 percent of all industrial enterprises are on the verge of bankruptcy. I wonder whether the World Bank could provide some technical assistance based on its quite rich experience with other transition economies in this regard.

On the adjustment of prices for household services, however, I am somewhat puzzled by the envisaged indexation scheme with the objective to catch up with inflation. Such a scheme complicates the anti-inflationary approach of monetary policy, as it tends to spread out to other prices and reduces the pressure to trim costs in companies providing such services. At least as an interim solution, I would like to recommend basing the indexation scheme on expected and, one hopes, decreasing inflation rates rather than on persistent ones. To conclude, I support the proposed decision.

Mr. Shields made the following statement:

This stand-by arrangement has had an unhappy history. Our first discussion due in January was delayed because of lack of financing--perhaps fortunately because it became evident in a matter of weeks that the program had gone off-track. It then took until August to bring the program back to the Board. But again the discussion had to be delayed because of problems on the monetary side.

As Mr Tulin points out, the authorities have achieved much in the intervening months. Inflation has fallen from just under 40 percent to 3.4 percent in August. This reflects tight control of net domestic assets, high real interest rates and a sharp reduction in the fiscal deficit. The latter has been helped by an impressive record on revenue collection (still over 48 percent of GDP).

I very much welcome these substantial achievements. However, two concerns have recurred again and again over the last year: the first is a growth in base-money, reflecting persistent intervention by the central bank to prevent appreciation of the exchange rate; the second, is slow progress on structural reform.

Inflows have been a problem since late 1994, prompting the staff to introduce a target on base money which has now twice been the cause of a delay in agreeing to the program. I must disagree with Mr. Kiekens's statement that the growth in base money was something "over which the authorities had no control." Instead, it reflects a fundamental incompatibility between what seems to be a persistent determination of the authorities' to target the exchange rate and the Fund's program which is based on monetary targeting.

I am dismayed by the continuing problems in this area. Not only did the letter of intent in January fail to mention this policy of "keeping the nominal exchange rate vis-à-vis the dollar relatively stable," as described in Mr Kiekens's statement but the authorities continued to intervene in the exchange markets against the clear advice of Fund staff.

Given this history, I was, pleased to see that the authorities responded to an overshoot on the base-money target in August by selling dollars rather than undertaking a massive sterilization operation which would have had large quasi-fiscal costs as well as a dubious impact on monetary targets over the medium-term. Surprisingly, the Belarussian rubel has remained (yet again) amazingly stable in nominal terms, despite this new shock. We do not, as a result, yet have a clear indication that the authorities are prepared to see greater flexibility in the exchange rate.

We have now seen this pattern of upward pressure on the exchange rate, intervention and base-money growth in a number of countries of the former Soviet Union. It was one reason why the first review of the stand-by arrangement in Kazahkstan was delayed and has been blamed for the failure to bring down inflation to program levels in Russia. The Kazak program has now been adapted to include explicit money base targets while the Russian program is moving more toward an exchange rate based system. I wonder whether the staff are ready to draw any conclusions from these experiences.

One conclusion they might consider is that it is important to agree whether a country is following a monetary based stabilization (in which case a base money target rather than just net domestic assets is appropriate) or an exchange rate target. Confusing the two is not a good idea. If we go for an explicit base monetary target we need, of course, to establish reasonable assumptions about developments in money demand and remonetization. It would be good to see these spelled out more often.

If this were the case, I hope we would no longer find the staff referring to large capital inflows as a surprising or "unexpected" response to stabilization programs in the countries of the former Soviet Union or elsewhere. The return of capital flight or cashing-in of domestic dollar balances is a very natural response to increased confidence, lower inflation and higher real interest rates. We need to ensure that all future programs include realistic assumptions about the return of flight capital and remonetization and perhaps contingency plans.

Getting back to Belarus, progress on inflation looked very impressive until early summer despite the much higher than expected money supply figures. However, this record slipped somewhat in the last couple of months, though some of this reflected increases in controlled prices. For inflation to continue on a downward path it is necessary for Belarus not only to maintain tight monetary and fiscal policy but also to push ahead on the structural reform front.

Progress on structural reform has been rather disappointing, particularly in the areas of privatization, demonopolisation, price reform, and land privatization, where Belarus lags behind a number of other countries of the former Soviet Union. But I am pleased to see that all the prior actions, including the restoration of licenses for investment funds, have been completed and I hope that the privatization program will now accelerate.

I am also concerned about conflicting actions and rhetoric on structural reforms. The latest example was the comments about more directed credits accompanying the merger of the savings bank (which is state owned) and Belarusbank (one of the largest private banks). Could the staff and Mr. Kiekens confirm that the new bank will not be used by the authorities to exert more control over lending policies. These should be based on commercial rather than political considerations.

It will be clear that I retain reservations about the structure of the program and am concerned about recent divergences from it. However, I hope that the detailing of my concerns has not drowned out a much more positive message: that the Belarussian authorities have come a very long way over the past year. There has been substantial progress in a number of areas which have taken courage and conviction to pursue. The achievements have been many, at a cost which has been considerable. Furthermore, the actions taken by the authorities to correct the effects of policy delays or mistakes show a considerable underlying commitment to the aims of the stand-by arrangement.

I very much support this stand-by arrangement and wish the authorities every success in realizing its goals.

Mr. Giulimondi made the following statement:

The staff papers make it very clear that Belarus inherited an overly specialized industrial structure focused on capital goods industries closely integrated in a declining productive net inside the countries of the former Soviet Union. A diversification of the economy and the opening-up of new markets are indispensable to address Belarus' deeply rooted economic problems and reverse output contraction. Such a reshaping of the economy must be supported by a profound correction of macroeconomic and structural policies. A substantial reduction of the monthly inflation rate--from the current high level of 4.5 percent--appears to be an absolute priority. Fiscal policies are confronted with the task of achieving budgetary equilibrium while, in the meantime, allowing the clearance of domestic and international arrears. Monetary and credit policies are responsible for exerting discipline upon productive sectors, through the restraint of subsidized credit and preservation of positive real interest rates, so that resources are increasingly destined to efficient uses. Finally, the structure of the economy needs to be deeply transformed in order to create a market environment--which is still lacking--encourage private initiative, and, eventually, attract much needed foreign investment.

Regarding fiscal policy, some positive considerations are in order. The authorities have consistently demonstrated in the past a considerable degree of responsibility in adapting expenditures to the actual level of revenues available on a cash basis. Moreover, the creation of an expenditure contingency in the state budget should insure that certain subsidies and capital outlays will be enacted only if matched by actual revenue collection. Finally, yesterday's staff supplement reports that the fiscal outcome for the second quarter of the year is in line with expectations.

However, as it did in January during the previous Board discussion, the fiscal program still raises some concerns regarding the possible optimism surrounding certain revenue projections. Even if tax collection improved during the first half of the year, the spillover of revenue shortages on domestic bank financing to the government is still a possibility to be taken into account. In this case, revocation of expenditures which have been formally identified and appropriated may prove to be politically difficult and cash sequestration itself, even when successful in maintaining fiscal targets, adds to the problem of financial discipline and domestic arrears.

Hence, a further improvement in the process of selecting and prioritizing expenditures would be advisable in compiling the 1996 budget, even if we are fully aware that social safety needs and political sustainability problems of the program after years of declining output make it delicate a selection of the outlays to be curtailed in real terms. I will touch on three expenditure areas. Under the program, wages in the public sector have been appropriately targeted to slightly decline in real terms, in order to support the deflationary process and preserve competitiveness in a situation of real appreciation of the exchange rate. A different area which is improvable is the Social Protection Fund. The ratio between contributing workers and pensioners is low by international standards and could be reasonably increased, in particular by raising retirement ages. A third major field of improvement for fiscal performance would be a further cutback in subsidies' structure, especially in the utilities sector.

The monetary program is centered on the maintenance of positive real interest rates and the expansion of the monetary base by no more than 1,352 billion rubles, or 4 percent of GDP, in the second half of the year. The overrun on the money base target, which caused the program's Board discussion to be postponed in August, was mainly generated by insufficient sterilization of exchange rate interventions by the central bank. Now that adequate sterilization measures have been identified and successfully implemented, sustained compliance with the central bank's net deposit assets and base money targets will require an effective control over actual expenses during the current fiscal year. In particular, state procurement in the agricultural sector was formally abolished in most respects on January 1, 1995 and, consistently, has been assigned only a modest portion of perspective credits. However, it maintains the potential to raise difficulties for the financial program if lobbying pressures are not resisted.

Regarding the exchange rate, the more than 100 percent real appreciation of the ruble since the adoption, in January, of a policy of maintaining a stable course of exchange is a remarkable achievement. We understand that the staff and the authorities consider that this real appreciation has substantially eliminated the previous real undervaluation of the exchange rate. In fact, the recent US$28 million sale of foreign exchange by the National Bank of the Republic of Belarus--in the frame of measures taken to reduce base money--did not induce the exchange rate to appreciate because foreign exchange flows eased in August. In this context, the authorities intend to pursue a flexible policy in the future and allow some nominal depreciation to preserve competitiveness if needed. However, the staff report and supplement are rather unspoken on this important point, and since exchange rate interventions were precisely at the root of the base money overrun, some more details on the conditions and magnitude of a possible exchange rate depreciation, and eventually the role of the exchange rate in the adjustment process, would be appreciated.

In the external sector, we note with satisfaction that the upward trend of the real exchange rate and positive real interest rates have encouraged the repatriation of export proceeds, as in the first half of the year residents began to shift away from foreign exchange deposits held abroad. Moreover, significant official external assistance has been pledged to finance the program.

Some final comments on the structural agenda, which is, in a sense, at the very heart of the program. Any sustained reversal of output contraction and diversification of the foreign trade pattern--still mostly concentrated within the Commonwealth of Independent States--will not be possible unless utilities' tariffs are increased, ownership rights for land in agriculture are established, and a serious privatization process gets started. The last point is especially important and worrisome, as, so far, privatization in Belarus has proved to be one of the slowest and least effective among the Newly Independent States and Eastern Europe transforming economies. In this light, it is comforting that the auction of 42 enterprises, which was envisaged as a prior action to today's program, is planned to be implemented shortly.

Only the clear perception--which is now mounting--that the authorities have definitely abandoned their past half-hearted attitude in redressing the economic management and are irreversibly committed to stabilization and reforms can pave the way to the actual disbursement of funds pledged for the program period and adequate private inflows--in particular direct investment--which are desperately needed to ease the financing gaps in the foreseeable future.

With these remarks, we support the proposed decisions.

Mr. Havrylyshyn made the following statement:

It seems that each time we return to discuss Belarus we are presented with a stronger and tighter program. First in January 1995 we saw an unfortunate shortfall in bilateral financing lead to a difficult tightening. Then an unexpected overrun of reserve money in the summer caused a delay in discussing this program here, and necessitated again a strong and quick tightening. These improvements are all for the good of course, but the tighter program measures as we now see after such a difficult nine months does not mean things will be easier. Indeed they may be like an overgrown heavily blooming rose garden: the flowers are wonderful to look at, but picking them will require a lot of care to avoid the many thorns, and a preparedness to bear the pain of an inevitable occasional thorn in the hand. The special feature mentioned by Mr. Kiekens (targets not only for net domestic assets and net foreign reserves, but also for monetary base and net domestic assets of the banking system) exemplifies the combination of blooming roses and painful thorns.

It is against this background of the painful thorn pricks due to previous policy slippages, and, as the staff puts it "a modest and at times erratic progress in implementing reforms," that the government of Belarus should be commended for embarking on a bold and ambitious economic program for 1995 and 1996. I support this program and the proposed decision. The main objectives of the program, notably a sharp and irreversible reduction of the inflation, improvement of the external position and liberalization of the economy through greater reliance on market mechanism for resources allocation, seem achievable, especially after the initial encouraging results of the authorities' actions to tighten the monetary and fiscal stance. In addition, Belarus has established a good track record of freeing external transactions and achieving partial price liberalization. In this light, while acknowledging the fact that in the first three years of independence the Belarus authorities were unable to put together a coherent reforms program, I strongly support this new ambitious effort to speed up reform and, therefore, support the request for a stand-by arrangement.

I broadly concur with the staff's recommendations and support the objectives and policies of the Belarus government outlined in the Letter of Intent. I remain, however, somewhat wary about the risks associated with the implementation of the program. Let me elaborate briefly on fiscal, monetary and structural reforms. I have nothing to add on exchange rates and agree with the staff report.

First, I fully support the staff's position that the government should not depart from the tight monetary stance that has been followed since the beginning of 1995. Having in mind the larger than targeted expansion in broad and base money in the last couple of years, money balances adjustment remains an important challenge facing Belarus. It is important, therefore, that the authorities avoid any slippages from the envisaged policies. This requires a containment of net domestic assets within the program limits, on the one hand, and more successful sterilization operations, on the other.

Second, bearing in mind the authorities success in keeping the fiscal situation under control (see Table 1 of the background paper on recent economic developments), I believe that the present government will be able to follow tight fiscal policy as a necessary complement to the restrictive monetary stance.

While I am generally satisfied with the authorities' commitment to adhere to tight monetary and fiscal targets, I remain concerned about the strategy of gradual systemic reforms that has been followed since the early 1990s. It is clear that Belarus is lagging behind many countries in transition in the process of structural reforms. In particular, there is modest or almost no progress on restructuring and privatization of the state-owned enterprises, on state-owned housing privatization, and on agricultural reform. In addition, I would argue that the macroeconomic adjustment program cannot be sustained without enforcing financial discipline on the state-owned enterprises, a problem that the staff emphasizes in its analysis. Especially worrisome in this respect is the sharp increase in interenterprise indebtedness and enterprise arrears to commercial banks (Table 47 of the background paper). Would the staff give some more information on the authorities' actions in this area?

Having said that, I would reiterate this chair's position, that a slower pace of structural reforms creates significant impediments to sustainable macroeconomic stabilization and in the end only serves to delay recovery. Therefore, I would urge the authorities to give priority to the processes of liberalization and restructuring of the economy and of private sector development.

Mr. Ryan made the following statement:

We are pleased to see the Belarus program back on track. Efforts to bring this stand-by arrangement to the Executive Board have resulted in a bit of a roller-coaster ride for Belarus and its creditors over the past year. That the arrangement is finally before us is encouraging, and we look forward to smoother sailing in the months ahead.

This stand-by arrangement offers Belarus the opportunity to redefine the government's role in the economy by letting market forces begin to guide development. The delay in program approval caused by the slippage in the monetary base performance criterion was a "wake-up" call. Steady implementation of program goals going forward is essential. Having achieved some degree of macro-stabilization, these positive results must now be reinforced with a redoubled commitment to systemic reform. Without a concerted effort, Belarus' hard-won progress on stabilization will ultimately be undermined by arrears already accumulating in the budget, the external sector, and among the country's unreformed industrial and agricultural producers.

As the staff supplement indicates, measures to sterilize the monetary base overshooting have resulted in a 12 percent "cushion" under the end-September base target and have substantially increased the credibility of the program. With these actions, Belarus has turned a regrettable delay into a positive reaffirmation of its commitment to the reform program. I wonder if the staff could clarify, however, the underlying factors which occasioned the National Bank of the Republic of Belarus interventions into the exchange markets in July. Mr. Kiekens's statement points to inflows from Russia and industrial countries over the first half generally, which were attracted by high domestic interest rates. Are there other pieces to the puzzle? Also, regarding the statement in the statement that the Belarussian authorities were "not technically prepared to neutralize the inflow" of foreign currency, we understand this to refer to the operational procedures for monitoring and managing reserve money growth. Can we assume that in the event of any future unanticipated inflows, National Bank of the Republic of Belarus interventions would be sterilized as necessary in a timely fashion?

Along these same lines, we wonder about the factors contributing to exchange rate pressures--in particular the "levitation" effects to which Mr. Shields referred. In addition to portfolio shifts and export receipts, might upward pressure in the exchange rate be partially attributable to market distortions. Looking forward, given the rather tenuous external position as well as the substantial real appreciation that has already occurred, the expectation that market forces could begin to impart a downward push to the exchange rate seems reasonable. Such pressures should not be resisted. Greater flexibility of the exchange rate ought to be accommodated in order to avoid misalignments requiring more abrupt changes at some later point. Good macroeconomic policies--not manipulation--are the basis for exchange rate stability.

Belarus faces a credibility gap that only steady performance can overcome. Tight Fund performance criteria appear a source of frustration to the authorities, but these targets can work to Belarus' advantage since they send a clear signal of the program's seriousness in achieving the end-year goal of 1 percent per month inflation. Tight monetary criteria are a useful counterpoint to concerns that seasonal pressures from traditionally influential sectoral lobbies combined with the growing accumulation of internal and external arrears could undermine stabilization efforts (recognizing that as money demand evolves, targets might be adjusted accordingly).

Assuming that monetary conditions and policies remain on track, other challenges remain. Belarussian fiscal performance has been strong, largely because the authorities have kept the levers of economic control firmly in their own hands. Necessary restructuring and privatization efforts will reduce this control. The government must be prepared to offset possible revenue declines resulting from the transition process, so we welcome the identification of ample expenditure contingencies in the budget.

Structural reforms are crucial to program success. There have been some encouraging signs, but many missed opportunities. Belarus has recently demonstrated a new, more sustained commitment to price liberalization, and the decision to increase communal tariffs was an important and politically difficult prior action that further demonstrates the seriousness of Belarus' commitment to the program.

Reasons for concern remain, however. Stabilization efforts in the absence of concerted systemic reform have led to the emergence of multiple stress points in the economy. As noted earlier, arrears accumulating in the budget, the external sector, and among the country's unreformed industrial and agricultural producers risk undermining stabilization gains. Faster enterprise reform is critical. The commitment by the authorities to accelerate the restructuring process must be unambiguous, the threat of bankruptcy and liquidation must be credible, and the necessary legal framework must be put in place and enforced. These steps are essential in order to increase pressure on enterprises to become more financially responsible and to restructure.

Popular support for the privatization process was dealt a serious blow by the suspension of investment fund licenses after the country's first shares-for-vouchers auction. Restoring that support will involve more than simply reinstating these funds. Privatization of small, medium, and large enterprises must be dramatically accelerated. There must be a clear signal that enterprises will be removed from the state sector and are expected to operate more efficiently.

Finally, we would like to re-emphasize the comments in the staff appraisal on the critical role the Belarussian leadership must now play in educating the public about the urgency of the country's economic problems and the inevitability of reform. A sustained public commitment from the highest levels of government to the process of stabilization and broad market reform will be essential in order to create knowledgeable and supportive constituencies for these policies.

In summary, the Fund program provides the international community with an excellent opportunity to urge Belarus toward greater efforts. We welcome signs of a growing commitment to reform, and support the country's request for a stand-by arrangement.

Mr. Desruelle made the following statement:

Like previous speakers, I welcome the presentation of this stand-by arrangement to the Board. Full implementation of the economic program supported by this arrangement would represent a definite and final breakthrough with the policies of the past; would consolidate the gains made in reducing inflation during the first half of this year; and would put Belarus firmly on a path leading ultimately to recovery of output.

As Mr. Havrylyshyn just said, it is clear that implementation of this program will be difficult. Implementation of this program does indeed raise some specific concerns. Let me mention two in particular.

First, I share most of the comments of Mr. Shields on the management of exchange rate and monetary policies. Judging from the record of the first seven months of 1995, it was not apparent that the authorities had made a definite commitment to a monetary-based program, even though that is the structure of both the former STF-supported program and the present program. On the contrary, both Chart 4 of the report and the recent episode of large unsterilized interventions in the foreign exchange market suggest that the authorities were at least implicitly following an exchange rate-based program. This impression is, of course, reinforced by the sentence in Mr. Kiekens's statement that reads, "This particular stringent commitment [the performance criterion on the increase in the monetary base] with respect to monetary aggregates as an intermediate objective of monetary policy came, to a certain extent, in conflict with the authorities' exchange rate policy...."

Notwithstanding the welcome and prompt response during the past few weeks to bring the monetary base back in line with the program, this past record creates uncertainties as to whether monetary policy will be implemented in full accordance with the program's monetary framework.

Second, I share the views of Mr. Tulin, Mr. Esdar, and Mr. Ryan on the seriousness of future challenges on the fiscal front; I agree with the staff that there is an unusual degree of uncertainty regarding tax revenue, given the difficulty of assessing the impact of macroeconomic stabilization on both the tax base and compliance.

While the indication that budgetary revenue remained strong in the first half of 1995 is welcome, the existence of mounting pressures on the budget in the second quarter, as reported in the Letter of Intent, and the experience of other economies in transition make one fear that future budgetary revenue could be seriously overestimated and hence that the program's fiscal target could be significantly harder to achieve than expected. After all, the forecast for general government revenue in 1995 is only 0.7 percent of GDP below the 1994 figure.

I agree with the comments by previous speakers on structural reforms and will not add to them.

I welcome the fact that the program reviews will focus on the major areas of reforms, including agricultural reform, privatization and restructuring of the banking sector. On a related note, I welcome as well the focus put on the prevention of new domestic and external arrears and on a careful handling of the existing state of arrears.

In conclusion, let me again welcome the will of the authorities to move forward with macroeconomic stabilization and structural reforms and let me hope that, with this program, the authorities will achieve definite and irreversible progress on both these fronts.

Mr. Huang made the following statement:

We commend the authorities for their notable progress in reducing inflation over recent months. Tighter financial policies have contributed to both increasing confidence in the Belarussian currency and sharply bringing down inflation. At the same time, further steps have been taken in structural reforms, particularly with regard to price liberalization, the exchange and trade systems, and the strengthening of market mechanisms for implementing monetary policies.

Notwithstanding these achievements, the authorities are confronting daunting challenges to attain macroeconomic stability, especially reversing the trend of a continuing shrinkage in economic activity and improving the extremely precarious external position. The need for consolidating macroeconomic stabilization and deepening reforms cannot be overemphasized. In this context, we are pleased to note the authorities' sustained commitment.

The authorities' economic program for 1995/1996 rightly stresses further progress toward reaching price stability, achieving a sustainable balance of payments position, and deepening structural reforms. When fully implemented, it could consolidate the recent success in reducing inflation and lay the foundation for an earlier resumption of economic growth. As I agree with the thrust of the staff appraisal, I wish to make only a few points.

First, in the fiscal area, the achievement of fiscal objectives is based on the authorities' revenue-enhancing and expenditure-reducing efforts. We share the staff's concern that the authorities' projections for certain revenue items might be optimistic in considering the tax base and revenue collection. The authorities should be prepared to protect fiscal objectives from any further deterioration in the tax revenue situation and adhere to a tight expenditure policy.

Second, monetary policy aimed at reducing inflation should be firm, and continued efforts are urged to strictly contain monetary expansion in line with the program target. We understand one of the main monetary instruments used by the authorities for sterilization is issuance of securities to commercial banks, which is a new phenomenon in Belarus and would be more efficient if technical assistance in this area from the Fund could be secured. Monetary policy should also be well-coordinated with other policies. In this regard, we note that exchange rate appreciation could be considered as an option to alleviate the pressure on monetary expansion. Given the large amounts of capital inflow, it would be difficult to justify the consistency between exchange rate depreciation and containment of the monetary base. We would appreciate staff elaboration on this issue.

Third, while further deterioration in Belarus' terms of trade and uncertainty in export performance are projected, the suggestion for exchange rate depreciation as envisaged in the path of the program exchange rate to promote the competitiveness and profitability of the export sector should be cautious. It would be helpful to assess exchange rate policy if the price elasticity of foreign demand for Belarussian exports could be estimated.

Finally, I join the others in emphasizing the importance of accelerating the structural reform process, which would significantly increase the market-orientation of the Belarussian economy.

With these remarks, I support the proposed decision and wish the authorities success in implementing this program and securing further external support.

Ms. Srejber made the following statement:

The presented program and the Belarussian authorities' commitments to implement it gives optimism that further reforms will be facilitated in the Belarussian economy.

As other speakers have already touched upon, there are a lot of problems ahead for the Belarussian authorities to solve; the staff appraisal in the paper, "Challenges Ahead" describes this very clearly. The recent supplement shows that the Belarussian authorities can do their best in bringing the program back on track. This is encouraging, but I still think there is a potential to go ahead with more rapid changes. As I broadly agree with the thrust of both the staff appraisals and with the remarks of my colleagues, I will just stress a few issues.

First, on the structural reform as other speakers, I think that more could be achieved in this area. We all know that the main lesson from the countries that are more advanced in the transition process is that resumption of output growth requires sound macroeconomic policies supported by comprehensive structural reforms. Therefore, I would urge the Belarussian authorities to bear in mind the high costs for the society of indecisiveness or setbacks. As it takes a long time to create credibility, the authorities should boldly go ahead instead. I feel somewhat anxious that the Belarussian authorities are still quite modest in their endeavors in, for example, privatization, thus shedding a light of doubt on the commitment to and direction of the reforms.

Second, on the arrears; arrears, although a common phenomenon in the countries in transition at the initial stage of the reforms process, should not be tolerated on any kind of excuse. Restructuring of the sectors with arrears problems, and closing of the most indebted nonprofitable enterprises is the way to release the economy from this kind of a burden. It is regrettable, therefore, that Belarus has been slow in the area of privatization and enterprise reform. The netting way for elimination of the arrears instead of more bold actions is not a good idea, for example. The experience in some of the countries in my constituency shows netting to be ineffective. Moreover, it entails a serious threat of pressure from enterprise lobbying to extend credit to the insolvent sectors of the economy. It only postpones the inevitable solution, rather than gives the awaited results. It also raises questions on the Government's seriousness in pursuing the reforms as well as creates a hope for possible bailouts. Even if it is said often, I think it deserves to be repeated that when adjustment in any sector of the economy has to take place, the choice is between adjustment now and more costly adjustment later.

Third, one remark concerning the unsettled political situation owing to the unavailability of a Parliament in power. This threatens the implementation of some of the anticipated economic measures, which require parliamentary approval, and shows the political situation to be very fragile. In April, 1995, when it appeared that Belarus had gotten financing to close the gap, slippages in the program appeared. And from the later developments one can notice that the prior actions were implemented actually quite recently--as Table 10 on page 30 of the staff report shows--mainly in June-July 1995, and the latest implemented prior action related to reinstating investment funds was taken in the middle of August.

With these remarks I wanted to highlight some potential risks I see in the program implementation, thus reminding the Belarussian authorities not to relax in their attempts, but instead to build a strong performance track record.

Mr. Oya made the following statement:

I welcome this long-awaited Board meeting to discuss Belarus' request for a stand-by arrangement. I also commend the authorities for having recently intensified their efforts at economic reform and for having achieved positive results.

What I would like to emphasize today is that it is now or never for Belarus's economic reform. A prolonged bad track record until last year substantially damaged the credibility of the authorities' commitment to economic reform. I believe that only by fully implementing the stand-by arrangement program without a single slippage will the authorities be able to enhance their credibility, which is essential for mobilizing capital inflows, including foreign assistance.

With these remarks, I support the proposed decision.

Mr. Shields requested that the staff elaborate on the authority of the Parliament currently in session.

Mr. Kaufmann made the following statement:

Last March, when the Fund program under the Systemic Transformation Facility was off track, the judgment of the staff was that the Republic of Belarus needed to establish a better performance in stabilizing the economy and implementing consistent market reforms before it could recommend approval of further Fund financial assistance.

Since then, we think that the Republic of Belarus has made several important steps to stabilize the economy and move toward a market economy. This was accomplished by reducing subsidies, strengthening fiscal revenues, sharply limiting the extension of directed credit by the National Bank of the Republic of Belarus to the ailing sectors of the economy, and bringing down inflation sharply. In addition, the program worked out between the staff and the Belarus authorities looks strong enough to tackle some of the remaining problems and achieve further progress in stabilizing and restructuring the economy.

However, the situation is still critical as GDP continues to fall and inflation remains at a double digit level. As regards stabilization policy, the track record in July and August is somewhat disappointing. In particular, monetary aggregates such as base money and net domestic assets of the banking system, increased too fast due to a lack in sterilization by the National Bank of the Republic of Belarus.

Certainly, as stated by Mr. Kiekens, these difficulties can be explained to a great deal by the unexpected amount of capital inflows, increased tariffs, and further price liberalization. However, an additional reason for the recent monetary slipping might have been the authorities' concern that financial policies could be too restrictive and could lay too heavy a burden on enterprises, tax payers and the state budget, with the result of increasing arrears in the whole economy. For this reason, the authorities seem to have loosened monetary policy to some extent, a policy which is reflected in the decline of interest rates through the month of July.

Bearing this in mind, we welcome the understandings reached mid-August between the staff and the Belarus authorities on remedial actions, which were immediately, and, apparently, successfully implemented by the National Bank of the Republic of Belarus and aim at reducing money supply, and, therefore, the inflation rate. This quick action has indeed broadly enhanced the credibility of the program.

Regarding fiscal consolidation, Mr. Kiekens's statement points out the good past performance of Belarus. We welcome the reforms undertaken in this area, in particular the recent steps to make tax collection more efficient. However, fiscal consolidation seems to some extent to have been based on increasing domestic and external arrears. Unfortunately, the agreement with Russia on a rescheduling of the overdue gas payments of 1994 is still not concluded. We share Mr. Tulin's hope that, for the time being, the governments of Russia and Belarus will find a solution which fits the interest of both partners.

Let me now turn to structural issues. We all know that the success of the transition depends greatly on structural improvements, in particular through a consistent and comprehensive privatization and enterprise reform program and through clear rules and regulations in the financial sector. To be frank, structural reforms have been a matter of great concern up to now, as the authorities did not seem willing to speed up the process. Hence, we welcome the authorities' intention to implement quick and decisive steps to broaden structural reforms, in particular to improve private markets' share within the Belarus economy through an ambitious privatization program, aiming at privatizing about half of the fixed capital of all enterprises within one year.

The various donor meetings aimed at filling the financial gap of Belarus have shown that both the multilateral financial agencies and a number of bilateral donors are willing to acknowledge the achieved results by committing significant amounts to Belarus. We request the Belarus authorities to implement further far-reaching reform steps in order to use these scarce donor resources as effective as possible and to establish a convincing track record. A lack in performance compared to expectations could indeed lead to a donor fatigue, producing a vicious circle: less gap-filling assistance may provoke smaller amounts of financial assistance from international financial organizations and vice versa.

To conclude, we support the staff proposal to back the reform program of the Republic of Belarus with a stand-by arrangement in the amount of SDR 196 million, and wish the Belarus authorities well in their difficult endeavor.

Mr. Al-Huseini made the following statement:

Belarus' performance under the Systemic Transformation Facility has been mixed. While good progress on the inflation front has recently taken place, the pace of implementation of systemic market reforms has been disappointing. This mixed performance notwithstanding, it is clear from the staff papers that the reform process has gathered momentum, and that the authorities' commitment to reform has strengthened. This is indeed encouraging and should bode well for the implementation of the program before us.

As I broadly endorse the staff appraisal and support the revised proposed decisions, I can be brief.

The lack of progress in systemic market reform represents a serious challenge to the objective of financial stabilization and recovery of growth. Experience in the newly independent states has clearly shown that without substantial progress in reforming the public enterprise sector, financial stabilization will likely remain elusive. Accordingly, the authorities are encouraged to accelerate the pace of privatization as well as the restructuring of public enterprises with a view to increasing economic efficiency and growth. To this end, enterprises must operate under a hard budget constraint and be more responsive to market signals.

Equally important to the success of the transformation process is the establishment of private land ownership. In this regard, the approval of the legislation extending property rights to state farms is a welcome step. It is important, however, for the Supreme Soviet to approve expeditiously the legislation giving property rights of land to Juridical persons. Such approval is needed to enhance confidence and increase investments by the private sector.

With these comments I wish the authorities success in their adjustment efforts.

The staff representative from the European II Department said that money-based targeting had been introduced in early 1995 out of concern that the inflation target would not be met in light of the capital inflows that had started to emerge in late 1994. Base money--rather than net domestic asset creation--had been chosen as the performance criterion because, in the face of inflows, net domestic asset targets were ineffective in containing inflationary pressure arising from overperformance of net international reserves. That had been the motivation for switching to a base money target.

A large part of the inflow of foreign exchange to the banking system had resulted from a portfolio shift away from foreign exchange--previously held outside the banking system or abroad--in favor of the domestic currency, the staff representative continued. At the time the stand-by program had been negotiated, the staff had estimated that those inflows would level off later in the year, and had encouraged the authorities to adhere to a more flexible exchange rate policy. The authorities had expressed some concern about the competitiveness of traditional industries during the consultations. On the whole they had agreed that a flexible exchange rate would be desirable, as reflected in the letter of intent.

In July, had the authorities faithfully pursued the monetary program, the nominal exchange rate would have appreciated, the staff representative remarked. Instead, the authorities had intervened in the exchange market to offset the nominal appreciation, and that had been the source of the base money expansion.

Having said that, the argument that a stable exchange rate had to be abandoned once and for all under a money-based program was less clear in the face of foreign exchange inflows to the banking system, the staff representative observed. The adjustment to the exchange rate consistent with observing the base money target under those conditions could jeopardize other aspects of the program. Presumably, the authorities had had that in mind in their de facto pursuit of a stable exchange rate policy.

That the sale of foreign exchange by the central bank to reduce base money in August had not resulted in an appreciation of the exchange rate was explained by the excess demand for foreign exchange that had materialized at the time, the staff representative noted. That development had been precipitated by the central bank's decision to reduce rather rapidly the refinance rate and to eliminate some of the minimum interest rates. Interest rates in Belarus had fallen below those prevailing in Russia, which also had given enterprises incentives to delay some of their export proceeds.

The staff would continue to encourage the authorities to pursue a more flexible exchange rate policy, with the understanding that reserves of the central banks should not decline much further, the staff representative said. The program had anticipated a small depreciation in the rubel in the order of 10 percent in the second half of the year, and that projection still seemed reasonable.

Mr. Shields agreed that a money-based program could be designed to contain consistent assumptions about both monetary and exchange rate profiles. However, the question was how the authorities would react to further capital inflows or outflows, and what the staff would advise in those circumstances.

The staff representative from the European II Department indicated that the staff would advise the authorities to adhere to the objectives of the program. In the case of capital outflows, the staff would recommend using interest rate policy to prevent sharp currency fluctuations, while allowing the exchange rate to depreciate where the exchange market pressure reflected weakening of export performance.

Mr. Shields remarked that the staff's response seemed to suggest that an operational exchange rate target was in place.

The staff representative from the European II Department replied that some assumption about the evolution of the exchange rate had had to be made in the projections. At the time the program had been negotiated, a modest depreciation in the context of a flexible exchange rate regime had been anticipated, based on the staff's assessment of competitiveness and the sustainability of the external current account.

Mr. Esdar said that encouraging Belarus to pursue both monetary and exchange rate objectives simultaneously could lead to some confusion for the authorities in terms of knowing how best to respond to capital flows. He wondered whether it might be more appropriate to encourage the authorities to focus on the monetary target alone.

The staff representative from the European II Department pointed out that the program was clearly a monetary-based program.

The Acting Chairman noted that if the pressure on the exchange rate were the result of a permanent shift in the demand for money, then a decision to adjust the base money target--rather than to have the exchange rate adjust--would still be compatible with the objectives of the monetary program.

Mr. Esdar replied that there were two basic ways to respond to pressure on the exchange rate resulting from capital inflows: adjusting the monetary aggregate and interest rates--and running the risk of exacerbating the capital inflows problem--or adhering to a monetary target and letting the exchange rate adjust, notwithstanding the impact on competitiveness. The latter approach was the simplest and seemed to pose the least inflationary risk. That was the policy direction that he had understood the authorities of Belarus were being advised to pursue.

Mr. Kiekens agreed with the Acting Chairman's observation that changes in the velocity of money over the course of a program would warrant adjusting the monetary target. The need to preserve some flexibility in monetary targeting was well recognized, and it explained why explicit performance criteria had not been specified in most other money-based stabilization programs. At the time the monetary target had been set, the extent of the capital inflows had not been fully anticipated. Indeed, only recently had the Board recognized Belarus as the first among transition countries to have experienced such massive capital inflows. Nevertheless, faced with an obligation to maintain relatively high minimum deposit rates--also agreed with the staff--and no room to maneuver, the authorities had opted to stabilize the exchange rate, just as the Russian authorities had chosen to do. Hence, while he agreed that concerns for competitiveness had to be addressed primarily through structural adjustment, the Board also had to be mindful of when countries were being put in an impossible situation.

The Acting Chairman wondered whether a flexible exchange rate policy was necessarily to be preferred when market uncertainty about the equilibrium rate would more likely than not precipitate excessive currency fluctuation. Fixing the exchange rate helped anchor market expectations, as Russia's experience thus far illustrated.

Mr. Esdar agreed that it was difficult to determine the appropriate exchange rate in the early stages of transition to a market economy, and that the market had to make certain assumptions before convergence could occur. Opting for monetary stabilization required specifying the appropriate money aggregate and the circumstances under which that base would be adjusted, the latter decision being independent of the choice of exchange rate policy. The other approach was to use an exchange rate anchor and to allow the money supply and interest rates to adjust. While that strategy might prove successful in the initial stages of stabilization, for reasons already explained, the sustainability of the exchange rate target would come under question in the face of capital inflows. That would be particularly true if the exchange rate policy were used as a political instrument. The experience of many countries suggested that finding a suitable exit strategy at that point could prove difficult. Hence, his chair was reluctant to advise that an exchange rate objective be pursued.

Mr. Tulin stated that he shared Mr. Kiekens's reservations about the appropriateness of specifying a base money performance criterion in the case of Belarus.

The staff representative from the European II Department clarified that the authorities had never told the staff that they wished to adhere to a fixed exchange rate, as reflected in the letter of intent. Also, capital inflows had already become apparent at the time the January program had been approved. In fact, the base money target had been proposed by the staff at that time precisely because of the risk to inflation that overperformance of net international reserves would pose.

Turning to enterprise reform, the staff representative noted that substantial accumulation of interenterprise arrears in the second half of 1994 had since leveled off in real terms, and the latest data suggested no increase in arrears between June and July. In addition, the authorities had called for a halt to the practice of netting interenterprise obligations. In June, no more than Rbl 400 billion had been netted, while the stock of interenterprise arrears had stood at Rbl 14 trillion. Measures to strengthen the budget constraint on enterprises had been taken. The Council of Ministers had approved the new bankruptcy law, which was to receive final approval when the Parliament reconvened. A presidential decree had also been issued in early July which proposed to identify insolvent enterprises and specified plans to reorganize or liquidate them, to introduce new management in nonperforming enterprises, and to establish a committee that would initiate the bankruptcy proceedings. The authorities were discussing the possibility of an isolation program with the World Bank in the context of a structural adjustment loan. A similar program had been implemented in other transition countries.

Efforts to consolidate the banking sector were continuing, the staff representative said. The requirement that banks increase their capital base had already encouraged several mergers and had prompted closure of a number of banks that had been unable to meet the requirements.

The staff proposal to adjust administered housing and utility prices to levels that would allow up to 80 percent cost recovery by the end of the year was not a form of ex post price indexation, the staff representative pointed out, but was rather a subsidy reduction. As the removal of subsidies would cause hardship for certain households, the authorities were planning to implement a compensation scheme, based essentially on means testing. The staff had suggested a simpler method of targeting social benefits, and expected the compensation scheme to become operational before the heating season, when the first round of tariff increases would take place. Provision of Rbl 500 billion had been made in the budget for that initiative, which was within the range of staff estimates. Hence, social expenditures were not expected to sour. Also, although the bill collection rate had fallen as low as 50 percent from a level of 80-85 percent in 1995, it had more recently risen to 95 percent, as noted in the supplement to the staff paper. Hence, gas arrears had risen temporarily.

It was difficult to assess the power of the current Parliament, the staff representative said. Several elections had occurred in July, but the majority required to form a new government had not emerged. Hence, the previous Parliament was still in existence, but the legitimacy of its legislative authority had been challenged, including by the President. It was hoped that the new round of parliamentary elections scheduled in November would produce a working parliament.

The staff representative from the World Bank reported that the Government of Belarus appeared committed to accelerating privatization and enterprise reform. The Bank was in the process of discussing a structural adjustment loan with the authorities, and was preparing a private enterprise development loan. Some financing for technical assistance for enterprise restructuring would be provided through the structural adjustment loan; however, the specifics remained to be determined.

Mr. Kiekens made the following closing statement:

> The Belarussian authorities are most grateful to this Board for today's long awaited approval of their request for access to the Fund's resources under a stand-by arrangement. Today's Board decision not only provides Belarus with needed financial

resources, but even more important permits a qualitative change in Belarus' creditworthiness, thanks to the Fund's confirmation that the country is in the process of implementing a strong program which will bring new impetus to the process of financial stabilization and structural reform. It will also enhance institution building so essential for a well functioning market economy. All this will bolster the confidence of private investors, both domestic and foreign, of the financial markets, and of the Belarussian people generally. Finally, this stand-by arrangement also opens the door for an early, and I anticipate, successful completion of Belarus' on-going loan negotiations with the World Bank. There is no doubt that the World Bank's programs will be most helpful in furthering Belarussian structural reform. In this connection, we heard encouraging information from the World Bank representative today.

As many Directors have stressed, the Belarussian authorities will continue to face difficult tasks for the foreseeable future. The best way for Belarus to maintain and increase its credibility is to forcefully and steadily implement the program, which includes most importantly systemic reforms but also calls for maintaining the monetary, exchange rate, and fiscal policies required to reach the ambitious target of a 1 percent monthly inflation rate by the end of the year. All this must lead to a viable balance of payments position in the medium term.

In this climate of increased macroeconomic stability and intensification of the structural reform process, domestic savings and investment should rise and enable output growth to become self-sustaining.

The authorities have courageously implemented the agreed increase in prices for basic products and services such as bread, milk, heating, and electricity. It is now important to keep the population from accumulating large payments arrears to the utility enterprises, since this could force the latter to default on their external payment obligations. The Belarussian government should therefore continue to pay close attention not only to imposing financial discipline on both enterprises and households, but to speeding up the establishment of a well designed and accurately targeted social safety net. The staff just pointed out that progress toward redesigning the social safety net will be one of the major subjects of the first review of this program.

The most important message of this Board is the need for Belarus to continue vigorously to implement structural reform, in particular privatization of enterprises, land, and housing; to put the banking sector on a sound footing; and to maintain financial discipline in general. Directors rightly pointed to the high cost of delaying these needed reforms and the risk of building up inter-enterprise arrears, budgetary arrears, and finally, external arrears. Without those reforms, the Government's good performance on the fiscal side risks deteriorating in the future. The Government, for good reasons, is concerned about the competitiveness of the Belarussian export sector. The single most important strategy for improving productivity and hence competitiveness is enterprise reform.

An important part of today's discussion concerned exchange rate and monetary policy. Several Directors pointed out the incompatibility between targeting monetary aggregates on the one hand, and on the other an exchange rate policy aimed at holding the nominal exchange rate more or less stable, or at least preventing it from appreciating, given the already very substantial appreciation of the currency in real terms due to the inflation differentials with Western countries. There is certainly more than one combination of monetary and exchange rate policies which will be effective in lowering inflation: the essence of today's debate on this subject was to point out the pros and cons of monetary based versus exchange rate based stabilization. In other words, should the central bank let the exchange rate float while stabilizing the monetary aggregates, or stabilize the exchange rate and let interest rates and monetary aggregates adjust to it? I conclude from today's discussion that the picture is not clear-cut. The stabilization strategy by itself should not be an objective of the stand-by program. I am therefore confident that the authorities, in close consultation with the staff, will monitor whether their policies continue to be the most effective for reaching the program target of very low inflation. I wish, however, to point out that although suboptimal stabilization strategy will certainly have important costs, the cost of delays in structural reform will be substantially higher.

I will end with a personal note. With today's Board discussion, Belarus more or less says goodbye to two eminent advisors who have greatly assisted Belarus in making very considerable progress with economic stabilization and reform during the past year, and in developing today's stand-by program. I speak of Mr. Lorie, who has been the chief of the Fund's missions to Belarus since June 1994, and Mr. Middlekoop, who has been the Fund's resident representative in Minsk for the last three years.

Those among us who never have attended program discussions with countries in the earliest stages of transition can hardly imagine how demanding and complex a task this is for the staff. I wish to express, on behalf of my authorities, heartfelt gratitude for the professionalism and the determination with which Mr. Lorie, Mr. Middlekoop, and the other members of these missions have accomplished their difficult and delicate tasks.

The Acting Chairman made the following summing up:

Executive Directors were in broad agreement with the views expressed in the staff report and the supplement. They noted that significant progress in economic stabilization and reform had been made since the last Article IV consultation, and welcomed the efforts of the authorities to introduce a market economy in Belarus. Directors expressed satisfaction that Belarus was embarking on a comprehensive structural and economic adjustment program which, if consistently and effectively implemented, would lay a sound basis for the resumption of economic growth. That would also be necessary to attract adequate external financing to cover the sizable balance of payments gaps that were anticipated in the coming years.

Directors commended the authorities for reducing inflation in recent months, reflecting the generally tighter monetary and fiscal policies being pursued. They also commended the decisive measures taken by the authorities in the last few weeks to reduce the money base. The recent real appreciation of the rubel had broadly offset the previous depreciation, and Directors observed that continued firm implementation of the adjustment program and progress in reducing inflation could be expected to lead to further capital inflows. Several Directors observed that Belarus appeared to pursue an exchange rate target, while in the view of those Directors exchange rate flexibility was advisable. Moreover, the apparent inconsistency between simultaneous monetary and exchange rate targeting needed to be clarified.

Directors welcomed the steps taken by the National Bank of the Republic of Belarus to improve its ability to manage monetary policy, the planned greater reliance on market instruments in the conduct of monetary policy, as well as the further liberalization of the foreign exchange system. They underlined the key role of a tight credit policy for bringing inflation under control, and noted with satisfaction that interest rates had achieved positive levels in real terms. Several Directors expressed concern about the faster than expected broad and base money growth in July, noting, however, with satisfaction the recent corrective measures taken by the authorities to bring the monetary program back on track. They also stressed the need for the National Bank of the Republic of Belarus to remain vigilant to ensure that the program targets for end-September would be met, and, if necessary, to stand ready to take additional measures to foster the further reduction in inflation.

Directors commended the generally sound fiscal performance in Belarus in recent years due in part to the robust revenue performance. Directors noted that strict cash rationing and prioritization of expenditures had also contributed to the relatively low fiscal deficits. However, they stressed the need for improved cash management and readiness to effect the expenditure contingency under the program if necessary, while avoiding delays in payments for some expenditures. They welcomed the planned structural reforms in the fiscal area and urged the authorities to fully implement the Treasury as scheduled. Directors stressed the importance of imposing greater financial discipline on enterprises, including through the adoption and effective implementation of a revised bankruptcy law. The authorities were encouraged to ensure full payment of 1995 gas deliveries, and to continue constructive discussions with Russia on the settlement of the stock of gas arrears accumulated through 1994.

Directors expressed great concern about the slow progress in the implementation of structural reforms, particularly in the areas of agricultural and land reform and privatization. They welcomed the recent move to restart the privatization program, but emphasized that transformation into joint stock companies was only a first step, and that efforts to expand ownership by the private sector must be an important element of moving to a market economy.

It is expected that the next Article IV with Belarus will be held on the standard 12-month cycle.

The Executive Board took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision in concluding the 1995 Article XIV consultation with the Republic of Belarus, in the light of the 1995 Article IV consultation with the Republic of Belarus conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The Republic of Belarus maintains restrictions on payments and transfers for current international transactions, as described in EBS/95/128 and Supplement 1, in accordance with Article XIV, Section 2. The Fund encourages the Republic of Belarus to eliminate these measures as soon as its balance of payments position permits.

Decision No. 11065-(95/85), adopted
September 12, 1995

Stand-By Arrangement

1. The Republic of Belarus has requested a stand-by arrangement for a 12-month period in an amount equivalent to SDR 196.28 million.

2. The Fund approves the stand-by arrangement set forth in EBS/95/128, Supplement 2.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 11066-(95/85), adopted
September 12, 1995

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/95/84 (9/11/95) and EBM/95/85 (9/12/95).

3. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 94/60 are approved.

APPROVAL: March 25, 1997

REINHARD H. MUNZBERG
Secretary