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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 94/34

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Contents

| | |
|---|---------|
| Attendance | Page 1 |
| 1. Staff Compensation - 1994 Review | Page 3 |
| 2. External Financing Requirements of Transition Economies and Possible Sources of Financing | Page 3 |
| Decisions Taken Since Previous Board Meeting | |
| 3. Eritrea - Membership - Governors' Vote | Page 54 |
| 4. Operational Budget for March-May 1994 - Amendment | Page 55 |
| 5. Executive Board Committees - Nominations | Page 55 |
| 6. Pension Committee - Nomination | Page 55 |
| 7. Approval of Minutes | Page 56 |
| 8. Executive Board Travel | Page 56 |

Executive Board Attendance

M. Camdessus, Chairman

Executive Directors

M. Al-Jasser

J. Bergo
H. Evans
H. Fukui
K. P. Geethakrishnan

D. Kaeser
A. Kafka
K. G. Kagalovsky
W. Kiekens

G. Lanciotti
K. Lissakers

A. Mirakhor
L. J. Mwananshiku
G. A. Posthumus

S. Schoenberg

D. E. Smee

Alternate Executive Directors

A. A. Al-Tuwaijri
M. Sirat

T. Fukuyama
L. E. N. Fernando
Hon C.-W., Temporary
K. Link
A. Calderón
E. Kouprianova, Temporary
J. Prader
J. Jonáš, Temporary
N. Coumbis
B. S. Newman
P. A. Merino, Temporary
J. M. Burdiel, Temporary
M. Daïri
B. S. Dlamini
O. Havrylyshyn
B. A. Sarr, Temporary
E. Wagenhoefer
Y. Y. Mohammed
S. Rouai, Temporary

A. M. Tetangco, Jr.
S. C. McDougall, Temporary
Wei B.
A. F. Jiménez de Lucio

L. Van Houtven, Secretary and Counsellor
L. Collier, Assistant

Also Present

IBRD: A. H. Gelb, Policy Research Department. Staff Association Committee: L. U. Ecevit, Chairman; J. M. Boyd, A.-M. Gulde-Wolfe, D. V. Kar, F. J. Rozwadowski, L. J. Unterholzner, K. Yao. Administration Department: G. F. Rea, Director; H. J. Struckmeyer, Deputy Director; D. A. Anderson, A. D. Goltz, J. P. Kennedy, C. C. Loureiro, R. Ramaciotti. Central Asia Department: O. J. Evans, Y. Horiguchi. European I Department: M. Russo, Director; G. Bélanger, S. S. Brown, A. Chopra, C. Christofides, L. P. Ebrill, S. Kalra, T. Krueger, J. Odenius. European II Department: E. Brau, Deputy Director; E. Hernández-Catá, Deputy Director; J. Anderson, D. A. Citrin, P. C. Hole, V. R. Koen, T. A. Wolf. External Relations Department: J. Morrison, H. P. Puentes, R. W. Russell. Legal Department: W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; J. L. Hagan, Jr. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; M. Allen, D. J. Andrews, D. Burton, S. V. Dunaway, H. M. Flickenschild, M. G. Gilman, N. L. Happe, M. G. Kuhn, A. K. McGuirk. Research Department: M. Mussa, Economic Counsellor and Director; F. Larsen. Secretary's Department: J. W. Lang, Deputy Secretary; A. Leipold, A. Mountford. Southeast Asia and Pacific Department: I. Kim. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; E. Decarli, D. Gupta, O. Roncesvalles. Office of the Managing Director: G. R. Saunders, Personal Assistant; J. Prust, L. Wolfe. Advisors to Executive Directors: J. M. Abbott, R. F. Cippa, A. Cserés, S. K. Fayyad, T. K. Gaspard, J. Jamnik, M. F. Melhem, T. Oya, A. Raza, N. Toé, J. W. van der Kaaij. Assistants to Executive Directors: R. N. A. Ally, D. A. Barr, J. A. Costa, D. Desruelle, G. El-Masry, R. Ferrillo, A. Galicia, C. Gaseltine, M. Giulimondi, N. P. Hahnemann, O. Himani, G. H. Huisman, T. Isataev, K. J. Langdon, B. M. Lvin, G. J. Matthews, F. Moss, C. F. Pillath, N. Prasad, S. K. Regmi, M. Ryan, A. Viirg, R. von Kleist, Wang Y., J. B. Wire.

1. STAFF COMPENSATION - 1994 REVIEW

The Executive Directors, meeting in restricted session, considered a staff paper on the 1994 staff compensation review (EBAP/94/19, 3/21/94).

The Directors endorsed management's recommendations.^{1/}

2. EXTERNAL FINANCING REQUIREMENTS OF TRANSITION ECONOMIES AND POSSIBLE SOURCES OF FINANCING

The Executive Directors considered a statement by the Managing Director on external financing requirements of transition economies and possible sources of financing (EBD/94/63, 4/8/94).

Mr. Kiekens made the following statement:

Let me begin with a warning about the historical data in Table 1 of the Managing Director's statement on financing flows to transition countries. The statement already notes that the need for external resources depends on the size and nature of the initial shocks and on the transition path followed by each country. The situation of other countries covered in Table 1 is quite different from, say, that of Cambodia: in 1993, the first year it is included in the table, Cambodia had little in common with Czechoslovakia in 1991 or Lithuania and Russia in 1992. Also, simply adding up the absolute ex ante financing needs of all these transition countries without trying to make the numbers more comparable will only invite confusion.

Contrary to the statement's conclusion that actual financing fell short of the assumptions by an average of 15 percent or so, a more careful reading suggests that shortfalls really occurred only in 1991 and 1993. The causes of shortfalls may as easily be related generally to the countries sampled in a given year, and particularly to the starting positions of each country sampled in that year. Moreover, the success or failure of a country's adjustment program during a given year will affect the amounts of financing actually obtained in that year. For all these reasons, differences between the financing requirement calculated ex ante and the actual financing calculated ex post are hard to interpret. Still on the table, I would like to point out a further source of confusion: on page 3 we find that if structural transformation is taking place "more gradually...smaller amounts of assistance may be required, but spread out over a much longer period of time." It is worth adding that overall, a more gradual transformation is

^{1/} The decision was subsequently circulated for lapse of time consideration in EBAP/94/19, Supplement 1 (4/13/94).

likely to require more external financing than a rapid transformation.

Turning to Table 2, I find it hard to understand why Russia's financing requirement should be three times that of all the other countries of the former Soviet Union (FSU) and would certainly appreciate any clarification from the staff. As the statement provides no data on Russia's balance of payments outlook, I had only the balance of payments outlook for the other FSU countries. But I recall that a staff paper prepared for the last Interim Committee meeting contained information on the decrease in official transfers from Russia and the terms of trade deterioration for other FSU countries owing to the move to world prices of Russia's energy exports. Both these developments were then expected to do considerable damage to the current account outlook of the FSU countries outside Russia.

The total financing requirement of \$62 billion for all transition countries during the 1994-96 period, as shown in Table 2 of the statement, seems to be a reasonable estimate: after all, the 1993 financing requirement for transition countries with Fund-supported programs has already been estimated at \$61 billion. I cannot be certain that this figure represents the upper limit of the most reasonable estimate, but I have a better reason to believe in the realism of this estimate. The Managing Director's statement indicates that it is unlikely that all the transition countries will implement comprehensive reform programs at the same time, and thus also unlikely that more financing will be needed up front. I would stress that even in the unlikely event that all transition countries immediately take the road to reform, the total financing requirement might be even less than \$62 billion. Under a simultaneous reform scenario, all programs would reinforce one another, creating positive rather than negative external effects, larger efficiency gains, greater increases in domestic savings and investment, and thus smaller needs for external financing.

But let me leave this Utopia and turn to the practical issue of financing sources, with particular attention to the additional mechanisms you propose. Clearly, a regular SDR allocation of reasonable proportions would do little to build up the reserves of the transition countries. This chair has described the advantages of a mechanism for retransferring allocated SDRs so many times that I need not do so today, and all the less so since we will have a further discussion on the SDR next week.

A larger involvement of the Fund's own resources confronts us with the question of additional risks to the Fund. I admit that I did not quite understand how activating the General Arrangements to Borrow (GAB) to finance currency stabilization funds would

involve any additional risk to the Fund. I was unaware until now that currencies other than the ruble could be financed. More important, a currency stabilization fund is only useful when accompanied by a strong adjustment program carrying sufficient conditionality, and under these conditions it is not very risky. Generally speaking, higher access to Fund resources has always been an option as long as it is accompanied by a stronger program limiting any additional risk.

Therefore, additional financing can come from the Fund only if it carries stronger conditionality, otherwise it must come from other bilateral sources. Because bilateral assistance, unlike Fund-supported programs, involves a calculus that goes beyond purely economic elements, it is possible that less conditionality might be imposed. In other words, more bilateral assistance than Fund assistance can be provided, because the bilateral sources are presumably willing to assume more risk. I can see no particular advantage in linking Fund assistance to bilateral cofinancings through a cofinancing trust account if the bilateral assistance from creditor countries is not forthcoming in its own right. Assistance might be more readily obtained from creditor countries if they received an additional allocation of SDRs. Moreover, retransferring the proceeds of such an allocation to the Fund would certainly improve the safety and effectiveness of both the Fund's and the bilateral creditors' support to the transition countries. But we will revisit the issue of the cofinancing trust account and the SDR on April 18.

Mr. Dlamini made the following statement:

The Managing Director's statement is a useful contribution to the debate on the external financing needs of the economies in transition. We now have a medium-term scenario that leaves no doubt as to the magnitude of the task that the international community must face in supporting the reform process in these economies. This should make for a better appreciation of the problems facing these countries. Perhaps this approach could be used to highlight the financing requirements of other country groupings that face the difficult task of reforming their economies and laying the basis for sustained growth.

There is no question that the annual financing requirement of \$62 billion is quite substantial. The gap of \$61 billion a year for the period under consideration, assuming disbursements materialize as laid out in the statement, will still call for a significant effort from bilateral sources. I hope that the international community will rise to the occasion. However, I cannot help but wonder about the impact such a demand for additional resources would have on the provision of aid to the developing countries, especially the low-income countries that are

dependent on such assistance to be able to continue strengthening their adjustment effort. I recall the difficulty in raising resources for the extension of the enhanced structural adjustment facility (ESAF), which had to be scaled back because of fiscal consolidation efforts in potential contributor countries. I would like to be assured that we are not in a zero sum game where low-income and other developing countries would lose if there is success in mobilizing the additional resources needed to keep the programs of transition economies on track. I would appreciate the staff's comments.

With regard to SDR allocations, our position is well known. We favor an allocation and believe that broader systemic reasons justify a larger allocation than that mentioned in the statement. I would stress that the usefulness of a general allocation of SDRs goes beyond its impact on the reserve position of transition economies. Others in the Fund membership could benefit similarly, and the allocation question should be treated in a manner that fully takes into account the needs of those countries as well. As for access, the Fund should be prepared to increase its support for a member's program if that program is strong and the member has demonstrated a commitment to reform.

Mr. Fukui made the following statement:

At the outset I would like to make some general comments on the Managing Director's statement.

The statement addresses the issue of financing assistance to transition economies based on calculations of the possible size of their external financing requirements in the period 1994-96. I am not convinced that such calculations make much sense. I recall that the Fund once estimated the total size of the financing requirements of the FSU countries and a package of financial assistance was formulated based on that estimate. What was the result? Has the estimate had any visible impact on the implementation of financial assistance to those countries?

It would be risky and misleading to discuss the total size of financing needs with a view to encouraging bilateral assistance from donors. In addition, actual disbursement depends to a considerable extent on such factors, on the part of debtors, as the degree of progress toward economic reform and of cooperation with creditors. I am concerned that if the Fund were to estimate the total size of financing requirements at an early stage, and the estimate was misunderstood--that is, taken as a targeted amount to be provided--it could invite undue criticism that we were delayed or falling short in disbursements, regardless of the true reason. Indeed, this was experienced in the past.

It is also regrettable that we did not have sufficient time before the Board meeting to consider properly the Managing Director's statement. It is impossible to conduct a fruitful discussion without having had sufficient time to examine all the crucial issues. Therefore, it is difficult for us to support any proposal to include a summing up of this discussion, or any figures on future financing requirements, in the report to the Interim Committee. Instead, I suggest we provide a clear analysis of the past record of assistance to the transition economies--as in Table 1--pointing out the implications and guidelines to be drawn from it. Such an analysis can also give a good indication of the magnitude of financial assistance for the coming years. The analysis, and the implications that can be drawn from the table, could be a source of valuable information to the Interim Committee. It is also important to analyze the reasons for the differences between estimated figures in programs and actual figures.

In addition, I am not comfortable with the statement in terms of the Fund's role. I believe that the Fund's role with respect to financing requirements should be limited to working out a program and providing an estimate of the financing gaps during a program period. There is a limit to what the Fund can do; it should not go too far in securing assurances to fill financing gaps. I am particularly worried that the Managing Director's statement implies that creditor countries are expected to provide financing assurances based on figures that are subject to huge uncertainties in the future. I appreciate the catalytic role of the Fund, but the question of how to ensure financial assistance is a joint exercise for the international community as a whole, and the Fund should not place itself in a stronger or more responsible position.

Let me now turn to some specific comments on the statement.

First, from a technical point of view, I cannot understand how the staff could calculate the total possible size of financing requirements during 1994-96 given that some of the transition economies do not have a Fund-supported program and that significant uncertainties lie ahead. I know the staff has spent a lot of time and effort to produce these estimates, but unfortunately we do not understand how they can arrive at this kind of calculation. Although it is stated that "the aggregate financing requirements can be viewed at best as only broad orders of magnitude," it is also stated that "they were derived from country-by-country scenarios." It is not clear to me how the financing requirements during 1994-96 were calculated country by country for countries whose economic futures are totally unpredictable. The so-called basic scenarios for countries can hardly be a base for these calculations.

The statement includes a new proposal that in the event the Fund should provide additional access to the transition economies, creditor countries should consider giving concrete and specific financing assurances on extending formal guarantees in respect of repurchase obligations to the Fund. I cannot support the repurchase guarantee proposal for the following reasons. First, the liquidity ratio of the Fund is at an unprecedented high, and it is difficult to find a convincing reason to justify shifting the increased risk to creditor countries. Second, the risk assumed by the Fund is also shared by all member countries according to their quota share. The risk that is inherent in assistance to transition economies ought to be shared by the membership as a whole because transition to a market economy is a global phenomenon. Third, I do not believe that it is justifiable that risk sharing among members regarding assistance to transition economies should be treated differently from the ordinary burden sharing scheme regarding members in arrears if any. Fourth, and most important, it could weaken the momentum of the transition countries' reform efforts if creditor countries provided financial assurances for repurchases to the Fund.

Regarding the required resources in support of programs under the systemic transformation facility (STF), the paper states that "the continued efforts [of the Fund] will be crucial to help mobilize the required resources from bilateral sources...notably to generate the requisite support for its STF-supported programs." This statement seems to imply that sufficient financing assurances are required even in the case of the systemic transformation facility. However, I believe that it has been explicitly recognized in the discussion of the STF that for countries in the initial stages of systemic transformation, firm financing assurances are not necessarily required before approval of an STF arrangement because the estimation of a program's external financing needs is subject to a greater degree of uncertainty, and prompt Fund support may be particularly valuable for these countries. I support this principle and cannot support any proposal that would intend to change it, particularly with respect to the systemic transformation facility.

On the cofinancing trust account proposed by the Managing Director, I am not convinced of the advantages or the necessity of creditors contributing resources to a trust fund if the risks are borne solely by the bilateral donors. Separate bilateral assistance would achieve the same results and be much simpler. In addition, I am not comfortable with a discussion of an allocation of SDRs in the context of financing assurances.

Having said all this, I do not want to give the impression that creditors are not forthcoming with financial assistance. What was observed in the past was the opposite. For Viet Nam,

Cambodia, Mongolia, and the Baltic countries, support groups were quite active and quite successful; Mongolia, for example, received more than enough financial assistance. But for some of the Eastern European countries, performance was rather weak, and the financial commitment of donors was moderate. And in some cases, disbursement was delayed considerably because of the lack of response by recipient countries. To the best of my knowledge--and perhaps Mr. Jeffrey Sachs will not agree with me--there is no case where a lack of financial assistance was the main cause of a delay in reform. In this sense, what we need at the moment is assurance of reform rather than assurance of financing.

Mr. Schoenberg made the following statement:

We welcome this opportunity to conduct a discussion of the fundamental concepts of the external financing requirements of transition economies and the roles the Fund and other multilateral financial institution and bilateral donors could play in providing the necessary financing.

The statement of the Managing Director provides a good overview of the relevant questions in this regard, and is, therefore, a good starting point for further discussion. The time between the distribution of the paper and today's meeting, however, was too short to allow my authorities to thoroughly investigate the questions concerned. Therefore, this discussion can be only preliminary and--I wish to stress this point--cannot be used as a stepping stone to far-reaching conclusions, either in this Board or in the Interim Committee.

We will probably have to face the question of how best to meet the financing requirements of transition countries for some time to come. It is most important to note that the figures and magnitudes for the financing requirements are at present tentative, with, as the Managing Director states, wide margins of error. We can assume with some certainty that the marginal propensity to consume will remain comfortably above zero for any given country at any time. As domestic production possibilities will always be limited, the theoretical external financing need is infinite. However, viewed ex post, each country manages to maintain balance of payments equilibrium by definition every year. This gives a wide scope of possible ex ante financing gaps.

Particularly puzzling is the projected ongoing large need for substantial external financing along with an assumed continuation or even intensification of the reform process. The observation that the more rapidly structural transformation is taking place, the more external financing will be needed up front may be correct in many cases, but may not necessarily apply, as Mr. Kiekens observes, in the longer run, nor does it necessarily apply to

official financing, particularly if at the same time similar strong progress is being made in macroeconomic stabilization.

Without going into much detail, it suffices to say that some figures appear far too large, for example, the widening of the current account deficit from \$0.2 billion in 1993 to \$22 billion in 1994 for all transformation countries, or the \$18 billion in amortization payments to Russia for 1995. Other figures, especially private capital flows, seem much too small. In this respect, I quote the paper: "Despite considerable efforts of technical assistance, data remain poor in many countries; great uncertainty remains with respect to the technical and behavioral relationships underlying any projections because of the unprecedented scale of the transformation; and policies that would conform to the assumed programs remain unspecified in most of the countries, especially in the outer years." It would be most unfortunate, therefore, if these preliminary figures would prejudice an open discussion about legitimate financing needs.

The Managing Director has listed three options for meeting the financing requirements of resolutely reforming transition economies. The first is an SDR allocation. We still believe that only a global need for additional reserves merits an SDR allocation. This global need has not been demonstrated. We, therefore, reject the idea of allocating SDRs to help meet any specific financing needs.

The second is increased bilateral aid. Each and every donor country must examine its potential for providing financing to countries in need. Germany has stretched itself to the limit during the past few years. The European Union has also taken on more than its share in the EU/G-24 process. Additional bilateral financing will have to come from those countries that have not yet contributed their fair share.

As to the proposed establishment of a financing mechanism to which donor countries could contribute monetary resources for cofinancing of Fund-supported adjustment programs, we see little difference from the existing mechanism. Any risks shouldered by central banks in making part of their exchange reserves, for instance SDRs, available for cofinancing would be reflected in the respective national budget. Also, from the perspective of the central banks, it is questionable whether their claims arising from participation in cofinancing schemes would satisfy their requirements in terms of risks and liquidity of their exchange reserves.

The third is increased Fund financing. The question of whether the Fund can enlarge its financial support for countries in transition has to be examined thoroughly. However, the basic

relationship--namely, that increased Fund support relative to the member's quota must be matched by the increased quality of adjustment programs--has to remain unchanged. In addition, the Fund should concentrate on its traditional catalytic role, as private financing will have to assume greater importance. In any case, the Fund should not declare itself, a priori, ready to fill any expected balance of payments gap.

In sum, official bilateral and multilateral financing sources will remain limited in the future as they have been in the past. The countries in transition, in close cooperation with the Fund, will have to adapt their reform programs in such a way that the resulting financing needs are more likely to find the available resources. Like Mr. Fukui, I note that it is more important to create certainty about the reform process than about the financing. In this regard, may I remind the staff and fellow Directors of the huge internal adjustment efforts, as measured by the strong increase in domestic savings rates, of those countries of the CFA franc zone in Africa recently supported by this Board.

The Chairman pointed out that his statement provided only a framework for the discussion, not a forecast of the financing requirements of economies in transition or of the magnitude of Fund financing. He agreed wholeheartedly with speakers' comments on the need for assurance with respect to the implementation of reforms essential for economic success, but it was also useful to explore all possible avenues of financial assistance to transition economies, with a view to guiding the Fund's future activities.

Mr. Smee made the following statement:

Let me begin with a few general remarks. I have considerable difficulty with these accounting-type "gapology" exercises that set out numbers for external financing requirements. My problem is not with the staff, which has been careful to caution that the estimates are based on many assumptions with many caveats, the most important assumption being that strong adjustment programs underlie the analysis in the paper. But notwithstanding the best efforts of the staff and management, the numbers appear in the press, as they have for Russia, and the assumptions and caveats are conveniently forgotten or ignored by the press or the countries in transition. Then if the policy conditions for financing are not met and the financing is not disbursed, the West is blamed for not providing enough support for adjustment. At the same time, while creditor countries are presented with these estimates of the financing requirements of transition economies and requests for more money, some officials in the transition economies are asking for debt and debt-service reduction of existing loans.

It is not clear to me--like Mr. Schoenberg and Mr. Kiekens--what is endogenous or exogenous in this adjustment financing equation.

The staff has estimated one speed of adjustment that could be useful in considering the various implications of adjustment. However, donors and creditors also face constraints, like the countries that must undertake reform. Thus, there should be further iterations based on different levels of possible external financing and domestic adjustment. Presumably, stronger adjustment would lead to both less need for external financing and higher estimates for private capital inflows.

Again like Mr. Kiekens and Mr. Schoenberg, I am somewhat surprised at the paper's inference that the slower the adjustment, the less financing needed; somehow, strong adjustment called for more financing. It seems counterintuitive. On the sensitivity of estimates of financing requirements to increased adjustment, what, for example, would be the effect on the financing requirement if Russia were to reduce its budget deficit by 1 percent of GDP a year more than currently programmed?

The increased risk implied by the concentration of Fund lending to the transition economies is overstated. Lending to Latin American countries in the 1980s was also large, in both size and risk to the Fund. Taking risks of the size indicated is not unusual; this institution was set up to address such challenges. It is a public policy institution, not a commercial bank, and it is appropriate that we as an institution be involved in the transition economies.

I disagree that there has been a "large" shortfall of official financing in the past. Given that a number of programs were not implemented, my reading of the numbers leads me to conclude that official financing through debt relief and bilateral financing has been rather good under the circumstances. What we have experienced is a shortfall of policy implementation, for a range of reasons.

Experience with economic stabilization and reforms in Eastern Europe and the Baltic countries thus far suggests that countries that have made the most progress in terms of reducing macro-economic imbalances early and abruptly, and implementing structural reforms designed to increase productivity, have not faced external financing difficulties. Indeed, as the paper states, private capital flows have been larger than expected for many of these countries that have performed so well.

An SDR allocation is touted as one of three possible sources of augmented external assistance. As you are aware, we do not

support an SDR allocation, but even if we did, the amount that would be involved for these countries is small. At \$1 billion for the economies in transition, it does not begin to solve the financing problems facing the economies in transition.

Cofinancing trust accounts do not require an SDR allocation. However, financing through a cofinancing trust account would still have a budgetary implication in Canada, whether it involved SDRs or any other asset of the Government. But cofinancing trust accounts may be attractive in some instances, and the Fund may want to pursue this avenue.

The third suggestion, raising Fund access, is a possible route I have argued in the past. In the paper, average annual access for countries in transition is a conservative 40 percent of quota, or about \$6 billion on average a year. If countries were to implement stronger programs, access could be raised to 68 percent, or even higher under the exceptional circumstances clause, implying that the Fund's portion of external financing could increase to \$10 billion or more.

Finally, it would be inappropriate for creditor countries to provide formal guarantees to the Fund with respect to commitments to bilateral financing of programs. If the program is too weak for the Fund to support, the Fund should not lend any of its resources. A formal guarantee would distort the incentives to negotiate good programs.

The Chairman observed that even average access of 40 percent would require a quota increase in 1996-97. He wondered whether Mr. Smee would give favorable consideration to such an increase.

Mr. Smee responded that as a shareholder of the Fund, his chair would be ready to consider any changes in the Articles, Rules, or financing required to permit the Fund to fulfill its agreed role when the issues arose.

Mr. Posthumus commented that the remarks of Mr. Fukui, Mr. Schoenberg, and Mr. Smee inferred that external financing requirements were not a problem but were merely estimates, and meanwhile the key factors were, inter alia, stronger adjustment, debt rescheduling, private sector flows. He did not recall such comments being made during the past decade when financial and technical support for the developing countries had been discussed. While the countries in transition presented a very different case, there were also some similarities: over a period of five to ten years, there would be a huge need for external financing, however well those countries adjusted and reformed.

He agreed with the Managing Director's statement that, at the beginning of the process, strong adjustment might call for even more financial

support, Mr. Posthumus continued. Unlike his three colleagues, he could observe the experience of the transition economies in his own constituency: they had good programs and moderate external financing requirements, and yet had had inordinate difficulty in obtaining resources. He would, therefore, suggest that there was a problem, and it should be given the serious consideration it deserved.

Mr. Schoenberg explained that he would not wish to be misunderstood. He would not deny that there could exist a financing problem for the countries in transition, but he would point out that the figures presented in the Managing Director's statement were subject to a number of important assumptions. Therefore, there was a risk that those figures could give rise to premature expectations, particularly by the public, but also by the recipient countries. Moreover, depending on the assumptions applied, the figures could also lead to unclear expectations about the share of official, as opposed to private, financing. Of course, the flow of private resources would increase concurrent with indications of a firmer transformation process and stronger Fund-supported program.

Mr. Fukui said that he could agree that the huge financial needs over the coming years were difficult to quantify. At present, however, it was more important to determine how to facilitate the flow of financial assistance disbursed in conjunction with other donors, including some multilateral agencies. For example, the World Bank required observance of particular conditions before funds were disbursed, which could lead to delays under cofinancing facilities. The removal of such bottlenecks in the flow of disbursements should be discussed.

Mr. Smee observed that, indeed, there were difficulties related to the external financing requirements of the economies in transition, but the circumstances should be an incentive for those economies to work with the Fund to establish strong programs, and for other countries to ensure the programs' proper financing. His concerns were related to the benefit, or not, for the Fund of the present exercise, and to the risks involved.

Mr. Jiménez de Lucio made the following statement:

We welcome the statement by the Managing Director on the external financing requirements of transition economies. This is a subject of great interest and significance to the international financial community in general and the Fund in particular. Many of our recent Board discussions on policy and administrative issues have been directly or indirectly related to developments in the countries in transition. A definition of the Fund's likely future involvement in these countries is critical to any assessment, inter alia, of the institution's liquidity, access limits, precautionary balances, and burden sharing. More important, such definition bears directly on the preservation of the Fund's catalytic role, and thereby on the fundamental nature of this institution.

Before addressing the options for meeting the external financing requirements of transition economies, a few general comments on the elements for success of the transformation effort seem appropriate.

First, the key element for the success of the transformation effort is the authorities' commitment to the reform program and their ability to implement the same. Experience shows that without full commitment and implementation capability no program can succeed, regardless of the amount of external financing.

Second, the main source of funds for the adjustment program must be domestic savings, therefore, priority should be given to reforms and measures that promote savings.

Third, expectations must be aligned with reality. This applies to local populations, which must have a basic understanding of the likely costs and benefits of the reform program, which in turn requires that the costs of the program be fairly distributed and that effective priority be given to social safety nets to ensure popular support. The statement also applies to policymakers who must design programs consistent with the likely net inflow of foreign resources and not with any optimum or desired level. Likewise, the statement applies to the international financial community. Unrealistic expectations about the pace and results of the transformation efforts can only lead to disappointment and frustration, thereby making continued or additional support for such programs more difficult.

Fourth and last, the most effective form of external financing that industrial countries can provide is increased market access to exports from countries in transition. This form of support also has the advantage of immediately benefiting the consumers of importing countries.

Given the above elements for success, external financing can significantly facilitate the transformation process, so let us turn now to some specific comments on the external financing requirements of transition economies. The scenario presented in the Managing Director's statement estimates these requirements at \$62 billion a year for the 1994-96 period and provides an indication of the expected sources of financing. Without questioning the global estimate, which is subject to a large margin of error, we find broadly appropriate the relative contributions of the various sources envisaged in Table 2, although we would prefer to assign to the private sector an even greater share.

The private sector should be the main source of finance for transition economies for at least two reasons: its vast resource availability and its flexibility to mobilize large sums on short

notice; and its ability to evaluate the risks associated with such flows. Efforts must be made to make countries in transition increasingly attractive to private capital. Indeed, one key indicator of the success of an adjustment program is the resulting inflow of private capital.

With regard to the Fund's contribution to the external financing of countries in transition, we firmly believe that it must continue to play its traditional catalytic role. The figure advanced in the statement, \$6 billion or about 10 percent of the total projected demand, seems consistent with such a role. Moreover, we consider the Fund's contribution in helping design and implement comprehensive adjustment programs of the utmost importance. Only with such programs in place will the contributions from the other sources of finance materialize. This is precisely the catalytic nature of the Fund's involvement.

The large amount that is expected to be forthcoming from bilateral and unidentified sources is a valid reason for concern. There is a clear need for resources from bilateral providers, particularly during the initial stages of the transformation process. However, without the necessary political will it is unlikely that bilateral resources of the projected scale will be made available. In this connection, the suggestion of forming financing groups led by one country or group of countries with particular interest in a recipient country is worth exploring.

We share the Managing Director's assertion that the international financial community must stand ready to support each and every program worthy of its support. However, this must be a joint effort and each member of the community must play its proper role. Caution must be exercised in having one member of the community compensating for the shortfall in another's contribution. In the case of the Fund, the institution is already assuming an unusual amount of risk in connection with financing the transformation of the transition economies. Increased Fund financing should be contemplated only after thorough discussion of its advisability, the associated risks, and cost distribution, and after the appropriate safeguards are in place.

Finally, three comments on the alternatives proposed for increased Fund financing. First, an SDR allocation in the amount originally proposed by the Managing Director is warranted on its own merits. Its contribution to filling the gap, although small, is of course a welcome bonus. Second, existing annual access limits seem adequate, although an increase might eventually deserve discussion. Third, no mention is made of the possibility of selling gold. Has this alternative been explored?

In closing, this chair would like to state that it looks forward to Board discussion of comprehensive adjustment programs for each and every country in transition. We are confident that if the authorities persevere in the implementation of such programs, we will be discussing the problem of excess private capital inflows into these countries in the not too distant future.

Mr. Geethakrishnan made the following statement:

The Managing Director's statement brings to the fore three important points that merit serious consideration. First, there has been a major change in the traditional direction of the flow of the bulk of Fund credit--away from the African, Asian, and Latin American countries to the countries of the former Soviet Union, Eastern European countries, and countries in transition. Second, the sheer size of the projected Fund support to countries in transition at \$6 billion a year is about the same as the annual level of credit support now provided by the Fund to all the countries, including those in transition, in each of the past three or four years. The third point is the immense size of the overall credit support that these countries will require. At \$62 billion a year, however rough that figure may be, Fund support of \$6 billion a year, as large as it may seem by Fund standards, becomes only a very small part.

Each of these factors increases the risk to the Fund enormously. The vast pool of expertise the Fund staff has gathered over the decades is based mainly on the experience in extending support to countries in the three continents that I mentioned earlier. Our commitments will now be more to the countries in transition, and to coin an American phrase, it becomes a totally different ball game. We will be dealing more with countries with a history, however short it may be, of repeated rescheduling and use of arrears as a financing item. We will be shifting to a system where financing is front-loaded and where, even with resolute implementation, the scope for adjustment in the face of unanticipated external shocks will definitely be lower.

Moreover, a standard monetary approach emphasizes stabilization through financial tightening at the outset of the program with emphasis subsequently shifting to structural areas. The requirements of institution building, the provision of legal underpinnings for a market economy, and the structural reforms aimed at removing growth constraints are vital and early complements to macroeconomic policies in these countries. Thus, macroeconomic stabilization will be slower than we are accustomed to seeing in the programs outside this region.

Finally in this connection, the targets set for countries in transition are usually not as ambitious as the levels suggested for other countries.

Large as it may appear, the demand for Fund financing of about \$6 billion a year pales in significance when seen against the projected annual requirement of \$62 billion. In other words, for these countries to effectively restructure their economies, they need to be assured that the entire \$62 billion, without major shortfalls, will be available every year--not merely the Fund's contribution of \$6 billion.

The recent world economic outlook report highlights the commitment of \$38 billion, with rescheduling during the period of only \$17 billion. In such a situation, full disbursement by the Fund of its share does not necessarily help the country, but instead puts the repayment of Fund money in serious jeopardy. There is a need for greater coordination on the part of all sources of funds to ensure movement in tandem. The recent experience of others challenging the Fund to take the lead and then not following, often for reasons not related to sound economic policies, does not help.

For most countries assisted so far in Asia, Africa, and Latin America, the need for such extensive coordination was somewhat less, with the Fund and the Bank taking on the bulk of the large requirements. Thus, to ensure that the risk to the Fund is not increased, we have to look closely at all three areas, updating and reorienting our approach to the scope and modalities of Fund assistance, and implementing a fail-safe coordination arrangement to ensure that when a package is agreed, all financial participants--official or private--will uphold their commitment.

The Managing Director's suggestion to assign lead roles to a group of donor countries is welcome and could, in fact, work well. We cannot afford to start with large uncommitted financing gaps, as shown in the Managing Director's statement. Although at present it is not easy to arrive at definite figures, even a guesstimate cannot afford to suggest a large gap.

Incidentally, with the EBRD having a specific mandate to support countries in the region, and the World Bank a mandate to support structural adjustments and development projects in various sectors, it is not clear why their commitments are the same as that of the Fund. The EBRD and IBRD are not constrained by access policies or liquidity considerations like the Fund. Also, these institutions have an established policy of provisioning against loan losses that are charged against income. I would have expected their support of these programs to be at least double that of the Fund's.

Similarly, bilateral support could be considered understated if the unidentified sources, perhaps a euphemism for gap, account for the bulk of the \$16 billion projected for this category. Thus, while we need to consider all the options listed in the statement, such as increased access and SDR allocations, we must also address the basic issues I have described so as to ensure that the Fund's future is not jeopardized. A full-scale discussion of these issues, after the usual three-week period to allow all chairs time to benefit from consultations with their authorities, would be fruitful.

Mr. Sirat made the following statement:

During the past few years, the international financial community has progressively moved away from the optimistic perception that it was possible to implement a "quick fix" in the transition economies. In fact, the past years have shown that sustained high levels of external financing are required to support strong, difficult adjustment programs. The Managing Director's statement provides illustrative figures on the magnitude of the amounts required.

The task ahead is not unprecedented. The present situation has aspects similar to that of the debt crisis at the beginning of the 1980s: the countries are primarily concentrated geographically; the amounts concerned are very large; and a cooperative strategy affecting all actors of the international community is called for.

But the existing mechanisms of external support that have been developed and used to solve this crisis have now somehow reached their limit. This is true, first, as regards budgetary support from bilateral donors. At a time of tight fiscal constraints in nearly all industrial countries, sustained higher budgetary support is not in the picture, particularly in view of the needs of other regions of the world. This naturally entails consequences for burden sharing among creditors--as illustrated by the recent debate on burden sharing within the Group of 24--which, in any case, was a temporary expedient and not a permanent tool. Moreover, the impact of tighter national fiscal constraints logically falls both on direct national contributions and on contributions through regional arrangements.

Debt rescheduling can play, and indeed has played, a role, but this role would necessarily be limited, first, geographically, as some of the transition economies--particularly the countries of the former Soviet Union, excluding Russia--have a very limited external debt, and second, temporarily, as post-cutoff-date debt, nonreschedulable by nature, is bound to expand.

Export credits, although useful, have also proved to entail their own financial limits: directly, because of potential losses of export credit agencies calling for budgetary support; and indirectly, as all agencies apply simultaneously similar and in some cases short-term repayment conditions, possibly leading to acute financial difficulties further down the road.

Finally in this connection, because of the history of the debt crisis it has proved difficult to return rapidly private financing back to countries suffering from balance of payments difficulties and a perceived climate of uncertainty. Because of this difficulty, in recent years the issue of risk sharing with the private sector through the development of escrow accounts has emerged with potential negative systemic risks.

Therefore, while the situation we are facing in the transition economies is not unprecedented, we cannot rely only on the means used to solve the debt crisis of the 1980s. Even if the financing needed was not larger, we would face difficulties. But such an hypothesis is not relevant for two reasons. First, we have to be ready to face a period of larger global financing requirements because we have to assume that most, if not all, transition economies will move toward reforms. Second, for a given country, it is possible to mechanically reduce the financing gap through a tighter limit on imports. Such a solution was mentioned by the management of the World Bank a few days ago when the country assistance strategy for Romania was discussed. But such an approach would not seem realistic or sustainable if implemented globally in all countries concerned. Moreover, the transition economies face a specific situation where structural and microeconomic reforms are needed for overall macroeconomic stabilization. These structural reforms are more difficult to implement in a context of a tighter limit on imports both directly, because such a cap would limit the availability of new machinery and investment goods; and indirectly, because of the greater difficulty of restructuring the industrial sector considering the sharp fall in output and no effective social safety net.

Thus, if I note, as did other speakers, the unavoidable uncertainties of the figures, I doubt that the magnitude mentioned could be--or should be--substantially changed. The magnitude cited is striking. Projected financing gaps are on average 100 percent higher than the average over the past four years, and the portion expected from bilateral sources, namely, the residual after taking into account the theoretical possibility of other sources of financing, is also 100 percent higher than the amount granted over the same period.

The question put forward in the Managing Director's statement is how to meet these larger requirements. Clearly, a situation is envisaged where higher financing would be directly linked to stronger reform programs. I am not sure one should enter into a "chicken and egg" debate on the relationship between reforms and financing. We must look at the correct perspective of reform, as conditionality has always been and legitimately remains the cornerstone of Fund activity.

I would like to elaborate on the three main options for increased financing for countries in transition: larger disbursements from multilateral development banks; higher access to the Fund's general resources; and an SDR allocation. But I would first mention that it would not be reasonable to expect private financing to expand substantially and rapidly so as to make up for any shortfalls from bilateral sources. Private financing will not flow until strong and sustained reforms have produced significant economic results. I cannot share Mr. Schoenberg's and Mr. Jiménez de Lucio's optimism in this regard.

Naturally, there will be a differentiation among the different countries concerned. As illustrated in Table 2, private financing could well play a major role in Central European economies--covering more than half of the financing needs--but this is not the case in the countries of the former Soviet Union, where it is expected to cover only one eighth of the financing needs. Indeed, trying to artificially foster private financing through the development of escrow accounts, leading to a "breaking up" of the balance of payments of the country concerned, would entail a significant risk to the status of the Fund, even with less involvement.

I consider the case for higher lending by multilateral development banks to be strong and obvious. It may be that, in the initial period of transition, by the nature of their actions, development institutions took longer to identify programs and projects for financing. But now we can presume that the preparatory work has been done, the pipeline of projects has been fed, and the programs of structural adjustment have been defined. Consequently, the disbursement of development assistance should now significantly increase, as more and more countries come under Fund programs. The order of magnitude cited seems reasonable, but clearly implies a significant takeoff.

I have some sympathy for the case for higher access to the general resources of the Fund in conjunction with strong programs of reform. We obviously need instruments that can deliver the flow of financing necessary to support ambitious programs. A higher access limit could have a significant impact; for example, every 10 percent increase in access could add approximately

\$800 million of financing to Belarus, Russia, and Ukraine and \$600 million to all the countries of Eastern Europe.

Higher access for strong programs is one answer. However, for at least two reasons, it cannot be the answer. First, the question is how high is enough? The combination of large financing needs and much reduced flexibility in bilateral balance of payments financing means that, if we rely too much on higher access, we will be forced to set the theoretical limit on annual and cumulative access very high. Then this Board will be faced with a new and thorny equity issue related to the actual level of access that will be allowed in each program. What criteria will justify the use in some cases, but not in others, of the large increase in access limits? Certainly, we cannot do so purely on a geographical basis. The strength of a program is obviously a theoretical answer, but the higher the access limit, the more difficult it would be to use this criterion equitably.

There is also the important issue of "composition" of financing. Higher access cannot be a substitute for bilateral financing, because if the Fund acts alone, without the clear and demonstrated support of members, confidence in its action is reduced, as is the credibility of the programs it supports; and also, it would be contrary to the nature of the preferred creditor status of the Fund, as "preferred" would not have much meaning if the Fund were the major creditor above a reasonable limit. In the period ahead, it is of the utmost necessity to protect the preferred creditor status of the Fund, which is its best protection against emerging arrears. This status has been granted by a consensus of the international financial community and is enforced by its actions. We cannot move access to such a high level that it requires formal guarantees from members as envisaged in the statement.

On the allocation of SDRs, this chair expressed its views during the last debate on SDRs, and I will limit myself to a few comments. External financing has many potential applications: temporary fiscal imbalances, investment expenditures, essential imports, trade flows, reserves buildup, financial stabilization, reforms, and increased productive capacity, all of which are necessary. This is reflected in Fund-supported programs that contain external financing of the current account and increases in reserves. It is therefore appropriate that a variety of financing instruments be used, as proposed by the international financial community.

Within the global need for additional resources, the need for additional reserves is a specific one that could legitimately be filled through the use of SDRs, because it suits the monetary nature of the SDR. Such an instrument would allow for the

specialized specific use of all existing instruments where they hold a clear advantage.

Whether some form of SDR redistribution would be needed depends on the size of the allocation. Given the magnitude of the need to build up reserves, specifically in transition economies, a redistribution without allocation would not be arithmetically reasonable; an allocation without redistribution would be of a size that might not be justified on its own systemic merits. Therefore, it seems reasonable to consider both a new allocation and a redistribution, as well as a cofinancing mechanism specifically targeted to reserve building.

In any case, the implementation of monetary financing would clearly require that issues such as the associated risk and liquidity be settled, through some form of mutualization or other means yet to be defined. This matter will be considered further by the Board next week.

An allocation of SDRs and a partial subsequent use in cofinancing obviously increases the flexibility of the Fund to respond to the needs of the membership. Coupled with high access, implementation of this mechanism can give us confidence that this institution has the means to assist countries in transition in a timely and relevant manner.

After adjourning at 1:00 p.m., the meeting reconvened at 2:30 p.m.

Mr. Calderón made the following statement:

This chair agrees with the Managing Director in that we recognize the effort that some of the transition economies have made in reforming their economies and, also, that they still have a long way to go.

The statement foresees that the transition economies' annual financing requirements during 1994-96 will be \$62 billion. Of this amount, \$21 billion corresponds to current account deficits and \$26 billion to net capital outflows. The statement, however, identifies possible sources of financing: private, official, and multilateral. A \$16 billion deficit would remain, to be financed by bilateral and unidentified sources.

Our first question relates to the Fund's access and precautionary balance policies. Are they appropriate in view of the potential needs of transition economies and the Fund's role in helping to meet them? Particularly, I am sure that the phrase "potential need" must be interpreted subject to the "principle" enunciated in the second paragraph of the Managing Director's statement, that is, that "strong programs deserve substantial

financial support," when it is warranted by balance of payments needs.

The more difficult question is, why are the expected net capital outflows so large, even more so when the underlying assumption is that the reform process will continue and the countries will pursue realistic exchange and interest rate policies. It would be helpful if the staff could tell us what part of the capital outflows are expected to be outflows other than amortization.

We would hope that the different countries or institutions that expect repayments would maintain, if not increase, their financial exposure in the economies in transition. This would not only decrease the need for additional resources from the Fund, but also maintain the level of the region's debt risk.

However, current lenders could seek to decrease their financial exposure in the economies in transition, which implies that the market has a pessimistic view of the future of these countries. This event would increase the level of risk of the Fund's current exposure. Moreover, additional Fund financing would be needed and, consequently, the level of risk would increase in a more than proportional way.

Under these circumstances, any additional financing would be feasible only with added safeguards for the Fund--thought might even be given to the acceptance of collateral--and only for those countries that would undertake a more rapid structural transformation. The latter prerequisite would lead, in the medium term, to a more rapid decrease in the perceived level of risk for the country or region.

Finally, this chair has supported the proposed new allocation of SDRs. It would help, although on a small scale, finance the economies in transition. Moreover, in the event that a post-allocation voluntary mechanism is reached, this would achieve both the objectives of equity for new members and an additional source of financing.

Ms. Lissakers made the following statement:

Like other Directors, we share some of the concern about the nature of this exercise, and particularly the risk of falling into the trap of gapology. There is a certain artificiality to the exercise, and particularly to the assignment of specific roles, but in fairness to management and staff, we also recognize the caveat that this is an exercise, not a decision process per se. It might have been useful to link this discussion more directly to the policy discussion that we will be having next week--on the

Fund's experience related to the policies of the economies in transition--but, nevertheless, there is some value in airing both our views and our concerns.

Much of the attention this morning has focused on Table 2 and the projections for financing needs. It might also be useful to focus on Table 1 and on our experience with respect to the differences between the projections that had been made in the programs designed by the Fund and actual results. The aggregation in Table 1 unfortunately obscures much of the story, particularly the considerable differences between the experience in and patterns of financing needs of Central Europe on the one hand and the former Soviet Union on the other. By referring to the world economic outlook paper--particularly pages 74a, b, and c--one can see that much of the problem has been, and most likely will be, focused, in terms of large financing needs, on the former Soviet Union and much less on Central Europe: the growth pattern has been weaker; inflation has been worse; trade dislocation has been much deeper; and the monetary systemic dislocation has been far worse in the former Soviet Union.

It is also interesting to note that the total financing requirements were less than programmed, and of course the projected current account deficits were much smaller, which presumably is a result of the very weak growth, particularly again in the former Soviet Union. It would be useful to have access to the country-by-country scenarios mentioned on page 5 of the statement to help in the disaggregation process and perhaps give a somewhat clearer picture.

Several other speakers have noted the fact that official bilateral aid flowed pretty much as programmed and hoped for, and that private capital performed better--more flowed to these countries than had been anticipated. This is something to pay attention to when we project future financing needs: that it should be a central focus of the structural reform process to do everything possible to encourage private flows. The official financing burden, therefore, should be smaller. I wonder why, in Table 2, the 1994 figure for private direct investment is smaller than the 1993 actuality. It seems overly pessimistic, especially when the reform process, in Russia particularly, may just be deepening and strengthening, which should at least encourage more private flows to that country. This is true to some extent in other countries of the former Soviet Union as well.

We would also point to the shortfall--if you can call it that--on the multilateral development bank side. However difficult the environment, the delays in disbursements from the multilateral development banks are highly regrettable, and one hopes that they will be in a position now to substantially speed

up the disbursement of loans and the negotiation of new projects, so they can pick up a bigger share of the financing problems.

In Table 1, the biggest discrepancy between plans and actuality is the "Other capital" flows item--a large black hole that is not clearly defined. One assumes that much of it is old-fashioned capital flight, but it would be useful to have some clarification of the extent to which it is also made up of unanticipated amortizations, new arrears, or unrecorded trade. However, the bottom line is that when one tries to carry the experience found in Table 1 over to Table 2, the former Soviet Union--particularly Russia--appears to be the nub of the problem; the financing problems of Central Europe appear to be manageable. I do not mean to dismiss other countries of the former Soviet Union, they too, as we have seen already, will have sizable financing demands.

Table 2 lays out the staff's scenario, with which we do not entirely agree, and others have already taken issue with some of its features, most notably the fact that bilateral donors are expected to carry the bulk of the additional burden--\$43 billion out of \$71 billion--even after substantial bilateral debt relief in the order of \$13 billion. As a forecast, this seems most unlikely; and as implicit policy, it suggests a continued modest role for the Bank and the Fund at a time when we would argue that the conditions in these countries calls for a more substantial increase in the role and the risk-taking of the multilateral institutions. Both Mr. Posthumus and Mr. Sirat mentioned not only that we have large adjustment problems, but also that the nature of these adjustment problems suggests the need for something more than just a conventional approach. The projections in the scenario are that the Fund, which had provided about 9 percent of planned and actual financing in the 1993 period, would provide about 10 percent for all transition countries, and roughly 11 percent of total flows for the former Soviet Union/Russia in the 1994 period.

We believe that a strong case can be made for a larger and more flexible Fund response. Perhaps one way is through increased access. Fund liquidity, as noted by others, is at an all-time high--some \$70 billion, depending on how you compute the numbers--and substantial progress has been made in the Fund's ability to undertake risk compared with the situation in the 1980s; arrears are down, and precautionary balances are up. We also find the distinction between the risks borne by the Fund, as an institution, and its individual members somewhat artificial. The risks ultimately are borne by the members, collectively or individually. This institution, finally, is in the risk-taking business. As Mr. Smee said, it is not a commercial bank, it is here to deal with troubled situations. It seems somewhat odd to set up

separate facilities for dealing with problems, because it raises the question of what is left for the Fund proper to do? Rather than diminish the central role of the Fund, we would seek to increase the role of the Fund in this difficult situation.

With regard to the SDR, on which I will not comment at length as it will be discussed next week, we do not find a compelling argument for an overall large allocation of SDRs, certainly not on the grounds of global need; and the question of using an SDR allocation basically to finance a special facility raises some questions about the monetary character of the SDR. In short, there is a special problem here that is very much concentrated on the former Soviet Union. Some special measures are needed that we should think more about, and the Fund--all of us collectively but in the guise of this institution--should be prepared to take higher risks in order to support this difficult adjustment and transition period.

The Chairman said that Ms. Lissakers had addressed the key issues. He shared her view that the institution had been designed to take risks; it had done so appropriately in the past and was well equipped to continue doing so in the future. Thus, personally, he had no intellectual or ethical aversion to risk taking. But, as Managing Director and Chairman of the Board, he recalled that over the past ten years the Board had on many occasions considered the limitations of the Fund's ability to take risks--particularly in light of the arrears experience of the latter part of the 1980s. On those occasions he had been reminded that the Fund's role must remain catalytic, with Fund financing accounting for about 10 percent of the financing requirement of a given country. That had been, in fact, the average of the Fund's participation in the past, with perhaps some rare exceptions.

In addition, the Board was familiar with the difficulties in obtaining a quota increase, the Chairman said. For example, Mr. Smee had commented, with some nuance, that he could support a quota increase at the appropriate time; perhaps the rest of the membership held a similar view. Before proposing increased Fund participation in financing of transition economies, he would first wish to be assured explicitly that Directors' governments and parliaments would be ready to recognize the need for a quota increase by the end of 1996, with the aim of having it in place in 1997. While that readiness might be present, experience with past quota increases had indicated that a lack of a sense of urgency led to a lengthy process of approval.

As to the risk to the Fund as a monetary institution, Directors could reasonably argue that the Fund and its membership were one and the same, the Chairman continued. Nevertheless, the Fund was an instrument of the central banks of the world, which wanted the Fund to remain liquid, precluding the need for them to provision against claims on the Fund. He recalled his own reactions as a central banker in 1988, when, in discussing the arrears

situation, several central bankers had considered provisioning against the Fund, to the detriment of many important elements of the special relationship between the Fund and central banks. As a result, he and the staff had been very cautious with regard to the concentration of exposure in any part of the world; the proposed distribution of risk sharing with members was aimed at preserving the Fund's monetary position in the judgment of the central banks.

If the central banks argued for the Fund's taking on a greater exposure--to optimize the degree of reform in the countries--and consequently for a quota increase, the Fund would act accordingly, the Chairman observed. However, the risks were not insignificant--the situation was more unstable than that in Latin America in the 1980s--with the chance that one country falling into arrears could lead to a domino effect, regardless of the precautions put in place.

Ms. Lissakers commented that there was indeed a risk in doing more, but there was also a risk in not doing enough in a timely manner. As to the relationship between an increase in the Fund's exposure and the need for a quota increase, in the U.S. political context the third player was Congress. The previous Administration had successfully approached Congress for a 60 percent quota increase for the Fund, based on the argument that there was a need to provide significantly more resources to the former Soviet Union and Eastern Europe. To date, not enough of that quota increase had flowed out, and it would be difficult to return to Congress with information, first, on the resources that had been disbursed thus far by the multilateral institutions, and second, on the Fund's historically high liquidity position--as well as gold holdings of 100 million ounces at \$35 an ounce--and then argue that another quota increase was necessary. When exposure was larger, there would be a strong case for a quota increase, and the U.S. Administration might be prepared to support it; but at present, it was difficult, if not impossible, to make that case.

The Chairman explained that he had not suggested that there was a need for a quota increase at present. He was reassured by Ms. Lissakers' comments that tended to support his view that, if the Fund's liquidity position should reach a precarious level, a quota increase would be appropriate.

On the risk not only of doing too much but also of doing too little, he had in the past stated his position on the "risk of irrelevance," the Chairman recalled. Therefore, he suggested that the Board explore ways to do what was needed, and to do more, when appropriate. It was important in the context of risk-taking by the Fund and other multilateral organizations, as well as member countries, to ensure the credibility and certainty of such actions. For that reason, for example, instead of the Fund assuming exposure of about \$20 billion a year over three years, the institution could take on \$40 billion, and bilateral sources, \$20 billion. If, however, it was argued that the Fund should assume exposure of \$60 billion, then the central banks must be reassured by a reconfirmation of the Fund's status as

a preferred creditor and by an indication of readiness by the membership to replenish the capital of the Fund when required.

Ms. Lissakers remarked that projections for debt-reduction exercises suggested that bilateral creditors were not given preference over the Fund. Thus, increased bilateral exposure would not necessarily contribute to the security of the Fund's own exposure. In fact, when countries could not pay a debt, their bilateral loan portfolio was affected first. With regard to the liquidity ratio of the Fund, she would not want her comments regarding future support to be linked to a specific liquidity ratio. The soundness of the institution also depended on the state of the global economy and of the institution's individual members.

Mr. Schoenberg asked for further elaboration on the implicit rule for Fund participation of 10 percent of a country's financing requirement.

The Chairman replied that 10 percent represented the approximate order of magnitude of the contribution of the Fund to the financing requirement of countries deemed necessary for the Fund to play its catalytic role. Of course, that figure was a broad average, and the amount varied from case to case.

The Director of the Policy Development and Review Department added that 8-10 percent had been the average of resources programmed to be disbursed by the Fund relative to the ex-ante gross financing requirements of countries over the preceding decade, although no explicit guideline existed in that connection. He recalled that some five years previously, the Board, in discussing several programs, had considered that level of Fund contribution appropriate to the Fund's catalytic role; but the amount had not become a rule.

Mr. Posthumus made the following statement:

I welcome the Managing Director's bold statement on the external financing requirements of transition countries. It is helpful to have at least an indication of those requirements, which are substantial, and it is time to consider the increasing problems some countries in transition face in financing their Fund-supported adjustment and stabilization programs. Clearly, the financing requirements are much higher than expected, as indicated by the estimates provided. The transition process will take longer than many had expected, and accordingly this should have consequences for the financing by industrial countries, who must consider putting in place a budget for transition countries, similar to the industrial countries' budget for developing countries. Debt rescheduling, export credits, and private financing will not do the job alone.

At the same time, the countries in transition should speed up their reform process; those countries that have started the

reform process have shown that it is possible to attain favorable results in a reasonable period of time. After all, there is in place a large basis of infrastructure, knowledge, trained workers, and so forth; thus, a radical reform could take less than a decade to start growth.

I support the Managing Director's statement that "the Fund has always acted on the principle that strong programs deserve substantial financial support." If we continue to act on this principle, then there should be no "tension between increased lending to transition countries and increased risk to the Fund." Increased lending by the Fund means stronger programs, which limits our risk. It is not the conditions of the former Soviet Union that govern our support, but their policies. We must be cautious not to give the message to reformers that the Fund is prepared to relax conditionality or can be pushed to do so. I am concerned that we are confronted with demands that the Fund increase its financing, and even soften its conditionality. Usually this message comes in disguised forms: for example, because the Fund's liquidity position is very high there is no great worry about risks; or the industrial countries have budgetary problems and the Fund should take a larger share in financing the countries in transition, even without additional conditionality; or the Chairman could indicate that it might be necessary to consider increased Fund financing, if appropriate safeguards are given to the Fund through the extension of formal guarantees in respect to the timely discharge by the borrowing transition countries of their repurchase obligations to the Fund. This indicates a preparedness by the Fund to increase its financing without increasing its conditionality, thus incurring abnormally high risks.

This is not the way out. Any support to member countries, whether in transition or in difficulties, should remain within the Fund's financial capacity in the longer run. If stronger programs require and justify more financial support from the Fund, that support should be given in the framework of the Fund's access policy. The systemic transformation facility is an additional instrument that has been put in place. Members should be prepared to supply the Fund with the necessary means, in the form of a quota increase, if the liquidity position demands. The major countries, in particular, have previously allowed only limited quota increases, so that the Fund's liquidity has shrunk compared with the size of the world economy, and Fund quotas are relatively small; an increase in a few years would not be worrisome. However, we must not allow the Fund to be pushed into the position of just another source of balance of payments financing; conditionality to support stabilization and the restructuring of economies is the Fund's real task.

An SDR allocation, as we have discussed formally and informally, should not be part of the measures to finance the balance of payments requirements of countries in transition.

The question is how to improve the process of meeting the external financing requirements. International cooperation is required. It is suggested that the individual creditor countries should step forward to lead the resource mobilization for particular countries in transition. This may work in some cases, but not as a general solution; even Russia, where substantial foreign financing for a few years is obviously needed, seems problematic. I believe that the Managing Director should give a clear message to the members of the Interim Committee, stating that they will have to make room in their budgets for the countries in transition, and at the same time guaranteeing that the Fund will stick to its conditionality.

The Chairman said that those two points would indeed be part of his message to the Interim Committee. He wished to reassure Mr. Posthumus that he had not intended in his statement to hint at the possibility of any trade-off between conditionality and guarantees with respect to increased financing. Any matter giving rise to possible risk for the Fund would be discussed with the Fund's shareholders before undertaking any future activity.

Mr. Evans said that, like Mr. Fukui, he believed that the past deserved more attention than it had received. The evidence presented in the world economic outlook paper was somewhat more encouraging than might have been expected. In particular, following good programs and the return of confidence, flows of private capital had been encouraging--for example, in the cases of Estonia and Poland. The difficulties of the past few years had been--with one or two exceptions--related less to financing than to other aspects, particularly some policies.

As to the future, he had some reservations about the approach in the statement, which seemed to concentrate too much on total financing gaps for an inevitably disparate group of countries, with and without programs, Mr. Evans commented. A complementary approach to assessing those gaps would be a country-by-country presentation indicating the level of imports a country could afford with a realistic level of external support, and, if that were not enough, to urge policies that increased foreign exchange flows--say, by more exports, increased capital inflows, or less capital flight. His serious concerns about how the financing gaps were analyzed increased as the number of countries rose. The figures for 1994-96 seemed uncertain, with questions about capital flight, debt relief, private capital, and multilateral development banks--notably the extent to which the figures had been agreed with the institutions concerned.

On the sources of finance, an SDR allocation did not seem to play a large role, Mr. Evans remarked. Rather, he was attracted to conditional

assistance in a policy framework that was more likely to attract private investment. On the average Fund participation of 10 percent in the past, the desirable level of Fund involvement should depend on the specific characteristics of the external finance situation of countries, including the amount of debt stocks outstanding and the opportunity for debt relief. As several speakers had noted, of the so-called financing gap of \$186 billion that had to be closed, the Fund contribution was \$19 billion, or about 10 percent. He had some sympathy for those who considered that increasing access limits would be a good way to increase the Fund's financial involvement, both as a tangible contribution and as a signal.

The risks to the Fund could be minimized by keeping the use of Fund resources and strong conditionality closely linked, Mr. Evans continued. Perhaps greater use could be made of the exceptional circumstances clause, but guarantees were not the proper avenue. The Fund existed, as several speakers had said, to take risks and also, as a collective entity, to spread risk among the members of the Fund.

Like Mr. Fukui, he believed that the Managing Director's message to the Interim Committee should include more emphasis on past experience, Mr. Evans said. He was concerned that the statement unduly highlighted financing; the situation presented risks, opportunities, and challenges, and emphasizing certain figures on financing needs in the statement could lead to unwelcome references and citations outside the Fund.

He had sympathy for those who supported the Fund taking more risks through higher access--in the context of strong programs--rather than an unconditional allocation of SDRs, Mr. Evans noted. His authorities had always supported quota increases whenever they had been necessary, and he was confident that they would continue to do so in the future.

Mr. Sirat remarked that he agreed with Mr. Evans's comments on the limitations of assessing financing gaps; nevertheless, the magnitude of the problem, as mentioned by the Managing Director, was forcing Directors to face it. Budgetary constraints limited new loans, but also debt relief and conditional assistance. While an SDR allocation would not have a major impact on financing, Table 2 showed the magnitude of the need for reserves, in which an SDR allocation--with some form of redistribution--could play a major role.

Mr. Bergo made the following statement:

The Nordic-Baltic constituency considers the question of adequate financing of the economies in transition to be of great importance. The Managing Director's statement is most welcome and important in this context. In fact, in view of the importance of the subject, it would have been desirable to have had somewhat more time to digest the facts and ideas presented in the statement. However, this is not the final discussion on this subject, and the views of my authorities will probably evolve and mature in

the period ahead. In evaluating the financing need and the risk involved, one has to bear in mind that meeting the financing needs of the transition economies is not simply a matter of the welfare of the individual countries--it concerns to some extent world systemic stability. Estimation of a global need is subject to greater uncertainty than projections for individual countries in a generally stable world economy. The world economic system is more than simply the sum of its parts.

The global impact of the financing assistance provided to all countries may well exceed the sum of the impact on individual countries, evaluated in isolation. Here I agree with what Mr. Kiekens says on the positive external effect of mutually reinforcing programs. By the same token, generally insufficient provision of financing may have systemic consequences of global proportion that exceed what can be inferred from the evaluation of individual cases. It is also worth considering that there is not necessarily a symmetry between the consequences of providing too little financing and the consequences of providing slightly more than necessary. The potential adverse impact of providing too little can be much more serious.

It is against this background that this chair can lend its support to the effort of management to study how the provision of financing to the economies in transition can be enhanced.

In my view, one can draw the conclusion from recent experience that the type of assistance provided by the Fund in the past has served its purpose well. We are beginning to see the results in countries where the Fund's policy recommendations have been implemented. The main elements of this strategy, with strong conditionality and monitoring of the implementation, should be maintained. The Fund should continue to resist, so as to safeguard its role as a monetary institution, political pressure to unduly soften the conditions. It is also, in the longer view, in the interest of the recipient countries to adhere to strong programs and reforms, in order to avoid the risk of building up severe debt problems. Countries with a history of poor implementation should generally be required to demonstrate their commitment through prior actions, for instance, before the Fund provides further financing. One might also consider more frequent back-loading of disbursements.

A critical element that determines the need for official support is, and will be, the success in attracting private capital flows. How to encourage private flows must be an important part of future analysis and program formulation. Nevertheless, official flows will no doubt remain crucial for a number of years ahead. The discussion we have today on the sources and mechanism for official assistance is therefore particularly relevant.

The experience from programs supported by the systemic transformation facility points to the problems of securing additional financing from bilateral donors. Among countries with a "normal" STF-supported program, that is, when the first tranche is not received in conjunction with a stand-by arrangement, only two countries--Kazakhstan and Moldova--have received sufficient financing for the program period.

Concerning the Central and Eastern European countries, the present difficulties in securing support from donors within the G-24 industrial countries raises the need for better coordination of future financing from this mechanism. However, it should be pointed out that delays in disbursements, in our experience, are to a considerable degree due to administrative and other obstacles in the recipient countries.

In the countries of the former Soviet Union, the consultative groups have produced mixed results at best. It can be discussed to what extent the problems of securing financing are due to inadequate conditionality. Apparently "donor fatigue" has also been a strong factor. Furthermore, this problem may be more serious in the future, as new programs are negotiated with countries of the former Soviet Union.

A striking feature of the financing from bilateral donors is the large variety of forms of assistance, and the terms and conditions involved. In many cases, the forms of assistance seem more adapted to the domestic considerations of the donor than to the need of the recipient country. As a consequence, there have been instances when recipient countries have declared that they cannot or will not make full use of the assistance offered.

The countries in transition are confronting more complex problems than originally expected. This suggests that the systemic transformation facility should be continued for a limited time so that the countries that have been late in starting up can receive financial support in the period of building up the institutions appropriate to a market economy.

We agree that it is essential that adequate financing be available for those countries that adopt strong programs and demonstrate their determination to follow such policies, for example, through appropriate prior actions. However, the Fund has scarce resources. Substantial external assistance, particularly in the areas of infrastructure and institution-building, is assumed to be required for a long period to come. Such assistance can only be successful if appropriate stabilization measures will be taken simultaneously. The Fund cannot be expected to shoulder an excessive part of the financial burden of such assistance and other responsibilities. Thus, there is a need for the interna-

tional community, in particular the largest industrial countries, to formulate a comprehensive policy approach in this regard, and contribute financially. So, I can agree with what is pointed out on page 7 of the Managing Director's statement as regards the need for an enhanced lead role for the creditor countries themselves.

Considering the extensive financing need illustrated in the statement, I conclude that various financing mechanisms have to be pursued. My authorities will study the merits of all the options presented in the paper with an open mind. They will review ideas to increase Fund financing for those countries following stronger programs and undertaking more rapid structural transformation in a positive spirit. On the whole, I think they would agree very much with the statement of Mr. Posthumus today. This chair has previously stated its position on the SDR allocation, and new ideas, such as an allocation in conjunction with new mechanisms like the cofinancing trust accounts, will be considered carefully.

Mr. Kagalovsky made the following statement:

I welcome this opportunity to discuss the external financing requirements of transition economies and possible sources of financing. This is the right time to put this issue on the agenda.

It was a tremendous challenge for the Fund when the former command economies began their transition to the market. The first response to this challenge was the creation of a new facility--the systemic transformation facility. Nevertheless, a lot of questions about the Fund's policy toward the countries in transition, and the way in which the Fund can better assist those countries in their reform efforts, still remain. I look forward to the forthcoming discussion of these issues.

In the Managing Director's statement there is an impressive description of the acute shortage of the financing needed by the transition countries if they are to be successful in their reform efforts. What has become obvious is that the problem of financing is urgent and should be tackled. Certainly the figures presented in the Managing Director's statement are provisional. The staff, in concert with the authorities of the countries concerned, must work to improve them. My authorities suggest that the staff should discuss the medium-term balance of payments for Russia. I hope that the staff will finally take this suggestion seriously and will cooperate on this issue. Good medium-term balance of payments projections will, no doubt, contribute to a clarification of the financing requirements of transition countries.

There are several sources of official financing: bilateral credits, debt relief for those countries that have a huge external

debt, and financing from the international financial institutions. The first avenue is unconditional, and the second and third are usually based on conditionality, although there are some exceptions.

The Russian experience, and probably the experience of some other countries, shows that bilateral credits as a form of assistance are not very effective. The policy of my authorities now is to reduce considerably the amount of bilateral credits that Russia will take. We are convinced that to render the assistance to countries in transition effective, one should increase the amount of conditional aid and correspondingly decrease the amount of unconditional aid.

The most important--even crucial, at least for Russia--form of financing is debt relief. As we can see in the Managing Director's statement, pages 3 and 4, the main reason for net capital outflows from transition economies will be amortization--\$25 billion a year in 1994-96. My authorities hope that they will reach an understanding with creditor countries on this issue. A very important aspect of this issue is appropriate conditionality --a program agreed with the Fund as a condition for debt relief.

The table on page 6 of the statement shows debt-relief figures for all the countries in transition--Russia is shown separately--both private and official. Could the staff elaborate on these figures and the assumptions underlying them?

The other important question related to the financing needs of transition countries is their lack of access to world markets: trade versus aid as a source of financing. My authorities urge all countries to renounce their protectionist policies against transition economies and give them access to their markets. It will certainly reduce their financing needs and will benefit everybody.

On the financing requirements of transition countries and the role of the Fund, I agree with the Managing Director that an SDR allocation would obviously lower the financing requirements of transition countries, and I appreciate the intention of the management to use the SDR allocation to help the countries in transition in particular.

Of all the countries in transition, only one has participated in previous SDR allocations, and only in the second allocation. None of the other 22 countries in transition has ever participated in an SDR allocation. The complete and consistent resolution of the "equity problem" and the catch-up allocation of SDRs to those countries that had not participated in SDR allocations according to their share in the Fund's capital will decrease the

financing requirements of transition economies by more than SDR 1.5 billion--more precisely, SDR 1,650 million. The following general allocation will certainly produce an additional contribution to the transition countries--SDR 1 billion more.

I strongly support the proposal of the Managing Director "to examine the ways to involve the Fund's own resources more deeply in meeting the temporary financing needs of the transition economies." One solution could be an increase in access norms.

Incidentally, I would be delighted if the staff could elaborate on the figure of 40 percent of quota for the annual average access of the transition economies as a group. In particular, I would be interested to know how the assumed levels of access "generally reflect a pace of reform that would suggest the need for the Fund to remain engaged in the countries for a number of years."

This can be supplemented by more frequent use of several different Fund facilities. We already have some cases where countries in transition received stand-by arrangements and STF purchases. My authorities consider that several countries in transition can now have access to the compensatory and contingency financing facility, particularly those that had a tremendous deterioration in their terms of trade.

And finally, I find extremely interesting the Managing Director's proposal on the extension of formal guarantees by the creditor countries in respect of the timely discharge by borrowers of repurchase obligations to the Fund. In any case, if we create any additional mechanisms to improve the Fund's ability to help countries in transition, this mechanism should be universally available to all Fund members. That means that if this mechanism is applied today to the countries in transition, it should be applicable tomorrow, if necessary, to any other country or group of countries.

Mr. Wei made the following statement:

I would like to join previous speakers in welcoming your statement on the external financing needs of transition economies and the possible sources of financing. However, I find that the Board has been given too short notice to consider such important and complicated issues. Of course, I understand the difficulties the staff faces in providing as comprehensive a report as possible in such a short period of time, and I appreciate staff members' hard work and efficiency. However, the Board should be given sufficient time to consider the papers and consult with their authorities on such important policy issues so that the quality of our discussion is not jeopardized.

On the statement itself, I appreciate the strenuous efforts the authorities in transition countries have made in restructuring their economies. And it is encouraging that the trend of declining production has been arrested in some of these countries. In general, the Baltic and Central European countries are doing better than those with economies in transition. In this connection, we are pleased to note from the Managing Director's statement that the pledged support from the international community, even when it was subsequently not forthcoming, has contributed to the transformation effort. However, enormous difficulties remain in the period ahead. In this context, except for private direct investment, external financing has generally fallen short of expectations. To some extent, this was caused by slower than expected progress and some domestic policy slippages in the transition economies. But the transformation difficulties have, to a large extent, been underestimated. Despite high expectations, progress in transition--although remarkable in light of the difficulties--was considerably less fundamental and comprehensive. Continued external financing, especially official assistance, is important because such inflows demonstrate the international community's support for the authorities in transition economies.

The Fund has played an active role in support of reforms in these economies, in terms of both technical and financial assistance. The Fund has innovatively established the systemic transformation facility to serve the transition economies. Such active involvement has been well recognized by the Board and the international community at large. However, the Fund should play only a catalytic role in providing financial assistance. Too heavy a financial involvement in a small group of countries is not healthy in terms of risk management. In addition, the Fund still has other formidable tasks, inter alia, avenues have to be found to help low-income countries in Africa to break out of their economic plight; the experience of some Asian economies has to be taken seriously; and surveillance has to be strengthened with regard to the industrial countries and the international monetary system. Therefore, I hope that the Fund can balance its focus in order to meet the needs of its membership at large. In this connection, I share Mr. Dlamini's concerns that the financing needs of African countries should not be adversely affected when the issues related to finding solutions to the needs of transitional economies are being addressed.

A general allocation of SDRs is the most straightforward and helpful approach to meeting, in part, the needs of the transition economies by increasing their reserve positions without further financial exposure by the Fund.

With regard to increases in access limits, given the Fund's strong liquidity position, we have no objection to this way of

increasing the Fund's financial assistance to transition economies. However, we must bear in mind the principle of uniformity of treatment. If we grant such an increase to transitional economies, then other borrowers should be treated the same way.

In addition, I find cofinancing an enlightening idea for assisting transition economies in a cooperative way. Recently, when we discussed the liquidity issue, I raised the question of the impact on the Fund's liquidity ratio if we approve the cofinancing approach. The staff's comments would be appreciated.

All in all, we fully share the Managing Director's view that innovative financing mechanisms should be created so that the international community can respond flexibly and promptly to accommodate the financing needs of the transition countries that are in the process of implementing adjustment programs. Meanwhile, the importance of the cooperation of bilateral creditors cannot be overemphasized.

Mr. Kaeser made the following statement:

I would like to begin by commending the management and the staff for their forward-looking approach to the financing problems of the countries in transition. But unfortunately, like many previous speakers, I have to question the timing of our discussion and the tactic followed by the paper that we have before us.

Concerning the timing, it is regrettable that the document for this discussion, whose careful preparation would have required extensive consultations with our capitals, was issued only two working days before our meeting, and our authorities were therefore not in a position to react. It would have been particularly helpful for me to have their views on matters of concern to them, such as the strengthening and extension of the financial commitments to members under strong Fund-supported programs, or on the even more sensitive proposition of supplementing traditional financing assurances by the extension of formal guarantees in respect of the timely discharge by borrowers of repurchase obligations to the Fund. Like other colleagues, I would have preferred to address the future financing needs of the countries in transition after the evaluation of the Fund's strategy vis-à-vis those countries, including Russia. Therefore, today's discussion should retain the character of a very preliminary exchange of views.

As far as the tactic followed in the background paper is concerned, it is right to draw the attention of the international community to the financial requirements of the countries in

transition. However, I wonder whether we should maximize the amounts involved, with the risk of appearing unrealistic.

For instance, we know that there is practically no chance of having all countries in transition sticking to strong Fund-supported programs at the same time, in spite of the fact that this would be highly desirable.

Second, looking at the tables and drawing from the experience of other Fund measures, there should be no major problem for the category of "other countries" to cover their financing requirement. On the contrary, there is the risk that some of these countries will have to face excessive capital inflows. In this case, they would draw less than anticipated on the resources of the Fund.

Third, the financial requirement of Russia might be smaller than expected in the paper. Russia usually shows a great reluctance to borrow.

Concerning the options to be discussed, I do not think that at this stage the Fund should press to provide more than the customary 10 percent to cover the financial requirements of the countries in transition. By doing more, the Fund would release the pressure exerted on other multilateral and bilateral creditors to take a fair share of the burden. In other words, I prefer the first option, that is, stepped-up financing from both other multilateral creditors and bilateral providers of finance, with the Fund playing its catalytic role by imposing the appropriate conditionality.

An SDR allocation does not represent an alternative, as this chair supports it anyway. In the size contemplated, it would contribute to a small but welcome increase in reserves.

Finally, let me suggest that if the Fund--after generous lending to the countries in transition--were facing arrears on the part of some of them, it would prove almost impossible to pass a new quota increase.

Mr. Tetangco made the following statement:

The Managing Director's statement reminds us of the large external financing requirements of transition economies. One can argue about the figures presented, particularly relative to the kind of assessment of the likely path of reform efforts, but the scenario does serve to highlight the magnitudes involved.

The amounts involved continue to be large, but we believe that they can be managed largely within the existing framework for providing multilateral and bilateral financial assistance.

As emphasized by previous speakers, the key to making a successful transition from a command economy to one based on the market is wide-ranging and far-reaching economic reform. If sufficiently comprehensive reform measures are in place, then the international community should respond with debt relief, direct credit assistance, and private capital inflows.

Consultative or support groups headed by a country or group of countries with a strong interest in the recipient country may help in catalyzing the needed support. If assistance is not forthcoming in "sufficient" quantities, then perhaps it is a signal that the international community does not believe that the proposed reforms are sufficiently strong or that some doubt exists about the authorities' commitment to reform.

From the Fund's viewpoint, the priority should be to help ensure that appropriate programs of reform are being followed--and in that regard we look forward to the forthcoming discussion on the Fund's experience with economies in transition. Of course, the Fund has an important role to play in providing limited amounts of financial assistance. The level of that assistance should continue to be based on the strength of reform programs. To date, it has generally been the strength of programs, not access limits, that has been the limiting factor.

I agree with Mr. Posthumus and Mr. Evans that the risks to the Fund of increased lending to countries in transition, including through a possible increase in access, could be expected to be balanced by the higher level of conditionality attached to that lending. However, this is something that could be considered in our regular reviews of the Fund's liquidity position and the adequacy of its precautionary balances.

Mr. Lanciotti made the following statement:

The first comment I would like to make on your statement, echoing Mr. Posthumus and Mr. Bergo, is that the time is indeed ripe to start the exercise of seeking a comprehensive and innovative approach to address the issue of the financing needs of Central and Eastern European, or the European transition, economies. Of course, the complexities of the exercise and its tentative nature have made today's discussion difficult and preliminary. The issue of an integrated strategy is thought-provoking and stimulates a number of questions.

Assumptions underlying the proposed scenario can only be provisional and uncertain, owing to the scarcity of available economic data and the uncertainty inherent in the policies to be undertaken by the countries concerned. In this respect, I share the point made by Mr. Schoenberg. Yet, some qualifications are necessary even at this early stage of the discussion to enable us to elaborate on concrete prospects; I will mention some of them.

Regarding the order of magnitude of the overall financial requirements, a provisional yearly breakdown by country for the three-year period 1994-96 would be necessary as soon as possible, with a tentative indication of the Fund's arrangements to be negotiated. Obviously, the principal entry in Table 1 of the document, as pointed out by other Directors, is net capital outflows data, especially on an annual basis.

Moreover, it is unclear to what extent larger than envisaged imports involved in ambitious reform programs would affect the preliminary figures for financing requirements. In fact, the paper by the Managing Director indicates possible additional support implied by a sound policy program that could substantially increase the requirements of the illustrative scenario.

In addition, it must be underscored that the staff's projections on the lending policies of the multilateral development banks appear to be particularly weak, insofar as they are not at least preliminarily reviewed with the multilateral agencies concerned. Some comments on additional requirements deriving from slower than expected lending procedures by the development banks would be appreciated.

Concerning possible sources of financing, some elucidation would be needed about the nature of securitized lending, which the Managing Director describes as inadvisable because of a weakening of other creditors' claims. In particular, it is not clear what the linkage would be with the negative-pledge waiver policy for some countries that are in the process of being adopted by the World Bank and the EBRD.

Finally, before eventually rejecting the idea, I would find extremely helpful some additional information on the proposed extension of official bilateral guarantees to the liabilities of borrowers of repurchase obligations to the Fund.

Mr. Merino made the following statement:

Like others, my authorities consider the Managing Director's statement useful and timely. The amount of financing needed, while subject to marginal errors, seems realistic. Taking into

account, on the one hand, past years' experiences-- SDR 115.7 billion in financing needs over the period 1990-93--and gapology exercises, the Fund has not made big mistakes. On the other hand, this figure is based on the assumption that all the countries will undertake Fund-supported programs; although this is difficult, we consider that it should be considered a possibility. However, I would request further analysis of developments in 1993 in order to draw a lesson for the period ahead. For example, the main differences between program and actual financing requirements are due to the evolution of capital outflows and current account deficits. How can we approach those problems in 1994-96?

On the lesson to be drawn from past experiences, it is necessary to dwell again on the conclusions of the world economic outlook papers on this matter, namely, that we should insist on the need for a strong adjustment effort in the countries in transition and be ready to provide international support for their effort by means of external financing. In this sense, we agree with previous speakers that assurances of reforms are the best assurances for external financing.

On the figures for the past two years, in spite of all the problems, the financing obtained fell short by only 15 percent, which is less than the difference between programmed and actual purchases from the Fund, or about 20 percent. I welcome comments from the staff on any linkage between these two shortfalls. Has the shortfall in financing from other sources prevented any country from purchasing from the Fund? Looking at the figures in Table 1 on new official financing, I was struck by the fact that the differences between program and actual financing from bilateral sources in absolute and relative terms were smaller than the rest of the other sources, namely, purchases from the Fund and other multilateral agencies. Could the staff comment?

We should consider all possible ways of financing transition countries without squeezing financing to other groups of countries. This will include recognition that the Fund is a quota-based institution; therefore, we should continue our work on the Tenth General Review of Quotas as an important element of the strategy to face increasing financing demands from countries in transition. I am surprised that the document includes only one paragraph about the possibility of a quota increase, and in our present discussion this issue has been raised frequently.

Equally, we consider that a general allocation of SDRs will make a contribution by reducing financing requirements that, although modest, cannot be neglected. The additional risk of larger and more concentrated lending should be hedged by means at the disposition of this institution, that is, by strong programs that limit the magnitude of the risk.

As regards bilateral financing, although staff figures are provisional owing to present uncertainties, we consider that there is a need for further effort to coordinate bilateral financing, in order to solve the problems of the present ad hoc system.

Mr. Rouai made the following statement:

We concur with Mr. Geethakrishnan and other Directors who have underlined the risks to the Fund, particularly if firm commitments are not forthcoming from other sources. For those reasons, we also agree with Mr. Geethakrishnan's comments on the contributions of the EBRD and the World Bank. And like Mr. Dlamini, we believe that steps must be taken to ensure that developing countries in Africa and elsewhere do not suffer from a shift in financing flows.

On the three options presented in the paper, we hold views similar to those of Mr. Sirat. Like Mr. Jiménez de Lucio, we consider that an SDR allocation is valid on its own merits. We also echo his comments with regard to gold.

We agree with the statements by Mr. Fukui, Mr. Schoenberg, and Mr. Smee emphasizing that the strength of the programs adopted and implemented by the countries themselves is the best inducement to ensure external financing, both official and private. We also strongly support measures to enhance the mobilization of domestic savings by countries in transition. An example should illustrate this point. According to Table 1, between 1990 and 1993, "other capital" was programmed at \$55 billion, but the actual amount was \$87 billion, or \$32 billion more. It can be assumed that a large portion, if not all, of the difference is capital flight. The paper asserts that the strength of the program in the next three years will reduce capital outflows to negligible amounts. But we find it paradoxical that while the importance of the Fund's programs is emphasized, the Fund is denied the tools it needs to do the job.

It is clear, as Mr. Fukui, Mr. Schoenberg, and Mr. Sirat have stated, that bilateral contributors all operate under their own national budgetary constraints that limit their flexibility. Therefore, timely decisions on an SDR allocation and quota increase would not only facilitate and strengthen the Fund's role, but also reduce risks for bilateral contributors.

Mr. Sarr made the following statement:

It is appropriate that in the present difficult financing environment, as described recently during the discussion of the ESAF successor, the modalities of financial assistance for the

group of economies in transition should be addressed in a medium-term perspective. The projections in the paper provide a good illustration of the magnitude of the financing needs for this group of countries, and the methodology used is broadly in line with the one used for other groups of countries. We share the high degree of priority that the staff attaches to reducing the uncertainties in the timely provision of committed resources to countries undertaking strong adjustment programs, and we welcome all the measures that the staff will explore to harden these commitments.

With regard to the different financing options, given the projected external financing requirements and the likely duration of the transformation process, only the simultaneous consideration of all three options outlined in the statement would begin to address, in a more balanced manner, the issues of financing for this important group of countries and also for the rest of the membership.

Finally, on the issue of access, I wonder whether raising the access limits of these countries is a prudent course of action, not only with regard to the risk factor outlined in the paper, but also given their need for further Fund support in outer years. Perhaps the staff could comment on this point.

Mr. Al-Jasser expressed his appreciation for the Managing Director's statement, coming as the Fund prepared for its major involvement in the transition economies; unfortunately, there had not been enough time to consult with authorities and, in that connection, he shared the views expressed by previous speakers. Nevertheless, he joined the Chairman, Mr. Posthumus, and others who had emphasized that strong programs and strong conditionality would bring about the needed results, including the bilateral, multilateral, and private financing necessary to rejuvenate the economies and help them through the current difficult period.

He also agreed with the Chairman that the Fund was in the business of risk taking; the institution had not shied away from it in the past, and it should not do so at present, Mr Al-Jasser continued. However, it was only prudent to evaluate the size and nature of the different risks that the Fund would face; although uniformity of treatment was the rule, the risks from country to country were not uniform. For example, the risks encountered in the economies in transition were different from those encountered in dealing with the problems of Latin America, although the amount of financing that the Fund had committed to each region--about SDR 5.9 billion--might be comparable. Therefore, an evaluation of the risks was important in enabling the Fund to help the economies in transition overcome their difficulties.

The Fund's catalytic role consisted of placing a seal of approval on a program that was considered to be fully implementable, Mr. Al-Jasser commented. As a result, such programs would raise confidence in those

economies on the part of not only the sources of external financing, but also the domestic economic actors, whose participation--through increased saving and investment domestically--was indeed crucial if external financing was also to be forthcoming.

The Fund's seal of approval and its catalytic role overshadowed the Fund's financial contribution, Mr. Al-Jasser remarked. The Fund's participation showed the institution's confidence in the adjustment program and, therefore, ensured the provision of the necessary financing. The precise amount should be considered further; but he would argue that the figure in Table 2 for Fund financing of SDR 19 billion was helpful only if it brought about the balance of the financing required; otherwise, the Fund's financing would flow out immediately as capital flight, only aggravating the consequent adjustment required.

Because of that catalytic role, it was important to be cautious in designing the Fund's assistance to those countries, and in considering financing assurances, Mr. Al-Jasser observed. Experience with the economies in transition presented a new type of risk that called for a special evaluation and the necessary financing assurances. He recalled that in Egypt's case, the Managing Director had noted that financing assurances were one of the prior actions of the program. However, because of the strength of the program, the Fund's major catalytic role, and the financing assurances, it had not been necessary for the member to draw the full amount approved.

He continued to believe that an allocation of SDRs could only be helpful, Mr. Al-Jasser concluded.

Ms. Lissakers observed that the Articles of Agreement set out that the Fund was created to provide adequate reserves to countries that were going through difficult financial circumstances, so that they did not have to compress consumption and imports to the point where their people experienced severe hardship, and did not adopt protectionist policies and currency arrangements that were damaging to the global economy.

The Chairman responded that, nevertheless, many had argued that the Fund should play a strictly catalytic role. Therefore, even if he was ready to depart from 50 years of Fund experience and take added risks--say, through increased access--that would first have to be considered thoroughly by the members.

Mr. Lanciotti observed that there were similarities between the business of the Fund and the business of banks, not only in relation to risk taking, but also in relation to the evaluation of the creditworthiness of borrowers, which, for the Fund, was done by evaluating the strength of members' programs.

Mr. Mohammed said that he had heard a wide range of views on the estimated financing requirements of transition economies. Undoubtedly,

those requirements were sufficiently large to support Mr. Dlamini's concern about shifting resources and to make it imperative that serious consideration be given to the three options outlined in the statement. His views on those options were broadly similar to those expressed by Mr. Sirat--in particular, that it might not be realistic to expect a role for private financing larger than that currently assumed.

The Director of the Policy Development and Review Department remarked that it had been suggested that Table 1, which presented the history of financing flows for transition economies, could also become a source of analysis of the implications of the needs of the future. However, the table would not be particularly useful, partly because of the enormous shift in the countries on the list over the period covered. Also, the diversity of country experience was masked by the aggregate presentation. For example, the performance of official flows appeared to be favorable, until Russia's larger-than-programmed flows from bilateral sources were subtracted. A country-by-country disaggregation would reveal specific cases in which large shortfalls had disrupted programs.

Nevertheless, certain lessons could be drawn from the background analysis concerning the problems that had arisen in the past, the Director continued. The situation varied from country to country, but in general, the problems included those related to burden sharing; the composition of assistance pledged in various forums--say, grain instead of cash; and disbursement lags resulting from donor countries' budgetary procedures or recipient countries' administrative constraints in channeling pledged resources.

To put in place better mechanisms for mobilizing resources, it would be necessary to go beyond the Board and to include, for example, the European Union in its role as coordinator of the G-24 and the World Bank as the chair of some of the consultative groups, the Director noted. It was essential to have a forward-looking view in considering the mechanisms to provide financing, through better organized and more specific information on a country's needs and, subsequently, on the timely delivery of resources. Directors would recognize that such an objective was difficult to achieve. The Special Program for Africa had undertaken over the preceding few years to streamline the flow of resources committed and disbursed to countries, and had made good progress in pressing countries to untie aid, to make ex ante commitments, and to modify assistance according to the country's performance. The task was not an easy one.

Mr. Fukui remarked that Table 1 could usefully provide an analysis of the previous four years' wide-ranging experience with financing flows. Taking into account the information shown in footnote 4, 1993 would appear to reflect the peak of activity under Fund financing capacity, and to provide some indication of the magnitude that could be undertaken in coming years. It would also be useful to discuss with management and staff the reasons for difficulties with respect to financing assurances in order to learn from that experience. Another problem was the significant delay

associated with disbursements, following large pledges. The factors detrimental to the smooth disbursement of resources should be analyzed to reach a solution for the future.

The Chairman noted that Mr. Fukui's comments on the \$61 billion financing requirement in 1993 were welcome, as that figure was close to the suggested annual average of \$62 billion over 1994-96 presented in his statement.

The Director of the European I Department stated that Table 1 showed that the amounts programmed for financing in 1991 and 1992 had been much larger, in relation to the number of countries, than those in 1993, but the shortfalls had been large in 1991 and 1992. Country performance had varied. Major problems had been burden sharing, as well as difficulties related to donor countries' disbursement procedures and the recipient countries' absorptive ability. Although programs had gone off track in particular cases for various reasons, the absence of disbursements had to be recognized as a contributing factor.

The Director of the Policy Development and Review Department explained that the figure for foreign private direct investment and other private inflows was higher in the 1993 outcome (Table 1) than in the 1994 projection (Table 2) because of country-specific factors: for example, in 1993 two countries in Eastern Europe had borrowed heavily on international capital markets, but they would not continue to do so in 1994. The validity of data for 1993 in Tables 1 and 2 as an indicator for the future should not be dismissed, even though data for the countries covered were not available to set out a forward-looking exercise that included models for, inter alia, savings and investment. Moreover, the response of economic agents to reform programs that had not yet been specified was difficult to predict.

The Fund could examine the reform and adjustment process in the context of programs in Eastern Europe and the Baltic countries, then carry that experience forward at a modest continuing pace, recognizing that there would not be a massive acceleration of adjustment, the Director continued. Unfortunately, for those mainly smaller countries with which the Fund had not had close relations, the staff had had more difficulty in preparing data, and the present exercise had been based chiefly on an evaluation of the external sector, with less macroeconomic analysis than desirable. Nevertheless, with some caveats, the attempt was useful, in his view, even in the context of the Fund's liquidity position.

As several Directors had noted, it was unlikely that every country in Eastern Europe and the former Soviet Union would adopt an adjustment and reform program that could be supported by the Fund, and thus the figures could be lower than projected, the Director commented. However, the present exercise should give those countries confidence that the international community was working to ensure that mechanisms were in place to provide in a timely manner the resources they needed to support bolder programs and more rapid reform.

The transition countries encompassed a diversity of economies, the Director commented. For some countries in Eastern Europe, the response of private flows to the reform efforts had been better than expected--although in interpreting the data in Table 1, it was important to recall the countries he had mentioned earlier that had borrowed heavily in the markets. Experience elsewhere--regrettably in much of Africa, for example--showed that countries took a long time, even under sustained adjustment programs, to attract foreign direct investment and other private inflows, and presumably that would be the case for many of the transition countries.

In looking at the residual financing requirement of \$16 billion a year projected in the table, the amounts seemed modest when considering the inclusion of countries such as Russia, Poland, and the Czech Republic, countries that would probably be attractive to foreign investors, the Director continued. Once the reform and adjustment process took off, it could be expected that exports would increase, usually financed through export credit agencies. That notwithstanding, the export credit agencies' view on prospects for future operations was gloomy. Also, countries' projected financing requirements varied widely, from an estimate of about 1/2 of 1 percent of GDP for one country, to an estimate of more than 30 percent of GDP for five other countries. The latter figure was related, inter alia, to an undervalued exchange rate; nevertheless, that amount could not be met through additional adjustment alone, and financing would be required, particularly in the early stages of reform.

The Fund's catalytic role, although not specified in the Articles, was appropriate in the current situation, in which there were some countries whose difficulties could not be corrected solely through Fund support for the country's reserves, the Director commented. Rather, the countries required massive official and nonofficial flows; Fund-supported macroeconomic adjustment programs implemented in a context of conditionality served as an endorsement and catalyst to the providers of inflows.

The projections for debt relief assumed that 1993 terms on pre-cutoff date maturities would continue, and that the share of relief for other maturities would decline, the Director said. The assumptions were subject to variation, depending on the behavior of official creditors, but the figures in Table 2 were based on established Paris Club policies or precedents for commercial bank operations, and should therefore approximate the actual outcome. It would be useful to meet with the authorities of Mr. Kagalovsky and others to look at the medium-term scenarios in more detail.

Another issue raised by Mr. Kagalovsky concerned the staff assumption of annual average access of 40 percent of quota for transition economies, the Director continued. Directors might wonder why access could not be increased proportionally to, say, 68 percent of quota, the current annual access limit; but that was not feasible because the 40 percent average included fairly high access of 50-60 percent for some of the transition

economies. Perhaps the information could have been presented in more country-specific detail to avoid misunderstanding.

On the question of financing assurances and the systemic transformation facility raised by Mr. Fukui, he was concerned that misunderstanding should not arise about the objective of the facility, the Director of the Policy Development and Review Department noted. The Fund was willing to move as quickly as circumstances permitted to encourage and support the transition economies. Given the countries' lack of experience and their fledgling relations with bilateral creditors and donors, it would clearly take some time to establish new mechanisms and obtain the usual financing assurances. Thus, while the Fund would not prefer to support STF arrangements without financing assurances, it recognized the realities of the situation; but the Fund expected the international community to provide the necessary resources and assurances under the program as soon as possible, and certainly by the time of disbursement of the second tranche of an STF purchase.

The Director of the European I Department recalled that the Board had considered Poland's program to be risky, even though it had been strong. The riskiness had been reflected in, for example, elaborate provisions related to possible drawings on the stabilization fund. As part of the response to the program, production had fallen significantly, and at the time of the first program review, doubts had been expressed about the sustainability of the situation. It had been recognized later that the risk had been justified; that had provided a good, but challenging, lesson for the Fund.

Mr. Posthumus observed that he could support more risk taking if it was coupled with stronger conditionality.

Mr. Fukui considered that the projected financing figure of about \$62 billion for the following few years was not meaningless. However, the projections could be misunderstood. The present exercise was valuable in providing a forum to discuss possible figures, but it was also necessary to recognize the risk associated with the calculated projections for future financing requirements. On balance, it was reasonable to consider figures of about \$55-60 billion in light of the experience in 1993. Nevertheless, he was not sure how to treat that particular figure, particularly in the context of the Interim Committee report.

Under the systemic transformation facility, Mr. Fukui continued, he had understood that there was a commitment from the recipient countries, which might not be expressed as a numerical target. The main purpose of the systemic transformation facility was to provide a way to monitor the direction in which the country was moving. When a numerical target could be determined, that was welcome, but that had not been his understanding during discussions on the systemic transformation facility. For that reason, he had expressed some doubt about financing assurance exercises.

Ms. Lissakers commented that she wondered where it was cited in the Articles of Agreement that, in any given year, the Fund's share of financial flows to countries with problems should be fixed at a relatively modest amount. The transition process in the former Soviet Union appeared to be different from the adjustment problems faced by many other members. The response, therefore, should be different, with larger front-loading by the multilateral official institutions, because in many cases, it would take time for the private sector--domestic and foreign--to gain enough confidence to commit resources. To play an effective catalytic role, the official institutions must provide in the first years a larger share of financing that could decline as the private sector's confidence grew and it assumed the financing burden.

The Director of the Policy Development and Review Department reiterated that, for a number of countries, access would be higher than the average of 40 percent. In some cases, the process would be similar to that in the early stages of the programs in Eastern Europe, when the Fund's initial participation had been at the access limit, because it could act quickly and effectively. Indeed, the experience of Poland, the Czech Republic, and others indicated that the multilateral development banks, in particular, had acted correspondingly. Other countries had not expected to use Fund resources during the period, but had been included because of their experience in the previous three years. The subject of the discussion was whether, in light of additional needs, the Fund should consider increasing access in those cases.

Mr. Posthumus noted that a country could, on the basis of its program, deserve access much higher than 40 percent--say, 65 percent.

The Deputy Director of the European II Department, commenting on the catalytic quality of the systemic transformation facility, noted that two countries in the former Soviet Union had been strongly affected by terms of trade shocks and the withdrawal of transfers from the central government, and the Fund would be likely to intervene in those cases in the context of a systemic transformation facility arrangement. Those countries had large financing requirements, under the assumption of strong adjustment. He hoped that Mr. Fukui would agree that the systemic transformation facility did not exclude--although it might not require--the provision of full financing assurances, particularly in such cases.

The Director of the Policy Development and Review Department, replying to a question by Mr. Kiekens on the relative magnitudes of financing suggested for Russia compared with the other countries of the former Soviet Union, explained that the figures for Russia included the amortization due on the debt that Russia had absorbed. Were that amount to be excluded, the figure for Russia would not be out of line.

As to Mr. Kagalovsky's comments on use of the compensatory and contingency financing facility, the staff's view was that the oil price shock to the energy-importing countries in the former Soviet Union was

neither temporary nor reversible, and therefore could not be addressed by the compensatory element of the compensatory and contingency financing facility, the Director said. The shock was permanent, and the systemic transformation facility had been introduced to assist countries to adjust to that shock as rapidly as possible.

Mr. Kagalovsky commented that his authorities interpreted the shock--and the reasons for it--differently; they considered it temporary. For two years, Russia had financed the countries of the former Soviet Union to help them overcome the related difficulties. Some period of time, perhaps several years, would be required for those countries to adjust to those shocks, and the compensatory and contingency financing facility was the appropriate facility to help them.

The Chairman observed that the rules governing the compensatory and contingency financing facility indicated that the facility could be utilized only when a shock would clearly be reversed. For the countries of the former Soviet Union that had experienced a rise in the price of oil, that change would not be reversed. The systemic transformation facility had been created for a limited period; once the facility expired, members would have to resort to the other instruments of the Fund, such as the traditional stand-by arrangement, the extended Fund facility, and the enhanced structural adjustment facility.

The Director of the Policy Development and Review Department added that under the compensatory and contingency financing facility, the shock that was viewed as compensable must be reversible--that it would reverse itself of its own accord. In the former Soviet Union, the countries would experience a nonreversible adjustment to a new phenomenon: the price of their energy imports. It was unlikely that that price would fall in the near future.

Mr. Kagalovsky said that oil prices had already fallen, and the tendency was for them to drop further. In principle, developments in world market prices would resolve the problem, and reverse the shock.

Mr. Fukui remarked that the various debt-reduction mechanisms used by the Fund, banks, and donor countries were confusing. For example, the Fund played a limited role in the consultative groups under the aegis of the World Bank, which coordinated and ensured financing assurances. The Paris Club was mainly responsible for official debt rescheduling. For the clearance of arrears, support groups had been useful in obtaining financing.

Perhaps the purpose of the paper was to present figures for discussion without any implications for future financing, Mr. Fukui observed. Alternatively, perhaps the Fund would play a major role in closing the financing gap in the future. He would appreciate clarification.

The Director of the Policy Development and Review Department explained that debt-reduction mechanisms differed according to each case. The Bank's

consultative groups served primarily as a forum for receiving commitments from development agencies, which, to the extent they provided balance of payments support, were also sources of financing. The Fund played an important role in that and other forums by defining the macroeconomic and financial scenarios necessary under a country's program. Because of direct discussions with the Paris Club, the Fund could be assured of the Club's participation before Board discussion of a program. For example, for Russia's request for Fund resources under the systemic transformation facility, the Paris Club's indications on debt relief had been important in assessing financing assurances for the Russian program. The Fund also played a lead role in the liaison between commercial banks and a country. Previously, the Fund had waited until the critical mass of financing had been pledged by banks before moving ahead, but the guidelines had changed under the Brady initiative, whereby arrears could be accepted by the Fund, but quarterly financing assurance reviews were implemented to ensure that progress was being made in the financial relations between a country and its commercial creditors. The staff foresaw more of that activity, but in a more optimal time frame for Fund operations. The support groups remained a possible model for certain cases--for example, the support group for Guyana--with a creditor country taking the lead in tailoring resource mobilization in a time frame and with the aggressiveness necessary to have resources in place when necessary for the Fund to act. Of course, a more routine procedure--including under the Consultative Group process--would be desirable.

For Egypt's program, creditors and donors had provided assurances about their involvement beyond the period of the Fund arrangement, the Director noted. The Chairman's summing up at the conclusion of the discussion establishing the systemic transformation facility referred to creditors' assurances to help secure the required financing under the systemic transformation facility. The staff could study the possibility of more formal mechanisms, if Directors so wished.

The cofinancing trust accounts would not affect the Fund's liquidity ratio, the Director of the Policy Development and Review Department said; the resources would be provided by bilateral providers, and would fall outside the General Resources Account.

Mr. Schoenberg considered that, in commenting on the purpose of the paper, two issues arose. One was the data provided for the financing gaps; although the staff had endeavored to present precise figures, the export figures deviated with large margins from ex ante data, and there was no guarantee that such deviations would not occur in future years. The second issue was the possible misinterpretation of the purpose of the paper: the Fund should not be seen as trying to initiate a new burden-sharing mechanism by determining which contributor should provide a certain amount of financing. The Fund should not run the risk of overburdening itself politically.

The Chairman stated that the paper merely presented a basis for discussion and did not represent a central scenario of the Fund. Certainly, he was not--and would avoid--proposing new burden-sharing mechanisms. In cases of financing requirements of the magnitude noted in his statement, burden sharing could be discussed only between heads of state, who alone knew the extent of national involvement in that area of international relations. The Fund's goal was to mobilize support for strong programs, with the assumption that such programs benefited the entire membership.

Mr. Schoenberg explained that he referred to burden sharing in a wider context: not only among specific donor countries, but also among groups of contributors. Evaluating Fund participation, resources from other international financial institutions, projected debt relief, and financing by bilateral donors was in essence a burden-sharing issue.

The Chairman said that the Articles did not include the concept of burden sharing. The Fund's objective was to assist in the preparation of members' programs and to provide financing that would induce a catalytic effect sufficient to finance the program. Although, in retrospect, the relative shares of financing provided by other contributors could become known, determining those shares was not the Fund's role.

Mr. Sirat remarked that the discussion had revealed that there was wide support in the Board for finding and implementing innovative solutions to the challenge of dealing with economies in transition.

The Executive Directors agreed to continue their discussion on Monday, April 18, 1994.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/94/33 (4/11/94) and EBM/94/34 (4/13/94).

3. ERITREA - MEMBERSHIP - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/94/41, Sup. 1, 4/12/94; and Cor. 1, 4/12/94) on the canvass of votes of the Governors on Resolution No. 49-2, with respect to

membership for Eritrea, approved by the Executive Board (EBM/94/19, 3/9/94) for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

| | |
|-------------------------------------|---------------|
| Total affirmative votes | 1,438,218 |
| Total negative votes | 0 |
| Total votes cast | 1,438,218 |
| Abstentions recorded | 0 |
| Other replies | 0 |
| Total replies | 1,438,218 |
| Votes of members that did not reply | 52,525 |
| Total votes of members | 1,490,743 |

Decision No. 10650-(94/34), adopted
April 12, 1994

4. OPERATIONAL BUDGET FOR MARCH-MAY 1994 - AMENDMENT

The Executive Board approves the amendment to the operational budget for the period March-May 1994, as set out in EBS/94/23, (2/15/94); and Supplement 2 (4/6/94).

Decision No. 10651-(94/34), adopted
April 12, 1994

5. EXECUTIVE BOARD COMMITTEES - NOMINATIONS

The Executive Board approves the nominations by the Managing Director for the vacant positions on the Committee on Interpretations and the Committee on Liaison with the CONTRACTING PARTIES to the GATT, as set forth in EBD/94/61 (4/7/94).

Adopted April 11, 1994

6. PENSION COMMITTEE - NOMINATION

The Executive Board approves the election of an Executive Director nominated to serve as a member of the Pension Committee for the term ending October 31, 1994, as set forth in EBAP/94/25 (4/7/94).

Adopted April 11, 1994

7. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 93/166 are approved.

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAM/94/52 (4/8/94) and by an Assistant to Executive Director as set forth in EBAM/94/54 (4/8/94) is approved.

APPROVAL: October 24, 1995

LEO VAN HOUTVEN
Secretary