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Minutes of Executive Board Meeting 94/109

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Executive Board Attendance

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

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
M.-A. Autheman	M. Sirat
	D. Desruelle, Temporary
J. Bergo	E. Srejber
L. E. Berrizbeitia	V. J. Fernández
I. Clark	
B. S. Dlamini	D. Z. Guti
H. Evans	J. Shields
K. P. Geethakrishnan	
J. E. Ismael	L. M. Cheong
D. Kaeser	K. Link
A. Kafka	A. Calderón
W. Kiekens	J. Prader
	J. Hamilius, Temporary
	H. A. Barro Chambrier
	B. A. Sarr, Temporary
G. Lanciotti	M. Giulimondi, Temporary
K. Lissakers	B. S. Newman
H. Mesaki	T. Oya, Temporary
A. Mirakhor	M. Daïri
	M. J. Mojarrad, Temporary
C. Saito	A. G. Zoccali
S. Schoenberg	E. Wagenhoefer
	Y. Y. Mohammed
	A. V. Mozhin
	J.-H. Kang
	O. Havrylyshyn
	Wei B.

L. Van Houtven, Secretary and Counsellor
C. P. Clarke, Assistant
S. Bhatia, Assistant

Also Present

IBRD: M. Riboud and J. D. Walters, Europe and Central Asia Regional Office. Central Asia Department: J. R. Dodsworth. European I Department: G. R. Kincaid, T. W. Dorsey. European II Department: J. Odling-Smee, Director; E. Brau, Deputy Director; J. Berengaut, D. A. Citrin, I. Coelho, S. W. Gilmore, L. Hansen, P. S. Ross, M. Shadman-Valavi, E. C. Suss, T. M. Tsikata. External Relations Department: S. J. Anjaria, Director; P.-M. Falcone, G. Hacche, D. R. Hawley. Fiscal Affairs Department: T. Ter-Minassian, Deputy Director; P. R. Gerson. IMF Institute: I, C. Lienert. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; J. L. Hagan, Jr., R. B. Leckow. Middle Eastern Department: G. M. Iradian, F. P. Mongelli. Monetary and Exchange Affairs Department: M. Guitián, Associate Director; M. I. Blejer, C. Enoch, D. C. Hardy. Policy Development and Review Department: J. T. Boorman, Director; M. Allen, Deputy Director; D. N. Lachman, Deputy Director; T. Leddy, Deputy Director; P. F. Allum, D. J. Andrews, A. G. G. Bennett, S. B. Creane, B. de Schaetzen, M. E. Edo, H. M. Flickenschild, N. L. Happe, A. C. F. J. Houben, A. K. McGuirk, S. M. Schadler, J. K. Wakeman-Linn. Research Department: M. S. Khan, Deputy Director; A. G. Berg, P. Wickham. Secretary's Department: A. Mountford. Southeast Asia and Pacific Department: C. M. Browne, J. H. J. Morsink. Treasurer's Department: D. Williams, Treasurer; J. C. Berrigan, E. Decarli. Office of the Managing Director: S. Sugisaki, Special Advisor; G. R. Saunders, Personal Assistant; J. G. Blanch, M. A. El-Erian, P.-I. Koupaki. Advisors to Executive Directors: J. M. Abbott, M. A. Ahmed, B. Andersen, P. Cailleteau, S. K. Fayyad, J. Guzmán-Calafell, A. R. Ismael, J. M. Jones, R. Kannan, J. Leiva, Y. Margoninsky, J. C. Martinez Oliva, M. F. Melhem, M. Petrie, C. F. Pillath. Assistants to Executive Directors: S. Al-Huseini, R. N. A. Ally, P. I. Botoucharov, M. A. Brettschneider, A. G. Cathcart, J. A. Costa, D. Daco, M. Dzervite, G. El-Masry, J. C. Estrella, R. Ferrillo, A. Galicia, C. Gaseltine, R. Glennerster, C. M. Gonzalez, O. Himani, T. Isataev, P. Jilek, W. C. Keller, A. M. Koulizade, V. Kural, N. Laframboise, K. J. Langdon, B. M. Lvin, J. A. K. Munthali, Ng C. S., H. Petana, N. Prasad, S. Rouai, A. Ruocco, M. W. Ryan, D. Saha, F. A. Schilthuis, A. Sighvatsson, V. Verjbitski, Wang X., Wang Y., J. B. Wire.

1. CURRENCY STABILIZATION FUNDS - FUND POLICIES - PRELIMINARY CONSIDERATION

The Executive Directors considered a staff paper on preliminary considerations of Fund policies with regard to currency stabilization funds (EBS/94/230, 12/2/94). They also had before them a statement by the Managing Director on the same subject (BUFF/94/111, 12/2/94).

Mr. Clark made the following statement:

In principle, I agree that currency stabilization funds (CSFs) in the context of exchange-rate-based stabilization programs can play a useful role in accelerating and strengthening a comprehensive reform effort, provided they are buttressed by strong financial policies. However, it cannot be overemphasized that a pegged exchange rate is not a substitute for strong macroeconomic stabilization policies. An exchange rate peg can only complement prudent policies that already exist or are in train. The main contribution that a CSF can make is to lend credibility to an ambitious economic adjustment program, thus helping to bring about a rapid change in inflationary expectations and reduce the impact of disinflation on the real economy. As the Polish case demonstrates, however, externally financed stabilization funds are most successful when they provide more of a signaling, rather than a financing, function.

At this early stage of our discussion and before drawing final conclusions on the establishment of Fund-financed CSFs, I would like to raise some general issues for consideration and share some thoughts on the broad modalities of the potential application of currency stabilization funds.

Although the credibility of an exchange rate peg, and the reform effort more generally, may be enhanced by a CSF, a pegged exchange rate is not a prerequisite for successful stabilization and reform. Stringent financial policies aimed at addressing the fiscal imbalance that are generally the underlying source of inflation must be in place if a durable stabilization effort is to be achieved. Successful exchange-rate-based stabilization also depends on fixing the level of the nominal exchange rate at an appropriate level. This is a particularly difficult task in countries undergoing economic transformation of the magnitude of the former Soviet Union. There will be a tendency to aim for an undervalued exchange rate so as to ensure that a country's competitiveness is not undermined. A substantially undervalued currency could, however, fuel inflationary pressures. Finally, the credibility of the peg depends on an adequate level of international reserves. It is vital that authorities understand that CSFs are not a source of general balance of payments or budgetary finance.

To the extent that CSFs would represent resources additional to those available under traditional facilities, there could be an incentive for some countries to adopt a fixed exchange rate regime rather than other arrangements that are perhaps better suited to their individual circumstances--such as a crawling peg, or a floating exchange rate for a country susceptible to asymmetric exogenous shocks. There is a risk that through the creation of CSFs the Fund could be perceived as advocating a general policy of fixed exchange-rate-based stabilization. Such a perception could harm the credibility of the Fund's policy advice. The Fund would have to take care to ensure that its "prochoice" attitude in the determination of appropriate exchange rate arrangements is preserved.

Turning to the broad modalities of a CSF, the particular features should strike an appropriate balance between providing the necessary safeguards to Fund resources and allowing the arrangement to be sufficiently flexible to fulfil its objectives. Here, as in the discussion on a short-term financing facility (EBM/94/104, 11/30/94), we should draw from our experience with the contingency element of the compensatory and contingency financing facility.

The "window" approach, whereby a CSF is encompassed within the context of an upper credit arrangement with the Fund, has considerable appeal. This approach highlights and strengthens the linkages between a CSF, policy conditionality, and performance criteria of an upper credit tranche arrangement. A window approach also has the added benefit that General Arrangements to Borrow (GAB) resources could be drawn upon, if the need arose. According to the staff paper, this would not be the case under a special facility approach.

While I agree that more onerous policy conditionality should be attached to successive tranches, I believe that the signaling effect would be eroded by excessive tranching of a Fund-financed CSF. The three-tranche approach of the Polish stabilization fund, with the second and third tranche requiring approval of the operating committee, seems to strike a reasonable balance.

I agree with the staff's proposals regarding the reconstitution of resources under a CSF. Providing for an early expectation within 3 to 6 months and a repurchase obligation within 12 months would work to ensure that resources under a CSF would not be transformed into general balance of payments support. A shorter obligation period would provide even greater assurance, however. Furthermore, staff proposals to allow potential users to purchase reconstituted resources would give a CSF the revolving characteristics necessary for a flexible arrangement. Finally, consideration could be given to ensuring that the risk to CSF resources is shared by the authorities, such as in the stabilization fund for Poland, whereby drawings under the CSF were made pari passu with the authorities' own intervention.

Mr. Kang made the following statement:

The staff paper indicates that currency stabilization funds would only be activated in conditions under which the exchange rate and exchange rate policy were firmly supported by strong economic and financial policies. However, if appropriate economic policies are in place, there is no need for a fund to stabilize the exchange rate. If a country's exchange rate is sustainable and is seen as such by international capital markets, there would be little prospect of that country being subject to an extended period of destabilizing capital flows. Indeed, in the context of a Fund-supported program, under which policy credibility should be increasing, it is more likely that capital inflows would be occurring.

This highlights a fundamental problem with the proposed CSFs: a CSF would only be activated in cases where economic policies are not sufficiently strong to maintain an exchange rate at a given level; but it is in precisely those circumstances that a CSF would not be desirable and would not be effective.

It was argued in our recent discussion on a short-term financing facility that it would be difficult--if not impossible--for the Fund to determine a priori whether exchange rate pressures are likely to be temporary or sustained. There would be even greater uncertainty in this regard in cases where a country is undertaking substantial economic reform, as would be the case for those countries utilizing a Fund-supported CSF. At the end of the day, additional financing from the Fund cannot hope to counter persistent and large private capital movements. Instead, similar to a short-term financing facility, a CSF could be used to delay adjustments to the real economy and/or the exchange rate, magnifying the economic costs of the adjustment process.

In contrast to a short-term financing facility, there is likely to be substantial demand for CSFs. Indeed, it seems likely that, under the current proposal, a CSF could become a regular feature of Fund-supported programs rather than the exception; the absence of a CSF in a program may well have a negative signaling impact, even in an economic environment where a fixed regime is not seen as appropriate.

Extensive use of CSFs, in combination with the introduction of a short-term financing facility, would have implications for the Fund's liquidity position and perhaps the distribution of the Fund's lending activities. Further, Fund-supported CSFs would place additional demands on staff surveillance and would lead to an increase in administrative costs. These issues deserve further consideration before the modalities of either facility are examined in detail. We would be concerned, for example, if the introduction of a short-term financing facility and CSFs led to a reduction in the liquidity ratio to about 70-80 percent by end-1997--as suggested in the staff paper--because the ability of the Fund to meet the financing needs of its members could be considerably constrained. Some members may be unwilling to agree to a general increase in quotas if a substantial portion of the Fund's resources were tied up by the use of these facilities.

In addition to doubts about the desirability of introducing Fund-supported CSFs, we are not convinced that the creation of a new facility or a new window would be necessary. If a country is facing truly exceptional circumstances, there is scope under current Fund arrangements for the exceptional circumstances clause to be invoked. Indeed, the existence of this clause obviates the need for an extensive set of new operational guidelines relating to currency stabilization or a new facility that could, in any case, prove to be too restrictive and inflexible. Timely consideration by the Board on a case-by-case basis using the exceptional circumstances clause would not suffer from these problems.

Finally, I wonder about the legality of establishing a CSF in the context of Article VI, Section 1(a). Similar to a short-term financing facility, it seems that there would be a strong possibility that CSFs could end up using "the Fund's general resources to meet a large or sustained outflow of capital." I would welcome a more explicit interpretation of what "large" or "sustained" would mean in practice.

Mr. Mohammed made the following statement:

Currency stabilization funds can have an important role to play in lending confidence to members' exchange rate and supporting policies undertaken in the context of an arrangement with the Fund. I am in broad agreement with the main guiding principles for Fund involvement in this area as set out in the staff paper. I would, for emphasis, underscore the importance we attach to CSFs being directed exclusively to short-term intervention to counter short-term exchange market disorders and not used as a source of general balance of payments financing; the CSF constituting an element of a comprehensive strategy of stabilization and reform that is supported by the Fund in the context of an upper credit tranche arrangement; the member's adjustment and reform program being fully financed, excluding CSF resources; the member's exchange rate and exchange rate policy being sustainable and firmly supported by strong economic and financial policies;

and a close monitoring of exchange market conditions and operations being maintained as well as ensuring that release of resources would be subject to continuing Executive Board judgments that Fund support for intervention is warranted.

In order for CSFs to operate in a manner consistent with these guidelines, the member's exchange rate policy has to be very clearly defined. Obviously, a fixed exchange rate regime meets this requirement, and a CSF can perhaps most easily be conceived of in the context of a member adopting a fixed exchange rate as a nominal anchor, with a view to achieving macroeconomic stabilization quickly. However, there are other exchange rate arrangements that could also meet the requirement of being sufficiently well defined and that, at the same time, are appropriate for achieving stabilization objectives. It would perhaps be useful to reflect on the possibility of not limiting Fund financial support in the context of CSFs to cases involving an exchange rate peg. Whatever the outcome of that reflection may be, however, I wish to stress that we attach considerable importance to the Managing Director's statement that Fund support for CSFs would be available to all members in comparable circumstances. Let me add that we take this statement to mean, inter alia, that members with arrangements prior to the elaboration of Fund policies with regard to CSFs would qualify for access to Fund resources under CSFs, provided, of course, that they meet the requirements set forth for such access.

I agree with the Managing Director that credible and strong fiscal and credit policies would limit the need to draw on CSF resources, and we have to keep in mind in this context that, as noted by the staff, a successful CSF would serve its purpose best when it does not need to be used. Nevertheless, provisions need to be set to assure qualifying members of the availability of resources should the need arise, and to specify the conditions that would govern the availability and use of those resources. In this connection, let me say that we find reasonable the ideas put forward by the staff regarding Board approval of access to CSF resources, tranching, early repurchase provisions, staff and Board monitoring of developments and policies, and appropriate and timely data reporting. I do not, at this stage, have a definite view on what the maximum access under the CSF should be, but the figure of 100 percent of quota mentioned in the paper may be broadly appropriate. I do not have firm views on when activation should take place either. One could argue that activation should take place at the outset of an arrangement. If, however, as in the case of the Polish stabilization fund, resources under the CSF are intended to replenish reserves already used for intervention, then activation need not occur at the outset, but rather at the time of a review, which itself need not be a scheduled under the arrangement.

As to whether CSFs should be set up in the context of a special facility or a window within stand-by or extended arrangements, on balance I would favor the special facility approach. This is so mainly because the window approach could entail appealing to the exceptional circumstances clause too often. I wonder, in this connection, whether establishing a special facility could make it legally permissible to reduce the transactions costs of revolving CSF operations by way of lower commitment fees, and especially service charges, than under regular arrangements. A staff comment on this issue would be appreciated.

Ms. Lissakers made the following statement:

The Fund has frequently established special facilities to address specific problems. We see the CSF primarily as a means of dealing with the highly limited situation of using an exchange rate anchor as a component of a comprehensive stabilization policy designed to achieve rapid and sustainable disinflation. There is now a considerable body of evidence that, in cases of high and volatile inflation, the success of conventional fiscal and monetary policies in reducing inflation can be considerably enhanced if those policies are buttressed by an exchange rate anchor. Establishing an exchange rate anchor provides a clear reference point for inflation expectations. If monetary and fiscal policies are providing the necessary discipline, the exchange anchor allows the economy to identify and move more swiftly and securely to a low inflation equilibrium.

Although a high payoff can be expected from an exchange rate anchored disinflation policy, it cannot be overstressed that a fixed peg is no substitute for the essential fiscal and monetary policies needed for stabilization. All elements of the policy must be integrated and reinforce each other. We do not see an exchange rate anchor as just a credibility add-on to an otherwise well-structured stabilization program. Rather, we see it as an integral element in an overall disinflation policy. To play its role, the peg has to be credible. Access to adequate reserves to withstand temporary market pressures is an important factor in securing this credibility.

This orientation brings out the importance of two features of the CSF proposal presented by the staff. A CSF should be tied to upper credit tranche conditionality, and it should be temporary. Strong conditionality is needed to ensure the success of the policies and to safeguard Fund resources. The temporary feature follows from the presumption that a CSF would support the transition from high to low inflation. It would not be used as a continuing source of reserves to maintain an exchange peg after price stability is restored. Thus, we also fully support the staff stricture that a CSF could only be used to counter temporary exchange market pressures and could not be employed as a source of balance of payments finance.

The credibility of a CSF will be maximized if its purposes are clear and limited. Thus, we should be careful about extending it to types of exchange rate arrangements that go beyond fixed pegs. The staff paper mentions the possibility of including variants of pegged systems, such as exchange rate bands. In our view, the firmer the exchange rate anchor, the greater will be its contribution to stabilization. Thus, we see little merit in introducing anything more than minimum fluctuation margins.

Somewhat more analysis of the pros and cons of whether a CSF might be used to support a crawling peg would be useful. In particular, it would be helpful to know whether there have been cases where crawling peg regimes have contributed decisively to successful stabilization in high inflation situations. Would not a crawling peg dilute the disinflation force that could be achieved by a fixed peg? Still, there may be situations where a crawl could allow policies to be bedded down before adopting a fixed peg or where a crawl could allow some adjustment of competitiveness after first round stabilization has been established. Further staff discussion of these issues would be appreciated.

The staff has also raised the possibility that CSFs may have a role to play in supporting an exchange rate peg in conjunction with policies designed to support exchange rate unification or current account convertibility. The rationale for these two justifications is not well developed in the staff paper. We do not have settled views on the appropriateness of CSFs in such cases and would be interested in a fuller exploration by the staff. On the face of it, supporting reforms like these would be an appropriate use of Fund resources. However, it may be that these adjustments could be better supported by something like the short-term facility we discussed a few weeks ago or even within ordinary stand-by arrangements.

We do not see a strong case either way as to whether CSFs should be established as a window or as a facility. Practical considerations should guide the choice.

Access seems to be the most important consideration in the choice between a window or a facility. The staff suggests that appropriate access for a CSF might be 100 percent of quota over the life of a program. As already noted, the expectation is that CSF drawings would be both temporary and short term. But, to be effective, drawings on a CSF, whenever they are required, may also need to be large relative to quota. Thus, it is easy to envision a conflict with existing access policy.

For example, a country that has already drawn a portion of its annual access under a stand-by arrangement may find that the amounts available under the CSF are restricted at a time when the full CSF financing is needed. It is also possible that some countries in transition that have made use of drawings under both the structural transformation facility and an upper credit tranche stand-by arrangement could find themselves at the limit of their cumulative access just when their policies would justify incorporation of a CSF.

For a CSF to be effective, we believe that the amounts authorized must be available. Therefore, access should be over and above the current annual and cumulative limits of 100 percent and 300 percent of quota, respectively. This could be achieved either under a window or under a facility. A facility would be cleaner, since access under a facility would automatically float. To achieve the higher access under a window would require the exceptional circumstances clause to be invoked.

As we understand it, the other elements of a CSF, such as its operational features and its repayment terms, would all be essentially the same whether it was structured as a facility or a window. Presentational issues, however, might have a bearing on the choice between a facility and a window. Structuring a CSF as a window within a stand-by arrangement has the attraction that the linkage of the exchange rate anchor to the overall adjustment effort would be unambiguous. In contrast, creating a CSF as a separate facility risks having the CSF drift into being used as generalized backstopping for exchange rate pegs rather than the more targeted purposes that we envision.

The staff paper asserts that GAB financing could not be used if a CSF were structured as a facility. As I understand it, this is because the GAB rules stipulate that GAB resources can only be used to support an "arrangement," and a special facility does not qualify as an arrangement in Fund legal parlance. I would appreciate confirmation that this is the case.

The operational procedures suggested by the staff place a heavy reliance on tranching and Board review of drawings of a CSF. These suggestions do a good job of protecting Fund resources, but they are also so elaborate they may tend to undermine the credibility of a CSF itself. We are all agreed that a CSF that is never drawn would be the best of all possible worlds. Nevertheless, to do its job, a CSF must be accessible and it must be known to be accessible. We like the idea of allowing a first drawing upon approval to provide working balances for intervention.

However, we think a total of six tranches is excessive. Two equal tranches would seem adequate.

We believe discipline over a CSF can be achieved by a combination of short repurchase requirements and Board reviews. Because a CSF is intended to be temporary and to act as a revolving fund, we believe it would be appropriate to establish an expectation of a three-month repurchase period. In keeping with the practice in central bank swap arrangements, it would be possible to extend this repurchase period for an additional three-month period on a routine basis subject to a lapse of time decision by the Board. If a drawing were continuously outstanding for a six-month period, however, the expectation of early repayment would become fully effective. This expectation could be backed up by further conditions. For example, failure to reconstitute within a six-month period might lead to suspension of the CSF element of the program.

I believe it would be appropriate to rely on the expectation of early repayment rather than making early repayment an obligation. If I understand Fund practice correctly, failure to make an obligatory repurchase would curtail access to any Fund drawings. In contrast, failure to meet an expectation would only invoke conditions that are explicitly attached by the Board. The less severe sanction would seem more appropriate in the case of a CSF, as failure to repurchase within a short six-month period would probably be more of a symptom that the exchange pegging feature of the program had drifted off track than an indication that ultimate repayment of Fund resources had been put at risk. Invoking an expectation of early repayment rather than an obligation would also facilitate decision making, because the expectation route only requires a 50 percent majority, whereas imposing an obligation would require a 85 percent majority.

If there were two tranches, we would expect Board review and approval of drawings to take place at the time of the initial approval, again at the time of any request to draw the second tranche, and possibly at six-month intervals just to oversee the progress of the CSF operation. Careful monitoring will be needed, and the additional reporting requirements suggested by the staff should put the Board in a position to render quick decisions, when required at short notice, without requiring more formal program reviews.

The suggestions regarding fees and charges applicable to drawings on a CSF seem awkward. We believe there should be a one-time commitment fee for the life of the arrangement and that, in keeping with the revolving nature of a CSF, service charges assessed on purchases should be limited to 1/2 of 1 percent of the maximum amount outstanding at any point during the life of the arrangement. Introduction of an administered account would be a convoluted mechanism to achieve this result and, unless there is a compelling legal reason to do so, we think this should be avoided.

The recommendation that provisions be made for cofinancing were unexpected, in view of the Managing Director's indication that GAB financing would not be necessary. The staff suggestion reintroduces the controversial issues of risk shifting that were highlighted in the recent Board discussion of the cofinancing trust accounts proposal. We would be interested in further discussion of the rationale for this feature of the staff proposal.

Mr. Al-Jasser made the following statement:

At this preliminary stage of our discussions on Fund policies regarding CSFs, I will make some general comments before turning to the clear and well-focused questions at the end of the staff paper.

I found the staff paper interesting and informative. While presenting the rationale for CSFs, the staff clearly laid down the conditions that need to be met for CSFs to play their intended role. Indeed, without a realistic and sustainable exchange rate that is supported by appropriate macroeconomic policies, a fully financed program, and a quick policy response to changing conditions, a CSF may do more harm than good.

The staff paper clearly indicates that CSFs are available only for members with fixed exchange rates. Is it now the Fund's policy to favor fixed exchange rate regimes and to provide additional funding to countries that adopt such a regime? We should be very careful not to be perceived as providing incentives for countries to adopt fixed exchange rate regimes. The Fund should concentrate on macroeconomic stabilization policies and leave the choice of the exchange rate regime to the individual country. Experience has shown that without the conviction and full ownership of the authorities, programs would not likely succeed.

A CSF shares a number of features with the short-term financing facility that we recently discussed. Thus, some of the cautions raised during that discussion, which I do not need to repeat, apply here.

In view of the recent Fund policy to substantially increase access limits, considerably more resources could become available to countries with strong programs. This should allow for a larger reserve cushion and minimize the need for use of CSFs. Thus, it would be expected that CSFs would be used sparingly. It is imperative, however, that evenhandedness and comparable treatment to all Fund members be maintained, including those under the enhanced structural adjustment facility (ESAF) umbrella. If ESAF-eligible countries decide to utilize a CSF facility, then their needs may have to be addressed through a blending process, where a stand-by arrangement would only be a conduit for a CSF, as noted in the staff paper.

Having said this, I will turn now to the specific questions in the order they are raised in the staff paper.

A window within a stand-by or extended arrangement with access subject to present guidelines, appealing if necessary to the exceptional circumstances clause, is the preferable course of action. I have always been averse to creating new facilities and further complicating the system when there is no clear need to do so. Moreover, as the staff notes, "incorporating CSFs into arrangements would underscore their special, transitional character."

On the issue of when to activate a CSF, a prudent approach is called for; the inherent risks involved in such an operation are particularly pertinent. Activating a CSF on completion of a review would allow for an adequate period of time to establish a sufficiently stable exchange rate that is both credible and realistic.

As regards the level of access, a balance needs to be struck between providing a credible and substantial cushion on the one hand, and limiting the risk to Fund resources on the other. A maximum access of 100 percent of Fund quota, if accompanied by adequate safeguards, appears to be broadly reasonable. Actual access should, of course, depend on the strength and comprehensiveness of the underlying program, and on the particular circumstances of the member. Close monitoring by the Fund, including the additional reporting requirements, is also essential. Although there may be room for some variation in reporting requirements depending on the circumstances of each member, it is critical that reporting on a core set of relevant data--such as exchange market quotations, exchange market intervention, and interest rates--be a standard requirement. Tranching of purchases, early reconstitution, and terminating of operations of a CSF with the termination of the accompanying arrangement are also needed. The revolving features to permit recurrent use of a CSF, with proper safeguards, is also appropriate.

Tranching of purchases would ensure that a CSF is being used for its intended purpose, and at the same time would limit the Fund's exposure. In this connection, the staff's proposals on this subject are reasonable, with one modification. Drawings under a CSF should be limited to one half of the member's net intervention activities in any given period, and CSF resources should be made available only for purposes of replenishing reserves after intervention, as was done in the Polish case. Such an approach would ensure that a CSF is being used for its intended purpose.

Tranching of purchases, and the unpredictable and sudden changes in sentiments that could occur in financial markets, would necessitate a quick response to a request for activation and use of a CSF. Thus, accelerated Board procedures along the lines described in the staff paper could be needed. In these circumstances, the Board will have to depend more heavily on the staff's analysis and judgments. Therefore, it is imperative that the staff be very candid in these cases.

On the issue of the reconstitution of CSF drawings, the proposed 12-month repurchase obligation for all purchases under a CSF--or coincident with the term of the associated arrangement--seems appropriate. As indicated by Mr. Clark, however, a shorter obligation period would provide greater assurances. A period of three months for the repurchase expectation, and the provision for Board approval of extensions of the repurchase expectation period by up to three months--but not beyond the repurchase obligation period--serve to provide the member with adequate time and flexibility to reconstitute its position. These expectations should apply to all tranches, including the first tranche.

I have already addressed the seventh question in the staff paper.

The provision for termination of the operations of a CSF with termination of the accompanying arrangement seems reasonable.

If a broad consensus on the establishment of CSFs is reached, the operational features of the CSF outlined in the staff paper, subject to the comments and suggestions I already mentioned, seem appropriate. Success will depend mainly, however, on the strength of the underlying program. Thus, for countries where CSFs are contemplated, the programs would need to be especially scrutinized.

The success of a CSF in achieving its goals also depends to a large extent on its signaling effects. Thus, willingness of donor countries to bilaterally cofinance Fund-supported CSFs could enhance market confidence and facilitate achievement of the desired results. These benefits notwithstanding, it is unlikely that cofinancing would be available on any meaningful scale. The difficult fiscal position of most donor countries does not bode well for such cofinancing.

The staff rightly points out that "a CSF is most likely to succeed when it is unlikely to be drawn upon." Frequent recourse to CSF financing is likely to indicate some underlying problems in policy implementation that need to be corrected. Thus, the transaction costs of revolving CSF operations should not be of great concern, and there does not appear to be any need to change our current system.

Mr. Saito made the following statement:

Today's topic covers two main aspects: the nature of currency stabilization funds, and the role of this institution in financing such schemes. The first topic is the most important one, because it is necessary to have a clear understanding of when a CSF can be successfully implemented. In the first place, we know that, despite its name, a CSF as such is not going to guarantee stability for a given exchange rate peg. In fact, that will only happen if the structural and macroeconomic policies that accompany a stabilization program are sufficiently strong. A CSF is intended for the sole purpose of enhancing the credibility of the authorities. As the paper rightly states, a successful CSF is one that does not need to be used. I would add that its full positive impact will occur when reflows of flight capital start to happen. Notwithstanding the fact that the role of a CSF in the maintenance of exchange rate stability is not decisive, the confidence-building characteristics of a CSF can help to create the proper climate for the authorities to introduce the array of measures that should accompany a stabilization program, such as the implementation of de-indexation mechanisms.

Having said this, the question arises as to what should be the role of the Fund in fostering the use of these schemes. It is clear in this regard that the Fund can play an important role even when there is no financing involved, as exemplified by the case of Poland and when the case of Mexico was brought up during our recent discussion on a short-term financing facility. Incidentally, the analogies that can be drawn between a short-term financing facility and a CSF are numerous. Although we agree that these are two different instruments, it is nonetheless true that there are many similarities and that much of the previous discussion could be used today to highlight the main areas of concern in respect of CSFs. I am thinking, for example, about the question of how to distinguish between foreign exchange market pressures stemming from short-term and reversible developments and those resulting from more fundamental balance of payments problems. In the latter case, activation of a Fund-financed CSF could be counterproductive and even contrary to the guidelines of

Article VI if it turns out to be financing sustained capital outflows. The reporting requirements to be imposed on recipient countries and the need to streamline Board procedures, as well as the substantial costs involved in terms of human resources, prompt similar considerations to those already raised in our previous meeting.

It is my impression, however, that the Fund should not abandon, in the case of a CSF, the possibility of fostering such schemes through actual financial support. The tranching of purchases, which should be accompanied on each occasion by formal Board approval, would limit inappropriate involvement by the Fund. I agree that Fund support for currency stabilization operations should be limited to cases in which the exchange rate peg is realistic and sustainable and appropriate economic and financial policies are being followed. I have noticed, however, an excessive emphasis in the paper in relation to the need for tight monetary policies as a condition for Fund assistance. The fact is that, except when the exchange rate is under temporary pressure, such policies will not be conducive to exchange rate stabilization. In the medium and long run, sound structural policies are better safeguards of stability.

Regarding the specific modality of the Fund's role, I would favor the option of a window within an existing facility rather than creating an entirely new facility. The access limitation embedded in the window option could be dealt with by resorting to the exceptional circumstances clause, if an actual purchase is ever requested. However, if credibility concerns would make the available amount look small, even with the exceptional circumstances clause, actions could be prompted to complement it with the participation of other sources of financing interested in strengthening the chances of success of a given stabilization program. The window option would give the right signal that Fund support for currency stabilization is intrinsically linked to the satisfactory performance of an upper credit tranche program.

I consider it appropriate that CSF resources drawn, including those in the first tranche, should be used to replenish a given proportion of reserves actually used in intervention. One half of net interventions, as in the case of Poland, seems to be a reasonable level of support. On the other hand, when capital inflows are larger than expected, a commitment to increase reserves should be imposed. A period of six, rather than three, months for early repurchase expectations and a one-year repurchase obligation for all purchases, including for the first tranche, seems to me the best way to avoid rigidities and to ensure that CSF resources are used for the intended purpose and not for general balance of payments support.

On the costs related to the establishment and activation of a CSF, I think that the problem lies with the commitment fee. Differentiating from a traditional program in which success is measured by the number of drawings made, which entitles a member to reimbursement of the commitment fee, in the case of a CSF the absence of drawings should not penalize a member that has to bear the full cost of such a fee. I wonder whether the staff could comment on the potential forgone income involved if this commitment fee were canceled altogether in the case of a CSF.

On the question of collateral, I think the Fund should not depart from its traditional policy of relying on proper conditionality and on its preferred creditor status as the best safeguards of its credit exposure with member countries.

Finally, perhaps the staff could comment on the inherent advantages of a fixed exchange rate regime supported by a CSF as opposed to alternatives, such as a currency board stabilization scheme.

Mr. Kang remarked that he supported the need to introduce greater flexibility into Board arrangements and to streamline Board procedures to provide scope for more timely consideration of issues that required urgent attention. Nevertheless, he was concerned that the compressed circulation period for the staff paper for the present discussion appeared to reflect a recent trend toward shorter circulation periods for Board documents more generally.

The Chairman noted that the present discussion was intended to provide only a preliminary consideration of the issues. While recognizing that the circulation period in the present case had been somewhat tight, he would nevertheless very much welcome the personal contribution of Executive Directors in helping the staff and management finalize their proposal.

Mr. Schoenberg said that he wished to associate himself with the remarks of Mr. Kang. In view of the Chairman's comments, however, it might be useful to clarify whether the rules regarding the circulation of papers for preliminary consideration differed from those governing papers containing draft decisions.

The Chairman replied that there were no formal rules governing the circulation of papers for preliminary consideration. The Executive Board, like the Fund itself, was a living institution, which was constantly trying to improve and adapt itself in the face of an increasingly challenging world. Although Directors might wish to reflect further on the matter, a certain degree of flexibility should be retained in certain instances to encourage the involvement of the Board in the formulation of proposals at an early stage. Indeed, he valued every opportunity to work with Directors on the elaboration of Fund instruments and policies; even when they were not able to consult fully with their authorities beforehand, the contribution of Directors was invaluable to management.

Mr. Mesaki made the following statement:

I can agree to the Fund's continuing to discuss CSFs, as I believe they could be useful for those countries that have prepared a sufficiently ambitious program supported by a stand-by arrangement and that are expected to achieve price and exchange rate stability.

Nevertheless, I believe that a CSF should be regarded as an extraordinary facility and should be activated only in exceptional circumstances. I share Mr. Kang's basic concern, although my view is not against introduction of CSFs. I will specify my concerns.

Pressure on exchange rate stability should be dealt with primarily by the implementation of sound macroeconomic policies; in this respect, I fully agree with Mr. Clark that it cannot be overemphasized that a pegged exchange rate is not a substitute for strong macroeconomic stabilization policies. Also, Mr. Kang rightly points out that a CSF could be used to delay adjustments in the real economy and/or the exchange rate. In addition, as several Directors have pointed out, it is difficult to judge whether or not the underlying cause of exchange rate instability is temporary in nature.

In the event a CSF is established, its actual use should also be strictly restricted, because the important thing is not the resources themselves but their function as a builder of confidence. In this connection, I share many other Directors' view that CSFs should not be a source of general balance of payments financing. A restrictive policy would also imply that the early repurchase obligation should be strictly imposed.

Let me touch upon issues such as situations in which it might be appropriate to use a CSF.

For the reasons mentioned, I believe that the Fund should be very cautious about recommending activation of a CSF. I do not agree with the view that use of a CSF should be the ultimate goal of the economic policy of a transition economy. I fully agree with Mr. Clark and Mr. Al-Jasser that there is a risk that through the creation of CSFs the Fund could be perceived as advocating a general policy of fixed exchange rate regimes. It is crucial for us to take a pragmatic approach, on a case-by-case basis, with respect to the introduction of a CSF. Specifically, the Fund should strictly require that members requesting to use a CSF have achieved macroeconomic and exchange rate stability through the implementation of sound policies before recommending its activation.

With regard to the specific preconditions for activation of a CSF, I would propose that the following should be fully satisfied. First, the adoption of an appropriate exchange rate, supported by the implementation of a comprehensive Fund program; second, the full observance of a stand-by arrangement; and third, the passage of a sufficient period of time, during which the exchange rate has been in equilibrium. On the third point, Mr. Al-Jasser's suggestion to activate a CSF on completion of a program review might be a reasonable idea.

As CSFs were originally designed specifically to help achieve price stability in economies in transition, I would like to stress that the CSF system should be transient and expire after those economies have finished moving to a market economy.

With respect to the modality of the CSF, of the two options presented in the paper, in terms of function there is almost no difference between the two. But my feeling is that the special facility approach is cleaner and simpler, whereas I am afraid that the window approach might cause some unpredictable legal problems in connection with the policy on stand-by arrangements. In addition, in the case of the window approach, like Mr. Mohammed, I am afraid that repeated invocation of the exceptional circumstances clause in respect of the access limit under stand-by and extended arrangements might cause some difficulty in connection with the basic principle of that policy. At any rate, I understand that this is the initial stage of discussion on CSFs, and I would appreciate it if the staff could prepare some comparative tables, by which we can find the difference between two approaches from all necessary aspects.

Finally, on the legality of the proposed CSF, I would recall that I raised a question about the consistency of the proposed short-term financing facility with the Articles of Agreement at a Board meeting a couple of weeks ago.

Mr. Kang pointed out that the same legal problem could occur with respect to the prohibition under the Articles of Agreement on the use of Fund resources in connection with large capital outflows. However, I would say that the situations under which these facilities would be used are different, and therefore the CSF would not seem to pose a legal problem. Actually, in most cases the CSF would be used in order to deal with substantial upward or downward pressure on exchange rates caused by inadvertent failure of economic policies, not by unpredictable capital flows, as envisaged in the short-term financing facility. Nevertheless, just for confirmation, I would appreciate the staff's comments.

Mr. Al-Jasser commented that it might be useful if the staff were to clarify the legal aspects of the exceptional circumstances clause. In his view, a currency stabilization fund would, by its very nature, be used only in exceptional circumstances.

Mr. Autheman made the following statement:

I welcome this opportunity to exchange preliminary views in order to provide guidance to the staff on this difficult issue. I found the staff paper very interesting but not convincing enough. I am not yet convinced of the need and appropriateness of creating a new facility to support currency stabilization funds or of creating a window above our access policy. Of course, I am pleased to note the growing interest of the staff in using nominal anchors in order to strengthen stabilization programs, although I am somewhat puzzled to read that some of my colleagues are interested in stabilization funds but reluctant to support fixed exchange rate policy. I fail to see the consistency of this position.

I would like to quote one of the main conclusions in the staff paper on the review of stand-by arrangements (EBS/94/84, 4/15/94): "the decision to use an exchange rate anchor in Fund-supported programs should place greatest priority on the prospects for resolute fiscal adjustment, the credibility of these prospects in the eyes of the public, and the removal of indexation." At this time, we had not identified the existence of a stabilization fund as a necessary element in the implementation of nominal anchor strategies.

I acknowledge that in some cases a stabilization fund could be a marginal, temporary, and a useful complement to a well-designed stabilization program on two grounds: first, the need to enhance the authorities' self-confidence in their ability to resist all sorts of pressures; and second, the possibility of helping to overcome capital market skepticism. The use of such instruments should be related to the expectation of a return of capital flight, which should be built into the assessment of the need for and the use of such a fund.

At the same time, I am concerned that we could have misunderstandings with possible users that would be mainly attracted by the higher access to external resources. I do not favor a new facility because I see a risk that it may be tailor-made to meet the specific situation of a very limited number of countries; of course, we can agree on constraints in order to prevent that risk. But I am also puzzled by the numerous references made by previous speakers to this notion of exceptional circumstances, which in my understanding cannot be defined and should not be invoked ex ante.

I do not see the case for supporting a crawling peg through a stabilization fund. This would introduce ambiguity at the outset. We know that a fixed exchange rate creates a strict constraint, but what would be the degree of constraint of a crawling peg?

Regarding the "window option," I see the merit in a window within stand-by arrahgements, but I do not see the merit of a window above access limits. In fact, I am puzzled to note that, less than two months after agreeing on a very substantial increase in access limits from 68 percent to 100 percent, we are now discussing a further increase in access limits. Three months ago, I would have been ready to consider a 125 percent access limit as in 1983, and I would prefer this straightforward approach to the one we are considering today. I believe it is very important for this institution to stay with the constraints it sets for itself. If we were to develop above-limit facilities, we would need to provide a very tight set of conditions in order to secure the use of these facilities, but then we would run the risk of designing too tight a corset for an overweight body. It seems to me that the intersection of the set of conditions on which we could agree and of the set of conditions met by requesting countries is a void set.

Finally, I am not in a position today to elaborate on the details of the scheme--whose usefulness I am not yet convinced of. I would limit myself to a few comments.

First, I would be reluctant to preclude the hypothesis of cofinancing. I think that the argument that our fiscal positions are tight is not relevant: we are talking of providing reserves to stabilize currencies, and I do not think that this would be a relevant use of fiscal resources. It could be a relevant use of monetary resources and of central bank support. We all know that it is very difficult to get cofinancing agreements to work smoothly; but this difficulty may help us remain cautious, because when agreements are difficult to reach they are sometimes easier to follow up on. So we should leave the option of cofinancing open. From my point of view, there is some consistency in sticking to access limits, on one side, and leaving open the window of cofinancing, on the other.

Second, I will always be ready to act under exceptional circumstances, but I am not ready to quantify exceptional circumstances ex ante, and I would be reluctant to act in the expectation that we would use this clause.

Third, I think we should take a further look at the possibility of acting within our limits through the use of set-asides, as we did under the debt strategy, through front-loadings and ex ante control over our conditionality.

Mr. Al-Jasser said that he shared the concerns and cautionary notes expressed by Mr. Autheman. Although he was among those who were not yet convinced of the need for currency stabilization funds, he did not see an inherent contradiction between support for such a facility and an aversion to fixed exchange rates. In any event, the Fund should not take a general view that pegging the exchange rate was appropriate for all or even a large group of members.

The Chairman noted that the general view to which Mr. Al-Jasser had referred did not appear in the staff paper.

Mr. Al-Jasser remarked that while an institutional preference for fixed exchange rates was indeed not explicit in the staff paper, that view had emerged elsewhere, as in the recent discussion on Kazakhstan (EBM/94/104, 11/30/94). No doubt there were cases in which pegging the exchange rate would be appropriate, but those judgments had to be made by the Board on a case-by-case basis. Caution, or even skepticism, on the advisability of pegging the exchange rate as a general rule for a large number of countries was not inconsistent with the view that a currency stabilization fund could be useful in certain cases.

He strongly supported the cautionary note struck by Mr. Autheman on access, Mr. Al-Jasser said. On a point of clarification, he was not suggesting that the exceptional circumstances clause would in effect be invoked ex ante through the establishment of a currency stabilization fund. As he understood the procedure, the exceptional circumstances clause would be invoked only after it had been agreed in the context of, say, the first review under a program that the exchange rate was sustainable; a currency stabilization fund would seem to lend itself to such a procedure. Thus, while he agreed with Mr. Autheman that invoking the exceptional circumstances clause ex ante would not be appropriate, the use of that clause in individual cases should not be ruled out either.

Ms. Lissakers said that although she understood the concerns of Mr. Autheman and Mr. Al-Jasser on access limits, it was useful to bear in mind that the purpose and operational features of the proposed facility were quite distinct from those of standard stand-by arrangements, for example. The purpose of a currency stabilization fund, whether under a special facility or a window would be to anchor the exchange rate, not to provide general balance of payments support. If the exchange rate were to be a credible anchor, the supporting currency stabilization fund would need to be substantial and readily available; it would also need to be an integral part of a Fund-supported program. If access under a currency stabilization fund were not to float in relation to existing access limits, countries adopting strong programs that warranted a high level of access under the existing limits, arguably those most likely to qualify for an exchange rate support mechanism, would in effect be denied access to that mechanism to the extent that the access limit had been reached in supporting the underlying stabilization program. In practice, therefore, the use of the proposed instrument would be negated under precisely those conditions in which it would, in theory, be permitted.

Mr. Al-Jasser considered that there was no disagreement on access between Ms. Lissakers, on the one hand, and Mr. Autheman and himself, on the other hand. From the perspective of the purpose of the facility itself and its utility for potential users, Ms. Lissakers was indeed correct. From an institutional perspective, however, it was important to balance the usefulness of the facility for the member with the potential liability it created for the institution. Both perspectives should be kept in mind. Indeed, in his prepared statement he had noted that, if it were decided to establish such an instrument, a currency stabilization fund would need to be credible to build the confidence necessary to support the exchange rate.

Ms. Srejber made the following statement:

> Let me from the outset underline that I am far less skeptical about the potential feasibility of a CSF than this chair was about the short-term financing facility, mainly because a CSF would only be considered as part of a bold stabilization program to be supported by Fund financing.
>
> I also agree that CSFs, and possibly also the mere existence of a CSF instrument, could lend added confidence to members' exchange rate policies undertaken in the context of strong Fund arrangements, and that a fixed exchange rate, backed by sufficiently strong fiscal and monetary policies, can be an effective component of an anti-inflationary strategy.
>
> However, I would like to emphasize that a comprehensive strategy to achieve and safeguard macroeconomic stabilization is still the only effective means for building the confidence necessary to avoid exchange rate pressures. I thus fully agree with Ms. Lissakers, Mr. Mesaki, and Mr. Clark when they emphasize that a pegged exchange rate is not a substitute for strong macroeconomic stabilization policies. But I am not sure that I understand Mr. Saito, when he says that the staff paper puts an excessive emphasis "in relation to the need for tight monetary policies."
>
> As the staff paper is intended to outline preliminary considerations in the area of possible Fund financing for a CSF, and a number of questions need further studies and clarifications, my views will also be of a preliminary nature at this early stage of the process. Thus, I shall try to focus on some of the subjects that need further consideration in order to provide a basis for coming to more firm views on the modalities and issues raised by the staff.

First, in the staff's preliminary considerations, like Mr. Saito, I do miss a discussion of comparative advantages of a CSF compared with other possibilities of Fund support for using the exchange rate as a nominal anchor in the stabilization process, including a currency board construction, which has been applied with considerable success within my constituency.

Furthermore, on the term "exchange rate anchor," the staff is not very specific, and I join Ms. Lissakers in her questions. I agree with her that we should be careful about extending a CSF to types of exchange rate arrangements that go beyond fixed pegs. A related issue is how to define the right exchange rate to support. Of course, I agree with the staff that it should be both realistic and sustainable. A too unambitious exchange rate policy would probably not do much to contain inflation expectations, and, in addition, it could have detrimental effects on neighboring countries.

Second, Fund financing for a CSF would entail increased risks for the Fund. These risks need to be balanced against the effectiveness of such an instrument in providing confidence to an appropriate exchange rate anchor. I fully agree with the staff that a successful CSF would serve its purpose best when it does not need to be used. I would even say that this should be our overriding objective in efforts toward establishing proper conditions and modalities for the use of such an instrument. If we are ending up with a situation where the instrument will be activated, we have probably not been sufficiently ambitious in drawing up the program. A CSF is thus much more a matter of signaling than of financing, given the inappropriateness of intervention alone to counter short-term pressures. Like Mr. Clark, I find the Polish case very illustrative in this respect.

Third, I agree that access to a CSF should be strictly limited to member countries having stand-by or extended arrangements. One crucial aspect will then be the conditions that have to be fulfilled before the CSF element of the arrangement could be activated.

I would find it particularly risky to activate the CSF element for countries having a poor track record, even if one has a strong forward-looking stabilization program. It, therefore, seems reasonable to require that at least some kind of a satisfactory track record be in place before entering into a CSF. In such a qualifying period, the country should have demonstrated its willingness and capacity to comply with a comprehensive stabilization program. In order to shorten such a period, it seems appropriate to front-load some measures, that is, to be rather ambitious with respect to prior actions. Such a phasing-in period, before opening up the possibility of a CSF drawing, could also allow for the establishment of a sufficiently stable exchange rate.

Fourth, I would also argue that drawings of the first tranche of a CSF should be conditional on certain prior actions, especially timely increases in interest rates to demonstrate the country's seriousness and commitment to abate the pressure. Such actions, together with a requirement of pari passu use of the authorities' own reserves, could provide time for preparing fiscal measures to be introduced if the pressure continues. Thus, we should seriously consider how to avoid using a CSF to meet a large or sustained outflow of capital. Requirements of some appropriate prior actions before drawing would play its part, and I also see here a strong argument for drawings being made subject to an early repurchase requirement.

Fifth, I fully agree with Mr. Clark and Ms. Lissakers that the signaling effect would be eroded by excessive tranching of a Fund-financed CSF, and that the Polish case also may be of relevance in this respect. In order to give a clear signal of confidence, I would also suppose that the first tranche should be made sufficiently large, but balanced by the strength of the program.

We should also avoid excessively frequent and detailed Board involvement in the monitoring of such arrangements. However, the Fund must be in a position where it continuously can ask itself whether and to what extent the exchange rate policy is sustainable. The overall objective of the Fund's procedures should be that they lead to action, when necessary, well in advance of the development of destabilizing expectations in the markets. I would certainly prefer delegating much of the monitoring responsibility to the staff; however, in order to ensure that imbalances are not allowed to accumulate, I would find it appropriate if some periodic discussions in the Board could be considered. I think that a quarterly review would strike the right balance. Such a review should not necessarily be a lengthy discussion, but would at least give the Board an opportunity to reconsider developments and convey views, if needed, to the authorities.

Next, some further clarification on the likely demand for such a facility would be appreciated. I am a little puzzled by the remark in the footnote on page 1 in the staff paper, which says that "the possible contribution of a CSF has also been raised in several countries...."

Finally, on the more general issue of financing of a CSF and of a window or a separate facility, we would need more studies and clarification before drawing firmer conclusions, but we share many of the thoughts of Ms. Lissakers and Mr. Clark on this issue. It may also be considered whether there is room and interest for some kind of cofinancing. Liquidity considerations in the medium term and risk sharing could make it desirable that a cofinancing arrangement be set up. However, the benefits of cofinancing need to be carefully weighed against any risk of injurious influence on the Fund's authority to approve or disapprove drawings of Fund resources, and it should be ensured that we do not end up with too complicated procedures.

In conclusion, I support the staff's continuing to develop the CSF concept, but perhaps also with a side view to alternatives.

The Chairman, commenting on the concern expressed by Ms. Srejber about the number of possible users of a Fund-financed currency stabilization fund, said that he saw such an instrument as being of potential use to a relatively small number of members from various regions.

Mr. Schoenberg commented that he would probably be able to contribute little to the guidance the staff was hoping for with respect to specific modalities and features of possible Fund policies in support of currency stabilization funds. In his view, before discussing the modalities of such an instrument, the Board should examine carefully the rationale for currency stabilization funds, in general. With that view in mind, his remarks would focus on the basic purposes of Fund-supported CSFs, and he would reserve his comments on the possible modalities and operational features for a future Board discussion.

Although the outline of the broad elements of the establishment and operation of CSFs presented by the staff appeared consistent and suitable to achieve the stated purposes under the implicit assumptions being made, Mr. Schoenberg noted, he had doubts about the validity of those assumptions. He had been especially disappointed that the staff had almost completely omitted a discussion of how the establishment of Fund-supported CSFs would relate to the Fund's general approach of assisting member countries in balance of payments difficulties.

A few fundamental issues came to mind in connection with Fund support for CSFs, Mr. Schoenberg said. The first issue was the theoretical justification for the Fund to create a new facility or to make additional resources available in favor of a specific stabilization instrument to be used by member countries. As was widely recognized, the use of the exchange rate as a nominal anchor was only one among many approaches to stabilization. Other nominal anchors that had been successfully used by member countries included the money supply, nominal GDP, inflation targets, and nominal income targets. He wondered why the Fund should favor a priori a specific method of stabilization by making additional financing available for that purpose. Mr. Saito and Ms. Srejber had made similar points. Put differently, it was useful to ask why the Fund should not also establish special facilities to support members in their efforts to stabilize the domestic money supply or the total volume of credit or to finance the establishment of a currency board system. While his chair had always acknowledged that the use of the exchange rate as a nominal anchor might be appropriate in many cases, in other cases other forms of stabilization might be more suitable. That aspect was of potentially immense practical importance, as was noted also by Mr. Clark. If the Fund were to offer additional financing for a specific method of stabilization, members whose objective circumstances would favor a different approach might opt for the exchange rate stabilization approach in view of the prospects for additional financing.

A second fundamental issue that arose in the context of Fund support for CSFs, if the Fund were to come to the conclusion that special support for the use of the exchange rate--as opposed to other nominal anchors--would be warranted, was why the Fund should support only an exchange rate peg and not other forms of using the exchange rate as a stabilization instrument, Mr. Schoenberg considered. Fund experience suggested that it was difficult in the early stages of the stabilization process to determine the appropriate level of the exchange rate. Even if the Fund were to succeed in that difficult exercise, an initially appropriate exchange rate might soon fall out of line with the fundamentals, because even the most successful stabilization process took time to bring inflation down to the level of the country against whose currency the exchange rate was pegged. The question arose, therefore, whether to peg the exchange rate at a level that was appropriate at the beginning or the end of the stabilization process. A firm exchange rate peg without adequate prior domestic stabilization could also easily overtax the ability to deliver the required domestic policy adjustment in countries that were still some way off the degree of stability prevailing in the anchor currency. To overcome such risks and difficulties, it might be preferable in many cases to use an adjustable nominal anchor. In any event, the considerations he had mentioned argued strongly in favor of the need for an in-depth analysis of the conditions under which an exchange rate peg could be expected to operate successfully and achieve the desired objectives.

If the Fund were to conclude that in certain cases a fixed exchange rate regime could constitute the most appropriate nominal anchor for a country, Mr. Schoenberg continued, a third fundamental issue to be resolved was the role that the level of available reserves should be expected to play in gauging the prospective success of such a policy. It appeared to him that the staff overestimated the role of exchange market intervention and underestimated the importance of prompt policy and, in particular, interest rate adjustments. After all, the use of the exchange rate as a nominal anchor was primarily supposed to provide signals for economic policy corrections, not for exchange market intervention. Certainly, a comfortable cushion of exchange reserves might have a certain confidence-enhancing effect. The credibility of an ambitious adjustment and reform program, however, did not derive primarily from the level of reserves but from the confidence that required policy adjustments were carried out promptly. That lesson was the essence of the recent experience of the European Monetary System. He would be interested to learn from the staff about the number of cases in which an exchange rate peg that had been considered appropriate by the Fund had subsequently failed owing to a lack of reserves.

The proposal for CSFs, like the proposal for a short-term financing facility, rested essentially on the assumption that the Fund and/or individual member countries could better assess the short-term adequacy of exchange rates than markets, Mr. Schoenberg remarked. He continued to have doubts about that proposition, particularly with respect to transformation countries, where sweeping structural reforms often had an unpredictable impact on the exchange rate.

Having dealt in the context of the discussion on the short-term financing facility with the repayment risks that arose for the Fund in the event that its exchange rate assessments were subsequently not confirmed by the markets, Mr. Schoenberg recalled, there was no need for him to repeat his views on that issue. Nevertheless, he wondered whether the Fund should not rely on its specific comparative advantage and advise countries how to improve their fundamentals rather than how to defend the exchange rate against market pressures. Presumably the prestige of the Fund would be affected if an exchange rate to which the Fund had officially subscribed and for which it provided financial support could not be sustained. Experience in many recent cases suggested that countries with convincing economic policies did not need additional reserves to defend their currencies but, rather, had to cope with large capital inflows. Dealing with large inflows of capital would actually require the opposite of a CSF--that is, a foreign exchange sterilization fund.

A fourth issue that emerged in the present context was whether a special Fund policy should be developed for circumstances that, as the staff acknowledged in the paper, would not be expected to occur frequently, Mr. Schoenberg stated. If it were felt desirable in some rare cases to express the solidarity of the international community with the stabilization and reform efforts of the transformation countries, then the question arose whether the Fund should not in fact deal with those rare cases on an ad hoc basis--Mr. Autheman had used the expression "tailor made"--and on the basis of existing instruments. Such an approach would not give rise to the impression among the membership that the Fund would establish a new facility offering additional financing to all countries using the exchange rate as a nominal anchor. While he agreed with the staff and other speakers that in any case very infrequent use of CSFs would be desirable, the criteria listed by the staff to guarantee such infrequent use--programs in the upper credit tranches, appropriate economic policies, secured full financing of programs, and a fixed exchange rate--were matters of course, which by no means would safeguard against widespread application. In that context, a further question arose concerning the Fund's liquidity over the medium term.

There did not appear to be any satisfactory answers in the staff paper to the few questions he had raised, Mr. Schoenberg, considered. With that in mind, if forced to choose between the two options discussed by the staff for the provision of financing for CSFs, he would lean toward the window option, as that approach would be more closely related to the traditional Fund approach to members' balance of payments problems. The Fund would also continue to rely on its existing instruments and access limits, including, if needed, the exceptional circumstances clause.

The Chairman asked Mr. Schoenberg whether he could elaborate on the ad hoc solution he envisaged for those situations in which a strong, credible program had been adopted and it had been agreed that the sustainability of the exchange rate could usefully be supported in some way.

Mr. Schoenberg replied that the main consideration was whether it was useful to develop a standard policy for only a few cases--perhaps only those of systemic importance--as was apparently the intention of the staff, because such a policy would probably be interpreted as having a more general application. The establishment of such a policy might give the impression that the Fund would offer financial support for any country that used the exchange rate as a nominal anchor. Like Mr. Autheman, he tended to believe that it would be difficult to determine in advance the special circumstances under which such a possibility should be considered. It would also be difficult to develop criteria that could be applied in only a very few cases.

Mr. Mirakhor noted that the Fund had a mandate under Article I to promote exchange stability. Clearly, a situation could be envisaged in which a country with a reasonably well-established record of stability chose to pursue an anchor policy. The country would have a need for reserves to make sure that its policy was credible. Mr. Autheman and others had suggested that, under those circumstances, there was a role for a currency stabilization fund. In his view, however, the number of such cases was not likely to be limited; indeed, there had been a number of occasions on which the Board, or certain chairs, had suggested in the context of an Article IV consultation or a program review that the country should move toward the adoption of an exchange rate anchor policy, the most recent case being Turkey. The Fund already had instruments to deal, perhaps tangentially, with the main function of the institution as envisioned in the Articles of Agreement, but the present discussion offered an opportunity to establish the means to deal direct with one of the functions of the Fund, namely, to assist countries that chose to move toward exchange rate stability.

Mr. Kafka made the following statement:

> The staff describes the basic purpose of its proposal as adding credibility to an exchange rate peg against short-term disturbances. More specifically, the staff conceives of a CSF as something to serve countries that have an arrangement with the Fund--that is, a different orientation from that underlying the proposed short-term financing facility. I assume that such an arrangement could be a precautionary stand-by arrangement, but

also a monitoring agreement of some sort--at least, I cannot see why it should not be, if performance before the use of a CSF has been "appropriate."

In addition to endowing a peg with credibility, one could also ask whether there could not be a more encompassing purpose, namely, to increase the Fund's influence over countries that do not normally use its resources by offering them an additional service--that is, funds for stabilization additional to those otherwise available. Some countries have, of course, large reserves or borrowing capacities--from the market or, perhaps, very short-term, unlimited access to the facilities of the European Monetary System--and would, therefore, be unlikely to use even very large access to Fund resources for currency stabilization. But there are others, and not only least developed countries or countries in transition, that might welcome a CSF.

In any case, I wonder whether a CSF could be useful unless potential access to it were very large. This would seem to me to be the case even if one expected a country to adopt policy measures if faced by exchange market pressure, rather than riding out the crisis by use of reserves. But because exchange market pressure is likely to be mainly or at least often provoked by capital outflows, it may be true that a useful CSF would have to be preceded by a reform of Article VI, Section 1(a). Because of its size, it seems to me that a CSF would most logically be established as a special facility and not as a window. We would in particular have to find a solution for the required resources.

I would like to hint at a number of other difficult questions.

The first question refers to the CSF's link to a pegged rate. But what exactly do we mean by pegged rate? Would it not be worthwhile to foresee use of a CSF also in connection with a crawling peg? If so, what rate of crawl would be appropriate? I pass over the question of how to estimate an equilibrium rate.

I have no problem, in principle, with the staff's conditions. The three preconditions--tight policies, likelihood of quick policy adaptation, and a fully financed underlying program--all seem sensible, although their definition is necessarily going to be somewhat vague. The same is true for other conditions mentioned by the staff, which are necessary to ensure that the CSF should be used only for the intended purposes: frequent monitoring of exchange market conditions, intervention operations, and program performance, as well as a reconstitution provision, and the possibility of revolving access--that is, automatic augmentation where repurchases have taken place.

I very much doubt whether access to the facility should be tranched. That would seem to me to conflict with the need for a high level of access for countries entering into such a facility as long as the preconditions mentioned above are met. I would support at most a division into two tranches. The first one would become available upon activation of the CSF, to be used and re-used without further review by the Board as long as the country remains in conformance with its underlying arrangement. The first tranche could be drawn without a need to demonstrate a loss of reserves. The other tranches could be drawn unless the underlying arrangement had been grossly violated. Somewhat along the same lines, it seems to me that to demand advance warning for purchases would be impractical.

Obviously, I have only adumbrated some of the problems we should try to solve if we want to establish a useful facility.

Mr. Ismael made the following statement:

At this stage of our preliminary discussion on the CSF, I will confine myself to three brief comments: one on the need for a CSF, another on the fixed exchange rate element of the CSF, and the last on the availability of the CSF.

I have sympathy for Mr. Kang's skepticism about the need for a CSF, as well as that of Mr. Autheman and Mr. Al-Jasser. However, while I am not sure whether a CSF as proposed is needed, I am open to persuasion. A Fund arrangement, in my opinion, should have a credible and therefore strong fiscal and monetary policy underpinning to begin with, which should result in a sustainable fixed exchange rate. In turn, by itself, a fixed exchange rate, chosen as part of a comprehensive strategy of a Fund arrangement because of the availability of a sufficient amount of international reserves, should be able to impose fiscal and monetary discipline. There is, therefore, a mutually reinforcing process, which would accelerate the achievement of macroeconomic stability. Therefore, what is probably needed is not so much a special facility, as supported by Mr. Kafka, but at the most a window within a Fund arrangement under the existing limits. In this way, we would preclude the possibility that the CSF would turn into a facility that is specifically engaged in financing intervention operations.

I am also uncomfortable with the fixed exchange rate element of the proposed CSF. As correctly pointed out by Mr. Clark and Mr. Al-Jasser, there is a risk that the Fund could be perceived as advocating a general policy of fixed exchange-rate-based stabilization. Indeed, the Fund has so far not followed a particular foreign exchange rate regime stance, but a case-by-case approach to its advice to member countries. Its advice to Bulgaria, Poland, and the Czech Republic, for example, differs. Therefore, I join Mr. Clark and Mr. Schoenberg in questioning why other foreign exchange policies are not considered. In particular, I join Ms. Lissakers in asking whether a CSF might be used to support a crawling peg. A crawling peg, in my view, might better withstand the likely deterioration in external competitiveness if the program does not start from a strong enough external position, although it has the necessary fiscal and monetary policy underpinning.

Finally, I welcome the intention that the proposed CSF would be available to all members in comparable circumstances. Failure to adopt such a policy would create the perception that the Fund is providing more favorable financing arrangements for members that adopt certain types of stabilization programs.

I am looking forward to further elaboration in the near future.

Mr. Geethakrishnan commented that currency fluctuation was an extremely difficult area in which to make assessments and predictions. It was an area fraught with uncertainty, and it was difficult to determine a priori the package of measures necessary to bring about order and stability. The difficulty applied with equal force to both the country concerned and those, like the Fund, wishing to extend support to that country. He was a little uneasy about venturing into that area, because the risks could be enormous.

Nevertheless, Mr. Geethakrishnan continued, there could be cases in which additional support at the right juncture could enable a country to set right its position and continue the good work of macroeconomic stabilization. As Mr. Mirakhor had pointed out, lending support to members in those circumstances could also be considered part of the Fund's overall package of duties under the Articles. If the Fund were to extend support for currency stabilization funds, the criteria for the choice of countries to be supported, and the conditions under which such support would be extended, would have to be set out clearly so as to leave no room for doubt at a later stage.

To be eligible, a country should have a good track record of implementing macroeconomic stabilization measures, Mr. Geethakrishnan considered. The country's domestic policies should be sound; it should not normally be having a problem in building up adequate net international reserves; and it should have a realistic exchange rate that it wished to defend in the face of currency pressure. For the Fund, one of the basic requirements would be an intimate knowledge of developments in the country concerned--knowledge that could become available through frequent discussions, as in program cases. In working only with countries having a good track record, management and the Board would be assured that the country had not failed to implement macroeconomic stabilization measures, had heeded good advice, and would again be in a position to implement sound policies.

With those thoughts in mind, Mr. Geethakrishnan said, he could go along with the thrust of the staff paper, namely, that the Fund should be able to extend support to program countries that wished to defend the exchange rate as part of a macroeconomic stabilization policy, and where the domestic policies were already in place. It would be necessary to establish fairly tightly defined criteria for both the countries concerned and the conditions of Fund support, and he looked forward to further elaboration by the staff on those issues.

Fund support through a currency stabilization fund should not be viewed as a substitute for achieving the net international reserves target, Mr. Geethakrishnan remarked. Given the purpose of a stabilization fund, Fund support would necessarily be extended on a short-term basis, and there should be provision for repurchase at an early date. If the risk to the Fund were to be kept to a minimum, the concept of a revolving fund would have some appeal, inasmuch as it would ensure that repurchases would allow for new purchases. In his view, a special facility, rather than a window under existing policies, would be the best approach. There was a certain element of predetermination or automaticity involved in the window approach, whereas treating currency stabilization funds as a special facility would help to ensure that the Board took a fresh look at each request. Although the window approach would allow the Fund to adapt its procedures in order to be in a position to extend support on an urgent basis, a special facility, as noted by Mr. Mesaki, would be cleaner and simpler.

Ms. Lissakers said that a currency stabilization Fund would need to be an integral part of a Fund-supported program, as it was not intended that such an instrument aim to support the pegging of the exchange rate independent of the stabilization effort. As she understood the proposal, a currency stabilization fund would not be used in the context of sudden, unexpected shocks--a situation that the proposed short-term financing facility was intended to address. Rather, a currency stabilization fund would be aimed at helping to bring inflation under control quickly in the context of chronic or sustained hyperinflation. Pegging the exchange rate was not, of course, an end in itself but a means of stabilizing prices in the economy and building confidence into the stabilization effort. Once stabilization had taken hold and the inflation psychology had been attacked effectively, the exchange rate mechanism could be very different. Thus, an exchange rate peg, supported as necessary by a currency stabilization fund, was a particular technique to deal with a particular problem but had to be viewed as an integral part of a stabilization program, not as a stand-alone facility.

Mr. Mirakhor commented that the interventions of Ms. Lissakers and Mr. Geethakrishnan had usefully clarified the debate. The key issue was whether a currency stabilization fund should be used to help bring about stability or to enhance existing signs of stability and strengthen its sustainability. Ms. Lissakers appeared to favor a facility that would be used in the initial phases of establishing stability in the context of hyperinflation, whereas Mr. Geethakrishnan seemed to have in mind a facility that would aim to maintain an already established degree of stability.

Mr. Schoenberg wondered whether it was wise to conclude that fixed exchange rates were inappropriate for countries, such as those participating in the exchange rate mechanism of the European Monetary System that had achieved a high degree of price stabilization and convergence and that shared the same political objectives, but that they were appropriate for countries in a situation of hyperinflation.

Ms. Lissakers remarked that the appropriate policy tools in the context of annual inflation of 2-3 percent or even 7 percent were rather different from a situation in which inflation was in excess of 1,000 percent a year. It was not clear to her that direct comparisons between those two situations were meaningful.

Mr. Geethakrishnan stated that Mr. Mirakhor's understanding of his view was correct. Essentially, support under a currency stabilization fund should be extended in those cases in which macroeconomic stabilization had already been achieved; the exchange rate need not be fixed, but it should have evolved over time toward as realistic a rate as possible, and the rate itself should have come under great and unexpected pressure. In such a situation, it might be worthwhile for a country to try to defend the exchange rate, and it might reasonably look for external support in that effort.

As he had mentioned earlier, Mr. Geethakrishnan continued, candidates for Fund support through a currency stabilization fund would generally be program countries--where the Fund had intimate knowledge of recent economic developments and performance. Such a criterion would provide assurance that the country had done reasonably well in the past in heeding international advice, thus helping to put in context any threat that might suddenly emerge to the stability of the exchange rate.

For the sake of illustration, it was possible to imagine that a country like India could be a candidate for such a facility, Mr. Geethakrishnan said. In the case of India, the exchange rate was not fixed, but it had remained reasonably stable over the previous two years. Macroeconomic policies were in position. In the event of the emergence of instability, while there might be differences in the domestic perception about the degree to which policy measures should be implemented, it would clearly not be in the interest of the country to effect a sharp devaluation or revaluation of the exchange rate; thus, the authorities might wish to defend the exchange rate at its present rate. In such a situation, in which the Fund had an intimate knowledge of the economy and in which it had certain reassurances, the Fund should be in a position to extend support for the defense of an otherwise stable exchange rate.

Mr. Al-Jasser stated that he viewed currency stabilization funds as serving the purpose of sustaining an already existing degree of stability in the face of occasional pressure not justified by the fundamentals. There should be no illusion that price stability could be brought about in the absence of macroeconomic stability merely by the pegging of the exchange rate. Indeed, in cases in which pegging the exchange rate had been seen as a panacea, the results had not been very encouraging. Only when the underlying fundamentals of macroeconomic stabilization had been tackled could the stability of the exchange rate be assured; the illustrative example offered by Mr. Geethakrishnan was illuminating in that regard.

On an earlier point raised by Mr. Mirakhor, he would caution against too broad an interpretation of the Fund's mandate under Article I to promote exchange stability, Mr. Al-Jasser stated. As mentioned by Mr. Schoenberg, the relevant provisions of the Articles had been framed in terms of balance of payments support, and it was through that link and macroeconomic stabilization that exchange rate stability was promoted. Taken to its logical conclusion, the interpretation offered by Mr. Mirakhor would come into conflict with Article VI, as mentioned in the staff paper. He would also caution against giving currency stabilization funds a broader role, as had been proposed by Mr. Kafka, which would be highly undesirable. To be useful, the proposed facility should be established within the most focused and narrow framework possible.

The Chairman observed that Mr. Al-Jasser had touched on the heart of the issue. He was absolutely right in arguing that currency stabilization funds were intended for a narrow purpose and not for a large number of cases. The question nevertheless arose whether there was a case for activating such a facility before internal and external stability had been achieved in those cases where additional support for a strong anti-inflation program could help to reduce inflationary expectations. Clearly, Directors were divided on that difficult question, but he could imagine a situation in which a currency stabilization fund could be extremely supportive of the Fund's purposes.

Mr. Autheman said that it should be possible to consider both options. A nominal anchor strategy, provided that it was supported by the appropriate policy commitment, could be successful either in ending hyperinflation or in bridging the credibility gap that a country, having implemented appropriate stabilization policies, might still face. Thus, it could be useful in either the initial or final stage. The difficulty arose from the fact that at the outset the Board was considering acting outside the agreed policy framework, namely, existing access limits. If the Board were to agree on an instrument that would go beyond the existing access policy, it would be necessary to restrict the use of that instrument; the Fund could not have both a general policy on access, which had recently been increased substantially, and another policy on access for a number of particular situations. The Board had agreed on the recent increase in access limits out of a common understanding but without elaborating on the application of the new limits. In that sense, it was somewhat surprising that the Board was considering the use of a window above existing access limits without looking closely at the appropriate use of the existing limits. He saw no difficulty in meeting the concerns of both Ms. Lissakers and Mr. Geethakrishnan within the existing access limits.

Mr. Mirakhor considered that differentiation of the two approaches had become necessary because of the emphasis in the staff paper on the need for an established track record of financial policy performance. If the purpose of a currency stabilization fund was closer to the ideas of Mr. Al-Jasser and Mr. Geethakrishnan, presumably a stand-alone facility with higher access would be more appropriate, as Ms. Lissakers had pointed out.

With respect to the Articles of Agreement, Mr. Mirakhor continued, he would note that while one of the purposes of the Fund set out in Article I was to promote exchange stability, balance of payments support was not mentioned as a mechanism to further that purpose. Therefore, establishing a facility specifically aimed at promoting exchange stability did not appear to be a contradiction of the purposes of the Fund set out in the Articles.

Mr. Schoenberg noted that many Directors, as well as the Chairman, had indicated that the proposed facility would be used in only a limited number of cases. The criteria outlined in the staff paper could not, however, guarantee that the facility would be used only rarely; indeed, the cited criteria were applicable to all upper credit tranche arrangements, in particular in support of programs incorporating the exchange rate as a nominal anchor. If the Fund were to offer substantial financial resources to support an exchange rate peg, some members would be inclined to try to create the conditions to obtain such support.

Mr. Al-Jasser said that it was useful to recall that the financial assistance provided by the Fund throughout most of its history had taken the form of balance of payments support. Although it was true that Article I did not refer to balance of payments support, Article I did not stand by itself. Clearly, the concept of balance of payments support was an integral part of the Articles and the tradition and culture of the institution.

Ms. Lissakers remarked that she understood Mr. Autheman's discomfort with the proposition that the Board should contemplate a new facility or window that would float above the access limits that had been raised only a few months previously. As a practical matter, however, such an instrument had to be large--and be seen to be large--to be effective in acting as a deterrent to certain behavior by exchange market participants. In that sense, Mr. Autheman might be right in suggesting that raising the overall access limits would be the best approach. It was difficult to see how, in view of the need for strong programs supported by a high level of access, the Fund could provide an adequate amount of support for currency stabilization funds within existing access limits.

Mr. Kiekens made the following statement:

We are discussing today how to replace the present piecemeal and ad hoc multilateral responses to members' requests for financial support for exchange rate regimes with a more systematic, appropriate, and impartial framework. This approach deserves serious consideration.

With respect to the question whether a CSF can bring about stability or is only useful once exchange rate stability has been established, my position is somewhere in between. A CSF could be a useful instrument for bolstering the credibility of a fixed exchange rate regime and aiding a country's stabilization process, provided that the country is already reasonably far along on the road to stability. As many speakers have already stressed, a CSF cannot create credibility where none exists, and thus cannot replace tight fiscal and monetary policies. Also, of course, the anchor currency must itself be stable and relevant in light of the trade patterns of the pegging country. Moreover, several countries with very low reserves have successfully managed to peg their currency without a CSF. In addition, only countries with a stand-by arrangement on track can request a CSF, so that this kind of intervention will unavoidably result in a concentration of the Fund's risk on a certain member. This is the background to my further comments on the staff paper.

We believe that there must be a close relationship between a CSF and an upper credit tranche arrangement. We therefore prefer to establish the CSF as a window within a stand-by or extended arrangement, as in the case of some facilities used during the debt crisis. This would bring the CSF under the protection of the strong conditionality of the umbrella arrangement. This conditionality is essential, because the track record of the countries that will apply for a CSF will be much weaker than the outstanding track record required to obtain access to the short-term financing facility that was recently discussed by the Board. We support the suggestion to activate the CSF only at a later stage, for example, at the time of a program review, instead of at the outset of the program. That would leave room for the country to establish a good track record. Making the CSF a window within a stand-by or extended arrangement would also permit, if circumstances warrant, activation of the GAB.

The staff paper discusses, as an alternative, establishing the CSF as a special facility, because it is intended to finance special balance of payments problems. As the borderline between "special" and "general," like that between "short term" and "long term," is not clear cut, this suggestion reinforces my fears that the CSF will be used to finance general balance of payments deficits.

The very nature of a CSF calls for quick decision making. Even so, I would like to keep the Board actively involved in the decision to actuate a CSF, even if this requires more frequent Board meetings, at short notice. However, with respect to the monitoring, I see the need for appropriate delegation to the staff.

The staff's proposals with respect to the CSF's revolving character permitting its recurrent use, and those concerning tranching, are appropriate, even though tranching somewhat reduces flexibility. I also agree that reconstitution should be based on the expectation that repurchases will occur early, namely, within six months.

The staff asks us to comment on the possibility of placing the resources earmarked for CSF purposes in a Fund-administered account, in order to reduce the costs for the beneficiary members. This would, however, probably increase the administrative costs for the Fund. I prefer correct cost pricing over artificial cost reductions, as cost considerations are an appropriate incentive for members to be cautious about requesting a CSF and avoid the temptation to keep a CSF active longer than needed. I would therefore not change the present cost structure for the use of Fund resources to accommodate a CSF.

The requirement for increased reporting is an inherent feature of a CSF and the counterpart of the higher risks of a CSF to the Fund. This increased reporting will allow the Fund to monitor more closely and deal more flexibly with members having a CSF.

Based on the experience gained from the two "Fund-accompanied" currency stabilization funds, the staff's proposals for the possible cofinancing of a CSF are suitable. In this respect, like Ms. Srejber, I would like to see the Fund's autonomy of judgment preserved.

Mr. Evans said that there were four basic questions facing the Board. The first was whether nominal exchange rate anchors were a good idea in the context of, and contributing to, strong Fund-supported stabilization programs; much more so than even a few years previously, most Directors were probably ready to accept that proposition. The second question was whether, assuming the first proposition was accepted, there was a need for a stabilization fund in cases in which the exchange rate anchor required some combination of owned reserves and access to additional reserves. The third question was whether the Fund should provide help in that context; the instinct of most Directors would probably be to agree that there might be some circumstances in which the Fund could play a role. The fourth question, assuming agreement in principle on Fund support, was how the Fund should in practice contribute. Form their remarks, it was his understanding that Mr. Autheman and Mr. Schoenberg held the view that, to the extent that Fund support was necessary or desirable, it should be effected within the context of existing Fund facilities.

Turning to specific cases, a few years previously the United Kingdom had supported the idea of a ruble stabilization fund for Russia as a means of adding credibility to and encouraging a strong reform effort, Mr. Evans recalled. In practice, the conditions for activating that fund had not been met. Indeed, there was a good deal of misunderstanding within and outside Russia about the purpose of the stabilization fund, with some viewing it as an additional $6 billion of general balance of payments financing; in that regard, it had not been helpful that on some occasions the $6 billion figure had been included in presentations of total balance of payments financing.

Another interesting case was Poland, Mr. Evans continued, where the United Kingdom had supported both in principle and with a sizable contribution the Polish stabilization fund, which had helped the reform effort at a crucial point. The fact that the stabilization fund had not been drawn on was an important element in its success, although there were other lessons from that experience; for example, the exchange rate, understandably, had been set at too low a level, which had resulted in considerable inflationary pressure in the system.

Those two examples illustrated some of the costs and dangers, as well as the benefits, of the proposal for Fund-supported currency stabilization funds, Mr. Evans considered. As noted by almost every speaker, much depended on the conditions established for their use. Clearly, a currency stabilization fund would have to be limited to circumstances in which a member had a strong, comprehensive, workable strategy, expected to achieve stabilization quickly in the context of a Fund arrangement involving upper credit tranche conditionality. There did not appear to be much difference between a special facility available only in the context of an upper credit tranche arrangement and the window approach, although his preference would be for a window, because the linkage was that much more secure. As suggested by Ms. Srejber, some track record and prior actions would also be required. In principle, the accompanying Fund arrangement could be not only a stand-by or extended arrangement but also an enhanced structural adjustment arrangement, because the necessary conditions might also be met in those circumstances.

On the question of ownership, apart from a general concern that rather too many letters of intent were prepared in the Fund and not in capitals, Mr. Evans remarked, there was also a concern that the Fund might be seen to be strongly encouraging a fixed-rate exchange regime through the provision of financing that was not available for other forms of stabilization. Such an impression might suggest that the Fund had a particular preference for that type of arrangement in the context of stabilization. Even if the Fund were not convinced that a fixed exchange rate was the right framework, there would be questions about the ownership of the program, which was a danger.

It might be useful if the Fund could show that a currency stabilization fund could support other forms of exchange rate arrangements, particularly a crawling peg, Mr. Evans said. In principle, a crawling peg arrangement was no more ambiguous than a fixed rate; in practice, however, there were not many examples of successful crawling peg arrangements. Moreover, any member considering a currency stabilization fund should be fully aware of its nature. In his view, a currency stabilization fund would demand a much more intrusive role for the Fund--in terms of both close monitoring and interventionist, frequent policy advice--than under a standard credit tranche arrangement.

With respect to the risks to the Fund and the need for safeguards, many speakers had made the point that a currency stabilization fund would not be a source of balance of payments financing, Mr. Evans observed. It was not clear that establishing a reconstitution requirement in terms of a repurchase expectation in the first instance would be sufficiently tough; provision should be made, however, to allow borrowers the option of seeking an extension of the reconstitution requirement.

On access, the Fund needed to balance clearly the need for sufficient resources to be meaningful and the need for prudence, Mr. Evans stated. The balance of those needs set out in the staff paper seemed appropriate, particularly for the window route. The case for establishing a currency stabilization fund with access at 100 percent of quota in addition to the existing access limits had not yet been made. Indeed, the establishment of an access limit of 100 percent for currency stabilization funds in addition to the existing limit under stand-by arrangements, which in many cases were likely to be accompanied by access under the systemic transformation facility, was bound to raise questions. Like Ms. Lissakers, he could go along with a lower number of tranches--say, four--than was proposed in the staff paper; two tranches would not be enough. In his view, the essence of a currency stabilization fund was that it should be difficult to use and should generally require additional policy measures. Use of a Fund-supported currency stabilization fund should involve the active and prompt involvement of the Board, because funds might be required at short notice, and should be accompanied by parallel use of the members' own reserves.

On legal issues, Mr. Evans commented, he was not fully persuaded by the footnote on page 2 of the staff paper, which noted that Fund resources could not be used to meet a large or sustained outflow of capital within the meaning of Article VI. The circumstances in which a currency stabilization fund was most likely to be used were precisely those dealt with in Article VI: pressure on a fixed exchange rate stemming from a capital outflow that was large in relation to quota. He would welcome the staff's view on how such a scenario could be consistent with the language of Article VI.

In conclusion, he could imagine circumstances in which a currency stabilization fund could have a useful role to play in supporting reform efforts and, most important, generating new sources of private external financing, Mr. Evans remarked. As Mr. Schoenberg had noted, successful stabilization programs often led to large capital inflows, but getting to that point took some effort and a currency stabilization fund could play a part in that process in certain circumstances. The proposal under consideration carried considerable risk for the Fund, however, both for its resources and for the credibility of its conditionality. Therefore, the Board and the staff needed to reflect carefully on the criteria for its use. In addition, the present discussion should be used to assess the potential interest in such a facility among potential users.

Mr. Mirakhor asked Mr. Evans whether the more intrusive role that he envisaged for the Fund with the establishment of a currency stabilization fund went beyond broader data requirements and more frequent and intensive monitoring.

Mr. Evans replied that the issues mentioned by Mr. Mirakhor would certainly form part of an enhanced role for the Fund, but it was also possible to envisage that requests for activation of a currency stabilization would need to be accompanied by additional policy measures. Monitoring would involve more than quarterly reviews; if funds were to be drawn, it was likely that monitoring would have to be on a weekly or even daily basis. The conditions that had been established for the use of the Polish stabilization fund, for example, were quite detailed and would have required considerable effort on the part of the staff and the authorities.

Ms. Lissakers, commenting on the remarks of Mr. Evans on the proposed access limit for currency stabilization funds, said that she assumed he was referring to augmented access under the systemic transformation facility. As the Polish case had shown, if the instrument were effective, it would not be used. The problem with the kind of access constraint that Mr. Evans envisaged was that a member's ability to draw on a currency stabilization fund would be reduced, possibly to zero, to the extent that it was drawing fully on its access under the accompanying stand-by arrangement.

The Chairman remarked that another interesting aspect of the Polish stabilization fund was the heterogenous nature of its sources of financing. At the time, neither the Board nor management had been fully comfortable with that financing arrangement, although it must be said that the Polish stabilization fund had been a great success. Nevertheless, homogeneity of sources of financing could help enormously in the present context.

Mr. Havrylyshyn noted that Mr. Evans had made a reference to the risk that the Fund would be seen to be encouraging a pegged exchange rate policy by offering additional finance, which was related to the concern of a number speakers that there could be more than a limited number of cases. In his view, those concerns were relevant less to the question whether a currency stabilization fund should be established than to the choice of mechanisms that would ensure that such funds were not used for balance of payments purposes, such as a reconstitution requirement. The Board should avoid the danger of a self-fulfilling prophecy in referring to the availability of additional finance and the attractiveness of such an instrument to many countries. The question whether a currency stabilization fund should or should not be established should be based not on fear of the risks, but on an economic analysis of whether an exchange rate peg and a stabilization fund could contribute to making stabilization successful.

Mr. Fernández made the following statement:

Let me start by saying that I do not believe in using a fixed exchange rate as shock therapy to reduce inflation or to break inflationary expectations. Consistent macroeconomic policies and key structural reforms are a prerequisite to profit from the assumed disinflationary effects of fixed exchange rates. In this regard, I fully support Mr. Clark's view that an exchange rate peg can only complement prudent policies that already exist and are in train.

Before we advise a country to use a fixed exchange rate as shock therapy to reduce inflation or to anchor its economy with the exchange rate, we must be sure that not only policymakers but also economic agents, namely, trade unions, exporters, importers, and consumers, understand and accept the implications of fixed exchange rates. Only in a very few cases are high-inflation countries in a position to guarantee consistency of behavior of policymakers and economic agents with the exchange rate rule.

Nevertheless, a fixed exchange rate rule can be of some help, not as part of a shock therapy treatment for irremediably sick economies, but as a way of consolidating, and even making further progress on, what has been already achieved. This is the reason I have some concerns about incorporating a fixed exchange rate rule in programs that require up-front strong adjustment measures. I am suggesting that it would be more credible and sustainable to introduce an exchange rate rule, not necessarily a fixed rate, with the support of a currency stabilization fund once it is observed that the program is on track and key macroeconomic and structural policy decisions have been taken and are being implemented. In this context, an exchange rate rule can provide additional stability and certainty.

However, this approach means that the rationale for a CSF is more closely related to the rationale of the proposed short-term financing facility and, therefore, that a CSF is not really needed, because exchange rate stability will follow from good and consistent policies, and a short-term financing facility may be used as an insurance policy to offset unexpected shocks.

Moreover, in my view, we should be very careful in advising countries to apply an exchange rate rule prior to the achievement of a high degree of financial and capital liberalization, among other things, because we do not know the equilibrium exchange rate level and serious mistakes can occur when choosing the wrong level, implying high costs for the economy. Therefore, an exchange rate rule may be advisable only after substantial progress has been made in liberalizing the financial system and perhaps, later on, the short-term capital account.

In addition, as is well established in international monetary textbooks, when the nominal price of the currency is fixed, all other nominal variables in the economy are endogenous--that is to say, beyond the control of the monetary authority. In this context, we should clearly advise governments to be prepared politically to accept large fluctuations in nominal and real interest rates, at least in the short term, if the market perceives inconsistencies or slippages in their policies, or if trade unions succeed in nominal wage increases not based on productivity gains. Here, the issue of the risks involved for the member and for the Fund of attempting to go counter to market forces is a very relevant one, as it was when we discussed the short-term financing facility.

More work must be done to convince us that a CSF and a fixed exchange rate are consistent parts of a strategy to combat high inflation rates. I believe it would be more appropriate to study the need for a CSF for specific country cases, instead of establishing a new facility of this kind. I agree with those who think that in only a few cases will it be advisable to recommend a fixed exchange rate to the authorities, because objective preconditions have to be verified beforehand in order for the Fund's involvement to be successful. The mere wishes and good faith of the authorities and the Fund would not be sufficient.

I did not touch upon modalities and operational issues. I would like to reserve our comments on these matters for subsequent discussions. But let me say that we tend to share the views expressed by Ms. Lissakers in this regard.

Finally, I also agree with other speakers that more work and consistency is required by the staff and the Board on three interrelated issues that we have started discussing in the past couple of weeks, namely, our advice concerning indirect instruments of monetary policy, the proposed short-term financing facility, and currency stabilization funds. A joint paper on these three subjects will allow us to appreciate differences and similarities, and check inconsistencies when giving advice on monetary management.

In summary, I consider a currency stabilization fund as a potentially useful instrument, which could in some cases be applied as a complement to sound and sustainable macroeconomic and financial policies that are already contributing to the stabilization of the economy. We do not view it as a shock-therapy mechanism.

The First Deputy Managing Director assumed the chair.

Ms. Lissakers remarked that it was not terribly useful to speak of sound and stable macroeconomic policies in the abstract, as the soundness of a given policy framework was influenced by the behavior of individuals. In one case after another, including Russia, it had become clear that the main source of pressure on the viability of the macroeconomic stabilization program had not been the failure of the government to exercise spending discipline but the steady erosion of the revenue base. As tax evasion went hand in hand with capital flight, exchange stabilization could play an important part in the early stage of a macroeconomic stabilization program. Along the lines of Gunnar Myrdal's famous observation on circular causation with cumulative effect, lack of confidence in the exchange rate led individuals to want to keep their savings abroad, resulting in constant pressure on the exchange rate; the mechanisms for maintaining money abroad often involved falsification of personal and corporate earnings, which in turn weakened the revenue base. Thus, the process fed on itself.

The question was whether that vicious circle could be broken by giving confidence about the exchange rate in order to change the behavior of individuals in the domestic economy, Ms. Lissakers considered. It would not guarantee tax compliance, of course, but it would at least strengthen the revenue side of the problem, which would in turn add credibility to the stabilization effort and strengthen the government's ability to keep the deficit under control, maintain a sound monetary policy, and so on and so forth.

Mr. Schoenberg said that it was difficult to contemplate a currency stabilization fund for countries facing hyperinflation while rejecting the possibility of a change in the exchange rate, as provided under a crawling peg system. Such inflexibility would put additional pressure on the internal adjustment process, as described by Mr. Fernández, that would be impossible politically to uphold. In the context of hyperinflation, an exchange rate fixed one day would be obsolete the following day.

Ms. Lissakers observed that her prepared statement had not ruled out a crawling peg as an alternative use of a currency stabilization fund. At the same time, however, such an arrangement would raise questions about the pace of the crawl and the point at which Fund support would cease being viewed as a currency stabilization fund and would merely devolve into another source of balance of payments financing.

Mr. Mozhin made the following statement:

First of all, I would like to thank the Managing Director and the Executive Directors who distributed statements on the issue of currency stabilization funds for greatly facilitating my task of presenting our preliminary views on the subject. In general, similar to the case of the short-term financing facility, my authorities will be in a better position to assess the rationale and modalities for currency stabilization funds once the broader issues pertaining to precautionary arrangements, enhanced surveillance, and the concept of the balance of payments need are clarified in the course of the forthcoming Board meeting in January 1995. Perhaps at this early stage, it would be preferable if I share with you my thoughts on what needs to be avoided while pursuing any Fund policies with regard to currency stabilization funds.

In the final analysis, we would definitely not want to see the Fund's monetary character and catalytic role eroded. We would not wish to create a new vehicle for financing fiscal deficits or sustained capital outflows through intervention in the foreign exchange markets. We are not seeking to encourage delays in members' necessary adjustment efforts by suppressing market signals to the authorities manifested by currency depreciation or by throwing money at a problem. In this regard, I share the concerns expressed by many previous speakers. Nevertheless, once we agree on this "negative list" of things that currency stabilization funds are not supposed to bring about--and I do not detect so far any major disagreements in this area in the Executive Board--one can be cautiously optimistic that it would be possible for the Fund to devise proper eligibility criteria, conditionality for using the CSFs, and other adequate safeguards, which, in any event, will need to be further tailored to each prospective user on a case-by-case basis.

The staff is quite explicit in stating and addressing these dangers in the quite balanced and realistic paper before us. In our view, it is prudent to tie prospective CSFs to upper credit tranche arrangements. Unlike the proposed short-term financing facility, the existence of such a close link could allow us to avoid a priori setting up CSFs as a separate special facility, and, instead, incorporate them as an integral part of stand-by or extended arrangements. Of course, the stabilization fund's role needs to be primarily of a precautionary nature in the context of a fully financed program, which must also include in-built contingency mechanisms. To boost the credibility of members' programs and to achieve a quick reduction in inflationary expectations, the CSFs need to be meaningful in size.

Perhaps one of the most controversial issues at the moment surrounding the possible use of CSFs in Fund-supported programs seems to be the staff's preference for a fixed exchange rate regime. This approach may not well suit many members undertaking adjustment efforts, especially where the adjustment process may be likely to reveal at a later stage unforeseen flaws in the program design and in sequencing of policy measures. Accordingly, like Mr. Mohammed, I encourage the staff to elaborate further on the issue of whether it might be useful to broaden the scope of Fund support in the context of CSFs beyond cases involving an exchange rate peg.

I shall conclude my remarks at this point and save my further comments on possible operational modalities of the CSF until our later discussions of this issue.

Mr. Sarr made the following statement:

I can summarize our preliminary views on the CSF as follows.

We see merits in the role that CSF schemes could play in furthering members' exchange rate stabilization efforts in the context of a comprehensive adjustment and reform program and the importance of the Fund's financial involvement in such efforts. Such a facility can provide member countries with the needed confidence to pursue their exchange rate policy, and it is mostly useful in those cases where a member's exchange rate peg and the underlying economic fundamentals are adequate but the member is faced with real or potential exchange market disturbances. We see the potential for such a scheme as part of the broad range of possibilities that member countries could consider in the early phase of their exchange market unification or current account convertibility. The staff does not rule out this possibility, but we will be interested in further elaboration on this possibility.

As previous speakers indicated, in the best of circumstances, this facility should only serve as a confidence-building or an insurance mechanism with little prospect for drawing on the resources. However, because the Fund will have to make these resources available for eligible members, it is appropriate to address thoroughly the financial risks to the Fund and the operational modalities necessary to minimize those risks. The staff paper provides in this regard very useful suggestions.

With respect to the general approach, we believe that a stand-alone facility seems to increase substantially the risk to the Fund, and we see the restrictions on the use of GAB resources as a substantial drawback of this option. In contrast, the risks attached to the window approach seem to be somewhat more manageable, and the combined upper credit tranche conditionality and the specific conditionality attached to this facility are commensurate with the financial risks attached to the use of these resources. The recourse to the exceptional circumstance clause in this approach does not in our view diminish the attractiveness of this option.

We remain open at this stage with regard to the various proposals on access levels, phasing, and early repurchase expectations, provided that the usual flexibility and the case-by-case approach that characterize Fund facilities can be preserved. We have no difficulty with the various reporting requirements as well as the extensive policies likely to be needed to ensure that this facility meets its fundamental objectives. However, we would like some elaboration from the staff on the rationale for suggesting the use of collateral with this facility.

Finally, it would be unfortunate if the overall cost of this facility makes it unavailable to some category of users undertaking strong adjustment and reform programs. We believe that cost considerations for members using this facility will need to be re-examined further. In this regard, we agree with Mr. Al-Jasser and Mr. Evans on the need to investigate further the modalities of access for ESAF-eligible members to this facility.

Mr. Wei made the following statement:

Today's preliminary discussion on currency stabilization funds is, in my view, a follow up to our recent meeting on a possible short-term financing facility. At that discussion, we were in favor of establishing a short-term financing facility, mainly because some member countries have encountered short-term financial disturbances, which have caused balance of payments problems not of a fundamental nature.

The call for a short-term financing facility also reflects the growing need for a quick response to member countries in urgent need of Fund financial involvement against a background of global integration of financial markets, and acceleration of the pace for countries to accept the obligations of Article VIII. In this context, I welcome the Fund's enlarged role in assisting those members that encounter damaging events either through streamlining existing Fund facilities or exploring new avenues.

With the foregoing in mind, and in view of these preliminary considerations, I will address the major issues on the proposed CSFs. Of primary concern is the relationship between CSFs and the short-term financing facility. There is some overlap between the two possible facilities in terms of purpose, conditions, features, and modalities. In both cases, the main focus is on helping member countries in need to weather short-term financial market pressures, including those from the exchange market, but not to address their fundamental balance of payments difficulties.

In my view, setting up a short-term financing facility could address the issue of supporting the exchange rate as a nominal anchor. Thus, I would be inclined to incorporate CSFs into a possible short-term financing facility, should a broad consensus emerge in forthcoming meetings to establish such an instrument. As an alternative, I can go along with the staff's suggestion that CSFs be established as an independent new facility or as a window associated with stand-by or extended arrangements.

Regarding the purpose of CSFs, while noting that they aim at supporting countries that adopt an exchange rate peg as a nominal anchor, I associate myself with the view of other Directors that eligibility should not be limited to those members only. In my view, irrespective of their exchange rate regimes, when confronting a similar situation, all members should have access to this facility, because many members not pegging their currencies and actively implementing adjustment and stabilization programs are also facing a volatile exchange rate and undue inflation pressure.

As the staff also pointed out, exchange rate unification and acceptance of Article VIII may, to a large extent, cause temporary difficulties for these member countries. Therefore, I am not convinced that the intended role of CSFs should be solely to deal with problems emerging from the adoption of a pegged exchange rate system.

As the staff clearly reveals in the paper on issues and developments in the international exchange and payments system (SM/94/202, 8/1/94), which was discussed by the Board one month ago (Seminar 94/10, 11/16/94), "[T]he number of member countries that peg their currencies to a single currency or a basket of currencies....has decreased in recent years....At the other extreme, the number of countries with more flexible exchange rate (particularly independently floating) regimes increased." This explicitly indicates that the expected role of CSFs would be restrained if designed solely for members with pegged exchange rate regimes. More important, the Fund should be prepared to meet members' financial needs resulting from, for instance, acceptance of Article VIII or a further opening of the capital account, which may cause exchange rate volatility.

On the operational issues regarding tranches, as substantial resources under CSFs will be needed for the country to cope with its problems, I can support Ms. Lissakers' proposal for two tranches. On the question of access, we can go along with the proposal of 100 percent of quota, which should be on top of the access for existing facilities.

On how to finance CSFs, while I agree that ordinary resources may be sufficient to meet the additional financing of CSFs under existing arrangements, I share the staff's view that by end-1997 the Fund's liquidity ratio will decline relatively sharply. Therefore, I would welcome exploration of external resources from major industrial countries for this purpose.

Mr. Link made the following statement:

I agree with those Directors who say that the Fund should have the ability to help countries able and willing to peg their currency by providing a kind of stabilization fund. Such a stabilization fund can play a useful role in accelerating and strengthening a comprehensive reform effort. But a currency stabilization fund can be a useful instrument only under particular circumstances. At least three conditions must be fulfilled: first, a strong macroeconomic stabilization program must be in place; second, using the exchange rate as a nominal anchor must be a logical part of that program--in other words, there must be good reasons for using the exchange rate as a nominal anchor; and third, the exchange rate must be fixed at a proper level, which is in keeping with the needs of the economy as a whole, and this is a particularly difficult task.

The main contribution that a CSF can make--as is rightly pointed out by Mr. Clark in his statement--is to lend credibility to an ambitious economic adjustment program. In fact, the purpose of the CSF is to stabilize expectations and not to fill the financing gap or to buy time. The CSF should not be a substitute for external financing. This means that balance of payments credits are useful if they are used but the CSF is useful if it is not used--and the Polish case shows that this is possible.

The fundamental difference between CSFs and balance of payments credits should therefore always be kept in mind when designing the features of CSFs. One aspect of this difference is underscored by the staff, when it proposes that CSF drawings be repurchased within a very short period of time.

Two ways in which the Fund could finance CSFs are presented in the staff paper: through a special new facility or through a window option within a stand-by or extended arrangement. I would prefer the window option within an existing facility rather than creating a new facility. The window option highlights and strengthens the linkage between support for currency stabilization and the satisfactory performance of an upper credit tranche program. I would also like to stress that this chair favors maintaining the present cumulative access limit of 300 percent, as the staff also proposes.

Turning to other operational aspects of the CSF, I would not intend to repeat and elaborate on all of them once again. I would prefer to support those proposals that are related to the solutions--tranching, monitoring, and conditions for the use of available amounts--based on the procedures used in the Polish stabilization fund, as they properly played their protective and restrictive roles.

Finally, if this chair has a relatively open mind in this preliminary discussion concerning the creation of currency stabilization funds, we have clear reservations about what seems to be the new currency pegging fashion. Mr. Clark and other speakers pointed to various problems linked with pegging. The usefulness of a pegged rate--fixed or crawling--should be carefully assessed in a case-by-case manner on the basis of criteria that we should establish in common, preferably in a seminar. In other words, it seems necessary to develop a common understanding of the pegging issues before letting the staff press member countries to introduce a par value for their currency.

Mr. Dlamini made the following statement:

This is another discussion that appropriately focuses greater attention on the potential benefits of exchange rate stability. Past considerations of exchange rate regimes have tended to focus on variability aimed at restoring external competitiveness. It is increasingly recognized that a variable exchange rate regime could itself be destabilizing, contributing to an inflationary spiral, while a fixed exchange rate regime, supported by sound monetary and fiscal policies, could be a viable option. The Fund should be prepared to actively support a fixed exchange rate regime, duly backed by sound macroeconomic policies, if that were considered appropriate to the circumstances of a member country.

I can agree with the suggestion that support for currency stabilization, aimed at strengthening the fight against inflation, should be linked to a Fund-supported program. This would save the Fund from the difficulties of establishing a new facility. The Board would only need to adopt a policy to that effect. This simple approach is justified on the grounds that Fund involvement in this arena is fully consistent with its mandate under the Articles. It would in fact be advisable to retain CSFs as a permanent feature of available Fund financial assistance to member countries.

It is important that resort to CSFs by a member be temporary and of short duration. This will ensure that they are used to address a specific short-term problem, while protecting the liquidity position of the Fund.

The necessary condition for the activation of a CSF must be the credible implementation of strong fiscal and monetary policies by the member. However, one can visualize some situations where highly restrictive demand-management policies could compromise the long-term objectives of economic reform, such as growth. It is important, in this regard, that adjustment programs not be driven by the exchange rate objective as an end in itself.

The staff proposals for tranching and early repurchases strike a sympathetic note. However, a balance will have to be struck between the need for safeguards and the benefits of quick disbursement. Although all members in comparable circumstances are expected to have access to CSFs, it is unlikely that the actual users would be many. This is mainly because of the short repurchasing period and the large amount of information that is expected to be provided by the country. Meeting information requirements might call for full-scale staff review missions; yet, the Board would have to act speedily lest the CSF lose its purpose. Streamlining the reporting and review procedures, leaving room to accommodate individual country experiences, should be explored further.

The structure of the ESAF Trust has virtually ruled out countries that rely on ESAF-supported programs. The possibility of a parallel stand-by or extended arrangement is not appealing, because these countries cannot afford the borrowing terms associated with such arrangements. This is not a question of the inability of low-income countries to use a proposed facility or window. The question concerns the enhancement of program design and the effectiveness of Fund financial support. On this score, the fact cannot be overlooked that there might be circumstances where some ESAF-eligible countries could benefit from the strategy of an exchange rate anchor. Were that to be the case, their adjustment strategy should not suffer because of the lack of adequate financial support. I wonder what options could be provided for ESAF-eligible countries.

Meanwhile, as the Fund tries to explore the benefits that could be derived from a stable exchange rate regime, it should also revisit the question of the exchange rate systems of low-income countries, which tend to be a crucial pillar of their adjustment effort.

Mr. Mirakhor, referring to Mr. Dlamini's remarks, asked the staff whether the need for ESAF-eligible members to put in place a parallel stand-by or extended arrangement in order to gain access to a currency stabilization fund, as indicated in the staff paper, would imply additional conditionality for those members.

Mr. Lanciotti made the following statement:

I would like to examine some general issues pertaining to the proposed facility before turning to the specific operational modalities through which such a new instrument would function.

By and large, the need for a new instrument aimed at smoothing the turbulence in the exchange markets of countries engaging in Fund-supported programs with a currency peg could be considered against the background of (1) the Fund's involvement in the macroeconomic stabilization of the countries concerned, (2) the Fund's monitoring of the international capital markets, and (3) the new instrument's relationship to a hypothetical, parallel, short-term financing facility.

On the first point, the proposed facility would imply that a Fund-supported program endowed with upper tranche conditionality would be in place and explicitly contemplates that the exchange rate would be used as a nominal anchor to foster credibility and help the adjustment process. Such an inclusion of the facility in a strong conditionality context adds to the attractiveness of CSFs in two ways.

First, the new instrument would integrate and make more adaptable the menu of policies and facilities available to the Fund to deal with the evolving and difficult task of stabilization.

Second, the CSF should be designed in order to put emphasis on the credibility of the underlying policy framework, in particular on the currency peg as a reference point, rather than to supply resources in view of their likely use. The case of Poland is enlightening in this respect. The currency stabilization fund activated by 13 industrial countries as part of Poland's 1990 stand-by arrangement remained merely precautionary, and there was never the need to draw on it. The likelihood of actual utilization of prospective CSFs would be directly related to the strength and coherence of the stabilization policies set forth in the underlying stabilization program. It is necessary to make it very clear that, in case the CSF is introduced among the instruments available to the Fund, excessive reliance on exchange rate nominal anchors should be avoided in the design of stabilization programs. This is clear in the staff's mind when it says that the exchange rate should be realistic and sustainable and that the CSF would serve its purpose best when it does not need to be used. However, two points need to be emphasized. I fully agree with Mr. Clark's remark that the Fund should not be perceived as advocating a general policy of fixed exchange-rate-based stabilization. Furthermore, in the special case of CSFs, both the design of the conditionality assisting Fund-supported programs and the actual sustainability of fiscal and monetary policies are to exert a direct, causal influence on additional potential financing. In an important sense, the frequency and magnitude of the recourse to the new facility by eligible members would be directly proportional to the riskiness built into the program and inversely proportional to the commitment of the authorities. As a consequence, conditionality should be particularly strong and carefully designed in Fund-supported programs benefiting from CSFs.

On the assessment of the international capital markets, the preliminary discussion on the proposed short-term financing facility highlighted the basic difficulty in assessing in very short periods of time and in a highly judgmental manner whether exchange rate pressures are driven by market misperception and *short-term speculation or, rather, whether exchange rate* turbulence is the expression of real, long-term market forces. As the markets, by definition, should usually be assumed to be right, a massive and repeated recourse to the CSF in the process of program implementation could be an alarm bell of the possible malfunctioning of the policy design itself. A very careful attitude should guide the Board and the staff in evaluating drawings of increasingly important amounts and in considering timely adjustments of the program. The CSFs should definitely contribute to stabilizing the economy by influencing exchange market expectations, rather than simply opposing them.

On the relationship between CSFs and the proposed short-term financing facility, although the CSF would be similar in nature to the proposed facility and would share the same conceptual uncertainty about the interpretation of the markets, the field of operation of the CSF would be clearly distinct from that of the short-term facility. The CSFs would be part and parcel of a wider supportive strategy, would be more limited and predictable in number, and would not bear any remarkable moral hazard of delaying necessary adjustment policies. These considerations redound to the credit of the greater feasibility of the CSF if compared to the proposed short-term financing facility.

Turning briefly to the technical modalities of a CSF, the window approach may better emphasize the close linkages that should exist between the additional financing and the conditionality of the "parent" arrangement. Moreover, avoiding the creation of a distinct new facility would help streamline Fund procedures.

I also see some merit in Ms. Lissakers' and Mr. Clark's remarks on the excessive fragmentation of CSF disbursements. The need for a close discipline, which should permit actual control over the amounts to be disbursed and timely adaptations of the policies as needed, could be coupled with a better efficiency of the CSF by reducing the number of tranches to be approved by the Board. Three tranches might be reasonable. Nonetheless, should the level of access be considerably increased above the order of magnitude currently suggested by the staff, a more meticulous tranching of disbursements could be appropriate in order to defend the Fund's interests, given the high volatility and inherent uncertainty that would characterize the operational context of the CSF.

Mr. Havrylyshyn made the following statement:

The currency stabilization fund that works best is the currency stabilization fund that works least. On that there should be no doubt, and no disagreement. It is attractive but misleading to conclude from this criterion that a CSF is redundant because it needs a strong stabilization, and then this may be enough by itself without a CSF. In certain limited circumstances where there is a special need for an additional element of discipline upon the financial stabilization program, and a need for strengthened credibility, having an exchange rate peg plus a CSF as an integral part of the stabilization program is better than not having them. Our task is to define the limited situations for such a special need, and to design a CSF that meets the stated effectiveness criterion.

It is somewhat misleading to start the argument for a CSF with the view that a pegged exchange rate is desired in and of itself and is chosen by the authorities, and then, to add credibility, a CSF is needed. One must go back one step further, as in the statement of Ms. Lissakers, and begin with the notion that the peg is an integral component of the stabilization program, providing a mutually reinforcing discipline for monetary and fiscal consolidation, and a clear reference point or signal. When, in addition, a special need for added credibility exists--as, for example, when a new and correct government policy of stabilization follows a long period of previous, inadequate government policy--the availability of a CSF can be just the extra element needed in addition to the unquestionably necessary fiscal and monetary tightness, like a booster rocket to ensure the launch of the stabilization program beyond a threshold of credibility into a sustainable trajectory.

It is important to stress the macroeconomic rationale for a peg--and the buttress of the CSF--for otherwise it can indeed be argued, as some do, that the requirement of strong financial stabilization policies implies these policies alone will do the job, and therefore a CSF is not needed. Although it will frequently, and indeed in most cases, be true that a strong program suffices, it will not always be true, and there will sometimes be special circumstances where a peg and a CSF will ensure the effectiveness of the stabilization. By definition, these cases will be very limited in number.

First, as stated by Mr. Link, there must be a compelling argument in favor of making a peg an integral part of the stabilization. Second, it cannot be repeated often enough that a strong stabilization program must be in place in the form of a stand-by arrangement, and that there should be no question of a stand-alone CSF. This incidentally defines a clear difference between the CSF and the proposed short-term financing facility. Third, CSF funds must not be used for balance of payments purposes, and the tranching, disbursement and review procedures suggested in the staff paper to ensure this should be put in place. Let me, by the way, assure Mr. Autheman, Mr. Evans, Mr. Schoenberg, and others who fear a flood of requests for new, additional financing that, as best I can tell, those of my authorities who might conceivably be interested in a CSF are well aware of its special complementary character and that it is not a substitute for sound stabilization policies.

Fourth, we are sympathetic to the arguments many Directors noted against creating a new special facility, while others preferred the simpler, clean-cut nature of a special facility. We are not against a window approach, as long as this does not place undue constraint on the amount needed. The size of the facility is very important, for the whole point of a peg and CSF as part of a strong stabilization is the additional threshold effect of a boost to the program. Paradoxically larger magnitudes of a CSF may be less at risk than too modest amounts.

Fifth, on timing, I am inclined to think that the nature of the peg and CSF as a booster rocket to launch a strong program similar to a stand-by program implies that the biggest contribution of the CSF comes at the beginning. Indeed, the further along one goes in a sustained stabilization without a peg/CSF booster, the less is the need for this booster. In a word, to say we should wait for a demonstration of a good track record before we provide the CSF will give one of two results: one, stabilization is sustained, and then the argument of Mr. Kang begins to apply--we do not need a CSF; and two, the stabilization fails, and we would of course then never know whether this failure could have been averted by an initial complement of a peg/CSF to the stabilization. In this connection, I wonder whether the staff could tell us whether the case of Poland could be considered as one in which a good stabilization performance was first established and then a stabilization fund put in place with a peg. Or was it a case of applying a stabilization fund at the outset? As there are not many previous examples, this would be useful to know.

Sixth, a comment on tranching. Once again, the threshold effect aspect of the peg/CSF implies a larger rather than a smaller first tranche, and I certainly think the proposed 20 percent in the staff paper could be made closer to the 30 percent ratio applicable in the Polish case. A low first tranche is not the ideal tool for covering risk and keeping to our philosophy of financial prudence. A better tool is the combination of a short reconstitution period and an increasingly tough attitude by the Fund and Board to subsequent tranches. Going to a second tranche should already switch on a flashing yellow light. Indeed, in this spirit, I would expect that the inclination of the Board, faced with a request for a third and fourth tranche, ought to be to turn on the red light--to say no--unless there are very compelling arguments presented that the drawing on the third tranche will in fact recoup the funds utilized for intervention under the first two tranches.

Like certain others, we would be interested in further staff proposals on the circumstances in which mobilizing GAB resources could be appropriate. On the very crucial point of how to ensure that the number of cases is very limited, I can only suggest that there are no axiomatic rules or criteria. But then, we do not have axiomatic criteria for a stand-by arrangement either, and we have always relied on the impeccably professional judgment of the staff, buttressed by the incisive wisdom of the Board.

As I noted earlier, some important technical conditions must be put in place--a stand-by arrangement, a short reconstitution period, and Board review of subsequent CSF tranches--and these already will limit the possible cases. The rest, as always, must be up to the good judgment of the Board.

Mr. Mirakhor remarked that he could agree wholeheartedly with the statement of Mr. Havrylyshyn. He supported the stand-alone facility approach, with high access along the lines suggested by Ms. Lissakers. He could also go along with two tranches, with the first being substantially larger, and a one-year repurchase obligation. He reserved for the time being his comments on the modalities and operational aspects of the proposal.

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

The Deputy Director of the Policy Development and Review Department said that the staff had not intended to convey the impression in the staff paper that it had a preference for fixed exchange rates. The staff had rather acknowledged the conclusion--described most recently in the paper on the review of conditionality--that the adoption of a nominal exchange rate anchor could in certain circumstances serve as a powerful component of a stabilization program, particularly in moving from high and volatile rates of inflation to low rates of inflation. That was not to say that a nominal exchange rate anchor was the only or the preferred approach in all cases, or even in many cases. Nevertheless, the staff believed that in well-defined circumstances, in which the authorities had both the desire and commitment to peg the exchange rate, including a commitment to the necessary supporting policies, there could be a role for a stabilization fund, carefully designed and financed by the Fund, to add credibility to that effort and, therefore, to enhance the prospects for success.

On the sequencing issue, the staff did not view a currency stabilization fund as an instrument to be introduced only at the end of the stabilization effort, the Deputy Director remarked. In order to have the desired effects on confidence and behavior, a currency stabilization fund would need to be introduced relatively early in the stabilization effort as an integral part of a comprehensive program. Nonetheless, the staff did not envisage establishment and activation of a stabilization fund until the Board had reasonable certainty that the policy framework and implementation capacity were in place. In the paper, the staff had discussed the possibility of activation at the outset or during the course of the program--say, at the time of a review--but a range of other alternatives could be imagined. The decision in each case would depend on an evaluation of the progress under the underlying program. The point at which a currency stabilization fund was introduced into the program might have a bearing on its tranching. a point to which he would return.

The staff clearly did not view Fund-supported currency stabilization funds as an incentive to move to a fixed exchange rate, the Deputy Director stated. Certainly, if the policy commitment was in place and the country was determined to move to a nominal anchor, a currency stabilization fund could be a positive addition to that process. If the basic commitment was not present, however, it would be difficult to see how such a mechanism could be viewed as an incentive to make such a fundamental change in policy direction; as suggested by the staff, the mechanism would entail demanding conditions, would involve only very short-term financing, and would not be without cost.

The staff would need to reflect further on whether a fixed exchange rate peg should be the only exchange regime eligible for support under a currency stabilization fund, the Deputy Director commented. Certainly, a fixed nominal rate was one of the most compelling cases for introducing a currency stabilization fund in terms of providing both clarity of the authorities' objectives and a firm and unambiguous anchor to the program. It might be possible that a crawling peg could serve that function, but he would prefer to reserve judgment until the staff had reviewed the issues carefully. The appropriateness of a peg with wide bands was more doubtful, as it would seem to raise questions about the nature of the peg and whether it could serve to change expectations. The staff would review the issues and return to the Board with a clear definition of the applicable circumstances for support under a currency stabilization fund.

On the question of access, one approach discussed in the staff paper was to establish a special facility for currency stabilization funds, access to which would be subject to decision by the Board in each case, the Deputy Director observed. In that case, access to a currency stabilization fund could be additional to access under the associated arrangement. Under the window approach, the currency stabilization fund and the traditional element of the arrangement would be subject to the existing access limits. For a number of reasons, frequent recourse to a currency stabilization fund seemed unlikely, and the staff would not make the presumption that a currency stabilization fund would naturally have access at 100 percent of quota; access could well be considerably lower. In reaching a judgment on that issue in each case, the staff would look at a number of factors, such as the level of reserves, potential volatility and turnover in the exchange market, and the size of the monetary base. Inasmuch as it was not expected that recourse to currency stabilization funds would be frequent, or necessarily involve high access, recourse to the exceptional circumstances clause could be envisaged if access under the combined elements of the arrangement exceeded the existing access limits. That was not a novel approach, as it mirrored essentially the approach taken in connection with augmentation of an arrangement to support debt and debt-service reduction operations; in fact, the exceptional circumstances clause had been invoked only once, in the case of Mexico, under the 1989 guidelines on the debt strategy.

The staff had not taken a particular position in the paper on the choice between the special facility and window approaches, because there were arguments in both directions, a number of which had been mentioned by Directors, the Deputy Director noted. The basic substance of the suggested elements for currency stabilization funds could probably be accomplished through either approach. It might be somewhat easier to establish the repurchase provisions, particularly if short-term repurchase obligations were involved, under a special facility, because those provisions would be provided for in the general decision establishing the facility. Under the window approach, by contrast, a shorter than normal repurchase obligation could be established only as a condition for a waiver, which required that Fund holdings of the member's currency exceed 200 percent of quota; although that requirement might often be met, it could not be assured in every case.

Regarding other considerations, the staff viewed currency stabilization funds as unambiguously linked to a comprehensive adjustment program in the framework of a Fund arrangement in the upper credit tranches, which argued for establishing a window within an arrangement to avoid any ambiguity, the Deputy Director remarked. Currency stabilization funds were also seen as transitory in respect of individual countries, effectively a one-shot operation: once a country had successfully completed the process, there should be no need to return to that instrument, which was another argument in favor of the window approach. Although it was not expected to be a frequent occurrence, the staff would nonetheless not want to establish a mechanism that provided for repeated recourse to the exceptional circumstances clause, which could undermine its exceptional nature. A further consideration was that the General Arrangements to Borrow could not be used under the present provisions for financing a special facility; the GAB could be applied only in the context of an upper credit tranche arrangement, which tended to point toward the window approach to the extent that it was felt useful to leave that possibility open.

None of the arguments relating to the choice of a framework for currency stabilization funds seemed overpowering, the Deputy Director considered, although on balance he tended to have some preference for the window approach. As an alternative to either approach, Mr. Schoenberg and Mr. Autheman had suggested an ad hoc approach: in cases that justified a stabilization fund, the operation could be framed under existing facilities in the context of an arrangement. Such an approach, although possible, would require that the Fund be prepared to introduce the specific operational features of the currency stabilization fund, such as its tranching, repurchase period, and safeguards, into arrangements for other countries facing similar circumstances, in view of the requirement of uniformity of treatment. Thus, it would still be necessary under an ad hoc approach to consider the general issues that arose for the Fund in entering into that kind of operation. With that in mind, the staff's view was that it would be better for the Board to consider those issues on their merit and in effect define the Fund's general approach, before having to shape particular provisions to fit a particular case.

Several Directors had agreed with the treatment in the staff paper of tranching under a currency stabilization fund, while others had felt that fewer tranches would be desirable, the Deputy Director recalled. There was an obvious tension between the desire for a stabilization fund that could be used effectively under appropriate circumstances and the need for safeguards on the use of Fund resources. The ideas presented in the paper were illustrative and not a proposal, and it might be best for the time being to leave open the question of the number and size of tranches; the answer in individual cases could depend in part on the size of the currency stabilization fund, the particular characteristics of the associated program, and whether the stabilization fund was introduced at the beginning of the program or after a reasonably long period of experience and a fairly firm track record. The concept of tranching would need to be firmly established, of course, but it might be useful to leave some scope for determination on a case-by-case basis.

In that connection, the Deputy Director continued, Ms. Lissakers had correctly noted that a failure to meet a repurchase expectation might not be evidence of a lack of capacity to repay but, instead, evidence that the anchor element of the program had gone off track. The Board would want to take that consideration into account not only in framing the repurchase provisions but also in determining the tranching. The Fund would want to know early on if the anchor element of the program was going seriously off track, particularly at the point that decisions were being made on disbursements, which argued for fairly tight tranching.

There was no proposal in the staff paper for the cofinancing of currency stabilization funds, the Deputy Director said. The paper had pointed merely to the possibility of cofinancing, which could have advantages for the Fund in terms of the sharing of risk and for individual countries in having somewhat more active and visible involvement of other players in the international community in supporting an exchange rate peg. There were also potential disadvantages, or at least complications, in trying to coordinate rapid decisions by the Board and rapid action by the Fund with decisions and action by other creditors, but those problems might not be insurmountable. While the financing of currency stabilization funds might not be consistent in present circumstances with the General Arrangements to Borrow--whose provisions had been tightly drawn for nonparticipants, relating to insufficiency of resources on the part of the Fund and to systemic threats--the possibility of cofinancing from other sources should not be ruled out for that reason.

There had been a number of comments on the possible areas of overlap between the proposed short-term financing facility and currency stabilization funds, the Deputy Director observed. Some degree of overlap was inevitable in certain areas, such as the short-term nature of the financing, the need to be able to move rapidly, and the need for close monitoring and understanding of the country's situation. Nevertheless, the two instruments were, in the staff's view, directed at fundamentally different cases: the short-term financing facility was designed for countries where a track record had been firmly established, where there was no question of a need for fundamental adjustment, but where the country might be subject to short-term market pressures; in contrast, currency stabilization funds were clearly directed at countries undergoing fundamental adjustment in the framework of a Fund-supported program. Thus, the target group of countries and the basic conditions associated with the two instruments were quite different.

With respect to the special case of an ESAF-eligible country wanting to make use of a currency stabilization fund, the staff had noted in the paper that the ESAF Instrument, as presently structured, could not accommodate a currency stabilization fund, the Deputy Director of the Policy Development and Review Department commented. In that case, the staff had suggested the use of a parallel stand-by arrangement as the shell in which a stabilization fund could operate. Such an approach would not lead to additional conditionality: the currency stabilization fund would have one set of conditions, while the conditions associated with the ESAF and stand-by arrangements would presumably be identical in substance. A parallel stand-by arrangement would be needed only under the window approach, however, as a currency stabilization fund established under a special facility could be linked directly to the existence of an ESAF arrangement.

Mr. Mirakhor wondered whether there were any differences between the two approaches with respect to the frequency of reporting and the need for more intense monitoring under a currency stabilization fund.

The Deputy Director of the Policy Development and Review Department replied that the frequency and nature of reporting would be linked to the currency stabilization fund whether it was incorporated within a stand-by arrangement, as under the window approach, or established as a special facility linked only to an ESAF arrangement.

Mr. Mirakhor remarked that he hoped that there would be coordination on the reporting and review process at the level of the Board in those cases in which a currency stabilization fund was combined with both a stand-by and an ESAF arrangement.

The Deputy Director of the Policy Development and Review Department said that the staff would not see a need to duplicate or multiply the reporting requirements owing to the existence of a stand-by arrangement alongside an ESAF arrangement; basic requirements associated with the currency stabilization fund would apply in any case.

In response to a question raised by Mr. Mohammed, the Deputy Director concluded, it would indeed be possible to introduce a currency stabilization fund into an existing arrangement, provided all of the conditions for the stabilization fund were in place.

The General Counsel said that he could confirm that the provisions of the General Arrangements to Borrow did not apply in the case of special facilities other than the extended Fund facility. That issue had been addressed specifically in a staff paper that had been prepared in connection with the amendment of the GAB in 1983 (SM/82/239, Rev. 1, 1/11/83, page 4, paragraph 7b). In that paper, the point had been made that the GAB could not be activated for purchases under other special facilities of the Fund, such as the compensatory financing facility.

Turning to other questions raised by Directors, it would indeed be possible to levy a special commitment fee or service charge under a special policy, the General Counsel remarked. Although different periodic rates of charge had been levied in the past, the trend in recent years had been in the other direction, and periodic changes had been unified.

On the criteria that would define "exceptional circumstances," the Board had addressed that issue in the context of the 1983 discussion on access in individual cases (EBM/83/167, 12/2/83), the General Counsel recalled. The Chairman's summing up of that discussion read in part:

> 5. The Executive Board preferred not to codify the exceptional circumstances that might entail utilization of the Fund's resources beyond the upper limit of 125 percent. In particular, the Board was opposed to singling out the impairment of the international monetary system as a criterion, because it might imply special treatment for larger countries. Several Directors had noted that, in their view, there might

> well be a good case for emphasizing the circumstances of smaller countries with no access to financial markets.

Thus, the issue had been identified but the Board had decided not to codify the relevant criteria. However, the fact that there were no explicit criteria for defining exceptional circumstances did not mean that access under exceptional circumstances was exempted from the general provisions on access to Fund resources. In particular, the condition of balance of payments need must be met and the Fund must be satisfied that adequate safeguards had been provided for the use of its resources.

With respect to the use of Fund resources for "a large or sustained outflow of capital," he had to some extent already addressed that issue at the recent discussion on the proposed short-term financing facility (EBM/94/104, 11/30/94), the General Counsel observed. At that meeting, he had noted that the issue had been raised in the Board in the past but that its discussions had been inconclusive. It might be useful to elaborate on the historical background to that issue.

In the very early days of the Fund, the General Counsel explained, the Board had adopted one of the few authoritative interpretations of the Articles of Agreement (Decision No. 71-2, adopted September 26, 1946). According to that interpretation, the Fund's resources could be used only "to give temporary assistance in financing balance of payments deficits on current account for monetary stabilization operations." Although there was no mention of capital outflows in that interpretation, the staff had felt that there was a conflict between the reference to "current account" in the 1946 interpretation and the specific reference in Article VI to the possible use of Fund resources for at least some capital transactions. The issue had been raised again in the Board in 1961, and the Board had adopted a further interpretation (Decision No. 1238-(61/43), adopted July 28, 1961). The second interpretation stated that,

> [a]fter full consideration of all relevant aspects concerning the use of the Fund's resources, the Executive Directors decide by way of clarification that Decision No 71-2 does not preclude the use of the Fund's resources for capital transfers in accordance with the provisions of the Articles, including Article VI.

Thus, use of Fund resources for capital transfers had been deemed possible as long as the conditions of the Articles were met, including Article VI, but what those conditions were had not been clarified.

In the preparation of the second interpretation, the General Counsel continued, the staff had indicated to the Board that the concept of capital transactions with respect to the use of Fund resources--not the Fund jurisdiction, which was quite a different question--appeared in three different contexts in the Articles. The first category comprised capital transactions that were deemed to be current--for example, short-term bank financing of international trade--which could therefore be financed fully from the Fund's resources. The second category of capital transactions, which was often overlooked, was set out in Article VI, Section 1(b), which stated in part that

> [n]othing in this Section shall be deemed...to prevent the use of the general resources of the Fund for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking, or other business....

Thus, access to Fund resources was not limited if the transactions were of reasonable amount and required for the purposes specified in Article VI, Section 1(b). In other words, those transactions were not deemed to be current transactions, but they were sufficiently related to current transactions to be treated differently than other capital transactions. The limitation under Article VI, Section 1(a) on "large or sustained" capital outflows applied only to a third, residual category of other capital transactions.

As part of the 1961 discussion of the issue, the staff had tried to clarify the limitations under Article VI, the General Counsel said. In its analysis, the staff had noted that both "large" and "sustained" were essentially subjective concepts, which had been intended to be left to the future discretion of the Fund. Indeed, there was clear evidence from the legislative history of the Fund that there had been no intention at Bretton Woods to impose a precise definition on those concepts. The staff's analysis had contained several other elements. First, under the Articles, priority must be given to the financing of current account transactions, although the financing of capital transactions was not precluded to the extent that the Fund had sufficient liquidity. Second, a capital account deficit could be financed even if it was not accompanied by a current account deficit. Third, and perhaps most important, while Article VI, Section 1(a) referred to certain limitations, Article VI had to be read in the light of all other provisions governing the use of Fund resources and, in particular, the purposes of the Fund. Therefore, even if an outflow was neither large nor sustained, it could not be financed by the Fund if the Fund found that to do so would be contrary to the purposes of the Fund. Similarly, the Fund would have to be satisfied that its resources were safeguarded.

Clearly, "the purposes of the Fund" had been considered, both in the staff paper and in practice, as an essential element in an understanding of the issues raised in Article VI, the General Counsel commented. Although that concept had not overtaken the importance of "large or sustained," much more attention had been paid to "the purposes of the Fund," probably because "large or sustained" had not been quantified. Another view was that "large or sustained" was only another way of saying that the transaction in question should not be contrary to the purposes of the Fund; if an outflow was large or sustained, the presumption was that something was wrong with the member's policies, and the Fund should not be prepared to support those policies. Intellectually, however, the three concepts were different, but it was easy to see how they could be combined.

On the specific meaning of the word "large," a number of criteria had been proposed in the past, none of which had been presented as being exclusive of the others, the General Counsel stated. In particular, it had been suggested that the meaning of "large" should be related to the size of the member's quota and the overall size of the member's international transactions. The question had been discussed by the Board, which had preferred not to codify the meaning of either "large" or "sustained." In those discussions, it had been made clear that the meaning of both concepts should be left to the judgment of the Board in future cases, that the circumstances of each member would have to be assessed on its own merits, and, in particular, that great attention would have to be paid to the economic and financial policies of the member to ensure that the Fund was not supporting inappropriate policies.

On the basis of the Board's extensive consideration of the issue over many years, the General Counsel concluded, it was clear that no precise figure could be assigned to the concept of "large," and no time frame could be ascribed to the concept of "sustained." They were judgmental concepts that had to be assessed on their merits in individual cases.

Mr. Fernández, referring to the comments of the Deputy Director of the Policy Development and Review Department, wondered whether there was a contradiction in the staff's view that, while currency stabilization funds were primarily an instrument of shock therapy for use in the beginning of a program, they might also be incorporated into an existing arrangement.

The Deputy Director of the Policy Development and Review Department recalled that he had not said that currency stabilization funds should be used only at the beginning of an arrangement. Rather, he had indicated that the timing of their use would depend on a case-by-case assessment. It was possible to imagine a case, for example, in which a member with an arrangement in place decided at a later stage to move to a pegged exchange rate. In that case, and assuming that the conditions had been met, the introduction of a currency stabilization fund would not be precluded; of course, the arrangement would need to be modified accordingly.

The Chairman made the following concluding remarks:

> I would like to thank all of you for your thoughtful preliminary statements and comments on the interesting issues raised in the staff paper and for the frank and lively exchange of views we had today on the pros and cons of possible involvement of the Fund in the area of currency stabilization funds.
>
> The preliminary nature of today's discussion reflects the fact that this was only the first reading of a still evolving concept. With this in mind, it might be useful, by way of an

aide-mémoire, to record some of the main points, suggestions, and reservations raised by Directors as guidance to the staff in its further work. I would suggest that as the next step the staff would return with a more precise proposal for consideration, taking account of today's discussion.

Many Directors expressed general interest and support for Fund financing for CSFs, but others were skeptical of the need for special policies in this area. Those Directors who expressed interest in Fund financing for CSFs felt that such operations would be consistent with the purposes of the Fund and, in certain circumstances, could significantly help a member adopting a strong anti-inflationary program. These Directors stressed that a CSF should be an instrument of infrequent use. The Directors who questioned the need for CSFs thought that the Fund could adequately support members' exchange rate policies, including policies involving a nominal exchange rate anchor, under existing policies. Questions were also raised about whether policies supporting CSFs would be available to all members or tailor-made for a few cases. In this connection, several Directors felt that the conditions necessary for successful use of CSFs were not yet sufficiently elaborated in the staff paper to differentiate the type of situations in which Fund support for CSFs would be appropriate, and they requested further work in this area.

All Directors agreed that CSFs could be effective only in the context of a strong stabilization program supported by a Fund arrangement. On this condition, we--staff, management, and Executive Board--are unanimous. Currency stabilization funds could, in certain circumstances, be a powerful complement to appropriately tight fiscal and monetary policies and could provide an important element of additional confidence to a nominal exchange rate anchor. Resources under a CSF should never be used for general balance of payments financing; they should only be available, if needed as a confidence-building device, for very short-term intervention to counter short-term foreign exchange market pressures, accompanied as needed by supporting macroeconomic measures. Several Directors commented that the most successful CSF is one that does not need to be used, and that limited or no recourse to a CSF during the course of a stabilization program would be fully consistent with its objectives.

There was considerable discussion regarding the exchange rate regimes to be supported by access to CSFs. A number of Directors saw a CSF as potentially most effective in conjunction with a nominal exchange rate peg supported by a comprehensive stabilization program aimed at rapidly reducing inflation. However, other Directors considered that a CSF might also be used in support of a crawling peg or some other arrangement that was less fixed than a peg. We should return to this issue. Some Directors also thought that CSFs might be useful to a country that aimed to unify its exchange rate in the context of a Fund arrangement or that had already achieved a measure of stability in its exchange rate and wanted to move to a nominal anchor. A few Directors questioned whether providing Fund financing for CSFs would indicate a preference by the Fund for fixed exchange rate regimes. In response to this last point, let me say that it was not the intention of the staff to suggest such a preference but rather to ask the question whether an additional instrument would be useful in certain circumstances involving a nominal exchange rate anchor. I think this is now well understood.

Directors supported the general proposition that CSFs should be available only in connection with Fund arrangements of upper credit tranche conditionality, but views differed regarding how, in practice, CSFs would be linked to these arrangements. Some Directors advocated integrating CSFs directly within Fund arrangements through a window, but others would prefer to see CSFs established as a separate facility under which members would make purchases in parallel with a stand-by or extended arrangement. Several Directors noted that, as the staff paper has pointed out, the substantive differences did not seem great. It was understood that under either approach it would be possible to use CSFs in parallel operations with ESAF arrangements. We will carefully review Directors' comments and the pros and cons of each approach.

On the access aspects, and particularly in view of the recent increase in the annual access limit under stand-by and extended arrangements, most Directors considered that a maximum access limit of 100 percent of quota for a CSF should provide sufficient scope for the Fund to effectively support such operations. It was understood that it should not be expected that this ceiling would be utilized in each case. This is an upper limit, not a target. In contrast, some other Directors were concerned that introducing special policies in support of CSFs could lead to undue risks and potentially channel additional resources to a narrow segment of the membership.

Many comments were made about the potentially high risks associated with CSFs and the need for adequate safeguards. In recognition of the potential risks, most Directors thought that a tranching mechanism along the lines illustrated in the staff paper would provide scope for flexibility while safeguarding the Fund's resources, including by requiring Board approval of purchases beyond a first tranche. However, several Directors expressed concern that tranching, as described in the staff paper, could be unnecessarily complex and inflexible in practice, which might discourage possible users, and that excessive tranching could diminish the signaling effect of a CSF. These Directors would prefer fewer--say, three or four--and larger tranches than suggested in the staff paper.

Directors generally considered that a relatively short reconstitution period for CSF purchases would help to ensure that CSF resources would be used as intended. Most thought that the combination of a repurchase expectation of 3 to 6 months and a 12-month repurchase obligation period would be appropriate.

There was clear support among Directors for strict adherence to additional reporting requirements that would be applicable under a CSF; these would need to be met on a continuing basis. Members requesting a purchase under a Fund-supported CSF would also need to be prepared to take quick additional policy actions *rather than, or in addition to, exchange market intervention.*

Directors agreed that effective operation of CSFs would require changes in standard Fund procedures, including accelerated Board procedures for both documentation and decision making, and that the flow of CSF-related information would have to be treated with the utmost confidentiality. It goes without saying that before finalizing any proposals in this area, particularly on more expeditious procedures, we will consult further with the Board.

Directors raised questions concerning the transaction costs associated with CSFs and requested that the staff further examine possible means to offset or reduce these costs.

While recognizing that close review would need to be kept over the Fund's liquidity position, most Directors considered that Fund support for CSFs could be met from the Fund's ordinary resources in present circumstances. Some Directors noted that the General Arrangements to Borrow would remain potentially available in case of need under certain conditions, and a few Directors expressed interest in exploring possible cofinancing arrangements for CSFs, a matter to which we will return when preparing our next paper.

Today's discussion has provided the staff with considerable guidance. As I have already noted, we will aim now to bring more specific proposals to the Board in the next few weeks. Indeed, any further thoughts by members of the Board during this time of further reflection would be particularly welcomed by the staff and management.

The Executive Directors concluded for the time being their preliminary consideration of Fund policies with regard to currency stabilization funds.

2. REPUBLIC OF ARMENIA - PURCHASE TRANSACTION - SYSTEMIC TRANSFORMATION FACILITY

Executive Directors considered a staff paper on the Republic of Armenia's request for an initial purchase under the systemic transformation facility in an amount equivalent to SDR 16.875 million (EBS/94/218, 11/14/94; Cor. 1, 11/16/94; Sup. 1, 11/30/94; Sup. 2, 12/12/94; and Sup. 3, 12/13/94).

Mr. Havrylyshyn made the following statement:

On November 19th, at the time of Parliament's approval of Armenia's stabilization and reform program--which will be supported under the systemic transformation facility (STF), upon approval by the Executive Board today--President Ter-Petrossian characterized the measures as the logical continuation of the economic policies of the past three years. Indeed, this remark embodies the spirit of the Board discussion of Armenia's Article IV consultation (EBM/94/60, 7/8/94) when, as summarized by the Chairman, Directors "acknowledged that substantive progress had been made toward a market-based economy" and "stressed the need to intensify stabilization efforts, accelerate structural reforms, and, as a first priority, reduce inflation." The path recommended is exactly the one that has been followed, culminating by the end of 1994, not only in the agreed-upon systemic transformation facility program we are discussing today, but in fact significant achievements in stabilization in the last five months.

The staff report thoroughly documents these achievements, but let me repeat the main points. The budget deficit was reduced sharply from 56 percent of GDP in 1993 to 23.9 percent of GDP in 1994, owing to a recovery in tax revenue--especially in the second half of 1994--a lower level of expenditures in several areas--wages, pensions, health and education--virtual elimination of net lending to public enterprises, and increased grants. Since April 1994, monetary policy was tightened significantly strictly limiting the growth of central bank credit and financing from the budget; also, interest rates were raised sharply to real positive levels. This fiscal and monetary tightening has already produced the intended results, with a decline of inflation rates from 30-60 percent monthly in the first half of 1994 to much lower levels in the second half, and a stabilization of the exchange rate.

As progress was made toward resolving the regional conflicts, the earlier liberalization of trade and private sector activity began to pay its dividend in the form of a steady growth in trade during 1994, which included a diversification of markets. An approximate balance is expected on the current account, but the external situation remains precarious and central bank reserves amount to less than a week's imports. Finally, the most important indicator of a turnaround is that the sharp output decline suffered since 1990 has now clearly been reversed, and indeed some sources, namely, the Statistics Committee of the Commonwealth of Independent States estimates a very modest positive growth in 1994.

Structural reforms continued in 1994. Prices of food, transport, and gas were liberalized and other prices were raised sharply. In the area of privatization, two hundred small enterprises were sold in the first three quarters of 1994, over one thousand state enterprises are being converted to joint stock companies, and transfers and lending to enterprises from the budget have been eliminated.

With the demonstrated achievements so far, this purchase under the STF, and subsequent early moves to an upper credit tranche arrangement in 1995 will provide support for a continuation and consolidation of the Armenian authorities' reform efforts. The fundamental strategy of this reform is to build upon the results so far, consolidating the fiscal and monetary tightening and accelerating structural reforms.

The fiscal deficit in 1995 will be cut to 12 percent of GDP, half of the 1994 level, and with foreign financing expected to be 15 percent of GDP, the authorities plan to repay arrears incurred and make a small repayment to the domestic banking system. Tax revenues are expected to rise by 2 percent of GDP, through the elimination of exemptions and the creation of a new structure of excise taxes, custom tariffs, and tax on land. Expenditures will be very sharply reduced from 61 percent of GDP to 42 percent, mainly through subsidy cuts. The major subsidy reduction will come from a complete liberalization of bread prices not later than July 1, 1995. Other subsidies have already been reduced and will henceforth be limited to 1 percent of GDP, resulting in total subsidies shrinking from 20 percent of GDP in 1994 to 3 percent in 1995. Regarding deficit financing, a move to market orientation will take place as treasury bills replace bank credit--an important step in the development of financial markets.

The goal of reducing monthly inflation to 1 percent will be achieved through limiting the Central Bank's credit growth and through keeping real interest rates positive. Financial system streamlining will include setting uniform reserve requirements, eliminating directed financing of enterprises, and expanding auctions in the interbank market.

The dram will continue to float and tighter financial policies will be relied upon to give continued stability, though later a fixed rate regime may be considered. Accumulation of official foreign exchange reserves is targeted to increase to 1.7 month of imports, and surrender requirements of foreign exchange earnings to the Central Bank will be eased significantly in order to broaden and deepen the foreign exchange market.

Structural reforms of the public sector will include imposition of market discipline on public enterprises by eliminating transfers and lending from the Government and the Central Bank; continuing the implementation of the program to privatize state enterprises, including large enterprises; laws on bankruptcy, collateral and condominia; and improvements in banking supervision and regulatory functions.

The picture that emerges clearly is one of Armenia moving from a committed reform effort in 1992-94--but one constrained by the extremely difficult circumstances--to a resolute acceleration of this effort as soon as circumstances eased a bit in mid-1994. While early positive results are already visible, the situation remains fragile and the authorities' commitment requires effective and adequate buttressing by the Fund and other international financial organizations, and complementary financing by donors on a bilateral basis. As the program is strong, the commitment unquestioned, and the implementation capacity already clearly demonstrated--and weaknesses are being addressed by intensive and effective provision of technical assistance by the Fund--the necessary domestic ingredients for further progress are in place. All that is needed to ensure progress on reform is adequate external financing. It is therefore essential that the indications given at the November 22, 1994 Consultative Group meeting of additional financing for an upper credit tranche arrangement be fully realized at the time of the next step forward, an early preparation for a program under the enhanced structural adjustment facility (ESAF).

Mr. Kaeser made the following statement:

My chair can support the proposed decision.

Our support should, however, not be deemed to be a recognition of the de facto situation in Nagorno-Karabakh and of the monetary union between the Republic of Armenia and Nagorno-Karabakh.

Mr. Newman, speaking on behalf of Ms. Lissakers, made the following statement:

We very much welcome and strongly support this much-needed and long-awaited systemic transformation facility for Armenia. Since the Article IV discussions in early July, when preliminary signs of progress were already evident, the Government has made a much more determined and courageous effort to deepen the stabilization effort and hasten the pace of reforms. The main policy concerns we had in July have now been addressed, most notably through further measures to reduce the 1994 deficit that will enable inflation to be brought down further and faster, but also because of progress on a number of key structural issues, particularly price liberalization and privatization.

The program developed by Armenia and the staff for 1995 is quite comprehensive and ambitious. Scrupulous implementation will be needed, as the still dire economic situation and lower than expected levels of external financing give the Government scant margin for slippages. Apart from that general observation, we have little to add to the staff's appraisal other than to offer a couple of comments on two policy areas that deserve special attention in the months ahead.

First, it will be critically important for the Government to achieve the targeted reduction in the 1995 deficit to remove the need for inflationary bank financing. In particular, further reductions in subsidies and liberalization of administered prices, especially for bread, will have to be carried out on schedule.

Second, on exchange rate policy, I can endorse the staff's suggestion that a shift to a pegged rate ought to be considered when Armenia is ready to move to a more comprehensive Fund program and reserves have been built up from the current precarious level. For now, adherence to a floating rate makes the most sense, and in this regard, I am concerned by the Government's recent efforts to use some of its scarce reserves to support the dram. As the staff suggests, currency stability is a laudable goal, but at this relatively early point in the stabilization process one hopes that it will be the by-product of tight financial policies, and not the result of an activist exchange rate policy.

The prospect that an arrangement under the systemic transformation facility will unlock additional financial assistance from the international community has been crucial to Armenia's ability to put together and implement a coherent reform program. Unfortunately, the needed amount of concrete support from new donors did not materialize at the recent Consultative Group meeting. We remain quite concerned about the additional external financing still needed for 1995, and would urge potential donors to not let bureaucratic impediments delay or jeopardize firm pledges of critically needed assistance.

Turning to the issue of further support from the Fund, this STF-supported program marks an important milestone in the reform effort, but will need to be reinforced by a more comprehensive upper credit tranche arrangement as soon as possible next year. Given the situation, the Government ought to consider whether it could move forward with a more comprehensive program prior to the midyear parliamentary elections. At the very least, I would urge the Government to work with Fund and Bank staff in the pre-election period to lay the groundwork for an ESAF to be put in place as quickly as possible following the elections, and not delayed until late 1995.

The staff representative from the European II Department stated that, while every effort would be made to move to an ESAF arrangement as soon as possible, putting together a three-year program would be time consuming, not only for the Fund and the World Bank staff, but for the Armenian authorities as well. In the interim, it might be necessary for Armenia to avail itself of a stand-by arrangement.

The Armenian authorities had provided further information on prior actions that they had taken, the staff representative noted. Excise tax rates, including equalized rates on imported and domestic goods, had been established and were in line with the program's assumptions. The authorities had also set rates of customs tariffs on all goods except gasoline, coffee, and chocolate, again in line with the program's assumptions. The Parliament had agreed to levy a tariff on those three items and had indicated that, if the rates were lower than assumed under the program, compensatory measures would be taken. Recent information confirmed the staff's assessment that the prior actions taken by the authorities were adequate to ensure that the program's fiscal targets could be attained.

Mr. Newman remarked that, for countries such as Armenia and Georgia, continuation with a program under the STF would be more appropriate in the interim period before a program under the ESAF could be put in place. That was another argument for extending the STF and increasing its access limits.

Mr. Mozhin made the following statement:

This chair had an opportunity to praise the Armenian authorities' management of the national economy during the recent Article IV consultation discussions. Indeed, they deserve much credit for their ability to maintain a democratic order, to keep the economy free from hyperinflation, and to avoid the temptation to recentralize the economy. Armenia proved able not only to pay its own energy bills--not a small achievement for an economy in transition--but also to provide partial cover of Georgia's energy consumption.

It is well known that the bulk of economic difficulties Armenia is facing have their roots outside the authorities' control. The consequences of a disastrous earthquake and disruption of trade with the Baltic countries, Russia, and the other countries of the former Soviet Union have been aggravated by a virtual blockade, caused by prolonged hostilities. Fortunately, the last ceasefire turned out to be durable, and the possibility of a peaceful settlement of the longest ethnic conflict in the region seems to be within reach. This paves the way for the much-needed recovery of Armenia's economy, and the Fund's assistance, under the STF, should trigger this process.

The program that the authorities present in their letter of intent definitely deserves our support. Because, from the very beginning of independence, Armenia adopted economic policies based on market principles, this program does not represent, in my view, a kind of radical change. Rather the program might be viewed as further clarification and strengthening of the policies already adopted.

Fiscal policy measures look consistent with the target of steady reduction of the budget deficit and the level of its monetization. However, some questions could be raised.

First, the issue of imposition of the value-added tax on non-CIS imports: In Russia, a long delay in implementation of this necessary measure was a serious mistake, and I see no reason why this mistake needs to be repeated in Armenia. Given the exceptionally low wage level in Armenia, one simply cannot afford to discriminate against domestic producers. Therefore, I would recommend the authorities consider the possibility of the imposition of the value-added tax on imports at an earlier stage than is anticipated under the program.

Second, on the issue of a modification of the tax schemes: Cancellation of numerous tax exemptions and a reduction of the number of excise tax rates and tariff rates are certainly most welcome. Against this background, existence of five marginal rates of personal income tax seems to be an unnecessary complication. By the same token, one can ask whether it is necessary to maintain import tariffs at all, when, according to the authorities, nearly 80 percent of imports happen to be zero-rated and contribution of the custom duties to the budget in 1995 is expected to be in the order of 2 percent of all revenues. I welcome the idea of having a comprehensive review of the tax policies to be undertaken in the next year, and I hope that all these issues will be addressed with the help of the Fund's technical assistance.

On the expenditure side, I would like to note a rather cautious approach adopted by the authorities. I welcome their intention to limit sharply the number of construction projects--in order to concentrate resources on those projects of vital importance to the economy--the setting aside some extra revenues from the sale of government property, and initiating a sizable retrenchment of the public service. I also welcome liberalization, or sometimes marked adjustment, of major food prices, fees, and tariffs for public utilities.

A sharp reduction in subsidies remains a cornerstone of the authorities' efforts to bring the state budget closer to balance. A painful rise in bread prices seems to be unavoidable, and the authorities should be strongly commended and supported for their willingness to undertake such an unpopular measure. Nevertheless, I have some concern with respect to elimination of the gas subsidies to households. I understand that prospects for effective compliance of households with respect to the payment of high rates for utilities look extremely bleak. There seems to be no plausible means of real enforcement of these payments. Therefore, freeing these prices can only result in mounting household arrears and pressure on the budget. Perhaps, it would be more realistic to retain explicit expenditure provisions and to allow for a temporary subsidization of these prices.

Turning to monetary policy, I welcome the termination of automatic access to the Central Bank's overdraft facility, and a disconnection of practices of direct monetary control, such as interest rate regulation, or creation of the wedge between cash and deposit balances. It has to be noted that projections for 1995 allow for only a modest increase in the net domestic assets of the monetary authorities, with composition of central bank credit changing substantially in favor of commercial banks, and therefore, in favor of the productive sector. It is expected that by the end of 1995 about one third of base money will be covered by foreign reserves, as compared to one fifth at the present time. Moreover, if we add purchases from the Fund, base money would be fully covered by foreign reserves. In that respect, taking into account the very liberal foreign exchange and foreign trade regimes in Armenia, the option of currency board arrangements in line with those in Estonia and Lithuania could be considered. Perhaps such an arrangement could be established in the framework of an upper credit tranche or ESAF-supported program. The basis for such arrangements will be created by consolidating all foreign reserves in the Central Bank and by streamlining the Central Bank's activities, envisaged under the STF-supported program.

Finally, I would like to say a few words about economic relations between Russia and Armenia. In 1994, Russia made a commitment to establish a new credit line amounting to Rub 110 billion. The bulk of this loan is expected to be disbursed in 1995. We are pleased to note that in the case of Armenia arrears to Russian suppliers constitute relatively small amounts, and we expect no difficulties in resolving the remaining problems. It is our intention to do our best to assist the Armenian authorities in their courageous efforts. I support the proposed decision.

Mr. Desruelle made the following statement:

Let me start by commending the authorities and the staff for their efforts over many months to develop a program, and let me state at the outset that we support the proposed decision.

The task of stabilizing the economy will not be an easy one. The initial conditions are indeed difficult: the budgetary situation is weak and this weakness is compounded by the recent accumulation of budget arrears; interenterprise arrears are extremely high, thus creating strong pressures for relaxation of macroeconomic policies; and trade routes are still affected by the regional situation. Thus, only extremely determined actions by the authorities will yield the desired results. In this respect, I agree with the staff that strengthening public finances is the key to success; and, I would add that a second key element of the program will be the way in which the authorities deal with, or rather do not deal with, interenterprise arrears. I fully agree with the fact that courageous measures to cut subsidies drastically and to replace them with a limited target safety net has to be the main element of fiscal consolidation.

Beyond these general comments, let me make four specific remarks. On revenues, the experience of many countries in transition, where the decline in revenue from traditional sources following the start of the transition process has often been underestimated, leads to extreme caution with respect to the precision of revenue forecasts. Thus, I welcome the fiscal contingency measures contained in paragraph 18 of the authorities' letter of intent. On the issue of interenterprise arrears, I am not entirely clear as to how enterprises are expected to react in the short term, especially in the face of a tightening of credit. I wonder, in particular, if the staff anticipates a further buildup of nonenterprise arrears, and what the staff recommends that the authorities do about the problem.

On monetary policy, and specifically on the modalities, I do not wish to rekindle the debate of last Wednesday. However, in light of the weak state of Armenia's financial sector, I continue to harbor deep skepticism about the value of an auction for central bank refinance credit and about the ability of such an auction to reveal a "true" market price for money and thus to allocate credit efficiently. I certainly hope that the modalities of conducting monetary policy will not distract the authorities from the serious objective of controlling monetary expansion, as specified by the program's quantitative benchmarks.

On exchange rate policy, I fully agree with the staff that a flexible exchange rate policy is the right option at the moment. Uncertainties regarding the evolution of the fiscal situation, the risks posed by large arrears to the implementation of a tight monetary policy, and the real risks of external shocks--either positive or negative-- stemming from the evolution of the regional situation are ample justifications for that choice.

In conclusion, let me state again the support of my authorities to the efforts undertaken by the Armenian authorities.

Mr. Mojarrad made the following statement:

We welcome the significant progress being made toward strengthening the peace process and improving political stability in the region. These positive developments have enabled the Armenian authorities to intensify their stabilization policies and accelerate the reform process during 1994. Indeed, the tighter financial policies implemented by the authorities in the second quarter of this year have reduced inflation sharply and resulted in exchange rate stability. In addition, economic activity has begun to show signs of improvement, and the volume of exports has expanded substantially. On the structural side, further price and trade liberalization, enterprise reform, and privatization took place over the course of the year. Despite these achievements, both the Government's financial position and the external situation remain weak.

To tackle decisively the economic difficulties facing the economy, the Armenian authorities have developed a comprehensive program of stabilization and structural reform for 1995 to be supported under the STF. The program aims to create an environment conducive to a resumption of sustained noninflationary growth. It contains bold and courageous measures and, in the staff's judgment, represents a clear break with the past. At the center of the program is the strengthening of public finances. The pace of structural reform in the areas of price, exchange, and trade liberalization, privatization, public enterprises, the financial sector, and the legal and institutional framework will speed up with the objective of improving the economy's supply response. The program also includes a targeted social safety net. With this wide-ranging package of policy measures for the next year--including many prior actions--the authorities are requesting the first purchase under the STF. We support this request. As we are in broad agreement with the thrust of the staff appraisal and recommendations, we wish to make a few brief comments.

On the fiscal front, we concur with the staff that the strengthening of public finances is the key to the success of the program. To this end, the authorities intend to take several fiscal measures to reduce the size of the 1995 fiscal deficit to one half of the 1994 level. Measures aimed at generating additional tax revenue, particularly elimination of tax exemptions, and simplification of rate structures, will broaden the tax base and increase the efficiency of resource allocation.

On the expenditure side, the authorities' intention to reduce total subsidies from 20 percent of GDP in 1994 to 3 percent in 1995 is commendable. We are encouraged that, concurrent with price liberalization, the authorities have allocated resources within the social safety net programs to fully compensate pensioners and the most needy groups in society.

The implementation of the fiscal package for 1995 requires substantial improvement in the administrative capacity of the Government to control expenditure and collect taxes. We welcome the authorities' intention to establish a treasury and support the authorities' request for technical assistance in this area. For the purpose of a comprehensive review of tax policy as well as improved tax administration, the authorities also intend to seek the Fund's technical assistance. We support the authorities request for technical assistance in these areas.

In the monetary field, despite the higher than expected inflation during the past two months, the program aims to bring the monthly inflation rate down to 1 percent through limiting the Central Bank's credit growth and keeping real interest rates positive. The pass-through effects of large administrative price increase may remain the driving force behind inflation and pose a risk in achieving the inflation target.

We believe that the authorities' program is comprehensive and ambitious. The implementation of a number of difficult prior actions and the authorities' past record of economic reform implementation, particularly in the area of land privatization, give one confidence that, despite the enormity of the task that lies ahead, the authorities are firmly committed to the program's objectives. We agree with the staff that the successful implementation of the program in general and the fiscal package in particular requires adequate and timely financial support by the international community, and donors, on concessional terms. It is unfortunate that even with a very encouraging start, the level of external financing is lower than the financing needs projected under the program. We join the previous speakers in urging the international community and donors to provide the additional external financing still needed for 1995.

Ms. Wagenhoefer made the following statement:

Despite difficult economic circumstances, the Armenian authorities have managed to implement, at least on an initial level, basic market-oriented reforms. These efforts in combination with an ambitious adjustment program constitute a sound basis for the prospective STF arrangement. Therefore, we fully support the proposed decision. Our approval is based not only on the implementation of prior actions, which we would consider as a reflection of the Government's commitment to its reform and stabilization program, but also on the recent positive developments regarding the peace process. Progress in this area will contribute not only to stability in the region, but also to limiting the Fund's substantial exposure.

As I share the thrust of the staff appraisal and the comments made by other speakers, I will focus briefly on a few areas of concern. The intended reduction of the budget deficit from 24 percent of GDP to 12 percent for 1995 seems quite ambitious. After a decline of the tax ratio below 15 percent of GDP in 1994, the tax ratio will presumably not climb over 17 percent in 1995. Over a longer period of time we see the need for further improvements on the revenue side. Apart from a broadening of the tax base, a reform of the tax structure will have to be considered, along the lines put forward by the staff. According to press news, the incentives for tax evasion are rather high with profit taxes up to 70 percent--could the staff comment? Budget consolidation in Armenia in 1994 relies heavily on expenditure cuts, which amount to nearly 20 percent of GDP. We very much welcome the envisaged reduction of subsidies, but I wonder whether postponement of higher return investment programs is really the best advice. According to press news, so far 30 percent of the budget is designated for military outlays. We would appreciate the staff's comments on these figures and on the prospect of cuts in that sector as a priority rather than a cut in high-yielding public investments.

Given the considerable uncertainties, it is understandable that for the time being the presentation of a meaningful medium-term balance of payments objective is not possible even if such an objective is--and should remain to be--a necessary prerequisite for additional Fund arrangements. We were, however, amazed to see that, among the summings-up of the program's main objectives, the achievement of a sustainable balance of payments position is not even mentioned.

My last point relates to the issue of exchange rate policy. As far as I understand, recent exchange rate movements have been rather stable. As acknowledged by the staff, the current system seems to be appropriate for the time being. But the staff

> appraisal also points to a need, that, at the time of an upper credit tranche arrangement, "serious considerations should be given to the introduction of a fixed exchange rate regime to provide a nominal anchor". Let me say, that I was somewhat surprised about this recommendation being made at this time, but the staff might wish to comment a little more on the rationale for such an approach and on the appropriate timetable for the introduction of a pegged exchange rate. Furthermore, would the staff also consider a currency board system as an appropriate alternative?

Mr. Al-Tuwaijri remarked that, like Mrs. Wagenhoefer, he wondered about the staff's suggestion that the authorities consider a fixed exchange rate in the context of an upper credit tranche arrangement.

The staff representative from the European II Department stated that a substantial portion of the enterprise arrears was energy related. The program allowed for payments by the Government to reduce the arrears and would thus benefit some enterprises. The staff did not know whether or not interenterprise arrears would increase in 1995; however, currently, neither the Government nor the Central Bank was in any position to provide financial assistance to enterprises. The World Bank, under its rehabilitation loan, had also been examining the issue of enterprise arrears.

A review of tax administration and tax policy would take place in 1995, and changes would be introduced in the 1996 budget, the staff representative remarked. The authorities were reluctant to take measures currently because of the upcoming parliamentary elections. However, they were giving the highest priority to tackling weaknesses in tax administration, and the Fund was providing technical assistance in that area.

A sound cost-benefit analysis of the public sector's capital expenditures had never been undertaken, and a review of public expenditures by the World Bank would be necessary before an ESAF program could be put in place, the staff representative observed. The authorities had acknowledged that a large portion of those expenditures was unproductive, and they were not concerned about the loss of public investment projects. The decline in capital expenditures under the program would not be very high; in fact, 7-8 percent of GDP would be devoted to capital expenditures, most of it externally financed on concessional terms.

The staff had not discussed the medium-term prospects of a balance of payments recovery because of the absence, until recently, of a reliable database, the staff representative explained. In addition, the authorities had only just begun to examine the relationship between the medium-term outlook and long-term policies.

There was a potential for recovery in Armenia, the staff representative considered, although its pace would depend on the progress toward peace in the region, the opening up of trade routes to Azerbaijan and Turkey, and the stabilization of the situation in Georgia. The Islamic Republic of Iran had become Armenia's second-most important trading partner. The Armenian economy's recovery also depended on its ability to diversify output. However, for the next few years, Armenia would need external assistance on concessional terms.

Despite some fluctuation in the exchange rate, Armenia's exchange rate policy had been quite successful, especially compared to its neighbors, the staff representative from the European II Department observed. The authorities wished to keep both prices and the exchange rate stable and were currently not willing to commit themselves to any particular exchange rate regime. The staff had been flexible on the issue, and felt that, if fiscal performance was good and the level of reserves was adequate, Armenia could benefit from a fixed exchange rate in the medium term to encourage foreign investment. Members of the Armenian expatriate community had shown an interest in investment projects, but were waiting for the situation to stabilize before making a commitment. A fixed exchange rate would restore confidence and could facilitate investment. However, fiscal imbalances were large, and it would be prudent to see whether or not the Government could implement the tough program that it had adopted. External grants contributed significantly to the budget and, if they discontinued, the fiscal deficit would remain large. Achieving price stability and exchange rate stability depended to a large extent on the availability of external assistance.

Mrs. Wagenhoefer asked the staff to comment on newspaper reports that had indicated that military expenditures in Armenia were quite high.

The staff representative from the European II Department replied that the staff could comment only on those items included in the budget and not on expenditures that were made privately or excluded from official statistics. More than half of the unclassified items in the budget referred to military expenditures, which were scheduled to decline sharply. Wages to the military were included in the wage bill and were higher than those to the civilian population. The authorities were aware of the potential for savings that the military sector offered, but they wished to see more progress in the peace process before making a commitment to reduce military spending.

Mr. Giulimondi made the following statement:

> The efforts made by the Armenian authorities in recent months to stabilize the economy and introduce structural reforms have been truly remarkable. After the disappointing performance and staggering hyperinflation that characterized the economy until May 1994, the emergence of a peace process in the regional conflicts has laid the prerequisites of a rapid stabilization process to take root. Difficult prior actions have been undertaken, which have the potential to expedite economic adjustment and trigger sustainable growth in the near future.

Together with the lower than expected commitment of external assistance during the recent consultative group meeting, the trend of inflation has been the most disappointing recent development. After the very sharp decreases in June and July from the extremely high previous levels, the monthly consumer price index has shown a limited but constant increasing trend, from 4 percent in August to 14 percent in November. This may be explained by moderate monetary growth in the third quarter, a larger than expected response to the increases in administered prices, and some seasonal factors. These price developments must be kept under close scrutiny, given the previous track record of the country and the early stage of the adjustment. I have some observations. First, I am not fully clear as to how the growth in broad money, which was expected after the sharp drop in June that followed the tightening of credit policies since April, was higher than projected and, if so, what were the reasons. My second and third points have been already touched upon by Mr. Desruelle. It would be interesting to learn from the staff if interest rates have recently remained markedly positive in real terms. In fact, the proportion of the credit to the nongovernment sector channeled through market auctions should have increased steadily, from the average 20 percent before the program to 70 percent targeted in December, thus introducing elements of volatility in the formation of interest rates, given that a modern financial system is still in the process of formation. Finally, the sizable stock of interenterprise arrears involves major risks for the monetary program. As with other economies in transition, the imposition of hard budget constraints, the avoidance of any financial assistance outside comprehensive restructuring plans, and extensive privatization are integral and fundamental parts of the efforts directed to attain fiscal consolidation and monetary stability.

Turning briefly to the adjustments necessary in order to offset the shortage of resources committed by the consultative group, it is comforting that the resulting compression of imports has not included project-related inputs, which are responsible for medium-term growth perspectives to a greater extent than the other imports. In the same vein, social safety provisions, which appear to be given adequate room in the program structure, and capital expenditure have not been affected, although at the expense of the already low level of official foreign reserves.

I hope that the authorities will be able to proceed shortly, if needed, to a transitional stand-by arrangement which would be, in turn, conducive to a full-fledged medium-term ESAF program. At that time when the stabilization process is firmly on track and confidence has begun to be re-established, a currency peg would be a precious instrument to lend further credibility.

With these remarks, I support the proposed decision.

Ms. Srejber made the following statement:

Let me first say that the Armenian authorities are to be commended for the progress that has been made so far in the very difficult internal and external economical and political situation. The authorities' determination to continue proceeding with structural and institutional reforms is also commendable. The sharp reduction of inflation and the first tiny green sprouts of economic stabilization through the implementation of prudent fiscal and monetary policies are encouraging. I certainly welcome the implementation of the difficult and also unpopular prior actions that have been taken by the authorities in a very complicated economic and political environment. However, I am a bit concerned about what might happen with the implementation of the program and the possibility of an upper credit tranche arrangement, as elections are approaching in May 1995 and there has been a surge in popular support for the opposition parties, who are extremely critical of the Government's economic policies. Could the staff perhaps comment on that?

As I concur with the basic thrust of the staff appraisal, I will limit my statement to a few remarks for emphasis.

Stabilization efforts need to be pursued at both the macro and micro levels. At the macro level, the authorities need to, inter alia, limit the growth of domestic credit as envisaged in the projections for 1995. At the micro level, like other speakers, I think that there is a clear need for reducing interenterprise arrears. The operation of netting out and settling arrears is undoubtedly a complicated process that will take time. In the meantime, new arrears are not to be allowed to accumulate.

Related to the issue of interenterprise arrears, the settlement of tax arrears is important and should provide the possibility for an improvement in the fiscal situation. I would appreciate the staff's comments on whether information on the level of tax arrears is available and, if so, the extent to which the Government's financial position would improve if such arrears were settled. I would also appreciate if the staff could provide more information about the authorities' intention to address the problems of insolvent enterprises and to go ahead with bankruptcy procedures.

I agree that the reduction in government subsidies, the prioritization of expenditure, as well as the careful planning of social benefits, would assist in scaling down government expenditure. Experience in other countries shows that social benefits, once introduced, will always remain a major government expenditure. Therefore, they should, from the very beginning, be carefully designed to match the country's budget constraints and social needs.

The exchange rate policy has already been discussed, but I still want to say that I agree with the staff that the current arrangement seems appropriate, given the still fragile situation and the very low level of reserves--less than one week of imports. Even though I think that a fixed exchange rate regime can add credibility to adjustment efforts, I think one has to judge it on a case-by-case basis. We have good examples in our constituency of countries achieving economic stabilization by adopting differing exchange rate regimes. In the case of Armenia, with its weak and still uncertain situation, I am--unlike Mr. Newman--a bit more hesitant, and I wonder if the staff's advice to contemplate a fixed exchange rate in connection with the first upper credit tranche agreement might not be premature; I would also appreciate the staff's comments on the sustainability of the level of international reserves forecast for 1995 and the years ahead, and the sources of those reserves.

Finally, on the subject of structural reform, while several reform measures were taken and progress made, particularly in privatization, I urge the authorities to strive to complete the process of restructuring within a shorter time span and to speed up the financial sector reforms.

With these remarks, I can support the proposed decisions.

Mr. Hamilius made the following statement:

The Armenian authorities should be congratulated for the considerable progress made with economic reforms, which allows them to request the first Fund-supported program for Armenia. I agree with the authorities that Armenia's problems can be handled best in the context of an upper credit tranche arrangement. I would therefore like to express the hope that the drawing under the STF will be only a brief and necessary prelude to a comprehensive economic program to be supported by the enhanced structural adjustment facility.

As I agree with the thrust of the staff appraisal and the comments made by previous speakers, I will only comment on the fiscal aspects of the program. The authorities' stabilization efforts will depend almost entirely on their success in putting public finances in order. The authorities face the tremendous challenge of changing the philosophy underlying the budget, by trimming subsidies, targeting and streamlining social safety, and introducing new and noninflationary sources of deficit financing.

Some positive results are already visible: revenues have increased and expenditures have been deferred, albeit at the cost of accumulating domestic arrears. The program calls for mobilizing additional revenues and reducing the overall deficit to an ambitious 12 percent of GDP. The bulk of the deficit reduction should come from an almost seven-fold reduction of subsidies and the liberalization of the price of bread. Although I recognize how important these measures will be for improving the country's fiscal position, I am still concerned whether such a radical price increase is politically sustainable, and whether the current social safety net provisions are adequate.

The decisions of the recent meeting of the Conference of Security and Cooperation in Europe could also have an impact on Armenia's public finances by providing room for reducing military outlays. Could the staff indicate the approximate magnitude of such outlays at present? Do the authorities see any room to reduce the military expenditures and, if so, within what time frame and to what extent would such a move affect the budget? In any event, possibilities should be explored to adjust the Fund-supported program eventually. The staff notes correctly that the achievement of programmed fiscal targets will depend not only on increasing revenues significantly and cutting expenditures, but also on prompt disbursements of external assistance. In addition, I am concerned that the Government's limited absorption capacities may also be an obstacle to meeting the program targets. I note from the staff report that out of a total of $33.3 million in World Bank loans, less than one sixth had been disbursed by October this year. This slow pace of disbursement is not acceptable, in view of the existing acute shortages of imports, and gives serious cause for concern about the realism of the promised sharp increase in external assistance.

With these remarks I support the proposed decision.

Mr. Oya made the following statement:

I commend the authorities for having embarked on serious economic reforms and for having reached an agreement on a Fund-supported program under the STF, despite the need for rehabilitation after the devastating earthquake and regional conflict over Nagorno-Karabakh. The track record is excellent both on macroeconomic stability and structural reforms. In view of the fact that almost all the prior actions have already been implemented, I have no difficulty supporting the request for a first purchase under the systemic transformation facility.

As I agree with the thrust of the staff report, I would like to make only one comment on the exchange rate policy.

I can agree with the authorities that, while a fixed exchange rate could be considered in the future, at this stage a floating exchange rate arrangement is most appropriate in light of the remaining large fiscal imbalance, modest level of reserves, and uncertainties affecting the availability of external financing.

I suggest that the authorities take a wait-and-see approach for the moment and consider carefully the most appropriate exchange rate system for Armenia. It should be noted that, while each of the Baltic states has a different exchange rate system, each has been equally successful in achieving good economic performance. In any case, exchange rate stability is crucial and to this end the authorities should persist with sustained implementation of tight financial policies.

Armenia intends to expedite the transition to an ESAF in late 1995; however, the challenges the authorities will face in the period ahead are enormous. One of these challenges will be the preparation of a timetable for the privatization of large-scale enterprises. I hope that the authorities will strengthen their effort toward economic reform and gain credibility in the donor community in the near future.

With these remarks, I support the proposed decision.

The staff representative from the European II Department observed that interest rates were lower than in the past, but continued to be positive in real terms. The auction market had not been functioning smoothly, but the staff hoped that it would improve once directed credits were eliminated. Growth in the money supply in June through October had been restrained, with a slight decline in broad money occurring in September and October. The staff did not have any information for November.

The total estimated tax arrears were approximately dram 3 billion, the staff representative noted. If the authorities were successful in improving tax administration, they would be able to collect some, but not all, of the overdue taxes.

Information for the first two weeks of December indicated that the increase in bread prices had not affected the prices of other commodities, the staff representative commented. The authorities believed that price increases, although not popular, would be politically feasible. All the political parties, save one, supported the systemic reforms; the issue was really one of the pace of reform. Elections were scheduled to be held in May 1995, and the pace of reform depended on the authorities' willingness to undertake additional adjustment measures, which would enable them to achieve their goal of moving to an upper credit tranche arrangement as soon as possible.

The staff had not discussed with the authorities the impact of the agreement of the Conference on Security and Cooperation in Europe on Armenia's military expenditures, the staff representative said. As noted earlier, the staff believed that the authorities would wait for some time before reducing defense spending.

Wages in Armenia were low, and provision had been made for a safety net that would be affordable, the staff representative noted. The authorities were naturally concerned about the impact of a social safety net on the budget. The Fund staff, together with the World Bank staff, had tried to identify the most vulnerable groups in society, but much more remained to be done in that area. There was also room for improvement in the area of targeted subsidies.

It would be more difficult to meet the reserves target if the financing gap were not closed, the staff representative remarked. In that respect, the program was highly ambitious, although the staff had not tried to make any projections beyond 1995. Although initially there probably would be a decline in foreign reserves, the staff hoped that they would strengthen later, particularly if the STF were replaced by an upper credit tranche arrangement.

The profit tax rate of 70 percent applied only to casinos; other enterprises paid only 30 percent profit tax, the staff representative from the European II Department explained. The staff believed that the exchange rate would stabilize under the reform program. If the reserves position were strong and a policy package to support the exchange rate were in place, the authorities ought to consider adopting a fixed exchange rate. That would inspire investors' confidence in the program. However, the staff and the authorities had agreed to wait before making a decision on the exchange rate.

The staff representative from the World Bank stated that the Bank was currently disbursing two loans. One of those was a technical assistance loan designed to provide assistance during the reform process. Only a small portion of the loan had been disbursed in 1993 because of the implementing agencies' lack of familiarity with the World Bank's procurement and disbursement procedures. In 1994, as a result of the training provided to those agencies, and because of the acceleration of the reform process, the pace of disbursements had picked up. A second loan was an earthquake reconstruction loan that had been available since April 1994 and had been disbursing at a normal pace. The World Bank's future assistance program would include a large element of quick-disbursing assistance.

Mr. Havrylyshyn remarked that his Armenian authorities recognized that there was room for a further rationalization of taxes, and they would continue with their efforts to modernize the tax system. The suggestion that, perhaps, the authorities ought to do away with tariffs, as those yielded low revenues, could be looked at differently. One could just as well surmise that improvements in tax administration would result in higher revenues.

The authorities had no intention of bailing out the enterprises that had accumulated arrears, Mr. Havrylyshyn noted. The primary tool for dealing with enterprise arrears was the adoption and continued implementation of a hard budget, which included adopting high real interest rates, instituting bankruptcy proceedings, and liberalizing prices and trade.

As the staff had noted, the authorities were currently not considering a fixed exchange rate regime, Mr. Havrylyshyn stated. He agreed with those who said that it might be premature to recommend moving to a fixed exchange rate; the staff was not suggesting that but instead had adopted a wait-and-see attitude. However, it was also important for the authorities to keep their options open with respect to an appropriate exchange rate policy for the future.

The Executive Board took the following decision:

1. The Fund has received a request by the Government of the Republic of Armenia for a purchase equivalent to SDR 16.875 million under the Decision on the Systemic Transformation Facility (Decision No. 10348-(93/61) STF, adopted April 23, 1993), as amended.

2. The Fund approves the purchase in accordance with the request.

Decision No. 10854-(94/109), adopted
December 14, 1994

3. SYSTEMIC TRANSFORMATION FACILITY - AMENDMENT

Executive Directors considered a staff paper on a proposed amendment of the decision on the systemic transformation facility (EBS/94/237, 12/7/94).

The Chairman made the following introductory remarks:

The period within which members can make a first purchase under the systemic transformation facility (STF) will expire on December 31, 1994. During a recent luncheon discussion, I had raised with Executive Directors the possibility of a brief extension of this period. I understand that agreement on such an extension can be reached by the Board, provided there is a consensus that, in accordance with the guidance provided by the Interim Committee in Madrid, there will be no decision on increasing access under the STF before agreement on the "package" is reached.

If this is valid and true--and this agreement should be recorded in the minutes of our meeting--then the only question that remains before us is the length of the extension period. The staff has circulated a paper on this matter. As the staff paper explains, several extension periods may be envisaged. An extension to February 28, 1995 would likely permit only one additional Fund member to make its first STF purchase. An extension to March 31, 1995 might enable a second member to make its first purchase, although it appears more likely that this member will be in a position to make the purchase if the period were extended to April 30, 1995, which is the day after the next scheduled Interim Committee meeting.

So, with a view to playing safe and arriving at the broadest and most constructive solution as possible, while staying within the guidance provided by the Interim Committee in Madrid, I would invite all of you--and I know that there is reluctance to go that far--to accept an extension to the April 30, 1995, in order to facilitate the work of the Fund. Of course, I hope that, in the meantime, sufficient progress will be made on the "package" for Chairman Maystadt to be in a position to announce to the membership his judgment that the prospects for a resolution of these issues are favorable. Then, indeed, we could go ahead not only with the desired extension, but also with the creation of the third tranche of the STF.

Mr. Schoenberg inquired why the guidance provided by the Interim Committee in Madrid allowed for an extension of the STF, but did not allow for an increase in its access limits.

The Chairman recalled the communiqué of the Interim Committee, which said, in part: "The Committee had a broad-ranging exchange of views with regard to the proposal to extend the systemic transformation facility with increased access. The Committee also had a broad-ranging exchange of views relating to proposals for allocation of special drawing rights. Committee members requested the Chairman to conduct further consultations and to call a meeting of the Committee when he judges that the prospects for resolution of these issues are favorable."

Unless he were informed by the Chairman of the Interim Committee that a consensus among members was approaching and that the prospects for an agreement on the "package" were favorable, he did not believe that he could take the initiative to invite the Executive Board to reach a decision on increasing access limits under the STF, the Chairman explained. However, he believed that it would be possible to decide on an extension of the STF and he would request Directors to agree on the period of extension.

Ms. Lissakers remarked that the guidance provided by the Interim Committee related not only to an increase in the access limits under the STF, but also to an extension of the facility. She also wondered why it was considered possible to address one component and not the other without violating the Interim Committee's guidance.

The General Counsel explained that the Interim Committee communiqué identified two elements that were linked: an extension of the STF with increased access limits; and a proposal for an allocation of SDRs. It had been understood that the two elements formed a "package," and that the Chairman of the Interim Committee would conduct further consultations to see whether members might be able to reach agreement on that "package." The question was whether it would be possible to disconnect the two components of the first element and address one or the other separately from the rest of the "package." A restrictive view of the Interim Committee's guidance would hold that neither of the two components could be addressed separately. A less restrictive view would allow for either of the components--extension and increased access limits--of the STF element of the "package" to be dealt with separately. During the Interim Committee discussions it had been proposed that the two components be disconnected and, indeed, that the term "with increased access" be dropped. However, that suggestion had not been accepted. The intention had been that, if both the components of the STF were to be addressed together, it would have to be in the context of the "package." That did not preclude the possibility of the Executive Board examining the individual components of the "package" separately and agreeing on an extension without increased access. It should be borne in mind that the recommendations of the Interim Committee were not binding, and that an extension of the STF would require a very high majority in the Board.

Ms. Lissakers asked whether that meant that the Board could address the issue of an extension of the STF but not the issue of increased access limits, independently of a decision on the "package."

The General Counsel replied that the two components could be addressed separately; however, it would not be possible to have a decision on both an extension and increased access limits without an agreement on allocation of SDRs.

Ms. Lissakers wondered whether it would be possible to extend the STF for one year.

The General Counsel responded that there were no legal obstacles to an extension of one year, a decision which would require an 85 percent majority in the Board.

The Chairman considered that the three options for extending the STF reflected the informal discussions he had held with Directors. There might be the requisite majority for an extension of two months; it would be difficult, although not impossible, to obtain the necessary majority for a three-month extension; and it would require an extraordinary spirit of consensus among Directors to extend the period to April 30, 1995. He was asking for that spirit of consensus to prevail. It would not be appropriate to go beyond that date, because to do so would require that several

Directors go beyond their mandates. Furthermore, he hoped that by April 1995 the Interim Committee would have reached agreement on the "package."

Mr. Berrizbeitia made the following statement:

I would like to express my support and the support of ten other chairs to the proposal that you have summarized at the beginning of your statement. The fact that these 11 chairs consult with each other on this issue reflects the importance that we attach to the issue of the extension of the systemic transformation facility and to the linked issue of the general allocation of SDRs, as we were instructed to do by the Interim Committee. We--at least these 11 chairs--have no mandate to allow these issues to be diluted in any manner at this point. The related issue of SDRs is also an issue of principle and of great importance to the 11 chairs--grouped under the Group of Nine (G-9). That is why we exchange views on these two issues, which were linked by the Interim Committee.

I would like to reiterate the position that we expressed during the informal luncheon we held with you last week, on our agreement to go ahead with an extension of the systemic transformation facility. We had said that we could support an extension of two months, with the understanding--which you expressed very precisely at the beginning of your statement--that there would be an agreement that there would be no increase in access limits under the facility, at least until such time as progress was achieved on the issue of the general allocation of SDRs as part of the overall "package."

In light of the proposal presented by the Legal Department, we considered the alternative dates suggested by you. After lengthy discussions and different points of view expressed, we are prepared to agree to an extension of the STF under the conditions mentioned until the day after the end of the spring meeting of the Interim Committee. That date may be very close to April 30--it could be April 28 or April 29. We are not being facetious. We want to emphasize that this issue is related to issues that the Interim Committee would be addressing and the fact that we would want to see substantial progress made on the whole "package" so that we do not have a deadlock in the Interim Committee, but that we have a solution to our differences during the meeting. We are prepared to cooperate in the search for such solutions. These 11 chairs are of an open mind. But the fundamental issues of the package are principles--and I understand there are principles on both sides--that must be respected, as guidance was given to us by the Interim Committee in Madrid.

> That is our position. I wanted to reiterate it at this point and emphasize our willingness to go further than we had originally thought--beyond the two months--until the day after the end of the Interim Committee meeting.

The Secretary noted that the agreed dates for the Interim Committee and Development Committee spring meetings were April 26 and April 27, 1995, respectively, although only the Development Committee had specified the date in its communiqué.

Mr. Mirakhor commented that he supported Mr. Berrizbeitia's position. The date of April 27, which would be the day after the Interim Committee meeting, was symbolically important. It would send a message to the Interim Committee and to the Chairman that the Board recognized that a compromise on the "package" and the efforts to achieve that compromise rested with the Committee and its Chairman. He would ask his colleagues to agree to extend the facility to the day after the conclusion of the Interim Committee meeting.

Mr. Schoenberg remarked that he welcomed the efforts of developing countries to work toward a solution. In light of the fact that the Interim Committee was not a decision-making body, even if it were to reach an agreement on the "package," the Executive Board would still have to take a decision to extend the STF.

Mr. Mirakhor said that extending the STF until the day after the end of the Interim Committee meeting would give the Board time to meet immediately after the Interim Committee meeting.

Mr. Wei made the following statement:

> Mr. Berrizbeitia's remarks on the proposed amendment to the STF fully reflect this chair's position. I have nothing to add but wish to emphasize one point.
>
> Our support in extending the STF to the day right after the next Interim Committee should not in any way be interpreted as delinking the issue of the general SDR allocation. The challenges arising from the economies in transition are of concern to us all. Today's action, in particular, from those countries that have tried very hard to safeguard the role of the SDR in the international monetary system, demonstrates the continuation of support to the Fund in helping countries in transition to meet their challenges. The spirit of cooperation from developing countries has been well illustrated. It is very regrettable to note that little progress has been made since the last Interim Committee meeting. I hope those countries still opposing the general SDR allocation could take a broader view in line with the long-term global challenges and with the objective of keeping the SDR as the principal reserve asset as set out in the Fund's

Articles of Agreement so that a compromise, which must include the element of a general SDR allocation, will be reached at an early date.

The Chairman observed that, despite what might appear to be a lack of progress on the "package," efforts had been made toward finding a resolution of the issues, and a serious discussion on the "package," including its most crucial element--the allocation of SDRs--should be possible before the end of January 1995. He was determined to continue discussing the "package" with members and would bring suggestions to the Board in early 1995. It was important to resolve the issues before the spring meeting of the Interim Committee, not because there was an urgent need for SDRs or for the STF, but because it was important that the members of the institution not remain divided. The Fund's management, member country authorities, and Chairman Maystadt were, he was certain, all anxious to find an acceptable solution. An extension of the STF would enable the Fund to continue with its work and would allow members to focus on reaching agreement on the "package."

Mr. Kiekens said that he seconded the Chairman's statement. The Chairman of the Interim Committee, Mr. Maystadt, had asked him to inform the Board that he would step up his consultations with members of the Interim Committee. The willingness of the G-9 Executive Directors to extend the STF would facilitate further consultations toward a consensus. Mr. Maystadt had invited the members of the Interim Committee to communicate with him and to suggest any ideas that would promote agreement on the "package."

In his capacity as Executive Director for his entire constituency, he wished to express his support for the proposal to extend the STF to April 30, 1995, Mr. Kiekens remarked. While symbols were certainly important, he noted that April 30 was very close to the date of the Interim Committee meeting; furthermore, one could not rule out the possibility that the Interim Committee meeting could be extended to Monday.

Mr. Havrylyshyn made the following statement:

I think I count myself, if my arithmetic is right, as a member of the group--lower case 'g'--of about five or six countries. I appreciate this opportunity to make a very brief statement, and I appreciate the refreshing transparency and openness with which the consultations have been described by Mr. Berrizbeitia.

We support the proposed decision and favor a later date, such as end-April 1995. We feel there is no need for an elaborate argumentation of our position other than to refer to one of the fundamental principles of the Fund's operations, namely, equal treatment. The additional one- or two-month difference among the proposed dates is surely too small to risk a member just missing possible access to this important temporary facility.

It is by now widely understood that the transition process is an extremely difficult one, and the euphoria of the early 1990s has been replaced with a realization that, in some cases, getting started on the path to reforms may take several years because it requires a coincidence of minimally favorable economic, political, and external circumstances. Understandable delays in starting do not change the widespread view that policies should be resolute and progress quickly--and program access to the STF should be judged on the adequacy and pace of these policies, not on how early or late the programs were started. Hindsight being perfect, perhaps the lesson for transition should have been clear from the experience with many Fund-supported programs, which shows how difficult structural adjustment--the closest historical analogy to transition--can be, and indeed how long it can take to get started even in societies where market activity is widespread. In any event, today there is a realistic awareness of how much can be expected.

In light of this new awareness of the difficulties and uncertainties, the original two-year period for the STF may be viewed as relatively short. This is not to argue there should be an indefinite period or even one considerably beyond two years; this would be unacceptable because one then loses the incentive effect of going beyond the systemic transformation facility. But it seems altogether reasonable to balance the principle of equal treatment, the needs of these countries, and the incentive effects by the proposed extension of the STF to end-April 1995.

Mr. Kaeser made the following statement:

My colleagues are probably aware of the fact that my chair is directly concerned by the proposed amendment of the STF decision. As alluded to by you, two countries of my constituency are likely to submit in the near future a request for a purchase under the systemic transformation facility. Uzbekistan has already agreed to a comprehensive economic program and its request is to be discussed by the Board in January, if the STF is extended. The negotiations of a program with Azerbaijan are tentatively scheduled for the latter half of January and early February, with a Board discussion that should take place in March or April under the same assumption. Since a golden rule of the Fund is to treat member countries equally, these two members should also be given the chance to go through the transition process within the framework of a facility, which has been introduced in order to smooth the transition to a market economy. Therefore, I appeal to my colleagues to grant an extension up to April 30, 1995, which is necessary in order not to impair the transition process. I will probably have to ask for a further extension if, and when, Turkmenistan and Tajikistan make a request for the Fund's support, but for the time being I would be content with an extension up to the end of April. I took note with satisfaction of the declaration made by Mr. Berrizbeitia, but I regret the fact that the discussions of this Board are increasingly conducted between groups.

As the transition process takes more time and as the catalytic effect of the Fund's involvement is very limited in the Baltic countries, Russia, and the other countries of the former Soviet Union, any further delay in increasing the access limits under the STF could impair the transition process. I therefore urge the Board to keep this issue under review.

Ms. Lissakers wondered whether, in agreeing to extend the STF, Directors would be declaring their support for the implications of that decision for future decisions. If a decision were being made on issues other than an extension of the STF, that would require a new proposal and another meeting.

The General Counsel noted that Directors would be accepting or rejecting only the proposal to extend the STF. However, some chairs had indicated that they could not support the decision, unless there was a consensus in the Board that a decision on increased access limits under the STF would not be taken during the period of the extension.

Mr. Mirakhor observed that his chair and others who shared a similar position were willing to compromise in good faith and had come to a decision that had not been easy for them to make. Like Mr. Schoenberg and Ms. Lissakers, he had had doubts about whether it would be possible to extend the STF. He had not been in favor of an extension, unless as part of a compromise. He had been persuaded to support the decision, on the understanding--as expressed by the Chairman at the luncheon and which had not been disputed by other Directors--that there would be no increase in access limits under the facility during the period of the extension. If that understanding were subject to revision, it would be important for Directors to be informed of any changes. The agreement of the G-9 Executive Directors was also based on that understanding.

Mr. Berrizbeitia said that he concurred with Mr. Mirakhor. The developing countries had been willing to extend the STF not just for two months, but for four months, in the hope that the efforts of the Chairman, Mr. Maystadt, the Governors of the Fund, and Directors would lead to an agreement--perhaps even as early as January--on the "package." The developing countries' understanding on that issue had been stated clearly at the luncheon and by him earlier in the meeting.

Mr. Evans said that he hoped that the discussions to reach agreement on the "package" would continue and that a consensus would emerge well before the spring meeting of the Interim Committee. He wondered how the understanding to which Mr. Berrizbeitia and others had referred would be affected, if there were an agreement on the "package" in January or February.

The Chairman observed that, if agreement were reached before the spring meeting of the Interim Committee, there would be no need to deliberate further on the "package" at that meeting. Members of the Interim Committee, in his view, would welcome an early resolution of the issues. In order to do that, it was important to develop a spirit of consensus, and he hoped that the decision to extend the STF would contribute toward that.

Mr. Evans commented that, in his view, there were a number of ways to interpret the communiqué of the Interim Committee and that not all members shared the same interpretation of it.

Mr. Autheman remarked that, according to the Interim Committee communiqué, members were bound to act within a framework of consensus, and the Chairman of the Interim Committee would notify the Board when prospects for a consensus appeared favorable. He wondered whether the "understanding" to which Mr. Berrizbeitia had referred added something to the Interim Committee's communiqué.

Mr. Berrizbeitia said that his chair was not opposed to extending the STF and increasing access limits under it--as that was an issue of great importance to a number of members--but, his chair was not in a position to agree to increasing the access limits, until progress had been made on another very critical issue for the Fund and for developing countries, namely, a general allocation of SDRs. There would have to be an understanding--a "gentleperson's" agreement--that no effort to increase access limits under the STF would be undertaken, unless substantial progress were made on the fundamental issue of the "package." While he was not in a position to say what would constitute substantial progress, once it had been achieved, there could be rapid agreement on both extending and increasing access limits under the STF.

The developing countries were being flexible and had made important concessions by agreeing to extend the facility, Mr. Berrizbeitia continued. Several Executive Directors of the G-9 had thought it preferable not to extend the facility, on the assumption that it could be reactivated when progress was made on the other issues. However, the consensus within the group was that, as another gesture of flexibility, they would agree to extend the facility, not just for two months, but until the end of the spring Interim Committee meeting. They were acting in good faith and in the hope that their flexibility would contribute toward a constructive dialogue, which would facilitate agreement on the "package."

Ms. Lissakers said that, while she understood the link certain Directors had established between the STF issue and the SDR issue, she considered that link to be largely cosmetic. She would support the decision as proposed by the staff and hoped that the support of the developing countries for the extension was also out of concern for members of the institution that had not yet made a first purchase under the STF and that would benefit from the facility.

She was not currently asking for an increase in access limits under the STF, but was uncomfortable with the idea of foreclosing that option during the next four months except as part of an agreement on the allocation of SDRs, Ms. Lissakers noted. She reserved the right, as a responsible member of the Board, to call for a decision by the Board on increasing the access limits, even before April, if circumstances so required. There were countries that had made a first and second purchase under the STF and whose stabilization efforts would be greatly strengthened by a third purchase. She would be interested to hear the views of those Directors representing potential users of a third purchase about the likely impact on the reform process if the Board were to fail to reach agreement on increasing the access limits under the STF.

Mr. Geethakrishnan said that he endorsed Mr. Berrizbeitia's statement on behalf of the developing countries. The developing countries had agreed to the extension in order to benefit those countries that had not yet made a drawing under the facility. Ms. Lissakers's suggestion to increase the access limits would benefit those members that already had access to the facility, and that would require a new decision. He hoped Ms. Lissakers could agree to the extension on the understanding that the matter of increasing access limits would not be taken up during the period of extension.

Ms. Lissakers reiterated that she was not currently asking for a decision on increasing access limits; but she did not want her support for the decision to extend the STF to be misinterpreted. While one could be optimistic that an agreement on allocation of SDRs would be reached, one could not be certain that such an agreement would materialize. She was proposing that, if circumstances arose--before the end of April 1995--such that a member's reform effort could be strengthened by a third purchase under the STF, the option to increase access limits should be there. She would not want to be accused of bad faith later on, if circumstances should warrant a decision on increasing access limits under the STF.

Mr. Mirakhor said that, if the understanding were no longer valid that a decision on increasing access limits would not be taken during the four-month extension, his chair could not support the decision to extend the facility.

The Chairman observed that he had carefully reviewed the reform process in the 25 countries eligible to make a third purchase under the STF and, in his view, a decision not to increase access limits during the four-month extension would not jeopardize their adjustment programs. If Ms. Lissakers wished to reserve her right to ask for a decision on increasing access limits, then an agreement on extension would not be possible, because the support of some Directors for the latter was conditional on agreement that there be no decision on increasing access limits during the period of the extension. There were two other options: members could agree to extend the STF for only another two months, since it was unlikely that the issue of increasing access limits would arise in that period; however, that was not an attractive option. A second possibility, in a situation of emergency, would allow a member to ask for deliberation on the issue of increasing access limits, but without asking for a decision on that issue. He invited Ms. Lissakers to accept the second alternative in a spirit of compromise.

Ms. Lissakers replied that she would support the proposal for a four-month extension of the STF, but she could not share the interpretation that others had given to the proposal. Put another way, she would support the decision as drafted in the staff paper, but would not endorse embellishments to that proposal.

The Chairman recalled that several members had agreed to extend the STF--an agreement that had been difficult for them to make--on the understanding, and in accordance with the guidance provided by the Interim Committee, that no decision on increasing access limits would be taken during the four-month extension of the STF, unless agreement had been reached on the "package."

Mr. Clark remarked that there appeared to be no further need to continue the discussion. Mr. Berrizbeitia's position was clear, as was Ms. Lissakers's. Unless extraordinary circumstances arose, it was unlikely that a proposal to increase access limits would be made during the four-month extension. He would support the Chairman's suggestion that members maintain the right to ask for a deliberation during that period.

Mr. Autheman noted that his authorities had not established a link between the extension and increased access limits of the STF on the one hand and the allocation of SDRs on the other. Although members could reserve the right to ask for a decision on increasing access limits during the four-month extension of the STF, his chair could only support a decision that was based on a consensus among Directors.

Mr. Berrizbeitia remarked that the approach suggested by Mr. Autheman might serve as the basis for a consensus in the Board.

Mr. Evans observed that, although decisions by consensus were preferred, there were other ways of reaching decisions. He would be interested to hear the views of Directors representing the transition economies, particularly with a view to avoiding a situation later on in which those countries might wish to make a third purchase but could be deterred from doing so because of an understanding among Directors not to increase access limits, unless there were a consensus.

Mr. Bergo said that his chair favored the extension of the STF for a period of four months, not out of concern for the transition economies in his constituency--which had all made their first drawings--but to assist other countries during the transition process. He would support

Mr. Autheman's approach, because without it there was a danger that there would be no agreement on extending the STF.

Mr. Mesaki remarked that he, too, could support Mr. Autheman's suggestion, but he hoped that there would be an agreement in the near future on an extension with an increase in access limits up to 85 percent of a member's quota.

Mr. Kaeser observed that the transition process was a long one and the catalytic role of the Fund in the transition countries had been less significant than in others. Thus, an increase in access limits under the systemic transformation facility was an important issue. On that issue and others, his chair held the view that any decision should be taken only on the basis of a consensus.

Mr. Mozhin commented that he, too, could support the proposed decision to extend the STF for a period of four months without increasing access limits. He had made a similar proposal in an earlier discussion on the work program. His country was among the 25 that would be potential beneficiaries of an increase in access limits under the STF, and would be interested in making a third purchase. However, his chair was also committed to reaching an agreement on the entire "package." Therefore, he agreed to Mr. Autheman's suggestion that a decision on increasing access limits during the next four months would be adopted only if there were a consensus.

The Chairman remarked that there appeared to be agreement that a decision on increasing access limits during the four-month extension of the STF would only be taken on the basis of a broad consensus.

Mr. Al-Jasser commented that it was in the interest of the institution that the Board proceed on the basis of that agreement, and that members pledge to intensify their efforts toward reaching agreement on the "package." The end of April should not be considered a target, but rather a date to allow other members to have access to the systemic transformation facility. His authorities were concerned about the time taken to resolve the issues, and he urged the Chairman and Mr. Maystadt to intensify their efforts to obtain an agreement.

Mr. Kafka said that he endorsed Mr. Al-Jasser's comments. The question of whether the facility should be extended to April 28, 29, or 30, however, remained. In order to give members the maximum amount of time, he would suggest an extension up to April 30, 1995.

The Chairman noted that an understanding had been reached among Directors on the following points: an agreement on the decision to extend the period for an initial purchase under the systemic transformation facility to April 1995; recognition that, in exceptional circumstances, a decision on increasing access limits could be taken; and such a decision would be taken only on the basis of a consensus among Directors. He asked those members who had indicated their preference for an extension up to

April 27, 1995 to agree, in a spirit of compromise, to extend the facility to April 30, 1995.

Mr. Ismael wondered whether it mattered that April 30 fell on a Sunday; if it did, then the effective date for an extension up to the end of April would be April 28.

The General Counsel remarked that, since the Board could meet on a Sunday, the effective date for the extension could be April 30, 1995.

Mr. Ismael said that developing countries had indicated the symbolic importance of an extension until the day after the conclusion of the spring Interim Committee meeting, which would presumably be April 27, 1995. There was only a three-day difference between that date and the one proposed by management--April 30, 1995. In order to expedite agreement in a spirit of goodwill, and, keeping in mind the needs of the transition economies, his chair could support an extension up to April 30, 1995. Acceptance of that date was predicated on the points of understanding mentioned by the Chairman, namely, that no increase in access limits under the STF would be considered during the period of extension unless there were a consensus on the issue of allocation of SDRs.

Directors agreed to amend the decision on the systemic transformation facility (Decision No. 10348-(93/61) STF, adopted April 23, 1993 as amended) to provide for an extension of the period within which members may make a first purchase under the facility, from December 31, 1994 to April 30, 1995, as follows:

> In the Decision on the Systemic Transformation Facility (Decision No. 10348-(93/61) STF, adopted April 23, 1993, as amended), paragraphs 1(a) and 11 are amended by deleting the references to "December 31, 1994" and by replacing them with "April 30, 1995."

Decision No. 10855-(94/109) STF, adopted
December 14, 1994

Directors noted the Chairman's introductory remarks and recalled the following paragraph of the communiqué of the Interim Committee (10/2/94): "The Committee had a broad ranging exchange of views with regard to the proposal to extend the systemic transformation facility with increased access. The Committee also had a broad ranging exchange of views relating to proposals for allocation of special drawing rights. Committee members requested the Chairman to conduct further consultations and to call a meeting of the Committee when he judges that the prospects for resolution of these issues are favorable."

In approving the proposed decision, Directors noted that it did not preclude the possibility of a proposal to increase the access limits under the systemic transformation facility during the period of the extension of the facility. However, the sense of the discussion on that point was that such a proposal, unless it were part of an agreement that also included a proposal for allocation of special drawing rights, would be adopted only on the basis of a consensus among Directors.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/94/108 (12/12/94) and EBM/94/109 (12/14/94).

4. JORDAN - EXCHANGE SYSTEM

The approval for the retention by Jordan of the exchange restriction evidenced by arrears on certain external debt service payments, granted under Executive Board Decision No. 10787-(94/84), adopted September 14, 1994, is extended until the completion of the second review under the extended arrangement or March 31, 1995, whichever is earlier. (EBD/94/192, 12/7/94)

Decision No. 10856-(94/109), adopted
December 12, 1994

5. MAURITANIA - EXCHANGE SYSTEM

The approval for the retention by Mauritania of the exchange restrictions evidenced by certain external payments arrears and of the multiple currency practice, granted under Executive Board Decision No. 10578-(94/6), adopted January 26, 1994, is extended until completion of the next Article IV consultation with Mauritania or March 31, 1995, whichever is earlier. (EBD/94/192, 12/7/94)

Decision No. 10857-(94/109), adopted
December 12, 1994

6. SURINAME - ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board extends the period for completing the next Article IV consultation with Suriname to January 18, 1995. (EBD/94/192, 12/7/94)

Decision No. 10858-(94/109), adopted
December 12, 1994

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/94/195 (12/9/94) is approved.

APPROVAL: December 11, 1995

LEO VAN HOUTVEN
Secretary