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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 95/39

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

Contents

Executive Board Attendance

M. Camdessus, Chairman
S. Fischer, First Deputy Managing Director
P. R. Narvekar, Deputy Managing Director
A. D. Ouattara, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
M.-A. Autheman	M. Sirat
	P. Cailleteau, Temporary
	E. Srejber
	B. Andersen, Temporary
L. E. Berrizbeitia	V. J. Fernández
	J. R. Suárez, Temporary
	G. F. Murphy
	N. L. Laframboise, Temporary
	D. Z. Guti
H. Evans	J. Shields
K. P. Geethakrishnan	W. Hettiarachchi
	L. M. Cheong
D. Kaeser	K. Link
	W. C. Keller, Temporary
A. Kafka	G. P. Ramdas, Temporary
W. Kiekens	J. Prader
Y.-M. T. Koissy	H. A. Barro Chambrier
G. Lanciotti	N. Coumbis
K. Lissakers	B. S. Newman
H. Mesaki	
A. Mirakhor	S. Rouai, Temporary
	A. G. Zoccali
	J. Justiniano, Temporary
S. Schoenberg	E. Wagenhoefer
	Y. Y. Mohammed
D. V. Tulin	V. Y. Verjbitski, Temporary
	J.-H. Kang
J. de Beaufort Wijnholds	
	Wei B.

L. Van Houtven, Secretary and Counsellor
T. Ranaweera, Assistant
S. W. Tenney, Assistant

Also Present

IBRD: R. Brigish, N. Kamel, International Economics Department; E. Ruedo-Sabater, Resource Mobilization Department. African Department: E. A. Calamitsis, Director; H. R. De Zoysa. External Relations Department: S. J. Anjaria, Director; A. Caminis, D. R. Hawley, H. Puentes, S. J. Willson. Fiscal Affairs Department: G. T. Abed. Legal Department: R. H. Munzberg, Deputy General Counsel; J. L. Hagan, Jr. Monetary and Exchange Affairs Department: M. Guitián, Director. Policy Development and Review Department: J. Boorman, Director; T. Leddy, Deputy Director; M. Allen, Deputy Director; A. R. Boote, J. W. Brooks, B. Christensen, P. F. N. Drummond, H.-M. Flickenschild, C. J. Jarvis, S. Y.-L. Jen, A. C. Kouwenaar, R. F. Krieger, P. H. Mathieu, T. Nakao, T. Nishizawa, C. Puckahtikom, K. Thugge, J. K. Wakeman-Linn. Research Department: P. Isard. Secretary's Department: A. Mountford. Southeast Asia and Pacific Department: J. Lin. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; J. C. Berrigan, J. E. Blalock, Z. Farhadian-Lorie, R. H. Floyd, D. Gupta, D. M. Hicks, S. T. Lurie, P. R. Menon, I. Otker, O. Roncesvalles, M. A. Wattleworth. Office of the Managing Director: S. Sugisaki, Special Advisor; G. R. Saunders, Personal Assistant; P.-I. Koupaki. Advisors to Executive Directors: J. M. Abbott, R. F. Cippa, S. S. Farid, S. K. Fayyad, J. Guzmán-Calafell, R. Kannan, B. Konan, M. F. Melhem, J.-C. Obame, T. Oya, Y. Patel, B. A. Sarr, K. Sundara, A. V. Vernikov. Assistants to Executive Directors: M. A. Brettschneider, A. G. Cathcart, J. A. Costa, D. Daco, J. Dagustun, G. El-Masry, A. Galicia, H. Golriz, C. M. Gonzalez, He J., O. Himani, G. H. Huisman, S. Ishida, P. Jilek, T.-M. Kudiwu, G. A. Kyriacou, K. J. Langdon, J. Mafararikwa, V. Rigász, D. Saha, F. A. Schilthuis, A. Sighvatsson, Song J., V. Trivedi, R. von Kleist, Wang Y., Zubir bin Abdullah.

1. REPORT BY DEPUTY MANAGING DIRECTOR

The Deputy Managing Director, Mr. Ouattara, reporting on his participation in the Conference on the Economic Prospects of the African Countries in the CFA Franc Zone and his press interviews, April 6-7, 1995, in Lyon, France, said that the conference had been attended by about 300 participants from the political, business, banking, and academic circles. On April 6, at the invitation of Mr. Denis Samuel Lajeunesse, the President of the Lyonnaise de Banque and Espace Bellecour, he had delivered a speech on the challenges facing the CFA franc zone countries, the Deputy Managing Director continued. He had reviewed briefly the progress made by member countries of the zone--since the devaluation of the CFA franc in early 1994--in inflation control, restoration of competitiveness, resumption of growth, and improvement of the external position. Many countries in the CFA franc zone needed to address urgently their weak fiscal revenue performance and the slow implementation of structural reforms.

The devaluation of the CFA franc had been widely accepted as a key instrument in strengthening the basis for sustainable growth in the CFA franc zone, the Deputy Managing Director noted. He had emphasized that the new exchange rate would require the continuation of tight fiscal and monetary policies, and the timely implementation of structural measures, aimed at creating an environment conducive to private sector development. Furthermore, the simplification of administrative procedures and the removal of remaining obstacles to the mobility of factors of production should help further economic integration in the CFA franc zone.

Some French and African participants--particularly from the small enterprise sector--had expressed concerns about the lack of appropriate investment opportunities, both inside and outside the zone, the Deputy Managing Director observed.

The lively discussion that followed his presentation had demonstrated the keen interest of the audience in the role of the Fund in Africa in general, and in the CFA franc zone in particular, the Deputy Managing Director remarked. He believed that active Fund participation in such fora was helpful in clearing any misconceptions about the Fund's role in Africa.

He had also met with representatives of the private sector and the press, the Deputy Managing Director concluded. In particular, he had been interviewed by the French television on April 7, for a special feature presentation dealing with the current situation and the future of the CFA franc zone.

2. LOW-INCOME COUNTRIES, INCLUDING HEAVILY INDEBTED POOR COUNTRIES - POSSIBLE MODALITIES FOR CONTINUED FUND INVOLVEMENT THROUGH THE ENHANCED STRUCTURAL ADJUSTMENT FACILITY

The Executive Directors considered a staff paper on possible modalities for continued Fund involvement in low-income countries, including the most heavily indebted poor countries, through the enhanced structural adjustment facility (EBS/95/60, 3/31/95) and the following statement by the Managing Director. They also had before them an executive summary relating to a forthcoming paper on bilateral and multilateral aid flows and Fund-supported programs (SM/95/73, 4/11/95), and background papers on multilateral debt and financing for the heavily indebted poor countries (SM/95/61, 3/31/95; SM/95/29, 2/7/95; and SM/95/30, 2/9/95).

In order to focus our next discussion on multilateral debt and enhanced structural adjustment facility (ESAF) operations, I would like to indicate the conclusions I personally draw from the staff analyses before us.

In view of the protracted nature of debt and balance of payments problems, particularly in Africa, it is highly desirable to build on the already existing potential of the ESAF to become a "self-sustained" facility of the Fund. This should be possible in view of the resources that will be accumulated in the Special Disbursement Account, as loans from the existing ESAF are repaid.

As the self-sustained ESAF could be a possibility from the year 2004 onward, the issues to be addressed concern (i) the financing of ESAF operations for the interim period between 1997 and 2003 and (ii) the most appropriate financing arrangements for the most heavily indebted poorer countries. My suggestions would be as follows:

On the first issue of financing ESAF operations in the interim period, I would propose:

For the loan component of roughly SDR 7 billion the use of resources from the General Resources Account (GRA).

For the subsidy requirement of about SDR 3 billion, the use of a mix of financing from bilateral sources and sales of the Fund's gold in the proportion of one third to two thirds, respectively.

More specifically:

SDR 1 billion would be provided by member countries, either from refunds of resources accumulated in the Special Contingent Account 2 (SCA-2), in a variant of the suggestion by

Mr. Geethakrishnan, or from contributions that are complementary to past efforts; and

SDR 2 billion financed from the sale of gold that would begin on January 1, 1996. 1/

To address the special needs of the few countries now in protracted arrears to the Fund, additional resources will be needed. The timing is difficult to predict, but the same principle of financing would apply in these as in other ESAF cases. I would thus also propose for these cases that subsidies for one third of the amount of arrangements following rights accumulation programs be made available from bilateral sources and two thirds from the sale of gold.

The membership has already pledged 3 million ounces of the Fund's gold to safeguard ESAF resources used for the encashment of rights. Particularly in view of this, I would not propose gold sales for ESAF larger than implied by the above proposals, so as to preserve the bulk of the Fund's gold holdings to underpin its strength and ability to discharge its global responsibilities. Moreover, the possibility exists that current ESAF resources will not be fully committed by the end of 1996 and, in that event, the interim period could be shortened and financing needs from gold sales would be reduced. It is, in part, for this reason that we have proposed gradual gold sales, which could take into account the requirements over time.

For the second, and special, issue of the most heavily indebted poor countries with high multilateral debt, the paper has carefully analyzed the debt service situation and the merits of an extension of maturities. Although the debt-service obligations of many countries are sizable and must be appropriately addressed, the immediate concern for the Fund relates to countries with the highest debt-service ratios to the Fund. The staff has illustratively identified nine cases in the staff paper, although the exact group of countries would depend on the specific criteria adopted and the external situation at the time support is considered. I would suggest that these few cases could appropriately be addressed through the continued availability of concessional ESAF resources on present terms. Through this instrument, the Fund would have the possibility of tailoring its financing to the individual situation of each member, extending

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1/ As noted in EBS/95/60, the Fund could either use profits from sales of gold of some 5 million ounces or income earned on invested profits from gold sales of 9 million ounces.

for the period needed--in a few cases through several successive ESAF arrangements--the concessional financing required to support continuing adjustment, while avoiding significant humps in net transfers from the member to the Fund. In addition, maintaining conditionality and monitoring of the member's economic policies during what may be a prolonged period of exceptional financing would avoid long periods without close monitoring which would follow from an extension of maturities. This would still leave the option open at a later stage, if needed, to adopt additional steps if such support did not prove sufficient. At the same time, such an initiative by the Fund should be a major incentive for other multilateral institutions to put into place financing schemes that would also help address the needs of the most debt-distressed poorer countries in a sustainable manner.

Mr. Mohammed made the following statement:

We welcome today's discussion and commend the staff for the high-quality work they have done since our recent discussion on multilateral debt. We are in broad agreement with the conclusions that the Managing Director has drawn from the staff's analysis. These conclusions underscore, in the first instance, the desirability of a longer-term availability of the ESAF in view of the protracted nature of the balance of payments difficulties of low-income members and the effective role that the facility has played, and could continue to play, in promoting adjustment and reform and in enhancing the effectiveness of other financial assistance flows. With these considerations in mind, we attach considerable importance to the ESAF becoming a self-sustained facility of the Fund as soon as possible and to securing the financing needed to ensure continued availability of ESAF support in the interim period between 1997 and 2003.

As regards financing ESAF operations in the "interim period," we find the Managing Director's proposals to be broadly appropriate. Thus, we agree to the use of about SDR 7 billion of the GRA resources for the loan component. We also agree with the proposed mix of financing needed to meet the subsidy requirement of about SDR 3 billion. On this latter point, let me add the following comments. First, it would be, in our view, very important to avoid linking bilateral subsidy contributions to refunds of resources from the SCA-2. However subtle, a link between these two elements could risk undermining the Fund's future ability to raise resources in that such a link could contribute to a perception that even when it is an integral element of a fund-raising effort, prospective refundability is less than fully assured. Indeed, as a further accumulation of resources in the SCA-2 is not justified by the purposes for which the account was established, we would favor a discontinuation of additions to the account.

My second point relates to the proposed sale of gold. On this issue, which, incidentally, we would have preferred to consider in the light of our forthcoming consideration of the overall role of the Fund's gold, our preference would be for using the income earned on invested profits from sales of gold rather than the profits themselves.

On the second key issue before us, namely, the difficulties of the most heavily indebted poor countries with high multilateral debt, I find myself in broad agreement with the Managing Director's conclusions, which appropriately leave open the possibility of going at a later stage beyond the continued availability of ESAF on present terms and conditions should that prove to be necessary. Options that involve either a restructuring of existing ESAF obligations or selectively extending the maturities of new ESAF lending raise important issues of principle, as well as issues of practicability and feasibility, that should be carefully assessed.

Let me at this preliminary stage of consideration limit myself to one comment and a question on the feasibility of extending the maturities of new ESAF lending in the interim period. The comment is that, from the staff's presentation, it is clear that if the loan component is to be financed through bilateral contributions, and if full protection for the claims will continue to be sought, then the introduction of a self-sustained ESAF will be substantially delayed. At the same time--and this is the question I have--if the loan component is to be financed from the GRA, would it be legally permissible to have differentiated maturities under the same facility? I would welcome a staff comment on this issue. While on the possibility of using GRA resources, let me add that the staff notes that "criteria for discriminating among members' access to facilities financed from the GRA could not include factors such as per capita income." I take the staff's reference to this matter to mean that discrimination on the basis of per capita income is not feasible under the same facility. Otherwise, the reference would imply that even for uniform maturities, the GRA resources could not be used to finance the loan component of the ESAF, unless extended arrangement repayment terms rather than ESAFs are adopted. Some clarification by the staff would be appreciated.

Finally, as regards members in arrears, we would favor financing programs of eligible members, following their completion of rights accumulation program arrangements, with ESAF resources, rather than a blend of GRA and ESAF resources.

Mr. Evans made the following statement:

I am grateful to the staff for the further work on examining the extent of the multilateral debt problem and its initial work on the future of the ESAF. Within the latter, I am pleased to see that the staff has looked at the proposals of the U.K. Chancellor of the Exchequer for increased concessionality for ESAF for a small number of our poorest and most indebted members following strong adjustment programs. Let me draw out a few points from the analysis.

First, the further analysis in the Fund/Bank paper shows that a substantial number of countries are grappling now with multilateral debt burdens that are very high indeed, whatever their projected export growth. Moreover, the analysis does not pretend that these heavy debt burdens will disappear in the medium term. Furthermore, countries are included that have shown sustained commitment to economic reform over the years. As we saw at the previous discussion (EBM/95/19, 2/24/95), the Fund/Bank analysis points to 14 countries that will continue to have heavy international financial institution burdens over the coming 20-year period. On slightly less generous assumptions of export growth, the Fund/Bank analysis projects the number of problem countries to rise to 23.

Second, the current poor outlook regarding bilateral funding brings an unpleasant realism to the more pessimistic scenarios set out in the new analysis which show the damaging effects of lower levels of new concessional lending--in terms of continued negative net transfers and high debt service.

Third, we need to look again at the generous assumptions about the effect that the implementation of Naples Terms will have on levels of outstanding bilateral debt. Even on the most optimistic scenarios, after Naples Terms no fewer than 20 countries will continue to face overall debt-stock ratios greater than 200 percent of exports--on a net present value basis; levels that have "generally proven to be unsustainable."

The key implication of this work is "that any new multilateral lending to the heavily indebted poor countries [should] be provided on the most concessional terms." This means that, in order to fulfil its purpose, the Fund needs to adapt its financial instruments, in order to be ready to provide balance of payments support to all its members--including the poorest--on appropriate terms.

The Fund cannot simply leave these problems with other international financial institutions or bilateral donors to help out countries who, in the context of heavy overall indebtedness, are substantially indebted to the Fund. The Fund will therefore need a continuing mechanism for providing finance on concessional terms--through a more concessional ESAF. This proposal aims at achieving sustainable overall debt burdens for the poorest countries; the Fund can--and should--make a significant contribution to this fundamental aim.

Let me explain why I believe it is necessary for the Fund to enhance concessionality for a small number of its poorest and most indebted borrowers.

As the Fund/Bank analysis makes clear, for some of the poorest and most indebted countries, taking on further debt even on ESAF terms is not sufficient. Fund staff have now identified nine countries--including the arrears cases--that would continue to be heavily indebted to the Fund even if they received continued loans on existing ESAF terms.

These countries need greater concessionality, and greater certainty about their ability to service their debts.

The Fund staff concludes that an extended maturities ESAF would make debt-service obligations more manageable for these nine countries. This would put Fund debt service on a basis that could be sustained without having to arrange successive new loans thereafter.

This could represent part of a broader "exit strategy" for these countries from their current and prospective unmanageable levels of multilateral debt.

I am pleased that the Managing Director has been able to recommend to us the use of the Fund's own resources--including gold sales--to contribute toward the ESAF in the future. Existing resources of international financial institutions need to be used in the most effective way--especially for the poorest and most indebted countries. The ESAF is too fundamental an instrument in the Fund's portfolio to be forever subject to those major uncertainties that necessarily arise with ad hoc replenishment arrangements. I am sure that it is right to consider the use of GRA resources to finance the loan element of the ESAF. Moreover, increased access to the ESAF would be useful in some cases.

How should the U.K. proposal for extended maturities be funded? Limited gold sales would allow the income earned on the invested profits from these sales to finance the subsidy needs of this scheme. The Fund staff calculates that the extra cost of the scheme could be financed in this way via the sale, over time, of about 5 percent of the Fund's gold. Of course, to a great extent the loan account needs for this proposal are not additional to the loan account needs under existing maturities; the loans are simply required for a longer duration. Moreover, we challenge the presumption that there is a trade-off between extended maturities and a permanent ESAF. The commencement date of a permanent ESAF, in the form envisaged in the staff paper, will be determined by the method we use to finance the interim arrangements. The issue of extending the maturities for a small number of countries is marginal to this.

It is important to monitor closely developments in these countries to ensure a good track record of reform. But unlike the Managing Director, I believe that longer maturities on ESAF need not imply "long periods without close monitoring." The Fund is already able to ensure that countries with outstanding Fund resources are subject to closer surveillance than otherwise might be the case. These countries should not have to rely on repeated Fund lending solely to cover their debts to this institution. And the Managing Director's approach ignores the very real problems that stem from debt overhang; both the Fund and Bank staff have recognized that heavy debt overhangs are instrumental in discouraging investment and private capital flows.

We should not be content with the Managing Director's conclusion to leave options open now, so that in the future we would be able to decide to adopt additional steps if the use of the existing ESAF mechanism does not prove sufficient. In our view, both the Fund and Bank staff have given us sufficient analysis for us to take decisions geared to multilateral debt problems.

The Director of the Policy Development and Review Department, agreeing with Mr. Evans, said that, in the case of some countries, it would be extremely difficult to reduce eligible external debt by 67 percent under Naples terms in the way that had been assumed in the staff paper (Table 4). That reflected in part the fact that the data reporting system of the World Bank could not readily identify external payments obligations that would not be covered under the Naples terms. In order to overcome those shortcomings, the staff intended to analyze the detailed external debt profiles of each heavily indebted country.

The World Bank's estimates of the external debt-service obligations had been a first step toward the identification of heavily indebted, low-income countries whose external debt profiles needed to be examined thoroughly, the Director commented. According to those estimates, a number of countries would continue to have debt-service payments exceeding 200 percent of their exports, even after substantial debt rescheduling under Naples terms.

In view of the shortcomings of basing debt-service estimates on average export earnings for the period 1991-93, the staff had carried out additional projections based on a more realistic assumption of export growth, the Director remarked. The alternative estimates showed that, for most of the countries, the total debt-service payments could be brought down to a level below 20 percent of exports, after the year 2014. In recent years, many countries had had sustainable debt-service ratios much higher than 20 percent.

In projecting Uganda's external debt-service payments, export earnings had been assumed to grow by 3 percent per year in nominal terms--which implied zero growth in real terms--the Director noted. Perhaps it was unrealistic to assume zero real export growth for a country like Uganda, which had established a good foundation for sustainable export expansion. As any underestimation of Uganda's export growth would overestimate its debt-service ratio, the assumptions about export growth would need to be specified with care.

The Chairman said that a more detailed analysis of Uganda's economy, including its export prospects, would be presented to the Board on April 21.

The Director of the Policy Development and Review Department noted that, while the staff paper to be presented to the Board on April 21 would focus on Uganda's recent development and prospects over the succeeding three years, the current staff paper focused on its debt and external prospects in the medium term.

Ms. Lissakers concurred that most countries should be able to meet their total external debt-service obligations up to the year 2014, if new bilateral and multilateral assistance would be made available to them on highly concessional terms. The short-term, nonconcessional financing, which some countries had obtained in the recent past to cover large trade deficits, had created an imbalance in financial flows, and had complicated debt servicing.

Mr. Evans said that an assessment of both the existing and the projected debt was crucial for designing any debt-relief operation. In that context, it might not be realistic to rely too much on a debt and debt-service projection that covered a 20-year period, because many changes could take place during that period. At the same time, the problem of large outstanding external debt of some countries, which was of current concern to both local and foreign investors, had to be dealt with immediately.

The Director of the Policy Development and Review Department noted that resources made available through the ESAF under more concessional terms might be helpful in reducing debt-service burdens of some countries. However, for a number of countries, the extension of the maturities of ESAF loans would generate a large hump in debt-service payments to the Fund in future years.

Lending on more concessional terms from the Fund would not be helpful in dealing with the existing debt and debt-service problems of most heavily indebted countries, because these countries would continue to remain in debt to both bilateral and multilateral donor institutions, the Director considered. Moreover, there would also remain a need for further Fund arrangements with these countries, since some donors had been providing additional resources on concessional terms to countries that had an arrangement with the Fund. For example, before providing additional aid, bilateral donors had exerted considerable pressure on Ghana to have an arrangement with the Fund.

Besides strengthening the relationship between creditor and debtor countries, the Fund was expected to play a major role in the stabilization and adjustment efforts of the heavily indebted countries, the Director observed. Moreover, in the event of a crisis, the Fund was expected to provide financing and create a solid foundation for growth in those countries.

Using General Resources Account (GRA) resources to finance loans with extended maturities under the proposed ESAF would make it difficult to target users of resources on the basis of per capita income, the Director indicated. Alternatively, if ESAF Trust creditor countries decided to provide financing for the same loans, this could still tie up resources in the Reserve Account as these creditors could insist on protection, and as a consequence, the creation of a self-sustained ESAF could be delayed. On the other hand, using gold sales to finance loans with extended maturities would not delay the creation of a permanent ESAF.

The Deputy General Counsel said that if GRA resources would be used to finance the proposed ESAF, GRA rules--including those pertaining to repurchase periods and charges--would have to be followed. Eligibility for GRA resources would be defined and access provided in accordance with the GRA criteria--possibly under existing special facilities or those that could be established. Per capita income, which was the main criterion for determining the eligibility for ESAF, was not a criterion for the use of GRA resources. Member countries eligible for ESAF could use GRA resources in their capacity as members of the Fund, and not because they were eligible for the ESAF. Therefore, the proposed ESAF could not be an exact copy of the existing ESAF. For instance, there could be no list of members with respect to access to Fund resources that would be limited to, and defined as, the ESAF-eligible group.

Charges under the GRA could be subsidized to lower their level to that of the ESAF charges, the Deputy General Counsel remarked. The rules of subsidization of charges were determined by the sources of the subsidy. If the subsidy were financed from the Fund's Special Disbursement Account (SDA) resources--either from new gold sales or existing SDA resources, it could be made available to a group of countries based on eligibility for the ESAF. In a similar manner, subsidies financed from contributors would not be subjected to the same limitations applicable to the use of Fund resources.

As regards the differentiation of repurchase periods within the GRA, it was necessary to note that the use of all GRA resources would have to be temporary, the Deputy General Counsel stated. However, the Fund had not given a precise definition yet to the meaning of the word "temporary." In the past, maturities of repurchases under the extended Fund facility (EFF) up to ten years had been considered within the meaning of temporary. Moreover, repurchase periods--based on a criterion that could potentially apply to all members--established under a special policy such as the EFF, would have to be uniformly applied.

Mrs. Guti made the following statement:

> The establishment of the ESAF in December 1987 represented a major turning point in the Fund's relationship with low-income member countries. Years of experience had led to two basic conclusions: first, that Fund involvement in these countries was more likely to succeed if it took a medium-term approach to adjustment, where the policy matrix would aim to achieve both stabilization and structural reform; second, that the terms of financing were also critically important, given the threat that the increasing debt burden posed to the achievement of external viability. The combination of medium-term programming and concessional financing has proven its worth. The recent World Economic Outlook confirms what was already becoming evident--that countries supported by the ESAF have improved their growth prospects and strengthened their balance of payments position.
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> Nevertheless, the problems of these countries are far from over, and the Fund should remain fully engaged in helping to move the process of reform forward. If we accept the basic premise that evolved out of the recent discussion on multilateral debt, that multilateral and bilateral lending to low-income, heavily indebted countries should be on concessional terms, and acknowledge the current downward pressure on aid budgets in donor countries, then we must conclude that the Fund would need to have

at its disposal an appropriate mechanism for assisting these countries in the foreseeable future. We therefore have a case for making the ESAF a permanent facility of the Fund. We believe strongly, given the experience of a number of countries in our region, that the continued existence of the ESAF holds the key to the ability of the Fund to remain a critical force for change in low-income countries.

At present, the lifeblood of the ESAF flows from the generosity of creditors and donors; and we do appreciate the efforts so far. However, it would appear that a more permanent approach calls for examining modalities for using the Fund's own resources. In addition to being more reassuring that resources will be available to sustain the facility, use of the Fund's own resources would also send an important signal that the Fund was committed to the rationale that gave birth to the ESAF. Such action by the Fund could also help to strengthen its catalytic role.

The question of a self-sustained facility has been addressed in terms of the use of resources that will be accumulated in the Special Disbursement Account owing to repayment of ESAF loans. However, it is clear that we can get to this bridge only after coming to some consensus on financing ESAF operations between the time when the present commitment period ends and the time when resources begin to accumulate in the Special Disbursement Account. I should note parenthetically that a catch-22 situation might emerge in that the availability of SDA resources to finance ESAF operations, as the staff paper acknowledges, could be substantially delayed if the Reserve Account resources are used to protect additional loans from bilateral creditors in the context of continued ESAF operations. This is a matter that would need to be explored further with the contributors to the ESAF Trust.

The staff's effort to estimate the demand for ESAF resources in the interim period is an important contribution to the debate. However, some further consideration of the assumption that SDR 7 billion would be required as the loan component for the interim period might be necessary. It would be helpful to consider a scenario for a higher amount, considering that adequate financing would be critical to helping many of the eligible countries enhance their growth potential and ameliorate poverty. Experience based on past disbursements could be used as a reference point, not necessarily the standard to replicate. Perhaps we should be asking the question, what is the resource need that is consistent with sustained growth and poverty reduction in the context of a strong adjustment effort on the part of low-income countries?

Regarding the financing modalities, the Managing Director's financing scheme for the interim period presents a good basis for further discussion, even if there are concerns about the specific numbers. I am drawn to the view that the larger share of the subsidy requirement be provided by the sale of gold. It could also be argued that the improved performance of countries under ESAF programs, the efforts being made to improve the quality of programs, and the steps now in place aimed at preventing arrears have together reduced the urgency for using the resources of the Reserve Account to protect additional loans to the ESAF Trust. Under the circumstances, I would encourage the staff to explore with ESAF Trust creditors the possibility of an early transfer of resources from the Reserve Account to the Special Disbursement Account.

Let me now turn to the issue of the heavily indebted low-income countries with high multilateral debt. The analysis of the Fund/Bank staffs on multilateral debt shows clearly that some of the heavily indebted low-income countries would find it difficult to manage with further debt even on ESAF terms. Pragmatism suggests that we give serious thought to this matter. The key to the debt problem of these countries is not continuous Fund financing under concessional ESAF terms as we know it; rather, the Fund should take action now that would guarantee exit of these countries from the use of Fund resources. This does not necessarily imply early exit from Fund monitoring. There is no doubt that an extension of maturities would give these countries some breathing space that would allow them to revive their economies and diversify their export base.

Against this background, we believe that further work is needed. The funding modalities in the staff paper present a situation where we are being offered a choice between a self-sustaining ESAF and the extension of maturities. We do not believe at this point that the two are mutually exclusive. In this connection, we share the views expressed by Mr. Evans in his statement. I would add that we should not exclude the possibility of selling more gold if that would contribute to the alleviation of the debt burden for the countries concerned.

On the issue of funding for countries with protracted arrears that complete rights accumulation programs, obviously, these are countries with the same problems as many other heavily indebted low-income countries. It would seem logical that they benefit from concesssional lending under ESAF. The Fund may want to explore with the donors their willingness to provide funds from the SCA-2 to assist these countries and avoid recourse to use of GRA resources.

Lastly, it is critical that the current efforts by the Fund to resolve the debt problem be complemented by other multilateral institutions and donor agencies. In this connection, we welcome the fact that the Paris Club has started implementing the Naples terms. We urge them to expedite the process and give more countries the benefit of the full 67 percent stock of debt that the Naples terms provides for.

Ms. Srejber made the following statement:

When we discussed multilateral debt in February, I was of the view that the assumptions behind the staff's projections of multilateral debt service on balance were reasonable. This is still my opinion. The extended sensitivity analysis provided by the staff does not lead me to different conclusions. I do not believe that we are, at this juncture, facing such a widespread multilateral debt problem as to justify a generalized solution to the problem.

I would even argue that, on the whole, there might be too much gloom about development prospects of the least developed countries, particularly in Africa. Africa is gradually emerging from a postcolonial turmoil that in some cases has led to a total breakdown of authority; in other cases authorities have, for a while, lost direction and stumbled into some ideological dead ends, which they are now gradually finding their way out of. They still have a long way to go, and this is not going to be a smooth ride, but there is, in most cases where a proper economic policy is applied, a glimpse of light at the end of the tunnel.

I think it could be useful to divide the severe problem cases into two major categories: on the one hand, we have the post-chaos countries where civil unrest is winding down and political stability and authority is being re-established. For these countries, export growth rates that substantially exceed the cautious assumption of 0-3 percent is not unlikely. Many of these countries suffer at present, for example, from depressed exports owing to crumbled infrastructure, but, as infrastructure is repaired or rebuilt, export growth might rebound strongly. Of course, starting from such low levels, in some cases it would take double-digit growth rates simply to restore previous levels of exports before the end of the century. Some countries may face temporary adverse terms of trade developments, that is, as a result of the Uruguay Round, but growing evidence that many countries have been able to successfully diversify their export base might justify cautious optimism on this account. Some of the post-chaos countries will undoubtedly face external adversities such as natural calamities, in which case bilateral emergency assistance would have to come forward. But in the medium or long term, there is little reason to believe that these countries' exports could not grow at least according to the baseline assumptions, provided that appropriate policies are in place and some degree of political stability prevails.

Thus, even if one cannot exclude negative developments in some countries, I find the scenarios assuming zero real growth rate of exports for all countries over a prolonged period (Charts 3 and 4) pessimistic. Nevertheless, even with these assumptions, there is only a handful of countries that seem to be facing substantial difficulties in terms of servicing Fund debt. I still think a case-by-case approach would give better information than the stylized approach, and I look forward to the studies mentioned by the Director of the Policy Development and Review Department.

A second category of countries are those still suffering from a breakdown in political authority. Unfortunately, these countries are not in a position to undertake a Fund-supported program. Some measure of political authority has to be established first. In these cases, the Fund's room for maneuver to help is very limited. It could be argued that it would be desirable to have a structure in place in order to deal with the problems of these countries as they emerge from the chaos, but such special treatment would raise questions concerning the principle of equal treatment and moral hazard. I am concerned that the availability of a super-concessional window, where multilateral indebtedness would be a criterion for eligibility, could become an incentive for taking more risk in terms of running potentially unsustainable policies, knowing that, in the event things go wrong, more concessional financing would be available. Especially concerning countries in arrears to the Fund, the availability of a super-concessional ESAF--even just the contemplation of such a facility--before these countries are willing or able to cooperate with the Fund, could send a very inappropriate signal to these countries, and to other countries, of the cost of failing to honor their obligations to the Fund. Thus, I agree with the Managing Director's proposal not to establish a separate ESAF facility for the "problem cases," but rather to, within the framework of the present ESAF arrangement, tailor the programs and financing to the individual situations, for example, through rollovers.

Consequently, I will not comment upon the financing of such a super-concessional facility as a separate matter. But, as the present ESAF is a useful vehicle for combining comprehensive policy measures with concessional financing for poor heavily indebted countries, I can see the desirability of continuing ESAF operations for an expanded period. Thus, I believe that we need to consider the future financing of the ESAF Trust, before the commitment period for new ESAF loans expires at end-1996, including the question of a so-called self-sustained ESAF. The staff paper contains a useful analysis of different funding modalities for an ESAF arrangement. In principle, I prefer a continuation of the present funding structure, even if I can see constraints on national budgets. As I understand it, the arguments for a self-sustained ESAF are as follows: as bilateral donors to the ESAF Subsidy Account would presumably be unwilling to commit themselves to finance the ESAF indefinitely, a permanent ESAF rests on the existence of alternative sources of funding, that is, the Fund's own sources. Special Disbursement Account resources, when they become available in 2004, could potentially give a useful supplement to resources from bilateral channels, and my authorities would be willing to consider their use at an appropriate time. The immediate sale of some of the Fund's gold could sustain the operation of the ESAF Trust starting at an earlier date. My authorities will consider this question of a more permanent ESAF and the "bridge" to it, as well as the Managing Director's proposal, with an open mind and at appropriate times.

We would, however, like to emphasize the following points. First, it could be argued that the limitation in time of the ESAF facility gives precisely the uncertainty about the future availability of ESAF or ESAF-like facilities that could be an important incentive not to postpone a program of macroeconomic adjustment and structural reforms. Second, we must consider how a possible long-term use of highly concessional credit can be reconciled with the temporary nature of Fund involvement, the Fund's monetary character, and the revolving nature of its resources. Having a de facto recurrent use of Fund resources is one thing; presuming a long-term use of Fund resources from the outset is quite another. The purpose of the ESAF has, that is, been to promote structural reforms in poor countries that have suffered from instability, partly caused by distortions in their economies and deficient institutional capacity. To plan for repeated use of the ESAF well into the twenty-first century might be seen as an indication of a failure of our approach to adjustment. At least, we will have to consider this question seriously before we reach the year 2004. The willingness of countries to replenish another ESAF at that time will, that is, depend on their assessment of our approach at that time, and it is perhaps not wise to pre-empt that judgment by rushing to judgment concerning the operation of the ESAF so far ahead.

More fundamentally, we have to consider whether it is generally desirable and consistent with the Fund's monetary character to use the Fund's own resources to subsidize its lending activity. The ESAF Subsidy Account can be seen as a generalized form of the Fund's catalytic role. The main difference from the Fund's ordinary catalytic role is that the "catalization" takes place on a more general level, ex ante, without direct link to conditions in any particular country. But if the Fund starts to finance the subsidies from its own resources, it might be argued that the Fund assumes increasingly a development role. Should that not then be acknowledged explicitly and steps be taken to define the balance between the Fund's monetary and development functions?

Concerning the use of GRA resources to fund the loan account, I would like to emphasize that evenhanded treatment of member countries, as well as the revolving nature of Fund resources which it is imperative to preserve, limits the use of GRA resources for this purpose.

On the issue of gold sales, my authorities also keep an open mind, but are very skeptical at the outset. Securing the Fund appropriate financial room for maneuver to meet unexpected disturbances in the context of more integrated world capital markets is setting clear limits on the use of gold reserves for assisting this particular group of countries. Reducing reserves would also run counter to the general sentiment that prevailed at the recent review of the Fund's precautionary balances. Arguments put forward then have not lost their importance. As the staff paper clearly shows, the amount of gold that needs to be sold to finance a substantial part of the total subsidy is quite substantial, compared to both Fund holdings of gold and to what could be sold without disturbing the gold market. A practical question here is how fast a sufficient amount of gold could be sold without disturbing the gold market. As a monetary institution we have a responsibility to take account of that. We also need to take into account that some part of the Fund's gold already is used as a collateral for the benefit of the poor countries. One country in my constituency would accept limited sale of the Fund's gold as long as the revenue from gold sales is kept in the Fund for its use in general liquidity policy. Another country in my constituency is fundamentally opposed to gold sales, while some others, although not having reached a final position at this stage, are rather skeptical.

The ideas of Mr. Geethakrishnan and Mr. Autheman of tapping SCA-2 resources could potentially play a limited role, as a part of resources. But the use of these resources would be up to the decision of individual countries, and additional resources would be required in any event. Thus, there is no guarantee that this approach would stimulate the generosity of members beyond what otherwise would be the case. As regards this chair's position on the use of SCA-2 resources, reducing reserves would run counter to our view on precautionary balances. Thus, we continue to favor merging SCA-2 with SCA-1.

In conclusion, although keeping an open mind to all funding possibilities, I have a preference for the present, or similar, modalities of funding the ESAF, and for once again seeking to extract contributions from the membership. It has been generally agreed that the ESAF operations have been relatively successful in achieving their objectives. Hence, the existence of the ESAF can and has been used by bilateral donors to enhance the efficiency of their bilateral development assistance. Despite budgetary constraint, therefore, there should be scope for many countries to maintain the efficiency of their development assistance by continuing to devote resources to the ESAF Trust. Let us not jump to conclusions about the availability of resources for ESAF III. There is a certain danger that if we start to give in to the demands for a free lunch from the Fund, it will further discourage bilateral donors to come forward and contribute to the ESAF Subsidy Account.

Mr. Koissy made the following statement:

At the outset, let me state that this chair considers today's discussion as critical in the process of finding appropriate ways for continued Fund involvement in low-income and highly indebted countries' adjustment efforts. At a time when the Fund has shown a leadership role in assisting the membership by becoming more involved in emerging country economies and economies in transition, it is appropriate that the Fund be seen as showing concerns for its least endowed members, and that it take the appropriate steps to ensure that their ongoing adjustment efforts continue to receive its full support. This has become more urgent in view of the strong budgetary pressures in some of the major contributor countries which point to a lower trend in financial assistance to the poorer countries, especially, at a time, when there is strong evidence that the adjustment efforts of these countries, under ESAF, are beginning to bear fruits. In this context, we welcome the personal conclusions that you have drawn from the comprehensive staff papers before us and which should help focus our discussion on the important issue of ESAF operations and the multilateral debt.

However the road toward sustainability for most of these countries is still long and difficult. Undertaking comprehensive structural reforms, including reforming the public sector and enhancing private sector initiatives, takes considerable time to succeed. Moreover, uncertainty with regard to exogenous shocks, reduced availability of external assistance, and the heavy external debtservicing burden, are still constraining factors. In this context, making ESAF a self-sustained facility is an appropriate response of the Fund to the need of the low income members and give them assurances that appropriate assistance will be available when needed.

Turning now to the issues for discussions.

First, on the question of whether the staff should continue to explore the possible operational and funding modalities for an interim and a self-sustained ESAF, we can go along with the proposal aimed at establishing an interim ESAF which will be followed by a self-sustained one. On the modalities of financing ESAF operations in the interim period, the staff has considered various assumptions from which the Managing Director has drawn his proposal. We consider the SDR 7 billion proposed as a preliminary figure, and we wonder whether further analysis on the financing needs of eligible countries during the interim period is not warranted.

Second, we can support the idea of combining various sources of financing for an interim ESAF as outlined in the Managing Director's statement and which could include resources from SCA-2 in a variant of Mr. Geethakrishnan's and Mr. Autheman's proposal.

Third, consistent with the objective of making a self-sustained ESAF operational as early as possible, we see a need to explore with ESAF Trust creditors an earlier retransfer to the SDA, as the number of countries in arrears has been substantially reduced, and prospects for clearing their arrears are good.

Fourth, on the countries with protracted arrears to the Fund, after the completion of rights accumulation programs, our position would be that these countries should have programs financed with ESAF resources rather than a blend of GRA and ESAF resources. I can therefore, support the Managing Director's proposal for addressing the special needs of the countries concerned as indicated.

Fifth, on ESAF maturities, we can go along with the Managing Director's proposal for the continued availability of concessional

ESAF resources on present terms with special attention given to difficult cases.

Turning to the issue of multilateral debt, we can generally go along with the Managing Director's suggestion to deal with the exceptional cases identified in the papers that will need extension-type maturities to smooth out their debt obligations to the Fund, in particular providing these countries with continued concessional financing required to support their adjustment efforts through several successive ESAF arrangements. This suggestion is in line with some elements of the U.K. proposal.

Finally, this chair firmly endorses the Managing Director's conclusion that this is a reasonable initiative that other multilateral institutions should also follow to address the needs of the most indebted low income countries.

Mrs. Wagenhoefer made the following statement:

Barely 15 months ago, made possible by generous bilateral contributions, this Board was able to approve a new concessional facility for low-income countries, ESAF-II. Against this background, the unseemly haste with which possible future issues concerning ESAF are brought to this Board is, at least, puzzling. I especially refer here to the Managing Director's statement and to the new staff paper that was distributed electronically to us at 4:15 p.m. yesterday afternoon.

Current ESAF resources, in our view, are going to last for quite a while, and even longer if some additional sensible restraint is put on the utilization of existing resources. There is, therefore, no need for a cloak-and-dagger Board action concerning these issues, quite apart from the fact that throughout the ESAF-II obligations, we were told that ESAF-II was to be regarded as a temporary facility. My question is, has the situation in ESAF-eligible countries changed so dramatically for the worse in the past 15 months that there is today a need to consider changing the basic features of the instrument in such a dramatic way?

This being said, we have supported both ESAF-I and the new ESAF-II generously, and we will continue to do so. We have to draw a line, however, at the use of resources from the General Resources Account. We cannot and will not agree to such a misuse of monetary sources. The idea of using General Resources Account funds for developmental purposes runs counter to the heart and soul of Fund financing.

We also firmly oppose the sale of gold to finance development. Any sale of gold for nonmonetary reasons reduces the financial integrity of the Fund. In other words, except for the open mind that Ms. Srejber has used in her well-balanced and detailed statement, we would fully share her skepticism regarding such funding mechanisms.

Concerning the question of multilateral debt in heavily indebted poor countries, we support the findings of the joint Fund-World Bank staff papers that "most heavily indebted poor countries should be able to manage their multilateral debt service," and "there is no evidence of a widespread problem of multilateral debt and net transfers per se."

The few true problem countries have to be approached on a case-by-case basis without jeopardizing general and well-tested rules of the Fund. Not least, this is necessary to prevent a moral hazard problem from spreading to other countries, which could put this monetary institution in a very uncomfortable situation.

The Chairman said that the Board should give careful consideration to gold sales. As the Fund was a monetary institution, development lending was not part of its business. He considered that providing GRA resources to member countries was not development lending, that use of the EFF with ten-year maturities was part of the Fund's normal monetary operations, and stressed that the ESAF had the same outside ten-year maturity.

Mrs. Wagenhoefer noted that her chair had supported the ESAF that had been financed through resources obtained from sources outside the Fund. However, the proposed permanent ESAF with concessional terms--financed from GRA resources and gold sales--was not in line with the monetary character of the Fund.

The Chairman replied that he failed to comprehend how the monetary character of the Fund was jeopardized when the GRA resources were used for funding the interim ESAF under the EFF. Owing to the generosity of the membership, the Fund had been able to avoid using GRA resources for those operations. The Fund had attempted to assist highly indebted countries and, in that context, and in light of the high cost, the U.K. Chancellor of the Exchequer had proposed that some gold reserves of the Fund should be sold in order to be able to continue to make concessional financing available.

Mr. Wijnholds said that his authorities had expressed concerns about the nonmonetary character of some operations of the Fund. It was possible that there could be differences of opinion in the Board about what would constitute monetary operations.

The Chairman remarked that there was considerable confusion about the involvement of the Fund in so-called development lending. When the Fund began to provide resources with ten-year maturities in 1974, it did not abandon its role as a monetary institution.

Mr. Evans, agreeing with the Chairman, said that providing concessional lending to members would not undermine the role of the Fund as a monetary institution. During the previous 18 months, there had been a greater recognition of the fact that multilateral debt and debt-service problems were restricted to a relatively small number of countries. In that context, the proposal of the U.K. Chancellor of the Exchequer to mobilize resources by selling some gold reserves was aimed at facilitating the Fund's helping its severely indebted member countries.

A case-by-case approach--which would be fully consistent with other proposals, such as the Brady initiative on commercial debt relief--would be required to resolve the external debt and debt-service problems of member countries, Mr. Evans concluded. Although critics had warned that such an approach would involve a problem of moral hazard, some way had to be found to resolve the severe external debt problem, which most developing countries had found difficult to overcome on their own.

Ms. Lissakers made the following statement:

> Let me start by saying that I appreciate the continuing effort of the staff to respond to our request for additional analysis of the issues before us by taking a more detailed look from various angles and assumptions. I think we are getting a clearer and clearer picture of what we are dealing with regarding the multilateral debt burden of the poorest members of this and the other multilateral institutions. I think the additional work the staff is planning to do on individual cases will further clarify the situation and enable us to draw some perhaps more concrete conclusions than we really can do today.
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> The Managing Director's statement is also very helpful, though preliminary, as are most of our proposals, but it certainly helps to move the discussion forward. The statement really presents two separate issues for our consideration: first, whether the Fund should remain involved in low-income countries in general through the ESAF; and second, whether the ESAF has been, and will continue to be, sufficient for the poorest, most heavily indebted countries on current terms. With respect to the first question, unless we are prepared to suddenly limit membership of this institution to higher-income countries, I think the answer has to be yes. I must say I disagree with my German colleague on the nature of the ESAF. It seems to me that the ESAF is a perfectly reasonable modification, or adaptation, of Fund

mechanisms to make it possible for the lower-income members of this institution to exercise their rights of membership, and for the institution to engage them fully in a policy dialogue supporting economic reform and adjustment as needed. I think it is a very useful tool. It is a tool that still has its function. The question is whether some further modification is needed. I will come back to that.

But as to whether we still need an ESAF, and whether it is consistent with the principles of the Fund, I think the answer to both of those questions is yes. It is very important that we not treat it, and not regard it, as a substitute for development aid, either multilateral or bilateral. On that score, I agree completely with my German colleague.

The Managing Director has laid out some proposals for establishing a permanent facility. I certainly think we should continue to consider both the operational and funding modalities for a self-sustained ESAF. I do, however, have some questions about the specific proposal and analysis on which the Managing Director's proposal is based.

First, the premise is that interim ESAF financing has to be identified for the period 1997 to the year 2003, with a self-sustained ESAF initiated in 2004. Given the complexities of financing an interim ESAF, we need to look carefully at whether there is a need for such an interim mechanism. Assumptions behind the seven-year estimate strike us frankly as maximizing, perhaps to the extreme, the calculation of the interim gap. As the paper acknowledges, past ESAF commitment trends would indicate that resources are, in fact, unlikely to be fully committed by end-1996. If ESAF commitments are not substantially accelerated, it is assumed that the interim gap would be shortened at a minimum.

The far end of the interim period is based on the staff's estimate of when the balance of the reserve account will exceed the liabilities of the Trust Loan Account, thereby allowing retransfers to the Special Disbursement Account. This is an understandable approach given the current requirements of 100 percent reserve coverage of the loan account. But I have a question as to the necessity of the 100 percent coverage requirement itself. The staff provides a helpful illustration of the impact of allowing retransfers to the SDA at a lower reserve threshold. They estimate that by halving the reserve requirement by 50 percent, the self-sustained ESAF could initiate operations in 2001 instead of 2004. I would note as well that an even more radical reduction of the reserve requirement to 25 percent would still be more than twice the current loan-loss protection on the resources of the General Resources Account.

Depending on the prospect for some revision of the 100 percent coverage requirement, and as current ESAF resources seem unlikely to be fully committed by end-1996--maybe the staff wants to comment on that point--I would question the scope, if not the need for even the existence, of an interim ESAF period requiring additional financing.

On the assumption that there is, in fact, a gap, I have some questions and comments about the financing proposals put forward.

Mr. Geethakrishnan's SCA-2 proposal is innovative but does not obviate the need for obtaining legislative approval, I would point out, for any U.S. contribution. And considering the difficulty we have had getting approval for our very modest contribution to the existing ESAF, I would have to say that there could be some additional difficulty on this score.

I was pleasantly surprised at the Managing Director's willingness to consider mobilizing a portion of the Fund's gold. I certainly think that this should be given careful consideration, including something along the direction recommended by Mr. Evans. On the issue of whether to use the profits from gold or only the investment proceeds, there are some legitimate trade-offs that we need to explore more fully. Of course, the former would require a smaller amount of gold to be sold, while using investment proceeds alone would, at least, retain the principle for general purposes of the Fund's membership as a whole.

On the more sensitive question of the multilateral debt problem, the late Henry Wallach, probably the most distinguished internationalist on the Federal Reserve Board, was the son of a distinguished German banker who helped develop Latin American markets early in the century. The senior Wallach taught his son to always ask the potential borrower two questions: "What is the money for?" and "Where is the repayment to come from?" When the answer to the first question comes back "debt servicing," and the answer to the second question is, "from more loans," the senior Wallach warned, "You have a serious problem."

I have to say that I think we have a problem. It is not a big problem for the institution, it is not a big problem for the world economy, but it is a big problem for a small number of member countries in this institution and the multilateral development banks. I think it is time we acknowledge that. The staff paper dances around that issue a little bit. But the facts speak for themselves, as Mr. Evans has argued very effectively, and I will not, therefore, repeat his arguments. He lays out the case very strongly, and I endorse his statements.

I think the Managing Director's statement hints at the problem when it argues that the few cases that are inarguably there with regard to excessive future Fund claims on the country's resources can be appropriately addressed through the continued availability of concessional ESAF resources, in a few cases through several successive ESAF arrangements. It seems to me that there is considerable moral hazard in arguing that we are going to need successive ESAF arrangements in some cases, not because there is a need for the underlying adjustment program, but because we need to continue to finance repayments to ourselves. I think that is where we are going to be in a few years, if not already, in some cases.

On the question of what to do about it, the first step, as I say, is to acknowledge that there is a problem. Second, to those who argue for a case-by-case approach, I share Mr. Evans's puzzlement with that argument, because it is being used to say that there is no need to consider adaptations or new mechanisms. I fail to see how you can address the special problem of one member when you are not prepared to adapt the modalities of what we are doing. As Mr. Evans said, having a generalized mechanism, having thought through a policy modification or program modification, does not preclude dealing individually with the cases that may come up. Those two are perfectly consistent, and they have, as the Managing Director said, been used; that principle has been applied quite effectively on the commercial debt front and now with bilateral development claims. I do not think that we should shy away from trying to create some facility, even if in the end it will only be applied to a few cases. I think there are enough countries--whether it is 14 countries or 25 countries--that depend a lot on where the world economy goes and interest rates and so on that have a problem now, and that will have a problem down the road. We have to look at the alternatives, and those that are least costly in terms of preserving the principles of the individual creditor institutions, and obviously a different approach that is suited to the Fund would not be suited to the World Bank, and vice versa. A coordinated multilateral approach is necessary, but clearly with the adaptation to the individual institution. Whatever we do has to weigh the cost to the institution and to the institutional integrity, and the benefits to the cases where we think there is a serious stock and/or flow of multilateral debt servicing problem.

The British proposal deserves serious consideration. It is one option for smoothing out the lumpiness and reducing the net present value of the stock of outstanding debt for a number of countries. I think there are some variations that we should look at seriously as well. If we were to use gold, for example, might there be an opportunity to actually use grant financing instead of long-term lending financing? But if we can at least acknowledge that there is a problem that needs something other than saying "more of the same" and simply perpetual refinancing, then I think we have already accomplished something. I hope that some sense of that sentiment can be conveyed to the Interim Committee with a request that the Interim Committee give us a mandate to look at innovative solutions that are consistent with the underlying principles of the institutions in question, but also address realistically the problem of this group of countries.

Ms. Srejber recalled that the Nordic countries had played a significant role in providing debt rescheduling on concessional terms for the heavily indebted countries through the Paris Club.

Although the Fund's monetary character had been preserved in the case of funding the current ESAF, the same could not immediately be said of the new proposal for funding the ESAF subsidy account, which therefore needed further careful consideration by the Board, Ms. Srejber continued. As regards the use of the GRA resources for the loan component of the ESAF, her authorities had emphasized that due consideration should be given to the monetary character of the Fund, the revolving character of the Fund's resources, and the uniform treatment of all member countries. In that context, she wished to remind the Board that the Fund's regular resources consisted of central bank reserves put at the disposal of the Fund; thus, the Fund was expected to manage those reserves judiciously.

Mr. Lanciotti made the following statement:

The challenges still experienced by the poorest developing countries today and in the foreseeable future suggest that the role of Fund concessional financing is far from exhausted. There is definitely a need for a continuation of ESAF operations following the full commitment of resources under the current ESAF.

In view of the uncertainties in the long-term outlook for the external viability and growth prospects of some low-income countries, the proposal to move toward a more permanent ESAF appears to be the most appropriate. The potential of the facility to become self-sustained from a certain time in the future deserves to be thoroughly explored.

However, we must proceed with great caution in outlining possible scenarios to bridge the current ESAF with a self-sustained one. I find that some of the illustrative hypotheses drafted in the staff paper would impose an inconceivably heavy burden on the Fund and would seriously undermine the Fund's ability to fulfill its overall responsibilities. The statement by the Managing Director provides a more realistic starting point for further analysis. The proposal tries to reconcile two concurrent, and somehow conflicting, issues: the budgetary difficulties experienced in some contributor countries and the preservation of the Fund's financial strength.

At this stage of the discussion, a precise breakdown of the sources of financing for an interim ESAF cannot be determined. Referring to the proposal made by management, some important qualifications regarding the scope of the need for gold sales should be attached. The disposal of gold holdings by the Fund is a truly extraordinary measure, which may potentially weaken the standing and integrity of the Fund. The resort to such a measure should be severely limited and assessed against the actual duration of the ESAF financing interim period, which should be shortened to the maximum possible extent. Under certain assumptions, 1997 and 2004 are the commencement and cessation dates of this period. Both these dates may vary, the first according to the actual commitment of the current ESAF resources, and the second mainly according to the repayment record of SAF and ESAF loans and the percentage of coverage by the ESAF Trust Reserve Account of the liabilities to the ESAF Trust Loan Account lenders.

Let me first examine the beginning date. As pointed out in the Managing Director's statement and in the staff report, it is likely that current ESAF resources will not be fully committed by the end of 1996, thereby shortening the interim period and reducing the financing needs from gold sales. I would like to add that any further Fund engagement in the financing of the lowest-income countries must be pursued by adhering to strong conditionality standards. This remains the most distinctive feature of Fund action and may need to be further strengthened in future endeavors.

I would like to elaborate on this. I find interesting some conclusions in the executive summary of the staff paper on aid flows and Fund-supported programs, which is scheduled for discussion on May 8. The executive summary emphasizes that, in view of a declining global level of aid flows, balance of payments support is likely to be concentrated more on those countries pursuing sound macroeconomic and structural policies. The document adds that strong programs, perhaps more ambitious than in the past in terms of promoting domestic savings and private sector development, will be required in order to attract support from the limited pool of funds, particularly for balance of payments support.

Therefore, the likelihood that current ESAF resources will not be fully committed by the end of 1996 is even more reasonable taking into account a reinforced conditionality strategy, which would ensure a more selective, but more productive, use of Fund resources. A non-negligible amount of resources might remain after 1996, thus considerably shortening the interim period.

Regarding the estimated period for the end of the interim, and the beginning of the self-sustained, ESAF--the year 2004--the correctness of the assumption on the settlement of previous SAF arrears and the nonaccumulation of ESAF arrears is difficult to verify. However, the possibility can be explored that the retransfers to the Special Disbursement Account from the Reserve Account are made when the amounts in the Reserve Account exceed a percentage of the total liabilities which is still prudent, say, 75 percent, but moderately lower than the present 100 percent coverage. This would anticipate the commencement date of the self-sustained ESAF and contribute to the offset of slippages in the expected repayment schedule, if any.

Turning to the proposal for an extended maturities ESAF, I fully share the staff's conclusion that the continued availability of ESAF resources on current terms could appropriately address the needs of those nine countries--indicated by the staff--with the highest debt service to the Fund.

First, I believe that the supplementary sensitivity analysis made by the staff of the potential emergence of a multilateral debt overhang problem is somewhat reassuring. Over the long term, a widespread multilateral debt problem is unlikely under conservative assumptions of output and export growth. In fact, World Bank and World Economic Outlook projections for real GDP growth in Africa over the next years are considerably more favorable than those prudently embedded in the multilateral debt sensitivity analysis; for example, the World Economic Outlook assumes a 4.7 percent average real GDP growth in sub-Saharan Africa until the year 2000, which should imply a substantial real export growth. Moreover, if, on the one hand, the poor outlook regarding bilateral funding is likely to depress the global level of future aid flows, on the other hand, the reduced amount of resources, particularly those for balance of payments support, will probably focus in a more selective and efficient way on the poorest countries.

Second, the need--which cannot be renounced--for strong conditionality in Fund-supported programs points to the fact that an extension of the maturities would inevitably dilute to some extent Fund monitoring, whereas a continuation of operations on present terms would enable the Fund to better address recipients' needs as they evolve. Strong conditionality and timely program adaptations are precisely meant to allow recipient countries to overcome their external assistance dependency and avoid a repeated recourse to Fund lending only to recover their debts to the Fund itself.

Third, an extended maturity ESAF is likely to imply a more difficult financing for the interim facility and a delayed establishment of the self-sustained ESAF.

Mr. Justiniano made the following statement:

At the outset, I would like to commend the staff for the very interesting and useful papers. Also, I agree with the Managing Director about the desirability of building on the existing ESAF to become a self-financing facility of the Fund and the need to find a solution for financing an interim period between 1997-2004.

I have only a few comments about the Managing Director's statement and the position of this chair.

As regards the financing of an interim ESAF, we support the combination of funding that allows its creation at the lowest cost to the countries and to the Fund, with due regard to safeguarding the interests of the members and the institution. In this vein, we concur with the Managing Director's proposal to use the resources from the General Resources Account for the loan component of the ESAF. To finance subsidy requirements of around SDR 3 billion, this chair could support the proposition of gold sales. We do not share, however, the proposal to use the resources accumulated in the SCA-2 to cover one third of the subsidy, as this constitutes a precautionary balance established to protect the Fund against the risk of loss arising in connection with the encashment of rights financed by the Fund's general resources following the completion of a rights accumulation program. Using these resources as a subsidy will be contrary to the spirit of the creation of this account.

This chair considers that the current ESAF conditions in broad terms are appropriate for the majority of cases. However, in view of the recognized impact that high debt overhangs have in discouraging investment and private capital flows, as noted by Mr. Evans, we support, on an exceptional basis, providing an extension of maturities of the current ESAF arrangements to deal with the nine cases identified in the staff paper. The Fund should strike a balance between providing appropriate incentives for countries to graduate and enough flexibility for ESAF conditions to help improve the overall debt profile of poorest countries. After all, the final goal for all these countries--including one in this constituency--is to graduate from this kind of financing and to achieve a higher level of growth and the alleviation of poverty.

Ms. Laframboise made the following statement:

I would like to take the opportunity to thank the staff, as others have, for the considerable amount of work it has done on the debt issue. The papers have produced some informative and interesting results.

My authorities welcome and appreciate the Managing Director's statement offering his personal conclusions and proposals for our consideration. At the outset, I would like to stress two general points before commenting on the issues for consideration.

We have some concerns about the conclusion on what to do for low-income countries with high levels of debt to the multilateral institutions. Drawing from the Chairman's concluding remarks from the earlier Board discussion, it was, "agreed that there are a number of countries for which debt service and the debt overhang to multilaterals at a level that would clearly impede development prospects in the future." This view is clearly substantiated in the staff analysis and, like Mr. Evans and Mrs. Guti, we agree with this conclusion. With that in mind, however, my authorities find the position taken subsequently by the Chairman to keep the status quo in this regard to be somewhat inconsistent with these concluding remarks. This exercise was driven by the request of Governors last fall to ensure that the Fund's resources are being utilized as effectively as possible. Continuing to extend Fund resources to a subset of poor countries with "debt at a level that would impede development prospects," does not really constitute to us the most effective use of resources. I think Ms. Lissakers laid out the logic very clearly in this regard. In this respect, my authorities are concerned that the Board is not responding adequately to Governors. While recognizing that the Fund is only a part of the whole picture, they do not want the issue shelved at this stage.

The second key general point relates to gold sales. The sale of Fund gold should be judged on its own merits, that is, separate from the question of how the proceeds would be utilized. Any decision should be based on such things as portfolio management considerations, whether it would enhance the return on the Fund's reserve assets. While this is not the occasion to enter into this debate, I wonder whether the staff could say when and if the Board will be reviewing this long-awaited paper on gold. For the purposes of today's discussion, my authorities are nonetheless in favor of exploring these possibilities or selling gold in exchange for higher-yielding assets. They believe this to be sound management practice, and also that it encourages the Fund to use its distinct resources to their full potential before approaching shareholders for additional contributions.

Turning explicitly to the two issues outlined in the Managing Director's statement, we support the proposal to finance a self-sustaining ESAF as well as one for the interim period. However, we do not think that further recourse to resources holds much promise, as has been noted cryptically or hinted at in the papers. The last ESAF fund-raising exercise and the very difficult negotiations currently under way for other international financial institution replenishments make that obvious. We support use of resources from the General Resources Account for the loan component for an interim ESAF, and we definitely support the development of ideas on how to make up the loan use of the Fund's gold reserves for the subsidy requirement. As I noted earlier, my authorities are keen on this. We would prefer that the income earned from investment of profits of gold sales be used, although this issue will require more analysis at an upcoming meeting on gold.

On the second point about increasing concessionality, my authorities not surprisingly do think that something beyond the means currently at our disposal should be done to address the needs of countries with high levels of multilateral debt. In this regard, there needs to be a coordinated solution involving the other multilateral institutions, namely, the World Bank and regional development banks. The international financial institutions together have to fulfill the objective of ensuring that multilateral debt burdens do not impede the growth prospects of the poorest.

Finally, with respect to the use of resources from the Special Contingent Accounts, or SCA-1, I think Mr. Mohammed's concerns about undermining original principles behind the establishment of these accounts are valid.

Mr. Mesaki made the following statement:

At the outset, I would like to touch upon the issue of the "multilateral debt problem" of the heavily indebted poor countries. I appreciate that the staff has provided us with additional analysis of various cases. After examining the additional analysis, I think that the staff's previous conclusion is still adequate: there is no evidence of a widespread problem of multilateral debt. It is important now to move toward a country by country analysis of the several countries that might have a problem, focusing on export growth estimations, debt repayment schedules, and economic policy assessments. In general, taking a new general approach for a few extreme cases would worsen the moral hazard problem. With this in mind, I do not think it is necessary at this stage for the Fund to take any new general approach with respect to multilateral debt, and from a practical standpoint it would seem to be more appropriate to take a case by case approach, examining each country's specific situation.

With respect to the idea of a permanent ESAF, before we make a decision we need to deepen our consideration of at least the following points. Also, it should be noted that the issue of a permanent ESAF cannot be treated separately from the resource financing issue, even if the following points are addressed satisfactorily.

First, in view of the Fund's basic role as a monetary institution, and the revolving nature of its financial resources, would it be appropriate to provide financial resources to a specific group of countries continuously and on a semipermanent basis?

Second, what effect has the ESAF had on economic and structural reform in the user countries as a whole? I think that we should review the current ESAF operation from various aspects, such as the content and strength of the programs, the size of access, concessionality, the staff's assessment of users' policy implementation capacity, and export growth estimates.

Third, how do we know there will be a permanent balance of payments need of around 1 billion SDR every year in the user countries? It is not necessarily clear to me to what extent this estimated balance of payments need is consistent with the medium-term forecasts of user countries' export growth.

Fourth, there remains the question of whether establishing a permanent concessional facility could decrease users' incentive to put in place strong structural adjustment policies and to graduate from these policies.

Let me turn now to the issue of the sale of Fund gold. The proposal to sell gold is quite important in relation to the Fund's financial activity. I believe that any hasty decision should be avoided and that the following points need to be fully considered.

First, we should consider from a long-term perspective and from various standpoints how the Fund's gold as a whole can contribute most effectively to the expanding role of the Fund. We also need to consider carefully the role of gold in the context of the international monetary system.

Second, in view of the current sharp increase in lending in the use of the Fund's resources, I believe that it is reasonable at least to maintain the current level of the Fund's reserves, in order for the Fund to maintain its financial viability in the face of unexpected events. At the moment, the Fund's gold is regarded as part of its reserves, and I wonder whether under the present circumstances it is appropriate to reduce those reserves through the sale of gold.

Third, I am concerned that once the sale of gold is permitted, there would be a strong argument from certain members that the Fund's financial demands should be financed by using as much of the Fund's own resources as possible, that is to say, by selling as much of the gold as possible and that it would be more difficult to get an increase in quotas or to borrow money.

Fourth, I recall that when we asked our respective parliaments to approve our contributions to the subsidy account of ESAF I and II, we told them that bilateral contributions were desperately needed as the sale of gold was impossible. If gold were made available to finance the ESAF, our parliaments could argue that our contributions to ESAF I and II should be replaced by an increase in the sale of the Fund's gold, and there might be an obstacle to the smooth disbursement of our contributions to ESAF I and II.

Let me touch upon the case of Japan. Parliamentary approval is necessary every year to disburse the subsidy contributions to ESAF I and II. The sale of gold would lead to an argument in parliament that the sale of gold should replace our budgetary support, and we might have difficulty continuing to make our disbursements smoothly.

On the sale of gold generally, let me reiterate my most serious concern, which is that once we decide to sell gold, it would be almost impossible for us to apply the brakes against subsequent sales because the sale of gold does not impose any pain on any country. Donor countries' moral hazard problem would become more serious.

On the issue of SCA-2, we should be aware that the accumulated resources in SCA-2 are not purely the Fund's own asset and that contributor members hold a right to claim a refund of their contributions. What "using SCA-2" actually means is that only members who have contributed to SCA-2 are being urged to contribute the same amount to ESAF that they contributed to SCA-2. It should also be noted that the purpose of establishing SCA-2 had nothing to do with ESAF, and there seems to be no convincing reason why only SCA-2 contributors should be asked to contribute to ESAF and why their contribution should be the same amount as their contribution to SCA-2. Also, if the contributions are to be made in the form of a direct transfer from SCA-2 to ESAF without first refunding to the contributors, special legal arrangements by the respective parliaments would be needed.

Finally, in his statement, the Managing Director made some extremely important proposals, namely to establish a permanent ESAF, and to sell some of the Fund's gold. The importance of these proposals requires that we give them full and careful consideration from various aspects. In addition, as our decision to establish the enlarged and extended ESAF was made just one year ago, and there have not been any emergent or dramatic events in the countries that are using ESAF, we should take sufficient time to consider the issues involved after the present ESAF expires. Moreover, since the present ESAF covers the period up to at least the end of 1996, we have relatively plenty of time to consider the issues involved, and I do not see any strong reason to make a hasty decision.

The Chairman, agreeing with Mr. Mesaki, said that the complex issues concerning gold sales needed to be carefully considered by the Board. In order to safeguard the Fund's gold reserves, he had proposed that resources obtained from gold sales should be supplemented with contributions from donor countries. While the specific financing arrangements could be debated, there should be agreement that proceeds from gold sales should be augmented with donor contributions.

He agreed with Mr. Geethakrishnan and Mr. Autheman that SCA-2 resources could be used for financing either the transitory or the permanent ESAF, the Chairman observed. He hoped that Directors, who considered the ESAF as a necessary instrument for the discharge of the Fund's responsibilities, would actively support the use of SCA-2 resources for the purposes of the ESAF.

Mr. Autheman made the following statement:

I have only a few comments on the supplementary joint paper. I continue to find the staff reasonable and to share its conclusions.

It is surprising that there were not many comments today on the hypothesis of export growth, which was so much debated at our previous meeting. I agree with the staff that an overall assumption of 3 percent real export growth is not unreasonable. In any case, I do not think we should base our scenario and our policies on the ex ante hypothesis of failure of our adjustment policies to restore growth in the poorest countries. Perhaps this is the right assumption, but we should draw other lessons. If we expect to fail, we should reconsider our overall approach.

I would like to make one comment on Table 6 of the supplementary paper. This table illustrates that the so-called multilateral debt problem is basically a balance of payments problem. The financing requirements of low-income rescheduling countries in 1993 amounted to 20 percent of exports and goods and services for actual debt service, and to 61 percent for the noninterest current account deficit.

Faced with this problem, what is the role of the Fund? First, we should not always ask for leadership; sometimes we are not the leading institution. On this issue I maintain that the leading institution is the International Development Association (IDA) and not the Fund. What is needed are flows of aid taking the form of balance of payments support to the poorest countries, which is why IDA was created long before the ESAF.

What role can the Fund play to make IDA support more effective? I disagree with those who are looking for an exit strategy for the Fund, because I am aware that all IDA donors request a macroeconomic framework supported by the Fund before considering balance of payments support from IDA. The Director of the Policy Development and Review Department mentioned the case of Ghana, among others. We know that the international community is not ready to provide the needed concessional balance of payments support through IDA without the framework of Fund agreements, which means that our responsibility is to continue to provide this framework; it is not to try to play the role of IDA or of other multilateral regional development banks. For instance, our responsibility would not be to bail out multilateral debt through more concessional ESAF terms.

Turning now to ESAF, I welcome the proposal of a perennial ESAF and do not think that considering a perennial ESAF would be introducing a moral hazard. Our poorest members have the same rights as every member to be allowed to remain permanently eligible for Fund support. The issue is not whether we should provide ESAF support permanently, but whether we should have this instrument permanently available, so that we do not declare that 60 or 70 members are de facto not eligible. That would be the consequence of Mrs. Wagenhoefer's suggestion, which, as she knows, we do not support. However, we have disagreed on that issue for eight years, and we could go on for a long time.

Turning now to some modalities, I am aware that we need at some stage to address our long-term agenda, but we should not forget our short-term one. I do not consider that ESAF replenishment has been completed; to be more explicit, we are still expecting some contributions to the Subsidy Account, especially from countries who today referred to their generosity. These contributions could help reduce the need for an interim period, among other things.

On the issue of the interim period, first, I agree with Ms. Lissakers and the staff that it is probably not needed to maintain a 100 percent coverage of existing ESAF liabilities through the Reserve Account; we would be open to considering a lower ratio, which would mean that we could consider a self-sustained ESAF earlier than 2004.

Between now--"now" being probably 1998, depending on the speed of disbursement and on the provision of supplementary subsidies--and the early twenty-first century, how could we finance an interim period? We are open to the option of using GRA resources. It seems to us that one of the reasons GRA resources were not used when we created ESAF was the difficulty we had at this time to assess the specific risk of ESAF lending. Because our precautionary balances then were rather low, it was thought cautious to finance the ESAF outside the GRA. The situation has changed considerably, and therefore we would be open to this option. My suggestion to consider a better use of SCA-2 is related to that.

The SCA-2 should continue to be used to strengthen reserves--be they GRA reserves or ESAF reserves, I have no specific view on that--but my only remark is that, if we were considering financing the ESAF in the future through the GRA, there would be a good case for keeping SCA-2 as it is, without major changes in its affectation.

I am not in favor of Mr. Evans's proposal to change the terms of the ESAF. We must prioritize our goal and first find an appropriate way to finance all of our members before turning, if need be, to the very specific needs of a few selected countries. We cannot afford everything; we do not receive enough bilateral support to consider being more concessional. May I recall that, when we discussed ESAF replenishment, views were expressed by many members that we should consider raising interest rates, which we did not support. Finally, if we were to consider lending over such a long duration, we would blur the difference between IDA and the ESAF in a very dangerous way. The ESAF has been useful to bail out the GRA, and I would not support ESAF being used to bail out IDA, the African Development Fund, or other facilities for which there is some reluctance to provide the necessary replenishment.

On gold, as we have never been very keen on discussing the issue, I will be short. I have the same question as Mr. Mesaki: can we seriously afford considering reducing our reserves? As Mr. Mesaki raised one aspect, I have to raise another. I am sure that, were we considering financing ESAF subsidy accounts with gold sales, many in my country would advocate a reconsideration of our bilateral support on the following grounds: "Do not be silly. Since the Fund's gold is there, why do you ask parliament for money?" Thus, I am grateful to Mr. Mesaki for having raised this difficult point.

More generally, I share his conclusion and would express it in two words: festina lente, or hasten slowly.

Ms. Lissakers wondered whether it would be possible to have different interest rates for different borrowers under the ESAF.

Mr. Wijnholds made the following statement:

As expressed in earlier discussions, I remain of the opinion that continued Fund involvement in heavily indebted poor countries is desirable. Besides the development loans and grants that these countries receive in support of specific projects, it is essential that prudent macroeconomic policies be pursued and external balances maintained. The Fund has a comparative advantage in supporting these efforts by assisting with the design and implementation of macroeconomic policies and catalyzing financial support by providing credits of its own in moderate amounts. Such financial support should be commensurate with the capacity of the member country to carry the resulting debt burden. Therefore, support to these countries should be made on concessional terms.

It follows from this line of thinking that I am interested in the staff's ideas to ensure the continued availability of the ESAF. The proposal for a self-sustained ESAF has merit. I would welcome a detailed discussion on the possible modalities in the future. As to the staff's preliminary suggestions, I would like to note that at best a self-sustained ESAF could support annual disbursements of SDR 0.8 billion as of the year 2004. This compares unsatisfactorily with the current annual ESAF capacity of SDR 1 billion, even more so in real terms. Moreover, I find it rather unrealistic to rely on a system in which disbursements in one period are fully financed by repayments of earlier loans. A single case of arrears would already undermine this mechanism leaving even less than the SDR 800 million SDRs available.

It seems likely then that more resources are needed for a satisfactory continuation of the ESAF. How shall this be done? A number of suggestions have been made by the Managing Director. Let me make clear immediately--and I think I have done that already--that I oppose using General Resources Account resources for that purpose: first, because this would undermine the Fund's monetary character, in my view--and I have noticed in some other Board members' views; second, because it would put undue pressure on the Fund's reserves, which is clearly undesirable, in a period where substantial and relatively high risk credits are being extended by the Fund. With respect to the interim period, I am not in favor of using SCA-2 resources but would prefer to shift SCA-2 resources to SCA-1, as this would safeguard these reserves.

I am, however, prepared to discuss the role that the investment income from gold sales could play in this context. I believe that this should be done in conjunction with the discussion on the multilateral debt question.

A point I would like to emphasize, and that has already been eloquently expressed by Ms. Srejber also, is that although budgetary constraints might reduce the availability of donations to the ESAF Trust in years to come, many donor countries find contributions to the ESAF Trust a highly effective allocation of their development budget. This would include my own country. Therefore, it would be worthwhile to assess the contribution which bilateral donors could make to a continued ESAF. In this regard, I cannot help but remark that those who allude to "the damaging effects of lower levels of new concessional lending" should not forget their own country's role in establishing the trend of falling aid levels.

As regards the issue of addressing multilateral debt problems of some heavily indebted countries, I have some sympathy on the one hand for the British proposal for a doubling of ESAF maturities; on the other hand, I agree with the staff that more concessionality for a few should not imply no ESAF at all for the many. So, clearly, I think more discussion on this issue is needed.

Finally, I would like to thank the staff for producing the sensitivity analysis with respect to the key assumptions in the assessment of the multilateral debt issue. I also welcome the fact that in the next exercise the staff will analyze individual country positions rather than the stylized approach. I hope that the staff will also find time to produce relatively soon an analysis of the impact of multilateral and total debt service on countries' budgetary positions.

The Chairman said that he could solicit the support of donors for financing the subsidy element of a third round ESAF. However, he had been warned about the bleak prospects for financing the next IDA replenishment, and had thought that the World Bank and the Fund should not attempt to raise funds simultaneously and to leave room for the urgently needed IDA replenishment. He considered that the Fund could attempt to finance its facilities with its own resources. He would welcome the views of Directors on that matter.

Mrs. Cheong made the following statement:

This chair shares the Managing Director's views on the need to make the ESAF a self-sustained facility to deal effectively with the protracted nature of debt and the consequent balance of payments problems of the low-income and heavily indebted member countries.

Mr. Evans's statement has, in a simple and direct manner, addressed the issues in a perspective in which it should be seen. I, therefore, fully agree with his approach. I support his conclusion that the staff papers, especially with the additional work by the staff, have provided sufficient basis for a decision on this matter--although further work on the various possible options on how the ESAF could operate may be required, in the light of the staff's explanation on use of GRA resources within the present framework and issues raised by other Directors.

On future operations, this chair supported proposals for more concessional ESAF lending as a way for the Fund to play a role in easing the debt burden of the poorest nations. In view of the recent encouraging moves by bilateral donors on easing the debt burden of poor countries, it seems even more appropriate that the Fund, as the premier institution on balance of payments adjustment, also participate in this process through a more proactive manner. However, I should emphasize that the Fund do this through financial assistance for macroeconomic stabilization policies. The Fund would not be able to take a leading role on debt because its approach is balance of payments support. Furthermore, the Fund's participation in this manner in matters affecting poor countries would be seen by the international community as taking a balanced stance, especially in the light of recent developments where a few large loans now account for a substantial share of the use of Fund's resources.

The staff paper has assessed the effects of improved concessional terms of ESAF-lending through a longer maturity period. In previous statements, when supporting this proposal, this chair stressed the need for conditionality and longer maturity to be implemented as an incentive scheme accorded only to countries demonstrating commitment and some success in undertaking stronger adjustment policies. A patient that is brave enough to accept a strong dose to cure a serious ailment should be encouraged through proper nursing care. In this sense, the Fund would be conducting closer surveillance over a longer period to ensure that countries can complete their stabilization policies and exit from use of Fund resources. To creditors, this would be necessary to ensure the effectiveness of Fund lending. In this approach, although the incentive of longer maturity should be accessible to all ESAF-eligible countries, in implementation, it would be made available on a case-by-case basis to members showing satisfactory performance. In this way, we can meet both the requirements of a general facility and a case-by-case approach on additional benefits of the scheme.

On administration of changes to the ESAF terms, it may be operationally neater to undertake changes after full commitments are made to the current ESAF, as suggested by the staff. However, these operational details can be decided after the staff has examined all options.

On funding, this chair supports the proposals made by the Managing Director. On the sale of gold, we remain guided by the need to balance the underlying financial standing of the Fund and the practicality of using available but dormant resources. Prudent financial management prompts me to prefer that the Fund use only the investment proceeds of its gold sales. In this sense, the Fund's financial strength is not affected because the gold is technically still intact, except valued at a new price. Although this may require higher gold sales, it is still a small proportion of existing gold holdings. Furthermore, sales will be executed in stages, so that the final amount of gold actually sold could be much less, especially if program countries improve their performance, as current evidence seem to show. This will address Ms. Srejber's concern on the effect of sales on the gold price. As raised by other Directors, our authorities urge that the Fund's resources be used first before approaching bilateral donors. Finally, on the fear that the sale of gold could open a Pandora's box, we support the Managing Director's approach. I should add that one should not fear opening a Pandora's box if that leads to a more innovative way of using resources in effecting the Fund's role better.

Mr. Verjbitski made the following statement:

At this late stage of the discussion, I shall briefly summarize our views on the issue as follows.

We recognize that balance of payments problems of low-income countries will not disappear by themselves without a coordinated effort by the international financial community. Therefore, we would support making the ESAF a self-sustained concessional facility, as proposed by the management.

We would not object to using the GRA resources for the loan component of the ESAF. However, we have reservations regarding the proposed ways to finance the subsidy requirement. Like Mr. Mohammed, we would have preferred considering the proposed sale of gold only after the Executive Board's discussion of the future role of gold in the Fund.

The use of GRA resources for loans under the ESAF may require higher provisioning within the GRA. Accordingly, it would be helpful to analyze this issue before we decide whether to transfer SCA-2 balances to the ESAF subsidy account or, alternatively, merge them with SCA-1 balances.

In line with Mr. Mesaki's comments, in the period beyond 1997, under the proposed future system of financing the Fund's operations based on the uniform adjustable norm, a more equitable and transparent quota-based approach to financing the Fund's share of the ESAF subsidy could perhaps require incorporating the amounts in question into the general expenses of the Fund to be financed through members' unremunerated positions.

We are open to other ideas on this very important issue and look forward to the next scheduled Executive Board discussion on May 8, 1995. On the basis of the three-page executive summary of the staff paper for that meeting, one may expect a very candid and interesting discussion.

Mr. Kiekens made the following statement:

Given the continued need of the poorest countries for continued financial support on concessional terms in order to avoid debt servicing problems, and the ESAF's appropriate blend of structural conditionality and concessional financing, we agreed that we would explore ways of continuing this support after the resources under the current ESAF extension have been fully committed. We do not, however, see any great urgency requiring quick decisions, and I noted that in the Managing Director's reply to Mr. Mesaki's statement he agreed with this position. According to the staff, ESAF operations could be continued within the present funding structure using contributions of creditors and donors. The basic argument for making a decision quickly is that all ESAF resources could be committed by the end of 1996, but this assumption does not seem wholly realistic. Finally, the ESAF was established as a temporary facility, and all its features were designed to suit this temporary character. Making the ESAF a self-sustaining facility risks creating inconsistencies that we should avoid.

In this light, let us examine the various alternative financing methods. It does not seem appropriate to finance the ESAF out of the Fund's General Resources Account. This use of GRA resources would be even more unacceptable should it be done in the framework of the proposed extension of maturities. For my authorities, the Fund reached the very limits of what is compatible with its monetary character when it was decided in the past to provide credit with GRA resources for ten years under the EFF and the systemic transformation facility, the latter being a temporary facility or arrangement. My authorities also consider that the present funding of the ESAF is precisely the expression of the concern of the contributing members about preserving the Fund's monetary character.

The countries of my constituency do not show great enthusiasm for selling Fund gold to finance the interim ESAF. One of our countries opposes the idea strongly, specifically because such sales would cause the financial markets to question the Fund's solidity and the adequacy of its available reserves. Our chair would like to wait for the paper on the role of gold before taking a position on the issue of gold sales.

Using the limited resources of SCA-2 would be difficult to implement because, as other speakers also stressed, it would require the individual assent of each member country. The SCA resources were originally intended to protect the Fund's financial solidity; they came mostly from central banks, whereas ESAF resources have usually come from budgets. We would therefore favor, like Mr. Mohammed, a discontinuation of additions to the SCA-2 account.

As to the retransfer of resources from the Reserve Account to the Special Disbursement Account, we need to be sure that the desirability of a self-sustaining ESAF is not balanced against creditors' legitimate interest in having their ESAF Trust contributions protected. In short, since none of the available financing methods is wholly acceptable, we must carefully weigh the pros and cons of each. It is certainly preferable that countries that have completed rights accumulation programs would be financed solely with ESAF resources. However, the limited amount of ESAF resources makes this option seem unrealistic, so that we will probably have to continue mixing general resources with ESAF resources.

The staff's preliminary analysis indicates that current ESAF maturities do not impose an undue burden on most ESAF-eligible countries. Since the amount of available ESAF resources is limited, there appears to be a trade-off between extending the maturities and continuing ESAF itself. For reasons of equity, we would, therefore, prefer to retain the conditions presently attached to the ESAF facility. We generally feel it would be counterproductive to try to define subcategories of ESAF-eligible countries and treat them differently. Finally, I fail to see how the extension of maturities will solve or resolve the heavy debt overhangs of some countries; it will only soften the need for adjustment by giving more time to act. In that spirit, I concur with the Managing Director that it would be preferable for those very fragile countries to maintain both the conditionality and the concessional financing through several successive ESAF arrangements.

Mr. Suárez made the following statement:

Like other speakers, we also welcome this discussion on possible modalities for continued Fund involvement in low-income countries. It gives us the opportunity to exchange views on ways to ensure an effective role for the institution in helping its poorer members through balance of payments support, provided that the required macroeconomic adjustment policies are undertaken with structural reforms aimed at laying the basis for sustained growth. Moreover, in our recent review of issues and developments in multilateral debt and financing for the heavily indebted poor countries, the possibility of a longer-term availability of the ESAF was stressed.

The staff has done an excellent job by updating the earlier analysis in the joint background paper on multilateral debt and financing for the heavily indebted poor countries. The results of the different sensitivity analysis included in the paper denote the necessity of making every effort to ameliorate the burden of debt for these countries.

Therefore, we consider that there is a need for a continuation of ESAF operations, including for the heavily indebted poor countries, following the full commitment of resources under the current ESAF. As highlighted several times in the staff paper, it is of paramount importance that the efforts of those countries continue to be supported by the international community with new assistance in sufficient amounts, on grant or highly concessional terms.

In view of the need for continued Fund concessional financing and the strong budgetary pressures in some of the present contributor countries, we consider pertinent the Managing Director's proposal for financing the loan component of the interim ESAF operations during the period 1997-2003 with the Fund's own resources through the General Resources Account, before making the ESAF a self-sustained facility. We also consider suitable the combination of financing from bilateral sources and sales of the Fund's gold. However, we are of the view that every effort should be made to obtain contributions from bilateral donors at least for the financing of the subsidy account. In the case of the use of gold, we would also prefer the option of using the investment proceeds.

Regarding the issue of the most heavily indebted poor countries, we could also support the Managing Director's proposal for addressing the few existing cases through the continued availability of concessional ESAF resources on present terms.

Finally, like Mr. Mohammed and Mr. Koissy, we would also consider that following completion of rights accumulation programs, those eligible countries should preferably have programs financed with ESAF resources.

Mr. Ramdas made the following statement:

After the comprehensive treatment of this subject, I would like to emphasize a few points briefly.

We agree broadly with the main conclusions in the papers that the balance of payments problem of the heavily indebted poor countries--even on the most optimistic of assumptions--is likely to be protracted and that concessional financing will be necessary over a longer period than the current ESAF would allow.

The papers also highlight the fact that there is a positive correlation between export growth and debt-servicing capacity. I would only mention briefly the importance of structural reforms pursued in a coherent framework to provide the best possible chance for export-led growth. Even with concerted reform efforts, very few of the low-income heavily indebted countries are likely to see meaningful results over the medium term. The exploration of modalities for providing continuing funding, therefore, is timely.

Having regard to the budget constraints advanced by potential donor countries to ESAF, we would suggest that the staff explore the impact of recycling loan repayments assuming that donors would allow their initial contributions to remain with the Trust rather than be repaid to them. The repayment cycle requires repayment to begin five-and-a-half years after the initial disbursement and, in the absence of arrears, these repayments could provide renewed resources for the so-called interim period and into the longer term. This would have the same impact on donors as extending maturities.

The concept of a self-sustaining mechanism is attractive and should be explored further. In this regard, we might also wish to assess the risk of arrears and defaults to determine the need for full coverage in the Reserve Account for the ESAF Trust loans. The Special Disbursement Account can also provide both additional resources and concessionality. Gold could be an important component in augmenting own resources for a self-sustaining mechanism. As the staff describes, the options regarding the sale of gold can vary--a higher level of sales would be required if both loans and interest subsidy were to be financed from this source. We will await the future staff paper on the possible use of gold before making definitive suggestions.

Finally, we agree with the Managing Director's vision to build on the existing potential of the ESAF.

Mr. Geethakrishnan made the following statement:

A few weeks earlier, when we discussed precautionary balances, some of the earlier speakers, including the U.S. chair, indicated that they might not be averse to the surpluses in SCA-2 being retained in the Fund for other uses. I wish to draw attention to this surplus, which could grow up to SDR 1 billion, and ask whether it could be used for giving relief to some of the heavily indebted low-income countries. The staff has proposed a self-sustaining ESAF from the year 2004 with extended repayment terms, and has identified several sources of funds, including the surpluses in SCA-2. If the surpluses in SCA-2 could be used for funding the new ESAF, my concerns about financing would be taken care of.

Basically, we are considering not so much the self-sustaining ESAF, but whether or not we should have the interim ESAF. Mrs. Wagenhoefer pointed out the "unseemly haste" in which we finalized the ESAF successor only 18 months earlier. I do not think the membership had any quarrel with the concept of ESAF on the last occasion. We raised the issue of funding the ESAF and found a solution. If the current ESAF could be sustained up to the year 1996, there would be no problem of funding from the year 2004, and we could arrange funding for the interim period; I do not think the membership has any objection to the new ESAF successor. Let us not give the impression that we think that the ESAF is bad, but still we agree to it because it is a short-term proposal. We think the ESAF is necessary; we created it as a short-term facility, because of the funding problems. If a solution to the funding problem during 1997-2004 could be found, let us not object to the ESAF.

Each one of us has some reservations on some aspect of funding, such as gold sales, use of GRA resources, and the extent of out contributions. However, let us not convey the wrong impression that we are against the continuance of the ESAF itself.

Mrs. Srejber said that we should not treat the ESAF as a long-term instrument. The problem of the heavily indebted countries is not going to vanish in five years; the problem of poverty is not going to vanish. The Scandinavian countries had been the most generous in terms of their contributions to bilateral aid, and their support for the poorer countries is well known. Let us not give them the impression that we are in a hurry and that we want to get rid of the debt problem in a hurry. That is not very practical.

While I agree with the general approach of Ms. Srejber, let us not delude ourselves into thinking that our advice is so good that all countries are going to turn the corner in two or three years. I agree that we should not look far ahead into the twenty-first century, but that century is just five years away. So there is nothing wrong in our planning for the next ten or 15 years; it is only practical.

Some Directors have mentioned that very large resources were required for the ESAF operation. I think this is a very valid point. However, if one considers the disbursements under the ESAF credits, the ESAF successor itself would be able to take care of the funding problem for another year or two more than earlier expected, with the result that the total funding required for the interim period for the bridging arrangement might not be as large as projected in the staff paper.

As regards gold sales, like Mrs. Cheong, I would prefer that we use only the investment proceeds of the gold sales, so that the gold stock is not affected. We would have to earmark a larger amount of gold to be sold in order to protect the Fund's interests fully.

I was hoping that, if there could be a consensus on this issue before the forthcoming Interim Committee meeting, it would provide us with one more hour of glory. I would, therefore, strongly urge the membership and my colleagues here to see whether we can build a consensus on the ESAF issue. I could support whatever consensus that emerges so that we will be able to take a decision at this Interim Committee meeting itself, rather than push it to the twenty-first century.

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

Mrs. Wagenhoefer said that she was opposed to the proposed self-sustained ESAF, because her authorities had considered it a fairly risky venture. She recalled that, as the majority of members had not favored financing the current ESAF from Fund resources, as a compromise, it had been financed through bilateral contributions.

The Chairman recalled that the ESAF had been created in 1987 to make available more resources to poor members, including some 26 member countries with severe external payment arrears, including to the Fund at that time, and to protect Fund resources invested in those countries. Since then, as the countries with ESAF support had improved their positions, and the number of countries in arrears had been sharply reduced, the Fund should venture to provide those poor countries with further financial assistance.

Ms. Srejber said that to decide now to launch a self-sustained ESAF after the year 2004 was premature, as it implied planning for repeated and long-term use of Fund resources well into the next century, which, in turn, implied that member countries failed to cope with their problems by adhering to Fund advice. If that were the view, the Fund should critically examine its advice--and not its credit facilities. Her authorities had preferred not to look as far ahead as well into the next century, but to wait for the right moment to deal with problems, if they arose.

Mr. Keller made the following statement:

The excellent detailed papers in front of us set out the issues, and in this morning's extensive discussion we have covered a lot of ground. I will thus keep my intervention brief.

We welcome the executive summary on bilateral and multilateral aid flows and Fund-supported programs issued yesterday. Although we would have preferred to have a discussion on these issues before today's discussion, we are looking forward to discussing them substantially in May on the basis of the paper and after consultation with different offices in our capitals as well as at the World Bank. Indeed, several times we had invited the staff's reflection on them.

We continue to carefully consider the background paper on issues and developments in multilateral debt and financing for the heavily indebted poor countries. The issues raised are complex and far-reaching. They are also of a politically sensitive nature for us.

The Managing Director's statement brings us two steps further down the road, to the year 1997 and thereafter. We are not in a position, as yet, to pronounce ourselves on the interesting, very concrete proposals that the statement contains, and which we appreciate. Our authorities definitely need more time to thoroughly reflect on the implications of the Managing Director's proposals, as they go well beyond the issues for consideration in the staff paper on possible modalities for continued Fund involvement in low-income countries.

At this point, we can only state that the transformation of the ESAF into a permanent facility constitutes a fundamental change in the Fund's approach to providing financing to the poorest countries. It should thus not be hastily dealt with. Before the various options of financing modalities for future ESAF operations are explored more deeply, the discussions on ESAF in general and on its role within the Fund's operations should be reopened, and a number of fundamental questions, such as the role of Fund gold and its sale, should be clarified.

Mr. Geethakrishnan said that, although India--a large borrower from the GRA, and a substantial contributor to the accumulation of resources in the SCA-2--could have insisted on a refund from SCA-2, it had agreed to maintain its accumulated resources in that account in order to facilitate the highly indebted, low-income countries to use them. However, if those resources were not to be used to help the countries that needed them most, but were to be retained as additional resources for the Fund, then India might insist on the refund of the SCA-2 surpluses.

Mr. Al-Tuwaijri said that the Managing Director's statement and the staff papers had raised a number of important questions, but his authorities had not had sufficient time to respond to them.

Mr. Wei made the following statement:

I would like to extend my appreciation to the staff for the work they have done on possible modalities of financing for the ESAF, through which the Fund provides concessional financial assistance to low-income countries. We welcome the discussion on how international organizations can enhance their assistance to the heavily indebted member countries with their adjustment efforts.

In view of the very positive role that has been played by the Fund through the ESAF operation in assisting low-income countries, I support the suggestion to consider the use of the Fund's own resources to support ESAF operations for the interim period between 1997 and 2003.

On the issue of the funding of the subsidy requirement of about SDR 3 billion, I support the Managing Director's proposal, namely, to use SDR 1 billion from the resources accumulated in the Special Contingent Account 2, and SDR 2 billion from the sale of gold.

On the issue of addressing the difficulties of the most heavily indebted poor countries with high multilateral debt, although I could support the proposal to extend the maturities of new ESAF lending, I share the concerns expressed by Mr. Mohammed. The staff's comments on this issue would be appreciated.

On the issue of meeting the needs of members in arrears, we would like to support their programs with ESAF resources, following their completion of rights accumulation program arrangements.

Mr. Mirakhor made the following statement:

I share Mr. Mesaki's view that the Managing Director's statement contains some very important ideas that merit deeper, fuller, and more careful consideration. With the caveat suggested by Mr. Mohammed and also the Managing Director's comments this morning relating to the SCA-2, we can support the broad thrust of the Managing Director's statement.

Having said that, let me make three brief remarks. First, because I share the intensity of interest in Mr. Evans's very interesting statement, I found a great deal of validity in his point that there are a significant number of countries that are grappling with the problem of multilateral debt burdens now and, therefore, there is an urgency with which we need to address this problem. On another point in Mr. Evans's statement, I think we should recognize that while the Fund, as Mr. Evans suggests, is already able to ensure that countries with outstanding Fund resources are subject to closer surveillance than otherwise might be the case, the international financial institutions and the donors require more than just monitoring. At least the last three years of experience with Ghana has shown that the donors and the international financial institutions require the involvement of the Fund with financing. Earlier, the Director of the Policy Development and Review Department commented briefly on Ghana, but last year alone, $250 million of promised aid was not disbursed to Ghana, principally and primarily because the Fund was not involved in Ghana with money. So, we have to be cognizant of that fact. Therefore, anything that will help to enhance the Fund's role in these countries with financing ought to be considered very carefully.

I also found Ms. Lissakers's comment very interesting that perhaps we should ask the Interim Committee for a mandate to explore innovative ways to deal with the financing problems of low-income countries, but I wondered whether we need such a mandate. Perhaps the staff could tell us whether a mandate is required before we can undertake that kind of study. Finally, I wondered whether in the future study that is going to be undertaken, as suggested by the Director of the Policy Development and Review Department, it is possible for us to consider a broader base of potential contributors to any concessionary windows we are going to offer, because it appears to me that the papers before us take the present pool of creditors into account, but we are now looking at 2001 and beyond. And given that a large number of countries are constantly being added in terms of the number of emerging countries, should we not broaden the base and look at a wider base, a wider pool of potential contributors to the ESAF?

Mr. Evans said that the Fund needed to give serious consideration to concessional lending--including the lengthening of maturities of loans--in order to deal with the debt and debt-service problems that a number of countries faced. In that context, he wondered whether Mr. Mirakhor had thought about other possibilities of how the Fund could help the heavily indebted countries.

Mr. Mirakhor replied that the Fund should explore all possible means of helping the severely indebted countries. Enhancing the revolving nature of the resources available to the ESAF and extending the maturities of loans under the ESAF should help the heavily indebted countries.

Although the financial commitments of the Fund in the debtor countries through the ESAF had been small, the Fund's involvement in monitoring the economic programs of countries had given a great deal of confidence to the donors and international financial institutions, Mr. Mirakhor observed. The Fund's efforts to promote sustainable growth through the implementation of appropriate policies had induced the donor community to commit additional resources to the heavily indebted countries.

Nevertheless, there were several issues that needed to be clarified as soon as possible, including whether or not the Fund's involvement should be permanent, Mr. Mirakhor noted. He had been surprised that some speakers had stated that the Fund's involvement in debtor countries should be temporary. He believed that the Articles of Agreement had required a more permanent involvement of the Fund with the member countries. In that context, the temporary character of some Fund facilities should not be confused with the Fund's permanent involvement with its membership.

The Fund should not expect that countries currently using ESAF resources would be able to make a speedy transition to the use of stand-by arrangements, Mr. Mirakhor concluded. Most countries had continued to have protracted balance of payments problems.

Mr. Newman recalled that Ms. Lissakers had suggested that the Board should obtain guidance from the Interim Committee on issues concerning multilateral debt problems of member countries.

He hoped that Mr. Geethakrishnan would reconsider his views about requesting a refund from the SCA-2, Mr. Newman remarked. As one of the largest borrowers from the Fund, it would be in India's interest to preserve the security of the Fund.

The Director of the Policy Development and Review Department said that most Directors had agreed that, for the majority of heavily indebted poor countries, multilateral debt service burdens should be manageable, if new multilateral lending were made available on appropriately concessional terms, and supported a policy framework which generated export growth. It would be necessary to convey that message to the Interim and Development Committees, because previous debates had given the impression that multilateral debt was a "generalized" problem.

There were differences of opinion on how to deal with the outstanding external debt of a number of member countries to multilateral agencies, the Director observed. In evaluating strategic approaches to the problem, legitimate questions had been raised about the reliability of the "stylized" analysis used so far. It was time to move on to a case-by-case analysis of the individual countries, which had been identified for special study. However, it would be difficult to extend the case-by-case analysis to cover a relatively long time horizon. In analyzing the external debt problems of individual countries, assumptions would have to be made about export growth, aid flows, and sustainable current account deficits. During the summer, the staff would prepare a paper analyzing case studies of severely indebted countries, including the fiscal implications of external debt.

Considering the extraordinary examples of Peru and Uganda, however, there was optimism that, even severe external payments arrears could be overcome, the Director remarked. Despite its heavy debt burden in recent years, Uganda had been able to attract substantial foreign investment. In that context, the adjustment programs of countries had played a crucial role in ensuring positive net transfers of resources to the heavily indebted, low-income countries. Given the uncertainties associated with their external environments, countries should continue with adjustment programs in order to achieve their economic and social goals.

In view of the beneficial results of the adjustment process in many countries, the staff had favored the maintenance of the current maturities of the ESAF loans, the Director stated. Some Directors, however, had recommended the extension of the maturities of ESAF loans up to 20 years. The Board should evaluate carefully the costs and benefits of the alterative proposals, before taking a final decision about the appropriate maturities.

The resources of the current ESAF could be available beyond 1996, if some of the larger potential users would not make access to the ESAF by then, the Director noted. In that case, there would be a greater demand for concessional financing in the period after the end of the current ESAF, and the launching of the succeeding ESAF would be somewhat delayed.

If the creditor countries agreed, it would be possible to put in place a self-financed ESAF before the year 2004, the Director remarked. In that regard, several Directors, including one representing a creditor country, had suggested that the Fund should explore with the present ESAF Trust creditors the possibilities of an earlier transfer of resources to the Special Disbursement Account through reducing the 100 percent coverage of claims on the Trust Loan account. If a self-financed ESAF could be implemented earlier than 2004, however, the magnitude of annual donor commitments would be somewhat lower than if it would be implemented after 2004. In that context, based on past experience, the needs of an interim ESAF had been estimated to be SDR 7 billion, as shown in the staff paper.

It was possible, in principle, to establish different interest rates for different users of ESAF credit, the Director observed. The legal and technical aspects of how to specify and establish different interest rates under the ESAF had been presented to the Board on an earlier occasion, but it had decided not to pursue the matter further.

Given the growth prospects of countries that had been developing rapidly in recent years, the number of providers of resources to the Fund would increase, the Director remarked. For the first time in the history of the Fund, a broad group of countries had contributed--as donors and creditors--to the ESAF.

Mr. Mirakhor said that the present study should have taken into account the flow of resources from the broader group of potential contributors to the Fund's facilities.

The Fund had an important catalytic role in the political processes of the member countries, Mr. Mirakhor noted. Even in countries where decision making was difficult, the presence of a Fund mission promoted close coordination among various agencies of the government. However, as Ms. Srejber had said, the Fund could not help the adjustment efforts of countries whose political situation was unstable.

He had advocated that the Fund should consider launching a cooperative effort--involving bilateral donors and other multilateral financial institutions--to provide resources for the Fund's activities in debtor countries, prior to an ESAF arrangement, Mr. Mirakhor concluded. In that context, it was worth recalling that the Fund, with the support of the international community, had played an extremely important role in bringing about considerable economic progress in Sudan.

While recognizing the difficulties of donor countries, he hoped that the number of contributors for financing the ESAF for the years after 1996 would increase, the Chairman concluded.

Mr. Evans considered that further studies of the external debt problem of the limited number of highly indebted, low-income countries would be helpful. Although he had stated earlier that the proposed case-by-case analysis would be useful, it was unlikely to solve the problem completely. Perhaps a more general approach should be adopted.

Development prospects of countries could fluctuate rapidly depending on commodity price declines, natural disasters, and policy errors, Mr. Evans continued. It would be prudent not only to deal with countries that were currently experiencing problems, but to anticipate any future debt problems of countries that were doing well at present.

He agreed with the staff that it would be useful to analyze the costs and benefits of the continuation of the present ESAF by extending the maturities of loans, Mr. Evans concluded. The United Kingdom's approach to the external debt problem was based on realistic assumptions about the anticipated decline in bilateral funding for member countries.

The Chairman said that the management and the staff considered that the Fund and other multilateral agencies should assume responsibility for their respective shares of the existing external debt of severely indebted member countries. The availability of gold reserves was not a justification for the Fund to take responsibility for a larger share of that debt. At the Copenhagen conference, the non-governmental organizations (NGOs), among others, had suggested that the Fund should assume full responsibility for solving the external debt problems of member countries. Although the Fund would not endorse that approach, it could nevertheless take a leadership role, coordinate, and encourage other multilateral institutions to solve the problem, with means at their respective disposal.

Mr. Sirat, agreeing with Mr. Evans, noted that financial support for the poorest countries from bilateral and multilateral sources could decline in the near future. Given the current external debt situation in those countries, a viable exit strategy did not exist for the multilateral institutions. In that context, as Mr. Wijnholds had mentioned, bilateral contributions to ESAF, IDA, and replenishment of concessional resources of multilateral development banks should be encouraged, in order to support the heavily indebted countries.

The Director of the Policy Development and Review Department said that additional costs of extending the maturities of loans under the ESAF would include increased subsidies to debtor countries over the extended 20-year period. Apart from the reduction in outstanding debt that had been mentioned as a possible benefit, it was not clear what other additional benefits could be gained by extending the maturities of loans.

The Deputy General Counsel said that the possibility to differentiate interest rates for ESAF or SAF loans was part of a broader issue concerning the limits imposed by the Articles of Agreement on the use of resources that are derived from the profits of gold sales. The Articles authorized balance of payments assistance and subsidization for a particular subgroup of the membership, that is, the developing countries. Furthermore, they required that the level of per capita income be taken into account, and allowed for making further distinctions within that group based on objective criteria. In principle, it would be possible to differentiate interest rates within the group of ESAF-eligible members.

The current ESAF and the proposed amended ESAF would have to take into account the additional provisions that would make it difficult to change the existing interest rate structure, the Deputy General Counsel noted. For instance, the Subsidy Account under the existing ESAF was targeted toward a reduction of interest for one group, and did not envisage the existence of two or more subgroups with different interest rate levels. Moreover, some loan agreements entered into for the existing ESAF contained review clauses, in case interest rate levels changed on the lending side.

The Chairman made the following concluding remarks:

We have had a constructive, although preliminary, discussion. I will attempt to summarize the main points made by Directors and would report to the Interim Committee and, as mandated, to the Development Committee along these lines. Indeed, we will need to return to this topic after the meetings in light of the Committee's guidance.

With regard to the joint Bank/Fund follow-up paper on multilateral debt and financing for the heavily indebted poor countries, Directors welcomed the additional sensitivity analysis of the impact on the debt burden of alternative assumptions about export growth and the volume and terms of new lending by multilateral institutions. Most Directors agreed with the general thrust of the conclusion that, for the majority of heavily indebted poor countries, multilateral debt-service burdens should be manageable, provided new multilateral lending is on appropriately concessional terms and supports a policy framework, which generates at least modest real export growth. Nevertheless, there are some countries that would face very heavy burdens, and we will seek to better identify the true problems in further analysis, which will be focused on individual cases.

There was broad agreement that there would be a need for a continuation of ESAF-type concessional operations. Most also welcomed the prospect, or were ready to explore further the possibility, of a self-sustained ESAF financed through resources that will reflow to the Special Disbursement Account from the ESAF Trust Reserve Account, which, under current projections, would begin to become available in the year 2004, or possibly before, as pointed out by some Executive Directors.

Most Directors also welcomed early consideration of possible ways to finance ESAF-type concessional operations in the "interim period," after the full commitment of present ESAF resources and before the SDA resources would become available. I have noted the view that we should not proceed with undue haste and we will not. But the issues are complex and in the view of most a beginning is timely. A number of Directors stressed the considerable uncertainty attached to the likely timing of full commitment of existing ESAF resources. Several Directors, including some representing ESAF creditors, also considered that it would be useful to explore with the present ESAF Trust creditors the possibility of an earlier transfer of resources to the SDA through reducing the coverage of claims on the Trust Loan Account. Slower commitments and/or lower coverage in the Reserve Account could reduce funding needs in the interim, and we will explore these possibilities as we move forward. Some Directors also pointed to the need for individual countries to reduce reliance on Fund support over time, in line with the temporary nature of Fund financing, including from ESAF.

For the "loan element", most Directors supported that further consideration be given to a combination of funding alternatives, including the use of the General Resources Account in the framework of extended arrangements, although others did not favor that approach. For the subsidy component, in light of suggestions by some Executive Directors, a few Directors supported the idea that members consider ways to utilize resources refunded to them from the SCA-2 to help fund a continuation of ESAF operations, which could cover up to one third of the projected subsidy requirements in the interim period, or that we seek alternative bilateral sources of financing. Others were opposed to that approach, but were open to exploring bilateral funding. For the remaining subsidies, many Directors thought that the possibility of gold sales should be further pursued, but others were firmly opposed to gold sales. Among those who favored utilization of gold, the prevalent view was to use the investment income from gold sales profits. In this connection, and on the use of gold more generally, Directors expressed interest in a wider discussion of the role of gold in the Fund on the basis of the forthcoming paper by the staff, which I mentioned earlier, would be circulated to Executive Directors before the Interim Committee meeting.

For some of the protracted arrears cases, Directors considered that the debt-service prospects were likely to be so severe that concessional resources would be the most appropriate form of Fund support in the period following clearance of arrears. The timing of possible requirements is particularly uncertain, but we will factor these into our work on needs and funding modalities as well as we can. However, in view of the magnitude that may be involved, assistance will be needed from the international community as a whole, and not only the Fund.

Directors discussed the question of an extension of maturities for ESAF loans under an "interim ESAF" for a category of ESAF-eligible countries. Most Directors considered that the present terms of the ESAF remained appropriate, and that for those countries that may face continuing heavy debt burdens and balance of payments problems, the Fund could best assist them through the continued availability of ESAF resources on present terms. These Directors generally considered that retaining present terms would better enable the Fund to tailor its financing to the particular situation of each member. That approach would also maintain conditionality and monitoring of members' policies over what may, in a few cases, have to be prolonged periods, avoiding the long periods without such monitoring that could result from an extension of maturities. Nevertheless, a few Directors felt that this approach would not adequately address the problems related to debt "overhangs" and the need of members for assurances that debt service to the Fund would be kept at manageable levels. In their view, further consideration should be given to the possibility of an extension of maturities. The staff will give further attention to this in preparing our next document.

3. ALLOCATION OF SDRS - FURTHER CONSIDERATION

The Executive Directors continued from the discussion on Fund financial resources and review of liquidity position and financing needs at EBM/95/28 (3/24/95) and EBM/95/29 (3/27/95) their consideration of an allocation of SDRs. They had before them the following statement by the Managing Director.

At our discussion on March 24 and March 27 on the Fund's financial resources, I put forward for consideration a number of alternative approaches as regards the issue of the SDR. On that occasion, and in view of the wide range of views expressed, a clear conclusion was not reached on how best to proceed. It may, therefore, be useful in connection with our discussions on the Fund's financial resources if I put on record and suggest for further consideration what may be a constructive approach to the issue of an SDR allocation in the sixth basic period and also the enhancement of the Fund's general resources.

The proposal to which I referred at EBM/95/28 and on which I will further elaborate, builds on my initial proposal made last year for a general allocation of SDR 36 billion. It takes into account both the issue of equity, which arises in particular for those members that have never received allocations since they joined the Fund, and the desirability of helping to finance the Fund, through a voluntary post-SDR allocation redistribution scheme, along the lines proposed by Mr. Hashimoto in 1991. The resources borrowed by the Fund would be used to assist those members that experience serious liquidity difficulties because of the external economic environment in resolving their balance of payments or external liquidity problems in a manner consistent with the purposes of the Fund.

Executive Directors will recall the considerations on which I based the proposal for a general allocation of SDR 36 billion. Using updated projections of an increase in the value of trade, the staff has projected that the demand for nongold reserves will increase by more than SDR 400 billion over the next five years to 1999. My proposal to allocate SDR 36 billion would meet less than 9 percent of this projected increase in demand. An allocation of this order of magnitude would have virtually no effect on global inflation. Furthermore, the share of SDRs in nongold reserves is now at an historic low of 2.6 percent and an allocation of SDR 36 billion would increase this share to only an estimated 4.3 percent at the end of the century.

These are by now familiar facts. However, I also believe an important qualitative change has occurred as regards the long-term global need for reserve supplementation since we examined this issue in Madrid. Following the developments in Mexico and the widespread consequences of the Mexican crisis, the private capital markets are considerably less accessible to a number of countries, both in terms of the reduced availability of resources to meet their demand for reserves and the increased cost of borrowing from the private markets. Furthermore, many countries have become vulnerable, or are potentially vulnerable, to sudden shifts in market sentiment regarding their creditworthiness, with the consequence that their need for reserves has increased sharply while the willingness of the private markets to supply those needs has in many cases diminished. In these circumstances, the higher cost of acquiring reserves through borrowing from the markets or through compressing the demand for imports can have severely damaging effects on the world economy and on the efficient working of the international monetary system. In these uncertain and volatile circumstances, the number of developing and transition countries that experience difficulties in achieving an appropriate level of external reserves is a matter of serious concern. An early correction of the inequities resulting from a lack of allocation of SDRs to many of these countries has become more pressing, both because of the need to support the widespread efforts of adjustment now being undertaken by these countries and also because of the more precarious chances of their gaining access to the private markets than at present seems likely.

In the light of the above, and taking into account the long delays and uncertainties that would be entailed by pursuing an amendment of the Fund's Articles of Agreement in order to effect a special allocation of SDRs along the lines proposed at Madrid by the authorities of the United States and the United Kingdom, I recommend that we proceed as follows.

First, propose to the Board of Governors an allocation of about SDR 36 billion for the remainder of the sixth basic period in accordance with Article XVIII, based on a finding of long-term global need.

Second, recommend that the allocation under the present Articles would be equivalent to almost 25 percent of members' present quotas

Third, report that the participants in the General Arrangements to Borrow and those members whose external financial positions have been judged sufficiently strong to be included in the designation plan would express their readiness to lend voluntarily the equivalent of their newly allocated SDRs to the General Resources Account of the Fund.

Fourth, as indicated by Mr. Hashimoto in 1991, the Fund would provide "financing to those countries with liquidity difficulties caused by the external economic environment." The Fund would provide such financing in parallel with an upper credit tranche arrangement.

Fifth, note that the borrowing arrangement with the Fund should be considered an exceptional and temporary measure.

Sixth, consideration could be given to the reintroduction of reconstitution to help enhance the role of the SDR as a reserve asset to hold, discourage disproportionate and long-term use of SDRs, and reduce disincentives to adjustment. I propose consideration of the reintroduction of reconstitution in view of the difficulties under the present Articles of agreeing beforehand on a future cancellation of SDRs, which was proposed by Mr. Hashimoto. 1/

The attached table (see ANNEX) illustrates the net impact of allocating SDR 36 billion to all members combined with a post-allocation redistribution mechanism of the type I have described. As the amounts to be allocated to creditor countries could be made

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1/ A cancellation of SDRs, which is subject to the same criteria as allocation, must be based on conditions prevailing at the time cancellation is made, rather than before an allocation is made.

temporarily available through Fund lending to other Fund members, including low-income members and the transforming economies, the systemic benefits of an SDR allocation would be enhanced. If all creditor countries contributed their full share of the SDR 36 billion allocation, the total amount of additional resources available for on-lending by the Fund would be SDR 23.4 billion.

I would like to make five points in relation to the above.

First, an allocation of SDR 36 billion would go far in addressing the issue of equity that arises from not all countries having participated in all allocations since 1970 and from 37 countries not having participated in any allocations of SDRs since they joined the Fund after December 31, 1981.

Second, under the proposed arrangement the Fund would, of course, bear the risk with respect to the credit extended which was financed from the effective borrowing of SDRs. The Fund would carefully assess the risk element, and the Fund's security would continue to depend ultimately on the strong adjustment policies supported by the Fund's resources.

Third, the operational modalities of such an arrangement would, of course, need to be carefully worked out, in particular taking into account the views of Executive Directors expressed at the recent discussion on the Fund's financial resources, and to ensure that it would be fully in accord with the Fund's basic principles, including strong conditionality and catalytic character.

Fourth, the arrangement proposed above cannot be regarded as a substitute for an increase in quotas, which we are now working toward. In my view, an increase in quotas is the only proper way of funding the central institution of the system. However, an SDR allocation combined with a post-allocation redistribution scheme to facilitate lending to the Fund, as described above, offers a constructive solution to address the need for additional resources which could arise during the period before an increase in quotas would be ratified, a period which may be of uncertain length and could be relatively remote. If the problem of long-term capital funding through an increase in quotas does not seem pressing until mid-1996, an immediate allocation of SDRs would have, as a minimum, the merit of addressing now the problem of equity for a large number of members, and would provide time for allowing individual countries which would need legislative approval for relending newly allocated SDRs to take the necessary steps for the arrangements to be activated when needed.

Fifth, the proposal presented above is a temporary complement to a quota increase by increasing the Fund's resources through borrowing at a time that potential problems are beginning to emerge in the context of globalized markets. In my judgment, such a scheme compares very favorably with other approaches that could be considered:

The newly allocated SDRs would be kept in the reserves of members until a collective decision to activate the arrangement is taken; it can therefore be put into effect relatively quickly, and, being associated with the adoption of strong adjustment programs by vulnerable countries, it has the significant potential of helping to create and maintain a climate of confidence in member countries and to the markets; it avoids the uncertainties and potential difficulties related to Fund borrowing in the private markets, or difficulties in arranging other borrowing at short notice in circumstances of potential market tensions; it also removes uncertainties that might be related to the amount of usable resources that would be available under the GAB and the associated arrangement with Saudi Arabia when an occasion would arise to justify a request for an activation of the GAB; 1/ lastly, such a scheme as proposed above would provide the membership with an instrument for crisis management which could also settle in the most acceptable and fairest way the always delicate problem of burden sharing among contributors to the Fund's financing.

It is evident that before adopting such a scheme, Ministers and Governors will need, inter alia, a detailed description of its modalities, including the conditions for its activation. Management and staff stand ready to provide such a description. It would nevertheless be important to have beforehand a first reaction of the membership on the appropriateness of such an allocation of SDRs and the post-allocation redistribution of the bulk of the amount allocated that would be lent to the Fund.

Let me also draw your attention to an alternative approach that, although having the same objectives as the scheme outlined above, would take a different and possibly longer way of achieving its objectives. The scheme proposed above would need an 85 percent majority to agree on an allocation of SDRs and the redistribution element to lend to the Fund may need legislative action in several countries. If it appeared that resolving the

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1/ In this connection, it should be noted that the currencies of three participants of the GAB and the associated arrangement with Saudi Arabia are not sufficiently strong at present for use in the Fund's operations.

issue of equity in the membership and of creating an arrangement whereby the Fund would have at its disposal an instrument that could be activated at short notice to resolve external liquidity problems of members could be easier to implement through an amendment of the Articles, then consideration could also be given to that course of action. If that were the case, I would then propose that an amendment of the Articles provide for both the implementation of the proposal for an allocation of SDRs as put forward by the authorities of the United Kingdom and United States last September, and also for the proposal mentioned in my statement at EBM/95/28, which would enable the Fund to make temporary and conditional allocations of SDRs for individual countries facing balance of payments or external liquidity problems. As noted in that statement, the purpose of such SDR allocations would be to help members overcome their liquidity problems in the present environment of globalized markets through the adoption of appropriate adjustment measures. I touch on this alternative approach, which in concrete terms could lead to similar results, because the individual members' authorities are best placed to appreciate which of the two approaches would be reached with the shortest possible delay so as to resolve quickly the issue of equity and the strengthening of the Fund in the discharge of its central responsibilities.

Mr. Tulin made the following statement:

I welcome management's renewed efforts to stimulate the Executive Board's work on the allocation of SDRs. The Managing Director's statement lays out a reasonable result-oriented framework that could pave the way to an eventual agreement on this complex matter.

As this chair has repeatedly pointed out, including at the previous discussion on March 24, an early resolution of the so-called inequity problem in the SDR Department of the Fund is fully warranted, as it represents a significant departure from the otherwise quota-based organizational and operational principles of the Fund. This problem directly affects 37 countries--or one fifth of the Fund's membership--which although participating in the SDR Department are virtually excluded from full-fledged participation in the SDR system for a single reason: they joined the Fund and the "SDR Club" after 1981, that is, after the last SDR allocation had been made.

At this time, two weeks before the Interim Committee meeting, it may be advisable to try to avoid involvement in a protracted philosophical dispute over the future role of the SDR in the international monetary system, and, instead, follow a more pragmatic path. To bridge the remaining differences, it could be helpful to accentuate further the following areas of possible agreement.

A new SDR allocation is now supported by all members of the Executive Board, albeit for different reasons.

The Fund has considerably grown in terms of its membership since the last SDR allocation in 1981, and it has become a global institution. In the absence of regular SDR allocations, the need to resolve this inequity problem by providing SDRs to members, whose reserve needs have never before been taken into account by the Fund in allocating SDRs, is self-evident and has been broadly recognized.

The fastest way to address the inequity issue would be to allocate SDRs in accordance with the existing Articles to all members in proportion to their current quotas. Although to some Directors a special allocation under an amendment of the Articles could seem a "cleaner" way to deal with the issue, such an option would inevitably prolong the existence of the inequity in the SDR Department for another two years, or perhaps indefinitely, in view of the uncertain prospects of the amendment's ratification by legislatures in various countries.

A broad review of the SDR system by the Board and consideration of recent interesting proposals put forward by the Managing Director may well result in further amendments of the Articles. Therefore, it may be desirable for practical reasons to combine these initiatives in a single package, together with a possible "equity amendment," before submitting them to parliaments for ratification.

An allocation of SDR 36 billion under the Managing Director's proposal would leave the bulk of new SDRs--23.4 billion--in the hands of creditor countries, where the need for them is less pronounced. A flexible redistribution mechanism would prove very useful in this context for those creditors that may wish to on-lend their surplus SDRs to the Fund in support of other members' worthy adjustment efforts, subject to Fund conditionality. The Fund's pool of readily available borrowed resources could be expanded far beyond the present level of GAB and include non-GAB lenders, thus strengthening its liquidity position in the face of future uncertainties. Of course, a redistribution scheme, in my view, must be completely voluntary, allowing those who do not wish to on-lend their SDRs to keep them. Another available venue for creditors that are skeptical about their need to receive

SDRs would be to opt out of an SDR allocation altogether, which could lower the allocation's overall size.

An allocation of SDR 12.6 billion to noncreditor countries would include a partial "equity" allocation of SDR 2.6 billion to those members that joined the Fund after 1981. As such, it would go a considerable way toward addressing the problem of inequity.

With SDR 4 billion and SDR 2.7 billion going to the countries eligible to use the enhanced structural adjustment facility (ESAF) and to the transition economies, respectively, the proposed allocation would bear virtually no inflationary risks to the world economy. Nonetheless, it would considerably alleviate the most needy members' reserve problems, while providing to many authorities additional confidence in the difficult period of economic adjustment. Systemic benefits of the SDR allocation for these countries could be further enhanced through the SDR redistribution mechanism that would need to be combined with strong Fund conditionality.

On balance, the Managing Director's proposal appropriately addresses the need for a very high majority of votes for adopting any decision by the Board and provides a practical basis for resolving the inequity problem for new Fund members in the shortest possible term. The decision to allocate SDR 36 billion could be formulated in such a way that it would allay the concerns of those members that would not otherwise be in a position to support a general SDR allocation. For example, the decision could specifically refer, inter alia, to the fact that the Fund would for the first time take into account reserve needs of its 37 new members in determining the existence of a need for an SDR allocation.

In parallel, I remain interested in studying other proposals by the Managing Director related to developing the SDR as an instrument for temporary conditional allocations of reserves to Fund members in the event of liquidity crises.

Mr. Mesaki made the following statement:

I am pleased to note the return to Mr. Hashimoto's proposal, which was originally put forward four years ago at a meeting of the Interim Committee. It merits serious consideration in the context of a review of the role of the SDR.

However, I am not fully convinced that this proposal should be discussed in the context of finding a solution to the Fund's liquidity problems, as proposed by the Managing Director, for the following reasons.

First, as I indicated at EBM/95/28, an increase in quotas is the traditional and best way to solve the Fund's liquidity problem.

Second, when a quota increase is under consideration, proposing new initiatives for the same purpose could undermine the momentum of the review of quotas in the Fund and of each member country. In fact, this was the dilemma facing the Hashimoto initiative during the Ninth General Review of Quotas.

Third, although the Managing Director believes the Hashimoto proposal could serve as an instrument to solve the issue of equity among members, my authorities are already committed to the U.K./U.S. proposal to deal with that problem.

In this connection, I would like to comment on the alternative approach proposed by the Managing Director. Although I support an amendment of the Articles for the implementation of the U.K./U.S. proposal, I cannot support the other element of the proposal--namely, the temporary and conditional allocations of SDRs for individual countries facing balance of payments or external liquidity problems. I have difficulty understanding why allocations of SDRs are warranted as substitutes for a quota increase, especially considering the greater complexity involved in amending the Articles. Consideration of this "selective" allocation of SDRs should be preceded by a thorough discussion of the role of SDRs.

More fundamentally, I do not support the Managing Director's "alternative" approach because in cases where member countries have difficulty accelerating their domestic procedures for approval, it is not hard to imagine that an amendment of the Articles would be even more difficult.

In conclusion, I would emphasize that although the Hashimoto proposal merits serious consideration in the context of a review of the role of the SDR, it should be preceded by an in-depth discussion of the current and future role of the SDR. To solve the imminent problem of the Fund's liquidity, we should first explore the possibility of a quota increase and then revisit the Hashimoto proposal.

Mr. Schoenberg made the following statement:

The existence and demonstration of a global need is the only criterion under which an allocation of SDRs can be made under the Articles of Agreement. Since the existence of a global need has not been demonstrated in our view, any further considerations of allocations of SDRs under the current Articles are purely hypothetical, and I will therefore not comment on them in detail.

If the necessary majority of the membership should want to change the nature and role of the SDR, we could do so on the basis of a fundamental and well-researched Fund document on the possible future role of the SDR. As far as I can see, the Fund membership is, indeed, in widespread agreement on the necessity of such a study. As long as such a document is not presented to the Board, however, and as long as such a basic discussion has not taken place, it is inappropriate to discuss an arbitrarily selected small number of the potentially large number of possible options regarding the SDR.

On that subject, let me only mention that at this stage there are no provisions in the Articles for helping to finance the Fund in whatever form through an allocation of SDRs. Personally, I also believe it would be premature to conclude that, because Mexico happened, the purpose of SDR allocations should be changed. Likewise, I doubt, like Mr. Mesaki, whether bridging the financing needs of the Fund between quota increases could be the preferable future role of the SDR. The Fund should take a longer-term and more fundamental approach when discussing the future of the SDR, instead of dealing with quickly changing--though quite creative--proposals for which good purposes the SDR might be used.

We still believe that a change of the Articles to achieve equity for new Fund members, for instance along the lines of the U.S./U.K. proposal, is feasible and warranted. We do not, however, accept the linkage made by the Managing Director which would include an amendment which would enable the Fund to make temporary and conditional allocations of SDRs for individual countries facing balance of payments or external liquidity problems. In this context I take note of the Managing Director's interesting new interpretation of inequity, namely the one perceived to be resulting from the fact that some members have access to the international financial markets and others have not. Again, this latest proposal should, if at all, be discussed in the framework of a broad fundamental review of the role of the SDR.

Mr. Berrizbeitia made the following statement:

I suspect the Board will not be surprised if I have a different opinion from that of Mr. Schoenberg. I have little to add to my March 24 statement on the Fund's financial resources. In that statement, I reiterated this chair's support, first, for an increase in quotas along the lines then suggested by the Managing Director, and second, for a general allocation of 36 billion SDRs, as originally proposed by him last year. I wish to again express this chair's support for both proposals.

I also support the Managing Director's current modified proposal, which combines the General Allocation with a voluntary relending scheme by creditor members to the General Resources Account. This recycling of SDRs would be used in parallel with upper credit tranche arrangements to finance "those countries with liquidity difficulties caused by the external economic environment," as was suggested by Mr. Hashimoto in 1991. This was a very prescient suggestion indeed, taking into account the prevailing situation in financial and exchange markets and of our current discussions in the Fund.

I will not repeat the several substantial arguments contained in the Managing Director's statement in support of his modified proposal. Suffice it to say that they present a well-reasoned justification for the general SDR allocation, all the more so in light of recent developments. In addition, I would note that in practice the proposal would add only 12.6 billion SDRs to nonconditional world liquidity, that is, about 3 percent of expected growth in world demand for nongold reserves to 1999--hardly an inflationary amount. At the same time, it would go "a considerable way toward addressing the problem of equity," as stated by Mr. Tulin.

In addition to being equitable, this proposal has the virtues of simplicity and rapidity; at the same time, it applies our Articles in the manner they were intended to be used. Although a consensus may be difficult to achieve for political reasons, I find that there are few solid logical or technical arguments against the Managing Director's proposal for a general allocation of SDRs at this time.

In my prior statement on these issues, I also expressed interest in the idea of a temporary and conditional allocation of SDRs, to be used under exceptional circumstances to resolve external liquidity problems that could arise in the environment of globalized capital markets. At the time, I suggested that this idea could be considered together with other proposals that could require an amendment to the Articles. I note that the Managing Director's alternative approach links the idea of the temporary allocation of SDRs with the original U.K./U.S. proposal.

This alternative approach has important merits and should not be discarded without appropriate consideration. Its merits are related to the equity issue and to strengthening the Fund's reaction capability in the face of special circumstances. Of course, it suffers from two serious difficulties: the first is the required modification of the Articles, with its accompanying delays and other implications; the second and most important is that it does not even consider the possibility of a small general allocation of SDRs under the existing Articles.

In my view, an allocation of SDRs based exclusively on an amendment to the Articles would, in practice, signal the death knell for the original Fund concept that SDRs were to become the principal reserve asset of the international financial system. I do not feel that we are ready to take this decision, nor that it would be a wise decision at this time; rather, it would seem premature in the context of current conditions in the capital and exchange markets, which seem to be characterized by increasing turbulence, and in the context of our ongoing review of the role of the Fund in the changing international financial environment.

Thus, I could only support the Managing Director's alternative approach if it were also accompanied by a small general allocation. This would at least ensure that the basic principle of the SDR's role would be preserved until such time as we may explicitly decide otherwise, as a result of a thorough analysis of what we want the Fund's role to be in the twenty-first century.

Mr. Newman made the following statement:

I have very little to add to Ms. Lissakers's statement on March 24 as we do not find the arguments in the Managing Director's latest statement a basis for changing our views. We continue to believe that exceptional demands for Fund resources to deal with extraordinary events should be met through targeted borrowing arrangements rather than a permanent increase in quotas. For this purpose, moreover, we see no advantage to creating a new borrowing arrangement based on the SDR when the GAB already exists and can be adapted more easily to address the changed circumstances that have emerged over the past 15 years. In particular, we are concerned that proposals for an SDR on-lending mechanism confuse the basic purpose of the

SDR, which was intended to serve as a source of unconditional reserves rather than a means of providing borrowed reserves.

We do not believe that recent events provide a basis for deciding that there is a long-term global need to supplement existing reserve assets through a general SDR allocation. Clearly, international capital markets may have become less hospitable to market borrowers as risk assessments are altered in light of the Mexican crisis. However, it is not clear to me that market confidence would be enhanced by providing unconditional liquidity in the form of a general SDR allocation. Our report to the Interim Committee on surveillance indicates, for example, that timely and more strict policy discipline is the necessary response to the emergence of globalized capital markets. Moreover, under the Managing Director's proposal, many of the countries most affected by market developments are included in the designation plan and thus would be expected to on-lend any SDRs received from a general allocation. The redistributed SDRs would be used to provide financing to countries that do not rely primarily on market borrowing and therefore have not been seriously affected.

The purposes for which the on-lent SDRs would be used are unclear. Thus, at one point in the Managing Director's statement, it is proposed that the resources would provide "financing to those countries with liquidity difficulties caused by the external economic environment." This is a rather vague and expansive criteria which raises the very moral hazard problems that the Managing Director's concluding remarks on March 27 suggested we must avoid. At another point in the statement, it is argued that the on-lent SDRs would be used to finance loans to transition and poorer developing countries, but these countries can be financed from the existing quota resources. I believe that the GAB, which focuses on systemic threats, provides a more targeted approach that would be more effective in containing moral hazards.

The Managing Director's arguments that an SDR borrowing scheme is preferable to other borrowing approaches, particularly a reformed GAB, are not compelling.

In the case of the United States, for example, loans to the Fund of SDRs or through a reformed GAB would require legislative approval, and thus both approaches would take time to implement. However, a reformed GAB is less likely to engender the kinds of opposition and delays that an SDR proposal, with its appearance of printing money, would raise.

Both approaches could operate as a standing borrowing facility that could be tapped on short notice and therefore both could be available as quickly.

The uncertainties about the amount of usable resources that might be available apply to both the GAB and SDR proposals. Thus, countries with weak balance of payments or reserve positions that may not be able to lend via the GAB are also unlikely to be included in the designation plan for initial on-lending of allocated SDRs or to acquire the SDRs sold by Fund borrowers.

Burden-sharing issues exist under each scheme, relating both to the initial lending arrangements and subsequent calls to provide financing.

We admire the Managing Director's tenacity in support of his views on a general SDR allocation and the staff's innovative approaches in trying to bridge views. However, it does not appear to me that we are any closer to narrowing the gap on this issue. In these circumstances, we believe the time has come to take a different path. We continue to believe that an equity amendment represents the most appropriate means of bringing new members fully into the SDR system. At the same time, we also recognize that the international monetary system has changed fundamentally since the SDR system was established. At previous Board meetings, there appeared to be widespread support for undertaking a comprehensive review of the SDR, including the involvement of outside experts. We believe that it would be useful to seek the Interim Committee's views on proceeding with such a study, which would take account of the changes in the system and the role of the SDR as provided in the Articles.

Mr. Wijnholds made the following statement:

To save time and to avoid a repetition of earlier interventions on my side, I will address this subject in telegram style.

First, the Managing Director's main proposal is presented as one "that may be a constructive approach?" I respectfully submit that it is not really constructive at this stage. Bringing up again the matter of an SDR 36 billion general allocation can hardly be seen as an attempt at compromise. Establishing it with the so-called Hashimoto-proposal is not that helpful either, and I noticed that Mr. Mesaki did not really promote it this time.

Second, reintroduction of the reconstitution requirement can best be taken up in the general in-depth study on the role of the SDR that has been promised.

Third, I agree that any arrangement concerning SDRs cannot be regarded as a substitute for an increase in quotas. Let us therefore concentrate on the quota issue rather than recycling proposals which are not going to lead anywhere.

Fourth, the Managing Director's alternative suggestion contains two elements. The first part refers to the U.K./U.S. proposal for an SDR allocation, which my authorities have supported on earlier occasions. The second part is an entirely different animal, envisaging SDR allocations to individual countries. I consider this second part as totally alien to the original concept of the SDR and therefore cannot accept it.

Mr. Zoccali made the following statement:

We find it entirely appropriate to search for a common ground on an SDR allocation which reconciles the need for an early correction of the equity issue for the Fund's newest members with the qualitative change regarding the long-term global need for reserve supplementation since Madrid.

On March 24, we supported the Managing Director's proposal for an allocation of SDR 36 billion in the sixth basic period and we continue to favor this option. We also indicated our willingness to favorably consider a post-allocation redistribution mechanism to reaffirm the Fund's role in the process of international adjustment through an early enhancement of its general resources.

A solid set of arguments consistent with the Fund's Articles, have once again been put forth by the MD in support of his latest recommendation. We see the merits of combining a general allocation with a post-allocation redistribution scheme along the lines of the 1991 Hashimoto proposal, even when it meets only a small part of the prospective demand for nongold reserves and relies on the reintroduction of reconstitution, to reaffirm the notion of the SDR as a reserve asset to hold. Higher volatility and sudden shifts in the willingness of private financial markets to supply liquidity are impinging on the ability of the Fund to fulfill its purposes. Adapting the instruments at its disposal in the context of strengthened surveillance is a necessity even if it means that the Fund would have to bear the additional risk of extending credit from effective borrowing of SDRs. Not doing so would leave the door wide open for market overreaction to produce potentially large disruptive effects in terms of national or international prosperity.

A combined SDR-based financing arrangement, such as the one now being proposed, perhaps broadened to include noncreditor members, would no doubt enhance the relevance of the Fund particularly for the more vulnerable low, middle-income and transition countries. Reserve supplementation would thus be fostered in a cost-effective manner and in the context of upper credit tranche conditionality. At the same time, it could offer a more satisfactory vehicle to resolve the delicate problem of burden-sharing among contributors to the Fund's financing by reducing uncertainty particularly in those situations where crisis management is needed to avert a major disturbance in regional or international financial markets.

The operational modalities of such a scheme need to ensure consistency both with the Fund's basic principles and the monetary reserve character of the SDR. Since this matter is the sole responsibility of the Board, there is no reason as to why it should not proceed quickly and without prejudicing the more comprehensive review to be undertaken of the SDR and its role in the international monetary system.

Finally, the alternative approach of an amendment of the Articles to address the outstanding issue of equity and enable the Fund to activate SDRs on short notice to resolve balance of payments or liquidity difficulties caused by the external economic environment would require an extremely long lead time to prepare without any assurances that it will ever get off the ground. Nonetheless, we remain open to studying further any proposal which develops the potential of the SDR to attenuate the shortcomings of the existing mechanism for providing international liquidity in emergency situations capable of destabilizing domestic or international financial markets.

Mr. Lanciotti said that his authorities remained willing to work with others in finding a solution to the present impasse that would provide the resources needed to help member countries address the challenges posed by the globalized international financial system. All countries must face the potential problems that could arise if--and when--the economic performance of countries still on the path of adjustment were deemed to be unsatisfactory by the markets. Indeed, the Board had held detailed discussions on the consequences that had arisen not only for Mexico, but also for other countries, following the abrupt reversal of market sentiment that had given rise to the Mexican crisis. The Board had also discussed various means to cope with the macroeconomic problems that could give rise to such crises in the future.

Although he recognized that the proposal contained in the Managing Director's opening statement was intended to further progress toward finding solutions to the problems that had arisen over recent months, he was not convinced that a general allocation of SDRs would provide the most appropriate answer, Mr. Lanciotti stated. That was particularly true, given the inability of the Board to reach a consensus on the existence of a long-term global need for liquidity. Moreover, the use of SDRs for the purposes outlined in the Managing Director's would require prior careful consideration of the future role of the SDR, an issue that should be taken up separately from the matter of an SDR allocation.

As he had indicated on previous occasions, he could support a one-time special allocation of SDRs to alleviate the current equity problem by allowing new member to participate in the SDR system, Mr. Lanciotti said.

Mr. Kafka made the following statement:

> We are grateful to the Managing Director for his further statement on the Fund's financial resources with special reference to the allocation of SDRs.
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> We agree that there is at present, and has been for some time, a long-term global need for reserve supplementation which has been enhanced by the Mexican crisis. In addition, and as a separate argument, the globalization of capital markets makes it necessary to demonstrate the existence of a functioning lender of last resort for the international financial community and the best way--in fact, the only practical way--to do that is to proceed to the type of allocation of SDRs that the Managing Director has been proposing for some time.
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> We therefore agree with the proposal to proceed to an issue of SDR 36 billion, or less than 9 percent of prospective demand for nongold reserves over the next five years. Such an allocation would contribute powerfully to improving the so-called equity problem related to SDRs. In order for the international financial community to be able to obtain full advantage from such an allocation, we agree that members in a strong external financial position should commit themselves voluntarily to lend newly allocated SDRs, in the appropriate manner, to the General Resources Account, and the Fund should use such financing to assist countries with liquidity difficulties as proposed by Mr. Hashimoto, and earlier adumbrated by several other Governors. The financing based on these loans to the Fund would occur in parallel with upper credit tranche arrangements; also, reconstitution would be reintroduced at an appropriate proportion of net cumulative allocations.

The allocation of SDRs would be a supplement to other measures to endow the Fund with additional resources that could comprise an enlargement, under appropriate conditions, of the GAB, but basically a large increase in quotas, as suggested in the Managing Director's statement on March 24.

We would therefore encourage management and the staff to soon begin preparation of the necessary studies and documents related to this scheme of SDR allocation, to be combined with a post-allocation redistribution by lending, in the appropriate way, to the Fund. Naturally, insofar as it would be possible to proceed without inconvenient delays to a review of the characteristics of the SDR, that should be taken in hand simultaneously.

The alternative approach described in the Managing Director's statement does not strike us as appropriate. For almost a year, we have stated our reasons for this, and they have not changed. They have been well stated, also, by Mr. Berrizbeitia and Mr. Zoccali. The alternative is almost certain to take much longer to result in an allocation than the Managing Director's proposal. Mainly, it threatens to undermine the existing SDR mechanism by creating an expectation that future allocations would take place by amendment of the Articles rather than by decision of the Board of Governors. While there is no reason an amendment of the Articles permitting a temporary and conditional allocation for individual countries could not be contemplated, we continue to maintain that any allocation of SDRs should be made in with the present Articles.

Mr. Kiekens made the following statement:

During our last discussion of the Fund's financial resources on March 24 and March 27, a wide range of views on alternative approaches to the SDR issue emerged. Although most speakers repeated their preferences expressed at the Madrid meeting, most agreed on the need for further in-depth study of the future of the SDR in light of today's closely intertwined global financial markets. For this reason, I was rather surprised by the circulation of the Managing Director's new detailed proposals for allocating SDRs.

The Belgian approach, as well as Mr. Hashimoto's view, for making a general allocation more effective via a reallocation scheme has been incorporated into these proposals. The advantages of an allocation-cum-redistribution are obvious: not only would it increase the resources available to the Fund, but, at the same time, it would have enhanced catalytic and confidence-building effects by virtue of the conditionality it imposes on members' use of the newly created SDRs to support their adjustment programs. However, in view of the substantial part of the membership that would participate in the general SDR allocation, which is an essential element of the scheme, and the profound changes that have occurred since the SDR Department was created 25 years ago, we should now primarily aim at reaching a consensus on the future role of the SDR that takes these changes into account. At our last meeting on the Fund's resources, we agreed that this long-awaited examination of the role of the SDR should include some non-Fund experts who might bring fresh viewpoints to the task. We look forward to such a study and are examining how best we can contribute to it.

The starting point for this study should be the central role of the Fund in the evolving international monetary system. An analysis of the adequacy of the present relationship between the Fund's surveillance and its financial support of its members will be critical. What kind of stabilizing role can be assigned to the SDR, and can it become an instrument for crisis management, capable of settling the delicate problem of a fair distribution of efforts among the members?

I feel that at this juncture, it will be neither appropriate nor productive to press concrete SDR allocation proposals at the upcoming Interim Committee meeting. The Managing Director's proposals can at best constitute a background for agreeing on an in-depth and decentralized study on the future of the SDR, which should be nonpolitical and benefit from a meaningful participation by outside experts. I advocate proceeding from step to step: first, completing our already full agenda on the strengthening of surveillance; then, examining the role of the Fund in detail; and finally, determining whether the institution has adequate resources to fulfill the responsibilities we will by then have assigned to it.

The Chairman noted that the Chairman of the Interim Committee had recently indicated that the Interim Committee would take up the proposals put forward by the Managing Director of the Fund on an SDR allocation at its forthcoming meeting. Therefore, it should not come as a surprise that his statement for the current discussion attempted to make those proposals more explicit.

Mr. Kiekens stated that it would be important to have a comprehensive review of the future role of the SDR before reaching any final conclusions about the need for an SDR allocation. Moreover, the Interim Committee was not likely to reach agreements on the issues related to an SDR allocation at its forthcoming meeting.

The Chairman noted that the Executive Board of the Fund was obliged to continue its work in examining the issues related to an SDR allocation, regardless of the prospects for agreement at the next Interim Committee meeting.

Mr. Cailleteau made the following statement:

I may have a more positive alternative for us, as guessed by Mr. Evans last Monday. The Interim Committee will be in a position in two weeks to address the SDR issue without the pressure of having to cut the Gordian knot. In order to do its work, the Board needs as much guidance as possible from the Interim Committee on at least two aspects.

The first aspect is how we should restore equity. In other words, is an amendment to the Articles still a credible option on which we could reach, some time in the future, a consensus? Another question is, under which conditions--if there are any--could we activate the existing Articles and address the concerns that have led to some strong opposition? Mr. Tulin's comments that a decision "could specifically refer, inter alia, to the fact that the Fund would for the first time take into account the reserve needs of its 37 new members in determining the existence of a need for an SDR allocation," inspires some questions. What can be the relevance of the Article XVIII, Section 1(b), for instance? We would be interested in discussing the possibility of using this article in the wake of Mr. Tulin's remarks.

The second aspect is what the proper use would be of such an allocation of SDRs. We are truly sympathetic to the Hashimoto principle, and apparently more enthusiastic than Mr. Mesaki. The redistribution mechanism, provided it is subject to a conditional use, reinforces the monetary character of the allocation. We would therefore like to discuss this new proposal, and we expect the Interim Committee to provide us with some guidance on the issues that need to be addressed. I will mention some of these.

The first issue is whether we should re-establish a reconstitution provision in order to enhance, I quote, "the role of the SDR as a reserve asset to hold?" I wonder, by the way, whether there is not some internal inconsistency in the expression "enhancing the role of the SDR as a reserve asset to hold?"

We are open-minded on this question, provided, however, that caution is taken not to make it more difficult for the Group of Ten central banks to manage their foreign reserves in a flexible way.

The second issue is whether it is preferable to design a system in which the central banks lend to the General Resources Account--and then lend the equivalent of the newly allocated SDRs in foreign reserves, or in their own currency, to the General Resources Account--or to have a system in which central banks lend directly those SDRs to a trust account, for instance.

We note that, in the Managing Director's proposal, the Fund would bear the financial risk. This is an important step.

Even more important is how to ensure that creditors can control the utilization of the money they lend to the Fund. Do we have to imagine a system of double conditionality such as in the event of activation of the General Arrangements to Borrow? This is another open question.

Those are some of the issues on which it would be useful for the Board to receive some guidance, that is, to know whether the Interim Committee wishes us to study them in the coming months.

I would like to add a last word on the new proposal of temporary and conditional allocation of SDRs. While we remain skeptical at the present stage, we would be interested in a paper presenting the technical modalities of such an idea.

The General Counsel noted that the Managing Director's opening statement indicated that an SDR allocation would help to resolve the equity issue related to the 37 countries that had joined the Fund since the previous SDR allocations were made. While it would not be in keeping with the Fund's Articles to base a finding of global need solely on the basis of the situation of those countries, they would need to be taken into account along with all other members in the assessment of whether or not a global need existed.

Mr. Evans stated that a careful examination of the future role of the Fund, in particular with respect to surveillance, was needed prior to any further consideration of the Fund's financial resources.

He still was not entirely comfortable with the reference that had been made to the Fund as a "lender of last resort" in the Chairman's summing up of the discussion at EBM/95/29 (3/27/95) on the Fund's financial resources, Mr. Evans commented. The Fund should avoid creating false expectations about the circumstances under which it could intervene in the system. Given the conditional nature of its resources, there would always be some ambiguity about the scope for Fund involvement in individual cases.

He could associate himself with the comments put forward by Mr. Schoenberg and Mr. Newman on the issues related to an SDR allocation, Mr. Evans said. The question of long-term global need had become almost a theological matter. Those who believed that the expansion of international capital flows to developing countries weakened the arguments suggesting a global need would not be convinced by the case of Mexico. He remained skeptical about any proposals for an SDR allocation that went beyond the U.K./U.S. proposal.

He agreed with previous speakers that there was little chance for agreement at the forthcoming Interim Committee, other than on the need for a wide-ranging review of the role of the SDR, preferably to be conducted by outside experts, who--with the assistance of the Fund staff--could bring a fresh perspective to the debate.

Mrs. Cheong made the following statement:

My authorities are fully supportive of the Managing Director's initiatives in this area. They recognize that we need to sustain efforts to resolve this important issue. Mr. Tulin says that we should move on from the philosophical stage to take practical actions that are easily feasible and within the present legal framework.

If practicality should rule the day, a general allocation that is easily implemented should prevail. However, recognizing other problems, my authorities welcome the Managing Director's initiatives and are willing to examine positively a package consideration, but this package must contain a general allocation as an important ingredient.

Mr. Barro Chambrier made the following statement:

I welcome the Managing Director's statement which provides us with the opportunity to further consider the issue of the SDR allocation. At this stage of discussion, I will briefly touch on the main points.

In the light of the indications clearly set out in the Managing Director's statement, we have no major difficulty in supporting the proposal for an allocation of about SDR 36 billion for the remainder of the sixth basic period. As we said in the Board's last discussion on this matter, recent developments in the global economy fully justify such an SDR allocation. Indeed, as a reserve asset, it could play a crucial role in strengthening the reserve position of many countries and in improving confidence. Moreover, this approach will resolve the issue of the inequity while helping other countries dealing with their liquidity problems. Therefore, I support the approach proposed in the Managing Director's statement.

Finally, I can associate myself with the view expressed by Mr. Tulin on the need to resolve rapidly the inequity problem facing some member countries of the Fund.

Mr. Al-Tuwaijri made the following statement:

I welcome the Managing Director's statement which elaborates on some useful and imaginative proposals on the role that the SDR could play in the future. I was hoping that these proposals would facilitate the reaching of an agreement on this issue.

This chair continues to support a moderate general allocation of SDRs. The rationale for such an allocation has been detailed on a number of occasions in the past. Recent developments in the financial markets have only strengthened this rationale, as noted in the Managing Director's statement. The proposal to consider the reintroduction of reconstitution should alleviate concerns regarding disincentives to adjustments as a result of such an allocation.

Coupled with the possibility of introducing a voluntary post-allocation redistribution scheme, such an approach could achieve a number of useful objectives in a timely and practical manner: facilitate needed external reserve accumulation by a large number of countries; address perceived inequities efficiently; provide a cushion to deal with future crises in a flexible and efficient manner.

As this chair noted during the recent discussion on the Fund's financial resources, the exact modalities and features of such a system would need to be explored further.

Mr. Kaeser said that the current discussion showed that the Board was not able to reach conclusions on an SDR allocation at the present stage and that further progress could be made only after a comprehensive review of the future role of the SDR was completed.

Mr. Mohammed made the following statement:

We welcome the Managing Director's statement on the allocation of SDRs. The approach outlined by the Managing Director is constructive in that, among other things, it refocuses attention on specific proposals in this important area ahead of the forthcoming meeting of the Interim Committee.

As we indicated during our recent discussion on the Fund's financial resources, we can support a general allocation of SDR 36 billion coupled with a voluntary post-SDR allocation redistribution scheme along the lines of the Hashimoto proposal of 1991.

We agree with the Managing Director that a general allocation of SDR 36 billion would go a long way toward addressing the "equity issue." It also has the clear advantage, over any proposal that involves amending the Articles, of possibly being put into effect relatively quickly.

Let me close by reiterating our interest in giving detailed consideration to the possibility of developing the SDR as a safety net instrument.

Mr. Andersen said that his chair was open to further studies and discussions on the SDR, including on the future role of the SDR and the functions of allocations in the international monetary system. His chair would prefer an order of discussion that would follow along those lines.

Mr. Geethakrishnan commented that, as his views on the need for an SDR allocation were well known, he would not repeat them for the current discussion. The Board had considered three different proposals for an SDR allocation, but had failed to reach agreement on any of them. To further the progress toward a consensus, he could support the Managing Director's proposal, which incorporated elements of the Hashimoto proposal, in the hope that it could garner the necessary support.

In view of Ms. Lissakers's comments on the difficulties involved in presenting any proposal for an amendment of the Articles to the U.S. Congress, he wondered whether it would be worthwhile to continue discussions on any proposal for an SDR allocation that would require such an amendment, Mr. Geethakrishnan said.

Mr. Murphy stated that his authorities' position on an SDR allocation--which had not changed since the previous discussion--did not go beyond support for the U.K./U.S. compromise proposal. Therefore, he could not support the proposal put forward by the Managing Director. He could agree with many other speakers on the merits to be realized from proceeding to a general review of the role of the SDR.

His authorities would not find it helpful to consider proposals, such as the one put forward by the Managing Director, at the forthcoming meeting of the Interim Committee only to again result in a deadlock, Mr. Murphy commented. He fully agreed with Mr. Evans that there was a need to carefully examine the future role of the Fund prior to any consideration of the need to enhance its financial resources.

Mr. Rouai recalled that his chair had made a substantive statement at EBM/95/28 on the Fund's financial resources, including with respect to the need for an SDR allocation. He could associate himself with the views put forward by Mr. Zoccali for the current discussion.

Mr. Wei said that, as the views of his chair were well known, he would not repeat them for the current discussion. His authorities continued to support the previous proposal put forward by the Managing Director for a general allocation of SDR 30 billion. However, in the spirit of compromise, his authorities would be willing to go along with the consensus among Directors on the proposal put forward by the Managing Director for the current discussion.

Mrs. Guti stated that the position of her chair had not changed since the previous discussion on an SDR allocation. She could support a general allocation of SDR 36 billion.

The Treasurer noted that, under the terms of the GAB, the Fund did not borrow in SDRs; it borrowed from members in their national currencies, which were then converted into their SDR equivalents. There would not be a need to establish a new administered account for a reallocation of SDRs.

The General Counsel said that the staff would prepare a draft text of the proposed amendment to the Articles, which could be circulated to members of the Board in due course.

The Chairman made the following concluding remarks:

> Today many Directors--although not sufficient in terms of the necessary voting majority--supported the approach suggested in my statement of an early allocation of about SDR 36 billion with the understanding, though not as a condition for the allocation, that such an allocation would be accompanied by a post-allocation redistribution scheme. Such "redistribution" resources could be activated quickly to help resolve the balance of payments or external liquidity problems of members in a manner that would be consistent with the Fund's purposes. In the view of these Directors, an allocation under the present Articles would meet a long-term global need to supplement reserves.
>
> Many Directors also said they could support an alternative approach to the issue of SDRs, as outlined briefly in the last paragraph of my statement, on the basis of which an amendment of the Articles would enable the Fund to issue SDRs to an individual country to help it meet--temporarily, and on a conditional basis--an external liquidity crisis.
>
> Several other Directors reiterated their previously stated opposition to a general allocation either because its criterion of a long-term global need has not been met or the amount proposed by

management was large; some of these Directors reiterated also that they could support only the U.K./U.S. proposal to achieve equity among the Fund membership.

There was general support among Directors for an in-depth review of the SDR and its role in the changing international monetary system, which would involve outside experts, as discussed at our previous meeting.

Finally, as many speakers reminded us, the Fund is, and should remain, a quota-based institution, and we should give appropriate focus to this in our continuing reflection on the role of the Fund. It was also noted that the Fund could consider borrowing to address liquidity problems that could arise in the interval between general reviews of quotas; the suggestions concerning augmenting the GAB or broadening its contributors were alluded to in this respect.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/94/38 (4/11/95) and EBM/94/39 (4/12/95).

4. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 94/51 are approved.

APPROVAL: November 19, 1996

LEO VAN HOUTVEN
Secretary

Illustrative Calculation of Potential (Redistributed) SDR Allocations of SDR 36 Billion

	Quotas (1)	Percentage Shares in Quotas (2)	General SDR Allocations (3)	Post-Allocation Redistribution of SDRs to the Fund 1/ (Hashimoto-type proposals) (4)
	(In SDR billions, except as indicated)			
1. Creditor countries 2/	94.1	64.9	23.4	-23.4
Of which:				
GAB participants 3/	77.4	53.4	19.2	-19.2
Other creditors	16.7	11.5	4.2	-4.2
2. Other countries	50.9	35.1	12.6	+23.4
Of which: 4/				
Members joining after 1981	*10.4*	*7.2*	*2.6*	...
ESAF-eligible countries	*16.1*	*11.1*	*4.0*	...
Transition economies	*10.9*	*7.5*	*2.7*	...
Former U.S.S.R.	*6.8*	*4.7*	*1.7*	...
(Russia)	*(4.3)*	*(3.0)*	*(1.1)*	...
3. Total	144.9	100.0	36.0	--

1/ For illustrative purposes, creditor countries are assumed to contribute the equivalent of their new allocations for lending to the Fund. The positive amount shown for other countries represents the potential maximum increase in debtor members' access to Fund resources arising from the illustrative post-allocation redistribution.
2/ Countries whose currencies are considered sufficiently strong for the purposes of the latest quarterly operational budget and designation plan (EBS/95/17, 2/15/95), plus Italy and Sweden.
3/ G-10 plus Switzerland.
4/ The subgroups shown are not mutually exclusive.